Pricing Risks and Initiatives: A Checklist of Steps to Improve Profitability

PRICING INSIGHT

Pricing Risks and initiatives: A Checklist of Steps to Improve Profitability

Company boards and private equity owners need to understand their pricing risks. Pricing is often either buried under management structures or listed as a marketing responsibility--as it tends to be incorrectly known as one of the 4Ps of marketing.

The First 100 Days: A Checklist to Manage Revenue, Pricing, and Margins

The reality is that pricing is your most powerful profit lever, and it is our experience that pricing today is still treated as an afterthought. We recently came across a freight company (with nearly $1b in revenue) that simply put blanket price rises into the market without any consideration for the commercial impact--and without having undertaken any analysis of customers, segments and products/services. This is high risk pricing behaviour and symptomatic of a cost-plus culture. The company is not making any money and has lost their way strategically.

What we find, having consulted to over 100 companies in the last 20 years, is that pricing is not well-managed. We have evaluated the pricing capability of dozens of companies and here is a list of the often-hidden problems or pricing risks we find:

1. Culture of “cost plus mark-up” pricing.
2. Sales teams offering excessive discounts to win or retain business.
3. Managing price across a large product and customer range leading to simplistic blanket pricing behaviours that leave margin on the table.
4. Large amounts of data and an inability to leverage that data for more strategic decision-making.
5. Cross functional management misalignment.
6. No clear understanding of value drivers for key accounts to support price position in the market.
7. Inability to obtain price increases.

These issues will be present in your portfolio, or in the businesses you may be undertaking due diligence on. Should we leave these issues for the CEO and management team to decipher and figure out? We want to be a supportive board; we don’t want to appear overly controlling.

How best to ensure that we are not risking margin loss and potential future pricing disasters?

Failure to understand pricing and pricing risks is more catastrophic than any other business element. Executives under pressure to meet a budget may start to drive excessive discounts, pursuing revenue at the expense of margin and EBITDA.

One of the most celebrated cases of this behaviour was Southcorp Limited, which drove their business into the ground through excessive trade promotions. Southcorp filled up the supply chain with discounted inventory that then did not translate into incremental consumption at retail. Recently, Bellamy's milk products also undertook a desperate discounting tactic to try to repair revenues after changing their go-to-market and business model strategy. The discounting tactic backfired and earnings collapsed.

When a business is cost-plus and there is no strategic pricing capability set up in the business (e.g. pricing management function and C-level support), we have found there is at least 200 basis points of margin improvement potential available. For a business with revenues of $100m and EBITDA of $10m, this represents a potential earnings gain of 20 percent in the first year alone.

Pricing improvements are cumulative--and, like a minimum viable product, they get better in the second, third and fourth iterations. In fact, you should be rewriting your pricing strategy at least two to three times in 24 months as you test and learn what revenue models and price levels are commercially sustainable.

At the end of three to five years of active pricing initiatives, pricing can deliver between $6-$21m for every $100m of addressable revenue. The inverse of this situation is also true: Failure to implement a progressive pricing function will mean these potential gains are forgone and further margin erosion may be experienced, making the delta even larger.

More importantly, boards, CEOs, and senior executives can now undertake robust and mature discussions around pricing strategy without the perception that it is a black art--or in the words of Warren Buffet, a prayer session that is required to implement a price increase.

Imagine a situation where your portfolio of companies has a common operating platform to manage pricing. You can implement successful price increases much more easily, driving further earnings growth. Sales, marketing and finance work collaboratively together to the agreed plan and there is no cult of personality or dominant behaviours that send the business into a tailspin because of one individual's cognitive biases. You will be able to cross-pollinate ideas and staff across business units--and company portfolios--to extract even further margin enhancements.
Upon exit, you can show prospective buyers your well-defined pricing strategy and methodology that de-risk earning projections and ultimately allow you to sell the business for a higher EBITDA multiple.

There are several benefits that accrue to active investors who get pricing strategy right. The first is earning growth. Expect to generate between $2-$7m of EBITDA for every $100m of revenue optimised. This is a conservative estimate for companies where pricing has taken a back seat and is not on the CEO's weekly radar, or has been managed on a cost plus mark-up basis.

The checklist below is designed to help investors and boards evaluate pricing strategically and operationally. The questions that can be asked by the board are designed to coach and empower the CEO to make high pay-off investments while reducing business risk.

Key Questions on Pricing Risks

Value Management
Do we have clear documentation of customer value drivers, and a communication and capture plan for our products and services?

Pricing Strategy
Is there a published pricing strategy that aligns brand positioning, customers served and tactics in the market?

Trade Agreements
Are the company's contract structures designed to maximise share of wallet and protect existing cash flows with the correct rebate structures?

Management Alignment
Are the executives aligned with the line managers across sales, marketing, finance and operations on pricing strategy and tactics?

Skills & Capability
Have we resourced our business with trained staff to manage pricing strategy, platforms and systems and daily operating decisions?

Sales & Negotiation
Do we employ value-based selling and negotiation strategies to generate more profitable revenue growth?
Structures that impact pricing risks

Analytics & Methods
Do we have a suite of analytics and methods that we use to provide leading and lagging indicators (both internal and external) of pricing power beyond standard margin reports?

System & Toolsets
Do we have the right pricing toolsets and systems that allow fast and accurate pricing decisions to be made?

Pricing Structures
Does our pricing architecture allow our business to maximise revenue and margin across all product/service and customer segments?

Ideally, this checklist of questions can be customised to your business model and refined through more detailed exploration with management in a workshop environment. Workshops provide a non-threatening, open forum that enables investors to evaluate the pricing culture, teamwork and capability that reveals so much more than the flat dynamic of a sit-down meeting.

Key Questions to Ask, to Identify Pricing Risks

During Due Diligence:

- Does the company have pricing power from its business model and industry dynamics?
- Is pricing expertise spread across the business, or is it in the hands of the founder or a select group only?
- What are annual EBITDA pay-offs if we can obtain 100, 200 or 300 basis points of margin? Does this change our priorities?
- Which project ranks higher than pricing in terms of annualised EBITDA pay-off?

During The First 100 Days:

- What methods and controls are in place to mitigate margin risk?
- How soon can we implement a dedicated pricing function?
- Where are the quick-win margin gains?
- Do we need to look at culture and team work initiatives to manage pricing better?
- What methods, tool-sets and platforms do we have or want in order to make pricing a strategic asset?

To arrange a discovery call, please go to www.pricinginsight.com.au to schedule a booking.

Pricing Insight

Level 26
1 Bligh Street
Sydney NSW
2000
+61 2 8226 8621

PRICING INSIGHT