Three Questions to Answer Before Raising Prices

Anthony Bahr
Vice President, VOC Strategic Practice
Strategex

The underlying motive for virtually all mergers and acquisitions is the pursuit of value creation, which is also the common denominator shared by buyers and sellers alike.

Going into a deal, investors are commonly sold on the notion that value will be created via cost synergies associated with the integration of the buyer and the seller. However, it is well documented that only a small fraction (about 20%) of post-close value creation can be attributed to the synergistic effects associated with a deal.

Revenue growth, which accounts for roughly 60% of post-close value creation, is the true driver of new value. But unlike cost-cutting, growing revenue is usually a cost center which often renders customer retention and expansion to be overlooked factors of many integration strategies that are built on improving margins.

There is another way to boost revenue without the margin compression that comes with organic customer acquisition efforts. Raising prices is a relatively quick and easy way to realize topline growth, but it comes with inherent risks: Will customers accept a price increase? Will price increases lead customers to lower their share of wallet? Will a price increase damage the company's position in the marketplace?

Based on our experience conducting customer due diligence on behalf of private equity firms and strategic acquirers, we have developed a three-part litmus test to help our clients determine if customers may be willing to tolerate a bump in prices. When considering a price increase, ask yourself the following questions:

Does the company have a high Net Promoter Score?
The Net Promoter Score® (NPS®) is the industry standard for determining the strength of customer relationships. An index ranging from -100 to +100, NPS measures the willingness of customers to recommend a company to others, and is used as a proxy for gauging customer satisfaction and loyalty.

Based on their response to the question, "*How likely are you to recommend this company to a friend or a colleague?*", customers are segmented as one of the following:

- **Promoter**: A customer that is highly satisfied; they tend to be repeat buyers, allocate a majority of their share of wallet to the company, and actively promote the company's products or services
- **Passive:** A customer that is somewhat satisfied; they would consider lowering their share of wallet if a competitor offered a better value proposition, and while they are unlikely to spread negative word of mouth they are not strong advocates for the company
- **Detractor:** A customer that is dissatisfied; they are unlikely to purchase from the company again and could potentially damage the company's reputation through negative word of mouth

A company with a strong NPS, particularly with a heavy concentration of Promoters among their top accounts (the 20% of customers which account for roughly 80% of total revenue), is better positioned to raise prices. And, the company with the highest NPS within a category is often the firm that commands the most premium price, frequently charging 20% or more than other players.

This is because Promoters see value in the relationship beyond the product or service itself. The higher price can be justified because the company is not seen as a supplier, but rather a strategic partner that offers an unbeatable customer experience.

Conversely, companies whose top accounts are mostly composed of Passives or Detractors have less leverage to raise prices since their top revenue generators are already likely to be shopping around for other suppliers.

How does the company's prices compare to competitors?

If one of your suppliers asked you to participate in a customer satisfaction survey, how would you answer the following question?

Which of the following statements best describes Acme's prices?

Very high
Somewhat high
Just about right
Somewhat low
Very low

Most of us would rationally select "very high" or "somewhat high" because it is in our interest to provide the company with feedback that could potentially improve the profitability of our firms via lower cost of goods sold and higher margins. With feedback like this, management would be hesitant to consider a price increase because customers are intimating that prices are already too high.

But, how would you answer this question?

> *Compared to other companies that offer similar products or services, which of the following best describes Acme's prices?*
>
> *Much higher*
> *Somewhat higher*
> *About the same*
> *Somewhat lower*
> *Much lower*

Quantifying customer perceptions toward price (or any metric for that matter) is certainly useful, but it's easy – and dangerous – to fall into the trap of generating and interpreting data without any competitive perspective.

When considering a price increase, the real question should not be, "What do you think of our prices?" It should be, "What do you think of our prices *compared to our competitors*?" If customers suggest prices are at par with or lower than other suppliers, there may be potential for an increase so long as a distinct and compelling value proposition exists.

It is also important to go beyond quantitative measures and qualitatively understand what is driving the price/value equation. Insights gained from capturing the voice of the customer helps identify low-cost levers that can be pulled to potentially increase the value side of the equation to help offset the increase in price.

Is price a critical influencer in the decision-making process?

There are dozens, and sometimes up to hundreds, of factors that decision makers have to consider when selecting a supplier. While price is always a consideration, it is rarely one of the primary factors in the decision-making process – at least in non-commodity sectors.

Other considerations such as quality, problem resolution, satisfaction with key account managers, ability to innovate, and responsiveness are very often ranked ahead of price in terms of their degree of influence on the purchase decision.

That's why when deliberating a price increase, it's critical to know how customers rank the importance of price relative to the broader hierarchy of buying criteria. If price is a secondary or tertiary factor, there is a potential to increase prices so long as the company is delivering strong performance on superseding factors.

Boosting topline revenue via price increases is one of the easiest ways to kickstart value creation but it can be a risky decision to make. If the answers to these three questions are favorable, especially among top accounts, we tend to find that a price increase rarely results in negative customer blowback.