The *Quiet* Price Increase!

By Andrew Ortyn, Andrew.Ortyn@Nimble-Leader.com

When contemplating a *price increase*, many business leaders run for cover! The dreaded price increase is often linked with loss in sales volume, disrupting customer loyalties, and providing competition with an open door to *"convert our business!"*.

In some cases, the above concerns are valid. In many cases, they are not valid! In all cases, a price increase represents an important tool for profit. Why is this so? Simple mathematics.

Of course . . . naysayers will indicate the above example is overly simplistic and unrealistic. However - in TRUTH - an organization's ability to benefit from a price increase is primarily dependant on two factors:

1. The *inherent value* attached by customers to a business's products and services
2. The method for implementing a price increase

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Example:

Price Increase

	Yr. '1'		Yr. '2'	% Chg.
Net Sales	$100	x 1%	$101	
Cost of Sales	$ 65		$ 65	
Gross Profit	$ 35		$ 36	
S, G, & A	$ 29		$ 29	
Operating Profit	$ 6		$ 7	+17%

With the above example, a 1% price increase results in an additional $1 of revenue. Assuming no change to the business's underlying volume and cost structure, the $1 of increased revenue drops to the bottom line, resulting in a 17% increase in year-to-year profitability.

Relative to inherent value . . .

If what a business *"stands for"* in the minds of customers – its MARKET POSITION – holds significant tangible value, customers will pay more CASH for the business's products and services than if it holds little tangible value. Assuming a "one of a kind" value-added product, a 10%, 20%, or even 30% price increase may be feasible. Assuming a non-differentiated commodity product, *no price increase may be feasible*. In simple terms, customers will only pay CASH for products and services if the perceived value of what is received is greater than the CASH paid out.

Relative to how companies implement a price increase . . .

Businesses have two choices. They can implement a LOUD price increase or they can implement a QUIET price increase.

A LOUD price increase occurs when leadership announces to the market *and competitors* that list prices are going up X%, effective X date. With a LOUD price increase, competitive sales organizations go into "hunt" mode with intent to convert customers to their own products and services. While easy to implement, LOUD price increases are also dangerous. They have a tendency to stir the market with potentially unintended consequences.

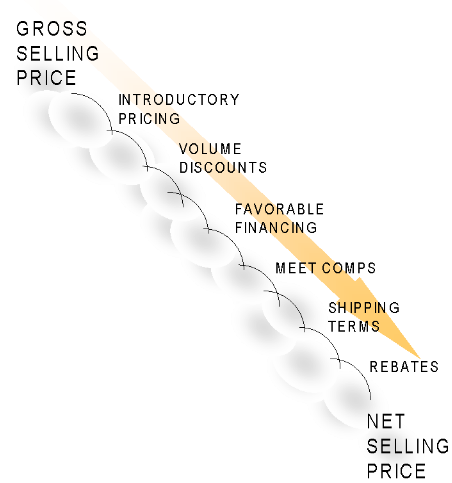
A QUIET price increase does not involve a shotgun announcement to the marketplace. Rather, a QUIET price increase embodies selective market actions linked to a deep understanding of the relationship between what a business *"stands for"* in the minds of its customers – its MARKET POSITION - and its price waterfall.

Let's first take a look at the **Price Waterfall . . .**

Every business starts out with a list price for its product and service offering. In the beginning, list price is the same as net selling price – what customers actually pay for a product or service. However – over time – companies often discount from list in order to "close" business. Discounts typically grow, consistent with the pressure to increase sales. Discounts also take on many different forms. Examples include the following:

- Favorable introductory pricing
- Volume discounts
- Favorable financing
- Special price promotions (Buy 2, Get 1 Free)
- Meet Comps (Discounts linked directly to meeting competitive pressure)

PRICE Waterfall . . .



All of the above **and more** represent

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different forms of price erosion. . . . . different components of the price waterfall.

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With <u>every</u> discount, profitability LEAKS out of the business; and oftentimes, the above discounts become "institutionalized" as standard pricing policy.

However - when business leaders take a close look at their price waterfall within the context of what they "*stand for*" in the minds of their customers, they begin to refocus on the value of their products and services relative to both past and current pricing actions. By engaging in this process, companies may find they can *selectively readjust* pricing over time on an account-by-account basis (i.e. Move from introductory pricing back to standard pricing, enforcing volume discounts, etc . . .). Such actions represent a QUIET price increase. There is no general market announcement, no change to list, no broad based communication to competitors. Yet - the impact to bottom line profitability is just as significant as an increase to the published price list.

Example:

A manufacturer of specialty chemicals increased its effective pricing +3% from one year to the next through better enforcement of its policy on volume discounts. Historically – the company's sales organization offered "truckload" pricing discounts for "less than truckload" shipments. After a thorough review of the competitive landscape, it was determined the company's pricing policies were already quite liberal relative to competitors. By holding the line on volume discounts, the business implemented a QUIET price increase and reaped significant gains in profitability – without significant loss in volume!

Again – with any price increase, whether LOUD or QUIET, the ability to realize favorable profit impact is directly linked to a business's MARKET POSITION, the inherent value of what it *"stands for"* in the minds of its customers.

In thinking about *your own* business, what is your MARKET POSITION? What do you "*stand for*" in the minds of your customers? Have you "institutionalized" discounts in pricing that undermine the value of your product and service offering? Have you recently executed a thorough review of your pricing policies with your existing customer base, relative to your competitors? Is it time for you to implement a QUIET price increase? If you have not recently given careful consideration to answering these questions, there just might be an untapped profit opportunity on your business horizon!

About the author . . .

Andrew Ortyn is Founder and CEO of Nimble Leader, a management consultancy focused on helping organizations establish the critical links between their people, customers, and business profitability. A frequent speaker at executive roundtables and business conferences, he is the author of numerous articles and ebooks on market positioning and its relation to business profitability. Mr. Ortyn holds a Masters in Management from the Kellogg Graduate School of Management where he studied marketing and business policy. He holds a B.B.A., magna cum laude, from the University of Notre Dame. He is a Certified Public Accountant.