FORTUNE.com
MARCH 8, 2022 CUSTOM REPRINT

LEADERSHIP MANAGING

3 COMMON PRICING BLUNDERS COMPANIES MAKE DURING PERIODS OF HIGH INFLATION

BY GEOFF COLVIN

"We're at a burning platform moment," says Mark Burton, a Boston-based consultant at Bain.

As inflation soars, companies are increasingly getting pummeled by rising labor, input, and logistics costs, putting "tremendous" pressure on the bottom line, he says. Inflation has now risen to a 40-year high of 7.5%, and just last week, Federal Reserve chairman Jerome Powell said that Russia's invasion of Ukraine will likely worsen inflation. So it's hardly surprising that the most urgent requests among Bain's clients center on pricing—specifically, crafting an effective inflation response.

Burton has 26 years of experience consulting on B2B pricing, advising companies across industries on commercial strategy, growth, and developing pricing as an organizational capability. During periods of financial turbulence, he says, most companies are already at a disadvantage before they create a pricing strategy. "Pricing is absolutely the longest lever you can pull when driving profitability, yet so many organizations have underinvested in it."

After all, no one in the C-suite has "pricing" in their title.

Through his decades-long career as a pricing specialist, Burton has found that when inflation spikes and companies, in response, hurriedly adapt the way they price their products and services, they typically make three costly mistakes:

No. 1: Taking the peanut butter approach

It's tempting to evenly spread price increases across all products and services, like peanut butter on bread. Doing so is fast and easy, but it's rarely a good idea. Most products and services have their own costs, competition, and value to customers, and require unique optimal pricing tactics.

Burton advises that leaders start by analyzing the company's costs to figure out where inflation is exerting the heaviest pressure. Companies must "establish a baseline of what the impact on cost pressure is doing to margins, and use that as a floor for formulating price uplift targets," he says.

But that's just the floor. An old business aphorism says, "Cost never priced anything." Value to customers carries weight and can sometimes justify price increases that far exceed the burden of higher costs.

Burton recalls a recent experience in which he compared a customer's contract renewal rates with the price increases in those contracts. He found that renewal rates were the same for a wide range of price increases. "Customers became less price sensitive because they saw good value," he says. The takeaway? That company had considerably more room to raise prices than it realized.

No. 2: Asking for big price increases, then accepting small ones

This negotiation tactic is worse than ineffective; it does lasting harm. A company, for example, may announce an inflation-induced 10% price increase "when in their minds, they're happy with 3%," Burton says.

Salespeople then carry that message to the market and say to customers, "I know the announcement you got says 10%, but how about 3%?" Customers are likely to respond, "Well, if you just retreated that much, how about none?" Burton explains.

Operating in this way not only breeds mistrust and leaves customers frustrated, but almost ensures that future price hikes will not be taken seriously.

No. 3: Underestimating the sales effort

Many companies are angling for larger price increases owing to inflation, much to the irritation of salespeople. "About half of our effort when we work with clients is getting the buy-in of the frontline sales organization," Burton says.

The key is to demonstrate to salespeople that customers aren't paying more for the same product or service; a sale has many facets, each potentially offering value for the customer and revenue for the company.

A good starting point that's often overlooked is to reexamine the terms stipulated in a sales contract. Burton recently advised a client whose contracts often allowed inflation-based price adjustments, but the company didn't always take advantage of them—or worse still, let its customers negotiate them away, Burton recalls. "That was a pretty easy fix." Contracts may also include shipping cost specifications and payment terms that have gone unenforced.

Other strategies include "give-gets," a simple negotiation in which a salesperson, for example, postpones a customer's price increase in exchange for a longer contract. Another tactic often used by companies, such as software-as-a-service suppliers, is to rearrange the elements of bundled service packages in ways that better meet customers' needs and merit a higher price but may not raise the seller's costs.

For salespeople, the moment of truth comes when a customer threatens to walk. Letting customers go is sometimes the right thing to do, but for frontline sellers who are compensated based on top-line revenue, that's "exactly the wrong thing to do," Burton says. The only solution is for management to celebrate doing the right thing, keep the frontline whole—by compensating salespeople when they decline an unprofitable sale for example—and practice patience. Former customers rarely disengage entirely, Burton says. "In my experience you often get another crack at that business."

An upside to inflation's 40-year rise is that it incentivizes managers to become significantly savvier on pricing, an advantage that will endure through business cycles. "Companies should price with pride," Burton says, noting that it's the only way companies get paid for the value they create for customers. "I'm hoping this period shines a brighter light on that."

(#S0102966) Excerpted and adapted with permission from the March 8, 2022 issue of *Fortune*. © 2022 Fortune Media IP Limited.
Fortune and Fortune Media IP Limited are not affiliated with, and do not endorse the products or services of, Licensee of this reprint. For more information on reprints and licensing, visit www.parsintl.com.