

Business Pricing Power – Part One

Business owners have viewed **pricing power** as one of the best predictors of a company's long-term financial success. Warren Buffett's famous quote from 2010 captures the sentiment.

“The single most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you must have a prayer session before raising the price by 10 percent, then you've got a terrible business.”

However, the simplicity of this statement doesn't reveal the complexity of pricing power; how to know when you have it, how to build it, and how to use it effectively. Let's have a look at some key questions to get started on your way to true pricing power.

Do You Have Pricing Power?

For most in competitive markets, if the price is too high, it will result in the failure to achieve desired sales volumes when customers either find a suitable alternative or choose not to purchase at all. However, there are many instances in which a suitable alternative or even a competitor doesn't exist. If you think your product is a commodity, do you see an opportunity to build pricing power?

Key Question: *“Is your product or service commonly sold at a discount?”*

If the answer is 'yes', you either lack pricing power, have the wrong offering structure, or both.

Can You Build Pricing Power?

Pricing power isn't just about raising prices; it's about matching the value you deliver to the price customers pay for your products or services.

You can build pricing power when you create a situation in which customers believe/know they receive more value from your product or service than the price they pay. However, what happens when customer needs and expectations change? How long will your pricing power last? The flow of information and the speed of innovation intensify competition and continually change the playing field.

Key Question: *“How well do you know your customers, and can you segment them into groups that have similar value needs?”*

The increased availability of information not only empowers customers to learn more about their options, but also empowers companies to learn more about their customers. You may, in fact, have pricing power in certain cohorts of your customer base that you haven't identified or do not understand.

Long-Term Vs Short Term Pricing Power

There is an interesting article: ***Pricing Power: Delighting Customers vs. Mortgaging Your Moat***. In the article, a distinction is drawn between companies who use pricing power to delight their customers versus those who use it to exploit their customers. This distinction, between two different uses of pricing power, is very important and more subtle than you may think.

Let's look at the following scenario:

A raw materials supplier has the advantageous position of excess inventory in a time of market-wide shortages.

- **Option A:** The supplier who “delights” customers will use pricing power to create a tiered offering based on delivery lead times and allow their customers to choose the price they are willing to pay based on the speed at which they wish to receive their goods;
- **Option B:** The supplier who “exploits” customers will raise the price for the supplied item across the board, giving customers no choice but to pay the higher price;

Is there a right option? Consider the alignment of your commercial strategy to your corporate goals and identify the critical opportunities to drive both short and long-term profit growth.

Part 2 of this article will be included in the March edition of BusinessPlus+.

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