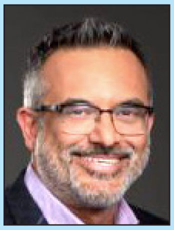
Pricing and Commercial Agility in Volatile Markets



by Jeet Mukherjee

With market volatility continuing for the foreseeable future, leaders need to play both offense and defense at the same time. Make sure you are approaching each offering in a distinct way and not using a "one size fits all" approach to your strategy. Your profitability depends on it, as the author explains. Jeet Mukherjee is the Vice President and Head of Pricing at Holden Advisors and the co-author of the recently published ***Pricing With Confidence: 10 Rules for Increasing Profits and Staying Ahead of Inflation*** *(co-author Reed Holden). He will deliver a keynote presentation at the PPS Fall Conference in Atlanta (October 10-13). He can be reached at jmukherjee@holdenadvisors.com.*

Executives are leading through the most unpredictable market conditions in recent history. Supply chain challenges are forcing leaders to pass costs to their customers, implement price increases, and find new ways to drive profitability while maintaining relationships and innovating to keep up with competition.

"I've never developed plans with such a span of differentiation. The pet category could be up 8-10% next year … But at the same time, there is a catastrophic view that there is zero growth. I've never had as broad of an array of outcomes."
– Ron Coughlin, CEO of Petco

This commercial volatility is not driven by what label the media slaps onto the current market conditions, but is largely driven by two main factors: cost and demand. Leaders need an effective approach that accounts for rapid change in these areas. We can no longer use one pricing strategy across all business units and products, and as a result, we must be prepared with flexible strategies that can address changing dynamics and volatile markets - not just overall as a business, but within each product line.

The matrix in Figure 1 can serve as a framework for commercial strategy depending on the cost and demand of your offerings, and this paper will provide tactics to improve profitability within each situation.

Bull Market: Focus on the long-term optimization of value

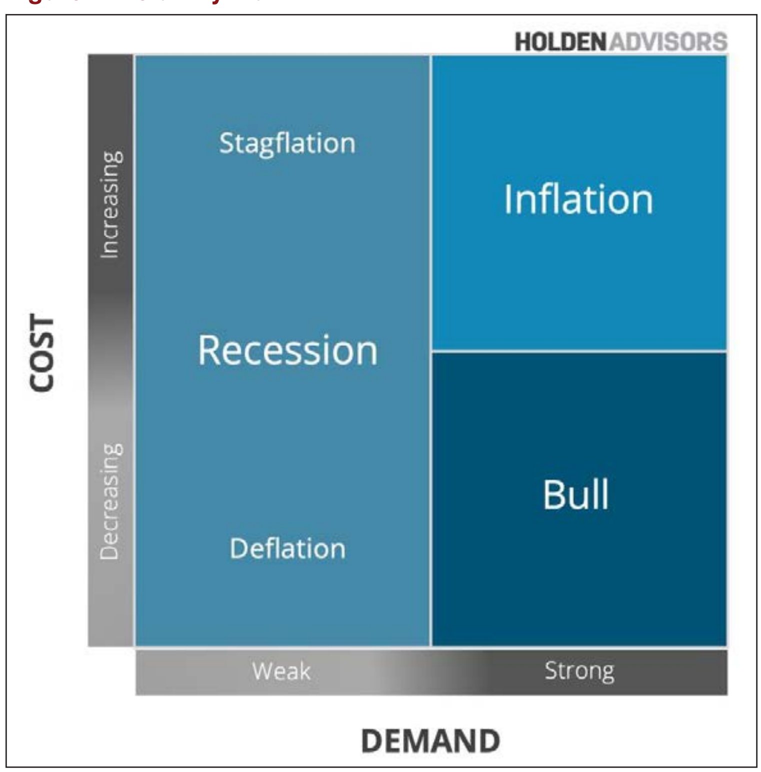
When demand is strong and costs are stable, leaders are advised to focus on new products, investment strategy drivers, portfolio gaps, and maximizing synergies. Read: look at the big picture!

Profitability serves as a margin of error, and in a bull market, you have that margin - which gives you the ability to take on more risk and look long-term. Make sure you're maximizing revenue per transaction and look at correcting legacy discounts to capture more value and share of wallet. Improvements in value for your customers falls under one of three categories:

1. Increased revenue
2. Decreased costs
3. Mitigated risks

Use these three categories as anchors for your fair pricing. Do the research by having conversations with your customers to figure out what value you provide today and in the long-term, and the dollar amount of that value (keep it simple!). In this situation, while many other companies are driven by costs, focus on building a long-term value-based organization where value is not just used for pricing but other key business activities like sales, marketing, R&D, and

Figure 1: Volatility Matrix



product management.

Inflation: Focus on speed and defending value

In my experience interviewing C-Suite executives in the last year, nobody has been surprised by inflation levels. What have they been blindsided by? Their ability to react to it quickly. As an example, many executives didn't realize that they had long-term contract pricing set in place that prevented any kind of price deviations.

Efficiency is a critical focus area when demand is high and costs are increasing. In this situation, look for areas to automate to expedite your price changes. Focus on more efficient delivery of products and services, and make sure to implement your price increases by product/offerings affected by cost increases, and not across the board.

While an overall price increase may improve profitability in the short term, partnership trust will ultimately take a hit. Keep the long-term relationship in the foreground, and focus on taking care of your customers during turbulent times as part of the value you're delivering.

Customer Profitability

When costs are high, it's a good time to review your customer base. Identify the accounts that take up the bulk of your resources as an organization. From our research, most businesses find that the majority of their profits come from the top 20% of their customers. Calculating your cost to serve can assist in creating a chart like in Figure 2, to better understand profitability by account.

For customer accounts "in the red," how can you make those accounts profitable? This is a situation where price increases become necessary. When positioning a price increase, keep the following considerations in mind:

- There is always a line in volatile markets where customers will start looking for other solutions. Figure out where the line is. It's typically on the third increase in a short period of time where customers will get price sensitive.
- Don't justify your increase based on value, as it antagonizes customers.
- Look at contracts with 6-12 months remaining. Request to change the terms so you can both renegotiate given the current environment.
- Give the customer something in return when you implement an increase.
- Focus on consumption instead of capacity and use costs to justify a price increase (but don't make that the reason).
- Customers are more inclined to partner on price increases when they feel like you are sharing in the risk with them.

Introducing Give-Gets to your conversations can help buyers decide between cost and value and provides choice for them about how to move forward. As always, transparency is key.

Recession: Focus on demand creation through value alignment

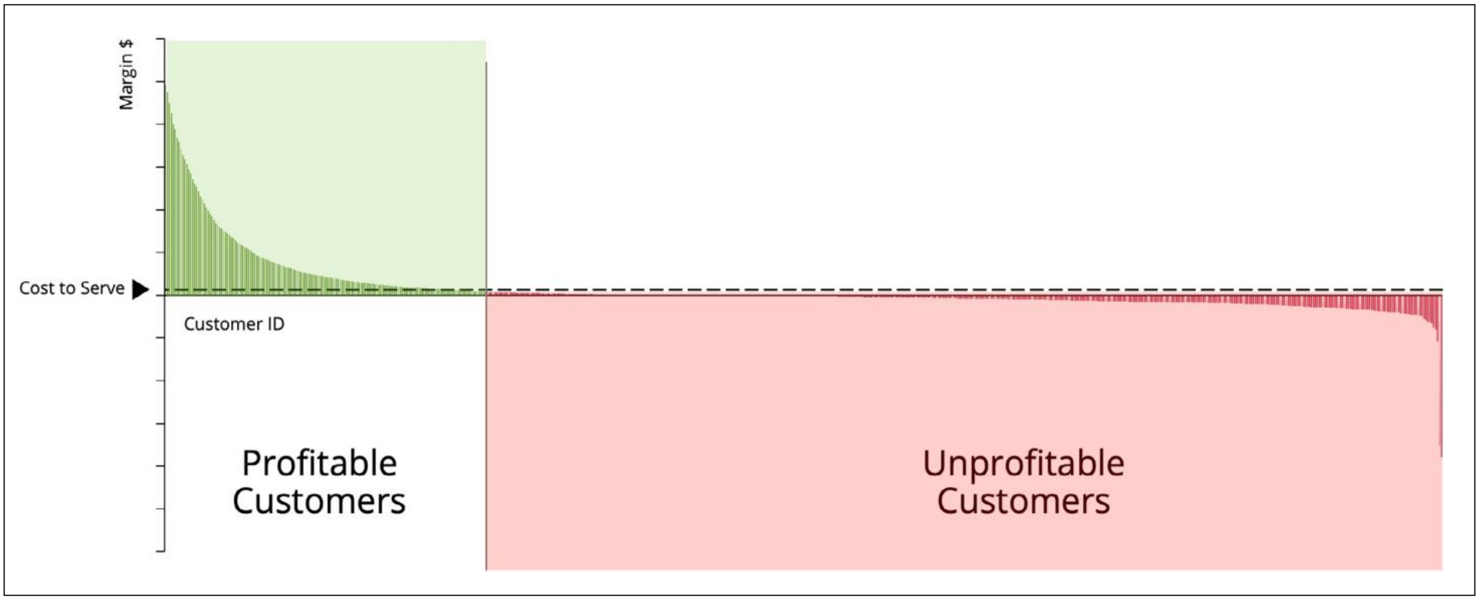
A recessionary environment is defined by one thing: a shrinking market. The focus here will be on creating ways to increase demand and prevent customer churn. Specific strategies will vary depending on if costs are decreasing (deflation) or increasing (stagflation).

Similar to an inflationary market, when costs are increasing, this is a good time to assess the profitability of your customer base. Start by reevaluating the partnerships dragging your profits down the most. In addition to obvious or necessary price increases, consider other ways to impact profitability. You may be able to renegotiate partnership terms based on what customers are sensitive to or value most.

Examples:

- Rush/no rush
- Net 30/60/90 payment terms
- Shipping fees

Figure 2



Deflation: Focus on demand creation through differentiation

Decreasing-cost and low-demand environments are extremely rare. Japan has experienced deflation for decades, but in the U.S., demand is still largely high as a result of momentum created during the pandemic.

In a deflationary environment, companies are looking to remove as much cost as possible. This can be a good time to hire specialized labor or find partners to break into new markets. This is also a time to innovate and expand your portfolio in order to create more value for customers.

In a recessionary market, many businesses are looking for solutions rather than products, and partnerships between companies can help provide a fuller solution to the end customer – in turn, creating more differentiated value and thus demand. Old mindsets will tell you that partnerships slow down the sales cycle – but keep in mind that they keep you out of procurement, because you're not seen as a commodity.

Stagflation: Focus on profitability and demand creation

When demand is decreasing, customers will often be asking for discounts. Make sure you have flanking products – a low cost, low value solution to keep your customers from leaving you. These low-cost alternatives are where ankle biter competitors enter markets and they grow from there. It's important to keep customers within your four walls as much as possible, and flanking products can be a great way to meet budgetary needs. There may also be cases where customer profitability is not acceptable. Where appropriate and necessary, be honest with yourself about who you need to fire as a customer. This strategy can free up your internal teams to better serve your profitable accounts—and provide a better return for the business. In most cases, it will be a huge relief for your employees as well.

Conclusion

With market volatility continuing for the foreseeable future, leaders need to play both offense and defense at the same time. Make sure you are approaching each offering in a distinct way and not using a "one size fits all" approach to your strategy. Your profitability depends on it. ❖