PER SJÖFORS

7 Easy Steps To Successfully Increase Prices

...and keep your customers happy!

Executive summary

I met Mr. T., CEO of an educational content provider C, at a networking event. I told him what Atenga does, and his reply was instantaneous: “That is so timely, we are just trying to find ways to increase our prices, but we don’t really know by how much, and we don’t know what our customers’ reactions will be.” A few weeks later, Mr. T. knew exactly what his new price should be, and how to “sell” the price increase to his customers.

Just like Mr. T., many executives tell me they have similar questions about pricing and price increases. Executives always want their company to reach its true potential, but at the same time, are often unsure how price, and particularly, price increases, will play into that quest.

If you are one of those executives, this short e-book is for you.

I will discuss how the results of price changes and price increases can be predicted with accuracy, and I will discuss the right process for increasing prices, a process that will always be successful.

Predicting the results of a price increase with accuracy involves two activities: pricing research and/or sale transaction analysis. In these two activities, price elasticity and coefficient of determination for just the products or services your company sells will be measured.

The actual process of increasing prices is all about communicating with customers early, training the customer-facing staff on how to defend the increase, and the unique value that only your company provides to your customers. The process also must include contingency plans for those customers who rebel, i.e., threaten to leave for a competitor.

Here is the problem

Executives like you are always on the lookout for ways to improve your business, and pricing "right" is often both the quickest and most effective way to improve both sales and profits.

In some markets, increasing prices is easy, in other markets it is not. We are all familiar with how consumer goods companies always change their prices. This is particularly pronounced for online retailers, where changing prices is free, and the results in sales levels can be immediately measured. In fact, many online retailers continually change their prices in order to automatically measure what customers are willing to pay for a product and to measure price elasticity. Price management software together with web scraping, which captures competitive prices from websites, automates this process.

However, if your company primarily sells in traditional ways with sales people and/or from a catalog, or if you sell in a B2B market, you are among the vast majority of companies for whom price changes, in particular price increases, cannot always be taken lightly.

Many executives are uncertain about the results of a price increase. They ask themselves questions like the following:

- Will I lose my best customers?
- Will I see an immediate drop in sales?
- Will I tarnish my brand?
- Will I see customers flee to the competition?

By following the process I will outline in this e-book, all these questions and others can be mitigated, and can provide you with solid answers before you execute any price increase.

The e-book

In this e-book, I will explain how to conduct a price increase with confidence. I will show how there are solid ways to predict the results of a price increase (see the appendix for a technical explanation), and that there is a time-tested and simple process that is used to increase prices. I will cover which mistakes are often made, and I will detail how you and your company can work with the price increase process to be successful every time.

<u>The process</u>

From a high-level point of view, the process of increasing prices is really easy. However, like in everything, the devil is in the details. From that high-level point of view, these are the steps:

1. Decide which product or service price should increase;
2. Decide for each of these product(s) how much the increase should be;
3. Model the expected results using price elasticity data (from sales transition analysis, pricing research, or, ideally, from both);
4. Plan and define how you are going to defend and justify the increase for your repeat customers;
5. Develop and implement a communication plan;
6. Train your customer-facing staff on how to defend and justify the price increase;
7. Develop contingency plans for cases in which customers do not accept the price increase and want to rebel;
8. Execute.

The right price increase process

Which products or services and how much

It is obvious that you want to increase prices on the products or services for which the margin is lowest, but it may not always be that simple; sometimes you can, sometimes you cannot.

Companies with many SKUs

If your company has many SKUs with a high frequency of sales, your sales data will allow you to identify the products' price elasticity (how much sales volume would change as prices change) and coefficient of determination (how much "price" as one of the attributes of the product effects the customers' buying decision).

- If the coefficient of determination is high, it means that you have little wiggle room, and you know that you will see significant volume changes from small price changes.
- Price elasticity will tell you how much change you will see for any given change in price.
- Your sales data will also tell you the halo effect of your products, a measure of which products drive sales of other products.

Armed with this and margin data, you and your team can assess the best SKUs for price increases, and the level of those increases. You can assess the SKUs for which the increase will have the most impact on revenues, where the sales level will be impacted the least, and where the halo effect can be maximized.

Companies with few SKUs

For companies with relatively few products or services, especially when those products or services are sold relatively infrequently, sales transaction data analysis will not provide accurate modeling data.

Instead, in cases like these, pricing research is the answer. Pricing research also measures price elasticity, willingness to pay, and willingness to buy by investigating your marketplace. The "marketplace" means your customers and people and companies who are not your customers. In addition, it measures how value messages and your particular differentiators affect willingness to buy and to pay.

It will help you to understand customers' willingness to pay and willingness to buy at different price levels, and understand price elasticity and cross price elasticity (a measure of how buyers migrate their purchases among the choices they have based on the price changes of those choices).

Once you have this data, you can easily predict the results of a price increase and you can make the trade-offs (if any) between sales volume and revenue that are right for your company.

Summary

It is paramount that the price increase is based on data from your own company or from the marketplace. When price increases are based on data, you will be confident that you are making the right decision for your company and for your particular situation.

Case study

A global services organization selling annual subscriptions had resisted a price increase for nine years. The reason was that last time they increased prices, they got a severe rebellion from their members. It was not that many people cancelled their subscriptions, because the company does provide real value to its subscribers, but rather that middle and upper management received a flurry of really nasty phone calls, letters, and emails.

The company had been absorbing cost increases and holding off another price increase until it was almost too late, because it didn't want to go through that same painful process again.

Pricing research showed that the company now could increase prices by 25% with a modest decline in subscriptions. The research also measured the monetary benefits the subscribers received from being a subscriber.

Not only was Atenga able to recommend new prices, but armed with the information collected in the pricing research we conducted, we also helped the company develop its communication plan around the actual return on investments (ROI) subscribers enjoyed in return for its membership fees.

The results were the largest one-time subscription increase with the lowest ever subscriber pushback, producing a very happy Atenga customer, and happy company subscribers.

Justify the price increase

Some of your customers will simply accept the price increase. Many will not even notice. Inevitably, however, some will not accept it, and will challenge you and your company. They will threaten to stop doing business with you and will threaten to take their business somewhere else. For that reason, it is imperative that you can justify your price increase to these customers. The following are the ways you can justify your price increase.

No increase for years

When this is true, you have to accurately say to the customer, that for (years), you have assumed your cost increases and not passed them on to your customers. Tell them that you worked diligently to make your operation as effective as possible to avoid price increases, but it does not work any more. You cannot assume more of your cost increases, and have to pass through a portion, but not all, of that cost to your customers.

Switching cost

There will always be some cost for your customer to switch from your product or service to some alternative. From a hard cost point of view, these may include the cost of certifying a new vendor, training your staff on the use of a new vendor, and setting up new purchase and support procedures. Maybe your customer has an inventory of spares that will become obsolete if they switch vendors. From a soft point of view, there is a cost to establish new personal connections and develop confidence in the new vendor, which your customer already has with you.

Maybe your customers resell your product(s) in some way. There will then be the added cost for them to convince their customers to accept the vendor change. There may even be associated certification costs. As you prepare to justify your new pricing strategy, you need to do your best to quantify these costs and remind your customers about them.

They buy from you for a reason

There are aspects of your product, services, and company that are more appealing to your customers than aspects of your competitors' products, services, or company. That is why your customer is your customer and not one of your competitors' customers.

It is paramount that you understand what makes your customers your customers. If you do pricing research, it will tell you what your customers (and your non-customers) really see as your particular competitive strengths (as opposed to what they might tell you). This information must be used to remind your customers why they are your customers in the first place. They buy from you for a specific reason, and should continue to do so.

ROI story

Maybe your product or service provides actual income for your customer. If so, there might be an ROI story to tell. If there is, it needs to be a cornerstone of your communication.

Small portion of the overall cost

If you sell a component into a large system, the price increase of your part is likely to be small compared to all the other components of the system. Find out how much, and contrast your increase with the overall cost of the system into which it goes.

Your competitors too

This is the real kicker. Most companies in an industry have a similar cost base. This means that if you feel you are forced to increase prices, it is most likely your competitors will too – maybe six or twelve months after you increase prices. Remind your customer about this in the context of all the other reasons for the price increase. Imply that even if they change to one of your competitors, it is highly likely that the competitors will increase prices in the next few months as well.

Train your staff

Paramount for a successful price increase is that your customer-facing employees and executives must be properly trained to deliver these important messages.

In preparation for this training, you must try to understand every possible objection a customer will come up with, and arm your customer-facing employees and executives to deliver a convincing, succinct, believable answer for each objection raised.

Appropriate staff need to receive detailed and comprehensive training on how to deliver these price justifications. Preferably, this will include a lot of role play to help practice the eventuality of many different scenarios occurring.

Case study

A company sells home security products to an army of independent installers, all of them repeat buyers.

The products are built in the Far East on specifications from the company. For six years, suppliers annually increased their cost to the company, and the company did not pass those cost increases on to their customers (the installers) for fear they would take their business to the company's competitors.

Pricing research showed that tentpole products had prices below what these installers expected to pay for the products, and also that "price" was not an important decision driver, whereas quality and availability were.

We recommended pricing increases of between 10–15% for the different tentpole products. As the price increase was executed, the company watched with astonishment how not a single installer even made a comment about the new higher prices. Encouraged by that, and our recommendations, the company, six months later, did another, equally-large price increase with the same results – zero pushback.

The company now does not hesitate to pass on suppliers' price increases, and regularly (every six months) increases prices by a few percent. Still, nobody notices. This has lead the company to operate with the highest margins in their industry, and it has led to a company that now has plenty of cash for marketing, developing new products, and constantly increasing quality and the benefits they provide to their customers.

Communication plan

Maybe the most important aspect of the price increase process is the communication plan, not only to your customers, but also to your staff. In the many hundred pricing projects we have executed, I cannot remember a single company's customer-facing staff who said their product or service was too cheap. So, before you communicate with your customers, you need to communicate internally with your staff.

Internal communication

The method and channel for your internal communication is what works best in your company. It may be internal newsletters or videos distributed on your internal network. For small companies, maybe a town hall style meeting or other ways that work for your specific circumstances.

This is what you need to communicate to your staff:

Why

You need to say why you are preparing for this price increase and why you decided to do it now. This is very similar to how you plan to defend the increase to your customers.

What will happen

Since you have modeled the results of the price increase, you can now also say and show with graphics to your staff what the outcome of the increase will be. If the modeling shows there will be higher revenues, but lower sales, you need to alleviate the fear that some staff will have of losing their jobs (if you do not also plan to reduce staffing levels). One way of alleviating this fear is explaining that your price increase will provide the company with more resources to market your product and/or services, so that after some time, you will see an increase in volume again.

The future

Part of the communication needs to be an optimistic view of the future after the price increase. If you, as part of your preparation, did pricing research, you now know your marketplace better than before, and you can leverage that into more efficient marketing and sales messages that will drive a higher growth rate and higher profits. Your staff definitely needs to know this information.

External communication

The external communication plan needs to be different. You can use the following steps:

Step 1

Your sales people need to tell your customers, as part of their regular customer communication, that they hear there will be a price increase some time in the future.

They should say they are not sure about when or how much. Before they communicate this with customers, they must have attended the training discussed earlier.

Step 2

The company makes a formal announcement that a price increase will take place at a defined point in the future. How far in the future depends not only on the reordering frequency of your customers, but also on how long you can sustain your current prices. Three to six months in the future is typical, but we have worked with companies who say they need to give their customers longer notice.

In this formal communication, you need to remind your customers how long it was since the last time you increased prices.

If you can, and if it is relevant, you might want to say that over that period, the consumer price index increased by X% while you increased by 0%.

Also, if you can, you should remind your customers about the products or services for which you do *not* plan to increase prices. You should also say that you are not passing all your cost increases onto your customers, but just a portion of them.

Continue to remind your customers about the pending price increase – make sure it will not come as a surprise to them.

Step 3

Your sales people should offer customers to buy now at the current price for delivery after the price increase. How distant in the future they can schedule delivery depends on your business, but six months is often a good compromise.

As you get closer to that price increase date, make sure your sales people are communicating the option to buy now for delivery later.

Step 4

Execute the price increase and communicate again to your customers about the increase. Remind them about the reasons and the times you communicated this in the past.

Case study

A nationwide retailer of home-improvement products markets itself widely, and its main marketing message is "low price." The company was barely profitable, and came to Atenga looking for that silver pricing bullet that would turn around its fortune.

Pricing research showed that the customers in the general market for the kind of products the company sells are not price sensitive at all. They are looking for quality and a slew of other variables, and "price" does not register very high as a decision driver. However, the company's customers were extraordinarily price sensitive.

What this means is that the company's ongoing message of "low price" attracted just the small portion of the market that is price sensitive, while those who are not price sensitive bought products in this category from other channels. The company had tried to tone down the "low price" message, but then the number of leads they received dropped substantially. They also could not raise prices, because their existing customer base bought on low price.

So, the company had really painted itself into a corner from which recovery was almost impossible. The only way the company could recover from this situation would be to develop a new, premium brand, and sell the same kind of products they sell with the first brand, but not with "low price" as the message, but, rather, with messages of "quality" and other variables. This was a long-term and expensive proposition, but it was the only possible way available for the company to take.

Contingency plans

Inevitably, some of your customers will rebel, i.e., tell your sales people they will stop doing business with you. If the training and communication has worked as it should, most of those rebels will be taken care of and will realize that the value your company provides is worth the added price. However, for those who do not, there are really only two options:

1. You can grandfather in some of the rebels by offering them the old, lower price for orders they place for a short period after the price increase is executed. Maybe for three or up to six months. After that, they too have to buy at the higher price.
2. You can simply drop them. Of all your customers, those who are the most price sensitive are also the customers who are the least loyal to you, and those who are often the most expensive to serve. In preparation for your price increase, I recommend you do a “cost to serve” analysis of your (main) customers so that if they are the rebels, you may take this as a reason for dropping them.

Unbundling

If everything else fails, and customers you really want to retain want to rebel and move the business you previously earned to a competitor, the final solution is unbundling. What this means in this context is to keep a customer at the old, lower price, longer than others, while at the same time lowering your cost.

For example, if you sell hardware, maybe you sold the hardware including power cables. To unbundle for the “rebel” customers, remove the power cable (or decrease the warranty or increase the minimum order size, etc.).

If you sell services, you have to find other ways of lowering your cost if the price is to stay the same. If, for example, an accounting firm provides an all-inclusive service to its customers, maybe personal retirement advice can be removed. Maybe tax preparation can be included, but not tax advice. A gym that sells monthly memberships can remove access to certain group training programs.

It does however, all depend on your circumstances, customers, and company.

Three more things to consider

In the case of the company selling hardware, there must be a SKU for the same product with or without that power cable. If not, the sales people who are negotiating with the rebellious customer cannot offer this alternative. Same for the other alternatives: there must be in the sales process a way to sell both a bundled and an unbundled version.

Customer-facing staff must be trained to defend this unbundled alternative just as with the bundled one. So, if selling hardware without the power cable, it must be “sold” as a benefit. Imagine what the purchase agent will say to his/her boss. This is the outcome you are looking for: “I got the old price! And we don’t even have to change the cables, we can use our own!” It’s a win-win situation, both for you and your customers.

However, even this lower cost for old pricing needs to stop. I suggested earlier that rebellious customers may be grandfathered in for six months with the old price. Unbundling may extend that for another six months, but then these unbundled customers need to get with the program and accept the same price as everybody else. By then, most likely, your competition increased their price and it is no longer a viable alternative for the rebellious customer anyway.

The future

Having successfully executed a price increase process, you now must make price increases an annual, or biannual event. Make sure that your customers get used to a price increase every six or twelve months. The increases do not have to be large, often just a few percent, but compounded year after year, they will start making a real difference for your company.

It also means you do not have to go through a process like the one described here every time. Price increases becomes part of daily business life and not a disruption that challenges your entire company.

Per Sjöfors
Woodland Hills, California, September 9, 2018

Appendix

This appendix is for those who are technically inclined and interested to know how revenue, price, and sales level (demand) can be modeled in pricing research.

Pricing research consists of reaching out to a company's marketplace and measuring its willingness to pay (yes, this can be measured with accuracy), value drivers and decision drivers. This includes both the company's customers and non-customers alike. What makes pricing research different is that it understands how these value drivers influence willingness to pay and how decision drivers influence willingness to buy. These drivers are aspects of the company and its products and services, and include how the company positions itself, how it markets itself, and the unique benefits of its products and services to its customers.

- The research can be done through online surveys, interviews, or both.
- There are three things that are paramount for pricing research:
- It has to be anonymous. If the research subjects can figure out who the company is, the results will be tainted. Anonymity is safeguarded by abstracting features and functions into benefits.
- It has to cover both existing customers and non-customers.
- It has to capture enough respondents for the data to be statistically significant. This means a minimum of 96 respondents for each of the important value and decision drivers (for any marketplace with more than a few thousand potential customers, 96 respondents equal 95% confidence +/- 5%).

Pricing research will generate demand and revenue curves – overall curves, but also curves for each of the important decision and value drivers. Demand curves model how demand (willingness to buy) changes as different price points are considered. Revenue curves take the following formula: demand times price (D x P) to model revenue at different price points.

With this data, it is possible to assess which value and decision drivers are most valuable in terms of both demand and revenue. Thus, it provides information both on how to set the price "right," and also determines which benefits (i.e., the results of features and functions) will drive higher sales.

On the next pages you will see the following:

1. An overview on how to read the price and demand model charts;
2. An example of actual modeling from the first case study on page 6. The first page is price vs. demand and our recommendation for the initiation fee to join the organization. The second page shows the same modeling for the annual fee.

How to read Atenga's "Willingness to Pay Measurement"

Price too low
The price of a product or service is a message of "quality" and "benefit."

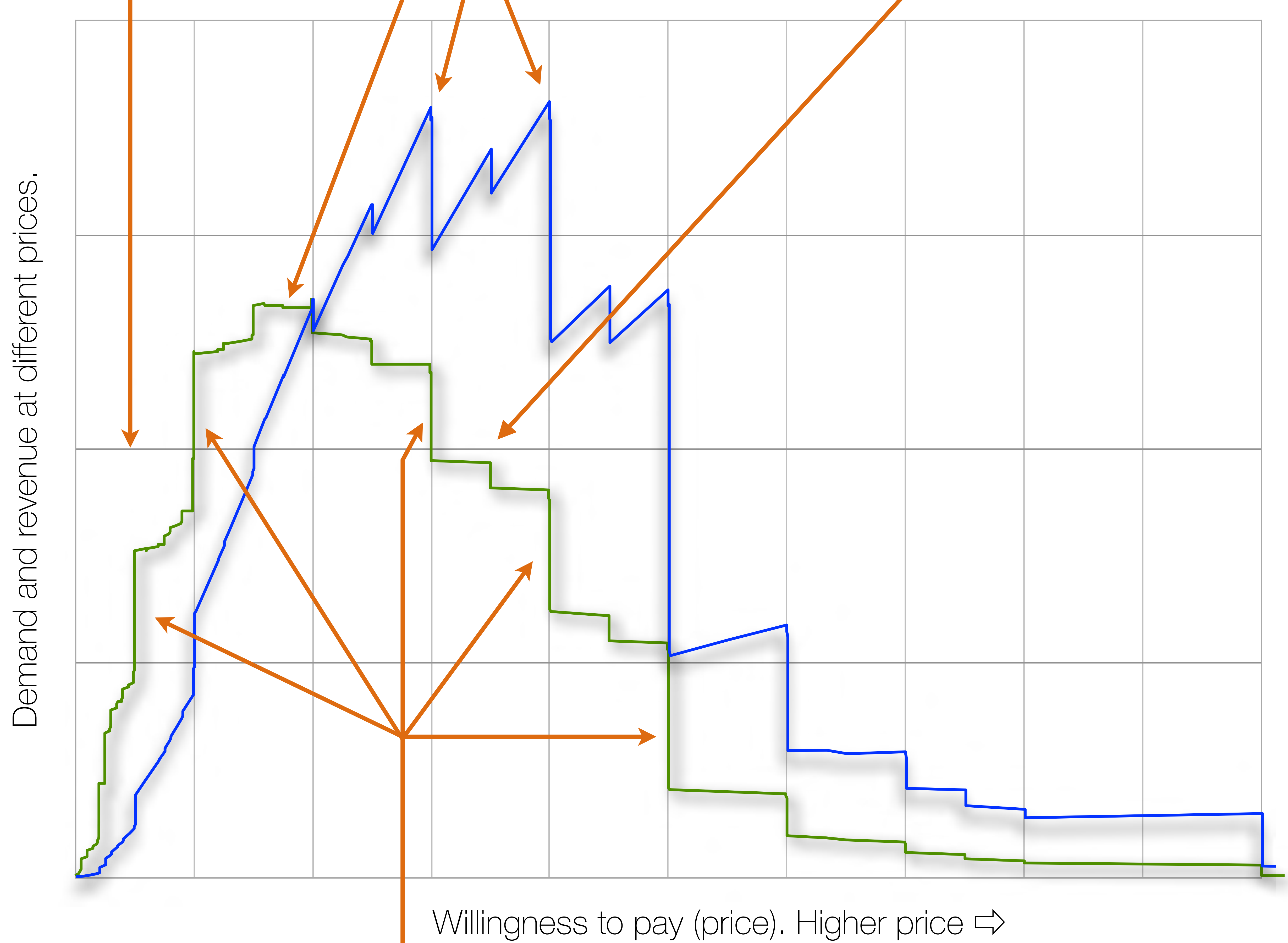
A too-low price generates lower market share. The lower the price, the more potential buyers assume low "quality" and "benefit." Thus, market share will decline.

Demand peak
The price where the seller will gain the highest market share.

Revenue peak
By multiplying price with market share,
it is possible to discover where revenues
will be highest, even if market share is lower.

Price too high
There are many reasons potential buyers will say a price is too high. It may be access to funds, but equally important is that the seller has failed to generate a message of "quality" and "benefit."

The higher the price, the higher the frequency of potential buyers saying they will not buy because the price is too high. Thus, market share will decline.



Price Walls
Psychological price points where small price changes make very large impacts on both market share and revenue.

Demand (sales volume) at different price levels

Relative revenue at different price levels

Initiation fee

The company sold its service with an “initiation fee” and an annual subscription. The current initiation fee was $100.

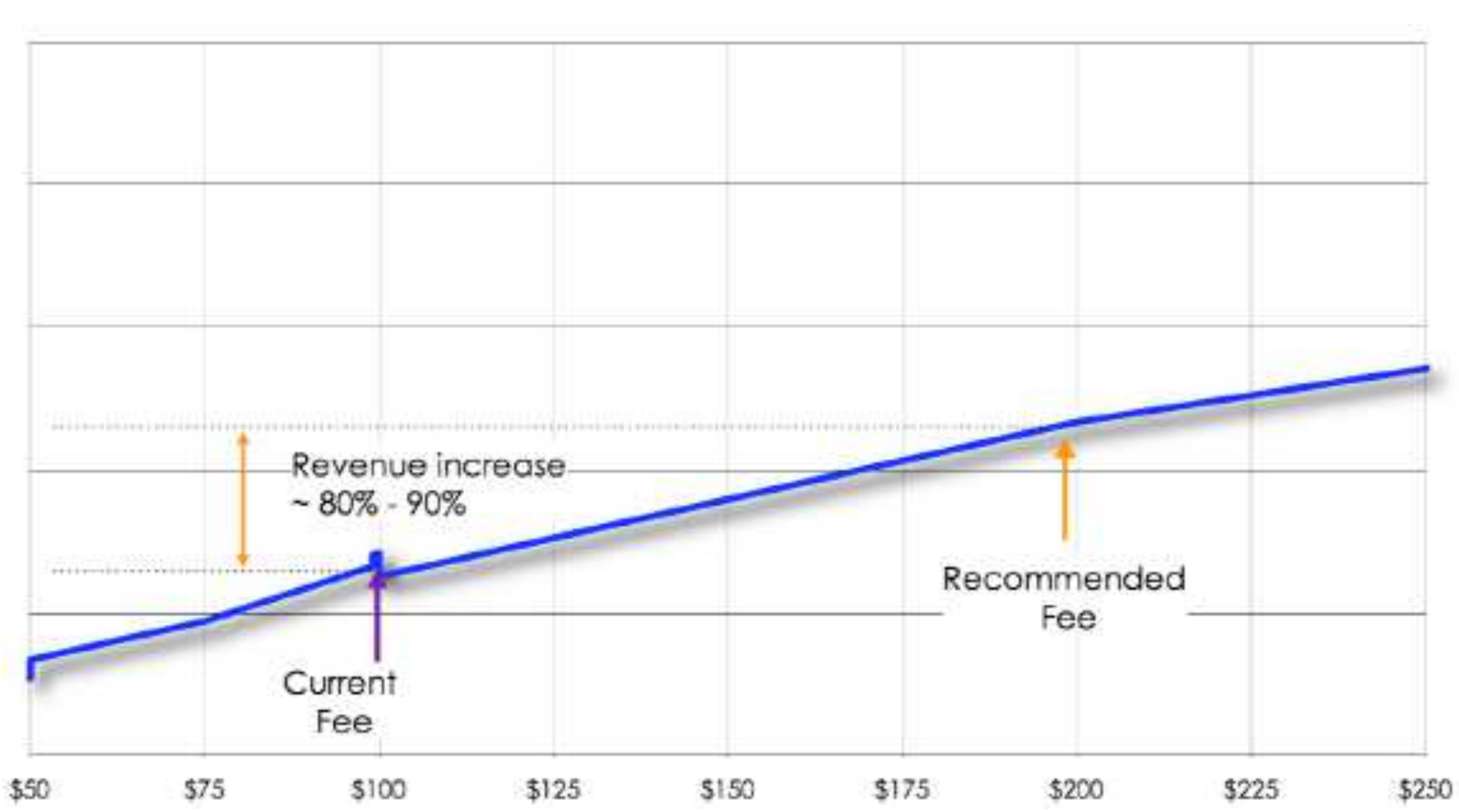
What is seen in these three charts is the demand at different price levels and the revenue increase that could be expected if the “initiation fee” was increased from $100 to $195.

Demand at $100 and at $195 being virtually identical means that no, or in a worst case scenario, a marginal, loss of new subscribers if the price is increased to $195, while generating revenues that are almost twice that of the current fee.

An overview of initiation fee demand measurement

- The flatness of the demand curve between $100 and $200 means that virtually no marketshare will be lost if the initial fee is increased to $195

A zoom in to the interesting area of the initiation fee measurement



Modeling of the expected revenue after increase

Annual subscription fee

Once the initiation fee was paid, the company charged members an annual membership fee.

What is seen in these three charts is the demand at different price levels and the revenue increase that could be expected if annual membership fees were increased from $360 to $495.

Demand being inelastic between $360 and at $495 means the company could expect a drop in subscribers of 4% when the price is increased to $495. However, this will generate revenues between 20–25% higher than at the current price.

An overview of annual fee demand measurement

- The market is substantially in-elastic at these price points, so a increase from $360 to $495, a 32% increase will only reduce memberships 4%

A zoom in to the interesting area of the annual fee measurement

- The market is substantially in-elastic at these price points, so an increase from $360 to $495, a 32% increase will only reduce market share 4% and therefore revenues can be expected to increase 20% - 25%

Modeling of the expected revenue after increase

Good luck!

For comments or questions, you can reach me at
per@sjofors.com + 1 818 512 9133, www.sjofors.com