# Pricing in times of turmoil

A practical framework for action as high inflation drives up costs

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*Disclaimer: Document intended to provide insights and ideas, and does not constitute client-specific advice. Published December 15, 2022*

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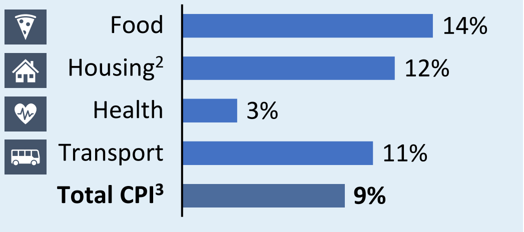
# Introduction

Nordic countries are currently experiencing 7-10% annual inflation. It started to increase markedly at the end of 2021, and further accelerated in February with the full-scale invasion of Ukraine. At that point, global food supply chains broke down and Europe was pitched into an energy crisis. Prices surged on a broad basis, with almost every sector of the affected.

**Nordic inflation[1], Y-o-Y October '22**




Just as the inflation was broad, however, it also reached deep into supply chains. It is not just consumers and households that have seen prices rise. Raw materials and utilities prices have risen as well, while metal and semiconductor prices saw large price spikes during the spring of 2022; these have since begun reverting to the mean, however.

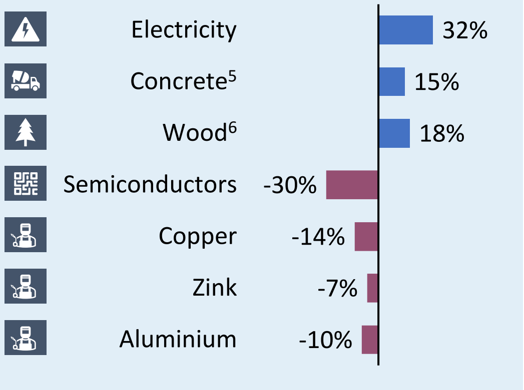
Both the rapid price increases and the high volatility pose challenges to businesses.

Census forecasts expect the extreme inflation rates to settle as interest rates are successively raised. However, inflation is still expected to remain above 4% into 2023 – well over the typical ~2% inflation target applied by Sveriges Riksbank or the ECB.

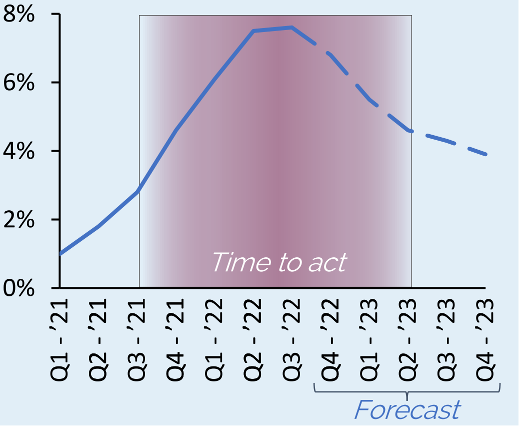
With forecasted inflation rates falling, the case to act now is as strong as it will ever be. Increasing prices sooner, rather than later, also shortens the time period where increased input costs eat into profit margins.

We have found that many companies adjust prices to experienced inflation in retrospect. This seemingly straightforward approach, however, often fails to fully offset the margin impact. And, if the last two to three years have taught us anything, it must surely be that we are living in a new era of turmoil and frequent disruptions. In this new environment, businesses have to be both more agile and more forward-thinking; this also includes a need to think ahead when trying to avoid margin erosion by adjusting their prices to inflation.

**Raw materials and utilities price change, Y-o-Y November[4] '22**




**Inflation OECD countries '21-'23F (%)**




Source: OECD; Millistream; WSJ; Skogsstyrelsen; SCB; Energimyndigheten
1. Non-weighted averages across Sweden, Denmark, Norway, Finland and Iceland 2. Includes Water, Electricity, Gas
3. Total Consumer Price Index includes other categories beyond those listed (e.g. furniture, communications, recreation, alcohol and tobacco, education) 4. Data accurate as of 2022-11-18 5. Includes other construction input-cost
6. Swedish Pine Wood used as reference

# The short-term approach

In times of high inflation and, thus, rapidly growing costs, many companies act under pressure to quickly defend challenged margin levels. It is often tempting to simply adjust prices in line with inflation. While this is certainly better than doing nothing, it comes with a range of attendant problems. Contracts have lock-in periods causing delayed effects, and new prices may become obsolete before they even take effect. A better approach is needed, and, at OPX Partners, we apply a five-step process:

**A Analytically understand the underlying historical cost development**

i. Determine historical increases (i.e. since the last relevant price change) in the largest cost categories

**B Make realistic assumptions on future cost development**

i. Apply a pre-determined forward-looking time period (e.g. in relation to typical customer contract length – this could be a long period!)
ii. Use sector-specific analyst reports and market indices to build a robust fact base on expected supplier behavior and how that will likely affect the total cost base

**C Set overall ambition for price increase**

i. Determine the necessary targeted average price increase – on an aggregated level – to cover recent *and expected* cost increases
ii. Determine any potential margin improvement opportunity beyond offsetting cost increases (and we stress that this is opportunistic)

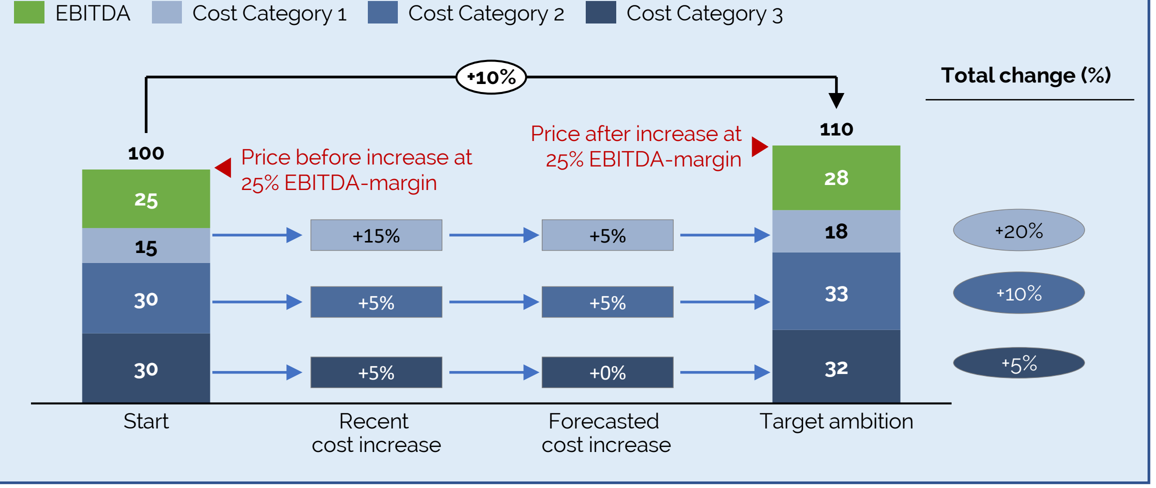
**D Craft a robust plan to safeguard overall ambition**

i. Break down targets and distribute to P&L units / owners
ii. Support units in building their plans, often per customer or per product. Be aware of practicalities which often hinder a flat average price increase across all customers / products / geographies. This could be level of competition, dynamics in the local market / industry vertical, USPs / technical edge, existing contracts, and other lock-in effects. <u>Only allow price increases below target average if offset by corresponding price increases above target average elsewhere</u>
iii. Opportunistically use additional pricing levers beyond price list increases where needed, e.g. surcharges and discounts

**E Build communication material and execute**

i. Use A and B to craft a strong message to customers, supported by indisputable facts
ii. Sequence customer contacts, allowing lessons to be learned *before* addressing the most complex customers
iii. Report back and track progress frequently

*Illustrative example:* **10% price increase needed to maintain EBITDA with historical and forecasted costs both increasing**



# Addressing the most common challenges

From our work, we recognize that the success of price increases in situations like this comes down to execution, and, specifically, in customer interactions. There are a few typical challenges that are commonly raised, and how well they are managed will in large part decide the outcome of the price adjustments. This partly comes down to the level of experience and skill in the commercial team, but also the level of detail and quality in the preparations.

Below are a few good tools and mitigation techniques to keep in mind for these typical challenges, all of which have proven to be powerful in customer dialogues. Applying those that fit your situation can have a drastic impact on how well you manage to execute your price changes and thereby defend your bottom line.

| Typical challenge | Potential tools and mitigation techniques |
|---|---|
| ***"We recently raised our prices – how do we communicate yet another price increase?"*** | ❑ **Build communication based on** how **costs have continued to increase** and emphasize **forecasts showing costs will continue to rise**<br>❑ **Assure customers you are applying a robust and considered approach**, and be ready to explain it<br>❑ **Consider connecting prices to established indices** to emphasize external cost development as driver of additional price changes (but have a plan for what to do when those indices begin to decrease) |
| ***"Customers are pushing back, and we are putting volumes at risk"*** | ❑ **Conduct scenario analyses** before launching price changes, quantifying expected volume and margin impact *before* high-pressure negotiations begin<br>❑ **Refer back to inflation macrotrend** to justify<br>❑ **Leverage benchmarks** and examples from your industry network to illustrate that "everyone is either raising prices now, or will have to do it soon"<br>❑ **Expect competitors to act opportunistically** in the short-term – **pre-empt this proactively in dialogues** and keep the focus on long-term relationship<br>❑ **Pair communication of price changes with your value proposition**, ensuring customers understand the full value of products and services they are receiving, and are not just focused on the price |
| ***"Inflation is now in regression, and customers are coming back requesting price* decreases"** | ❑ **Balance how transparent you are on your input costs** – e.g. your customer may know your production is based on steel as input, but they may not know the quality of your steel, how you process it, the specifics of your supplier contracts, or any other variables<br>❑ **Prepare counter arguments in advance when trends reverse**, leveraging your information advantage and deeper knowledge about your supplier landscape |

# How others have managed their pricing

**Client:** Industrial OEM

**Background:** Historically experienced margin loss every time input costs rose due to customer contracts being locked in 6+ months before delivery.

**Approach:** Price increases bundled with new discount model to allow flexibility where needed. Customer contracts with delivery in 6+ months adjusted to accommodate price increases.

**Total price increase 2022:** +12%

**Key insights:** The total outcome was significantly better in markets where a firmer approach was applied, as opposed to frequently "giving in" to objections from the commercial teams – have courage, and hold your ground

**Client:** Electronics OEM

**Background:** Very limited actual increases of total input cost, but key competitors were increasing prices.

**Approach:** Continued ambitious price increases as part of long-term plan. Tactical list price maneuvering to avoid psychological barriers.

**Total price increase 2022:** +8%

**Key insights:** Margin improvement opportunities occur in times of turmoil. Stay alert and ready to act on them, even if your cost base is not increasing.

**Client**: B2B trade company

**Background:** Significant exposure to raw materials with substantial cost increases.

**Approach:** Started early (2021) and raised prices beyond initial input cost increase to accommodate expected additional increases – no volume drop despite significant price adjustments.

**Total price increase 2022:** +9%

**Key insights:** Act early and forcefully. Leverage information advantage on detailed costs to mitigate customers' simplified comparisons to general costs indices. Price based on expected input costs, not historical actuals.

**Client:** Process-heavy manufacturer

**Background:** Significant increase of input costs already in 2021 and continuing into 2022.

**Approach:** Re-positioned value proposition emphasizing premium position (high flexibility, quick time to delivery) to support prices. Added trigger points in contracts to accommodate future price changes.

**Total price increase 2022:** +9%

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**Key insights:** Dare to price in relation to provided value (not a single customer complained!). Capture opportunity to also drive other change, such as repositioning to 'premium' messaging, remodeling price and discount logic with trigger points.

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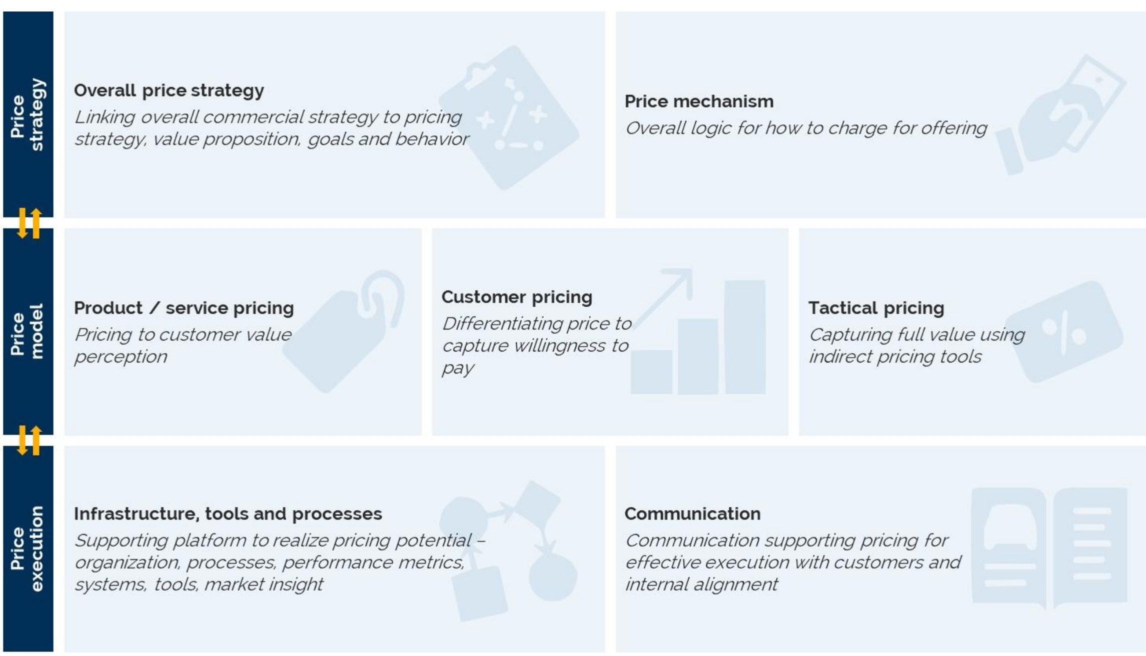
# The longer-term perspective

When acting on the current pricing opportunity – created by the macroeconomic turmoil and high inflation – speed is of the essence. Not raising prices fast enough to compensate for rapidly increasing costs inevitably leads to lost margin. To some extent, this motivates a trade-off where being "directionally right" is sufficient. As long as you move fast enough.

However, to secure a future-proofed pricing approach and to capture the full pricing potential on a continuous basis, a higher ambition is needed. Having acted on the most pressing needs to defend margins by off-setting short-term cost increases through price adjustments, many companies find themselves in a good position to level up their general pricing performance. The power of pricing has become apparent to many organizations of late, and is top of mind among many key stakeholders with influence on pricing decisions.

At OPX Partners, we apply a robust framework to capture full pricing potentials together with our clients, where opportunities are identified, prioritized and addressed across three levels: price strategy, price model, and price execution. While the framework serves as a good starting point, the detailed solutions must be adapted and designed for the specifics of each situation, and – as with any consultant-supported initiative – brought to life together with the client organization.



## About OPX Partners

OPX Partners is a Nordic management consulting firm. We support our clients in solving complex strategic and operational problems, from diagnosis to implementation – across a range of business topics.

Our approach has been shaped through working extensively with PE-owned companies across a variety of industries. Our approach is characterized by 3 factors:

**Smart**: By bringing experienced teams that know, and have first-hand experience of the problem at hand, but also have top-tier management consulting experience, we can hit the ground running, quickly understand and design the solution, and then move into implementation mode.

**Pragmatic**: Our extensive line experience and senior teams
ensure that solutions are pragmatic, implementable and
tailored to the client's specific environment.

**Collaborative**: We take a partnership approach with our clients and are normally present on the ground for the duration of the project, and especially during implementation to help ensure successful change. We work together to build our clients' capabilities and ensure ownership at all levels and functions of the organization.