



How do I: Achieve a price increase?

Considering a price increase but not sure how to execute it? Increasing price can generate significant revenue for your company: if the trade and the consumer accept it. This guide outlines the key principles and options to planning a successful price increase.

Pricing can be used effectively - both tactically for short-term gain and strategically for the long term. Critical to successful pricing management is the careful planning of any price changes and an understanding of their potential implications - both immediate and in the long term. Of the possible pricing changes a company can make, price increases are the most difficult to execute and attach the highest risk. However, they are necessary and powerful business tools, which, if used successfully, have an immediate, positive effect on the business.

Of course, price is just one part of the overall value equation and must be viewed in its proper context. Meeting consumer expectations on all key indicators e.g. product, function, versus the competition, will affect the value your product represents.

BENEFITS

Achieving a higher price provides many business benefits, including:

- Additional revenue.
- Improved profit margins to accommodate increased costs.
- Focus on value and quality delivery.

GETTING STARTED

Be prepared. Increasing your price will change the whole of the marketing environment and evoke reaction from your distributors, competitors and the consumer. If managed particularly badly, even the media, trade bodies and the government can get involved. Preparation is key and should include:

- A thorough understanding of why the company is increasing the price. This may be for *external* reasons (e.g. to cover increased raw material costs or additional resource costs through new regulations or legislation), or for *internal* reasons (e.g. the company is seriously underperforming, or to raise increased revenue for promotional investment).
- Establishing your justification for the price increase. Either directly or indirectly, the majority of customers and consumers will want to understand why the price has risen. In premium or high inflationary markets, an increase slightly above inflation may not be noticed. However, as a planning rule, you should over-estimate the need for justification. In this way the company is prepared for most reactionary situations.
- Consider your distributors and the competition. Each group will most likely respond to your actions and, as part of the planning process, provision for this reaction has to be made. For example, you may need to provide additional marketing investment to communicate your differentiated quality versus your competition, or you may need to provide new trade incentives to support the new price introduction.
- Plan the price introduction with the same degree of detail as any other piece of major marketing or sales activity. This includes a clear understanding of who is responsible for what, a thorough briefing on the mechanics of the price increase, its justification and even training where necessary.
- Ensure all the necessary disciplines are working together from the outset. This includes sales, finance, marketing and, dependent on the specific nature of the activity, new product development and PR.

Above all, ask yourself two simple questions:

- What effect will the price increase have on volume of sales?
- What will the effect be on **profit** per sale?

PRICE ELASTICITY

This simple concept is at the heart of successful price management. In essence, it means understanding how far you can stretch your price before losing a significant amount of customers - stretch the elastic too far and it will snap. It focuses on the effect of pricing on customer demand and, in practice, is a difficult concept to quantify. The classic demand curve shows that if price goes up, demand should fall and vice versa. However, in reality, there are a number of factors which distort this effect. These include consumer trends and habits, perceived values, fluctuation in disposable income and competitive products. Elements which contribute to strong price elasticity include:

- Perceived quality of your product.
- Loyal customer base.
- Lack of direct competition.
- Strong brand values.

When considering a price increase, you will need to review the potential effect on market demand. You may have research that will help you determine this (for more information on this area see the **How do I: Conduct Market Research?** guide). There are a number of factors, which will affect the level of demand for your product. These include:

- Target market
- Product benefit
- Product quality
- Product usage
- Competitor activity

For more information on market demand and forecasting, see the **How do I: Determine the right price level?** and the **How do I: Forecast sales and profitability?** guides.

POTENTIAL STRATEGIES

There are a number of strategies that can be used to effectively increase the price of your product, including:

Innovation: is one of the clearest methods of adding value and supporting the differentiated benefit of your product. It is a long-term strategy but not, however, the quickest method. Innovation could be product based (e.g. improved flavour, low fat or sugar-free versions of existing lines) or packaging based (e.g. sports caps on mineral water bottles). Whichever the route, innovation can justify the additional price if it represents real added value for the consumer.

Segmentation: offers the opportunity to increase price by targeting less price sensitive customers or markets. By positioning your product in a higher quality segment you can justify its price increase. However, entry into the higher quality segment has to be justified e.g. by product quality, perceived benefit or brand strength. This will involve marketing investment to communicate and substantiate your product's positioning. Segmentation can also be exploited by introducing new products or line extensions into other segments of the market and so achieve an overall higher price across the range.

Brand building: a proven route to reduce price sensitivity is to build brand strength in the marketplace. Brands are not immune to eroding demand through price increases: however, they often have greater price elasticity than weaker product offerings in the marketplace. Key to this insulation is that brands build their customer franchise on other elements that can detract from the pure price/value relationship. Such elements include product quality and brand image. Each time a customer chooses the brand leading product, instead of the "me too" which is 15% cheaper, is proof of the strength of this strategy. This is, however, a long-term strategy and one which demands consistency (in strategy, investment and company support). Careful consideration and planning is therefore needed before the company embarks on this route.

Margin enhancement: focuses on increasing the price you get from your customers without necessarily increasing the price to the end user. There are a number of options that can be used to do this, including:

- Contract terms: develop contractual relationships which allow for automatic price increases based on pre-agreed criteria e.g. inflation or industry index prices.

- Cost cutting: develop initiatives which seek to reduce the costs of distribution e.g. category management (for more information on this area see the **How do I: Implement Category Management?** guide).
- Increase the cost to the distributor: this is often a risky route but it can be successful in certain circumstances. For example, strong brands or unique products can often leverage their position to negotiate a better price.
- Reduce distributor's margin: again a difficult route but one which may be justified by negotiating a reduced margin at higher sales levels, thus increasing the overall cash throughput.

MANAGING IN THE MARKET

Whatever the reason for your price increase or the strategy you adopt, there are a number of important elements to managing the price increase into, and in, the market:

- Build full justification for the price increase, including level and timing.
- Engage the sales team and develop the selling-in plan with them.
- Give key accounts advance notice of the increase and ensure time is allowed for any necessary logistical amendments to their systems.
- Be prepared for negative end-user reaction and have plans in place to manage this.
- Ensure all key functions of the business are briefed.

THE ROLE OF THE SALES TEAM

The sales team has a vital role to play when trying to achieve a higher price for your product. It will provide invaluable information and be the ultimate interface with the trade. You should involve key sales personnel from the outset of your evaluation. Consider methods of ensuring their full support to selling in the price increase e.g. developing targets based on sales value and profit as opposed to volume. Ensure they are fully equipped to sell the initiative. In addition to briefing materials (e.g. information and timing plans), particular training may be required. All salespeople going into negotiate with the key accounts should have a thorough knowledge of that account and some basic negotiation training.

HOW DO I? SUMMARY

1. Preparation is key – plan the price increase thoroughly and involve all the necessary internal personnel.
2. Evaluate your product's price elasticity and the potential effect on demand.
3. Review the options and develop your strategy.
4. Plan the price increase into, and in, market.
5. The sales team is vital to success, ensure they are fully engaged and prepared.

OTHER SOURCES OF INFORMATION:

Visit **www.scotlandfoodanddrink.org**

- Market Information: you can access data on geographic markets, consumers, retailers, foodservice operators, specific product sectors and more
- There are many other How Do I? Guides which can help you grow your business

www.scotlandfoodanddrink.org - The information service tailored to the food and drink industry.
Contact the Scotland Food & Drink Helpline on **0845 601 3752**.