KEYNOTE INTERVIEW

Rising costs put pricing in the spotlight

As inflation skyrockets, executing an effective pricing strategy has never been more important, say Tim Ham and Tom Wells at Pearson Ham

Almost every day brings more bad news on prices. Key European economies are grappling with inflation running at multi-decade highs, and the situation is set to escalate further during the winter if feared gas shortages materialise.

Tim Ham, CEO of Pearson Ham, and Tom Wells, a director at the pricing consultancy, warn that companies frequently lack ambition on pricing and pay insufficient attention to their pricing strategy. But with companies facing a delicate balance between offsetting rising costs, while not raising prices to a level that drives away customers, ignoring the question of price is no longer an option.

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Q We are living through the highest inflation in decades. How should companies go about deciding on price moves?

Tim Ham: The fundamentals are no different now than they are during more benign market conditions: as a company, you need to consider your costs, your competitors and your customers when deciding on prices. However, getting pricing right is more important than ever. That is partly because of margins being squeezed by increasing costs. With larger increases in prices across the economy, there is more money at stake and therefore it is even more worthwhile to get pricing right.

Companies need to have a detailed understanding of how their costs have changed and think about how that aligns with price changes they would like to implement. That will help companies substantiate to their customers why they need to increase their prices.

Tom Wells: Due to rising costs, it is quite easy now to justify a price increase. People understand that rising costs lead to rising prices, but you still need to think about what the customer can bear, especially for discretionary products. Companies need to do their research on customer pinch points.

More companies are thinking about changing prices more frequently than they would usually do. High inflation makes it more difficult to forecast market conditions. What happened last year may no longer be relevant to what could happen next year. This increases the importance of market research to understand how consumers are thinking, and to project future changes.

Q Are there situations where it makes sense for companies to try and absorb costs, rather than pass them on to customers?

TH: There is a truly difficult challenge in some sectors – costs are going up, but customers are unable to pay more. It is going to get even tougher during the winter, when a lot of people are going to struggle to afford the basics. Restaurants are a good example of a sector that is in trouble because the costs of labour and ingredients are increasing, but customers are not likely to pay more for a discretionary purchase.

On the other hand, there are sectors like Software-as-a-Service, where business customers are spending a very small proportion of their revenues on the software. SaaS companies can increase costs and it doesn't have a material impact on the customer. In that sector, it is more about making sure the customer feels comfortable with the price increase.

TW: It is easy right now to just raise prices across the board and put it down to inflation. A smarter move would be to work out where you have customers with a greater ability and willingness to pay, and target price increases there. With more price-sensitive consumers, you may be able to communicate that you are holding prices and present that as a strategy to help your customers save. There is a real opportunity for targeted price changes now.

Q What are the main challenges involved with increasing prices?

TW: On top of understanding customers' price sensitivities and being aware of what competitors are doing on price, one of the main challenges is internal engagement. Key functions often resist a price increase, so companies need to put adequate time and resources into a price change campaign. Then they need to focus on the execution. One thing to bear in mind there is that salespeople can be more price sensitive than consumers, especially in a B2B sales environment, and they will often discount the increases away.

TH: Pricing is often a neglected subject. Most organisations have a robust finance function, but they don't often have a robust pricing function that can drive the best outcome. Pricing is complex – it is about finances, consumer needs, modelling and behavioural science. It is not easy to do well.

The result is that companies are not always as ambitious as they should be. There is a conservatism with respect to price – partly because customers tell the salespeople when they think a product is overpriced, but they never tell them when products are underpriced. In addition, the senior leadership team often does not realise the level of opportunity that they are sitting on. They do not have high-quality market insights.

> *"Companies need to put adequate time and resources into a price change campaign"*
>
> **TOM WELLS**

Q What role should PE firms play in helping their portfolio companies decide on price increases?

TH: As one of the biggest determinants of business performance, any private equity firm will rightly want portfolio companies to be ambitious when it comes to pricing. The most constructive way to approach this is to make sure the management teams are considering all the options. Far too often, we see the pricing functions effectively taking pricing decisions for the company's senior management, because they put forward a recommendation almost as a fait accompli.

Playing a constructive role therefore means making sure that the management team is truly exercising their powers and choice, as well as making sure the pricing team is evaluating alternatives. There may be a need to coach them a little bit on the process of how to do that.

Q How can external consultancies support the process?

TW: Bandwidth is a key resource that consultants can provide, because often companies do not have that internally. Most organisations probably have subscale pricing departments, so consultants can be a good way to bring in specialist expertise with the ability to conduct detailed analytics. Also, using consultants turns pricing decisions into a project, rather than a business-as-usual workflow. It creates focus and gets board-level sponsorship to push changes forwards.

TH: Businesses need to ensure that consultants can demonstrate a real depth of pricing expertise, but also that they have an implementation mindset. The risk is that consultants come up with the solution, but the solution doesn't get delivered successfully. A good consultancy will go beyond just identifying the solution, to making sure that the problem gets solved. ■