How B2B Firms Can Price with Confidence as Inflation Rises

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A long-forgotten problem, higher inflation, has eroded the finances of many companies. Right now, many are struggling with high costs for raw materials, labor, energy, and other inputs, along with supply bottlenecks. At the same time, demand is surging as economies reopen for business in the wake of falling Covid-19 cases.

Some businesses have started to raise prices in response, with producer prices in the OECD countries up 9% in the 12 months through April 2021.

Consumer prices were up 3.3% over the same period (with the U.S. consumer price index well above that at 5.0% through May). Kimberly-Clark recently raised list prices on consumer products in North America, with percentage increases in the mid-to-high single digits. Consumers will now pay more for Pirelli and Yokohama tires and Energizer batteries. Hercules Industries boosted prices by an average of 15% on heating and cooling equipment, mainly due to rising costs for steel. Various chemical companies are charging more for polyethylene, one of the most widely used plastics.

Yet even companies that increase prices will still feel the pain of rising costs if they simply take incremental steps. For example, one landscaping equipment manufacturer recently signaled challenges to its earnings despite strong revenue growth and three price increases in the past year.

Prolonged inflation has not reared its head since the 1970s. While chronic inflation might not occur, companies need to hedge now against a medium- or long-term inflation scenario. Most corporate leaders have not dealt with macro inflation during their careers, leaving them unsure of how to proceed.

At one manufacturer, for instance, the CFO recently told us that although revenues have grown steadily, the bottom line fills him with dread, as spiking costs for raw material, labor, and energy have reduced profit margins from 15% to 10%. A food manufacturer is suddenly staring at a $200 million hole because of exploding commodity prices. And a building products manufacturer, experiencing the highest sales and worst margins in 20 years, discovered that one of its distribution channels — historically an attractive, high-volume channel — is now unprofitable in absolute terms, as weekly cost fluctuations and supply chain delays wreak havoc.

Moreover, many business-to-business (B2B) companies granted their customers pricing relief due to the pandemic, meaning they'd already sunk into a pricing hole even without inflation.

The pinch point is especially acute for midsize firms that have global supply chains but have not invested in the capabilities required to ensure their pricing keeps pace with market changes. Bain & Company's recent survey of more than 400 industrial companies worldwide found that midsize companies (under $5 billion in revenue) are less confident than large companies in their ability to handle inflation through price increases, to respond dynamically to market conditions, or to equip their front line with the right tools to make good pricing decisions.

Some executives seem paralyzed, because fixing the problem involves breaking informal arrangements with channel partners and customers. It's tough to give customers bad news twice — higher prices and longer waits for the goods. Still, the current environment favors companies that act quickly to make the right pricing moves.

For one thing, most business leaders view price increases due to inflation as fair. These customers will not, however, give their ~~suppliers much credit~~ for delaying price increases only to push them through six or 12 months from now.

For another, in supply-constrained industries, buyers have limited alternatives with which to negotiate. Price may be less important than supply and inventory availability.

Five No-Regrets Pricing Moves

As price increases from multiple suppliers eat into B2B customers' budgets, we expect customers to push back harder. The most effective pricing moves will be bold but tailored. These five tactics will hold up no matter how long or severe inflation proves to be.

1. **Treat customers differently.** Instead of blanket pricing moves, use surgical increases informed by the cost to serve, historical performance, and value to the supplier of an individual customer or segment. When your capacity is constrained, don't be afraid to walk away from one

low-value customer in favor of a more attractive customer or segment. And don't punish your sales team if that happens.

2. **Exchange price for other valuable features.** Prepare for customers resisting a straight increase, by offering other benefits. These range from volume guarantees to bundled products or adjusted service levels.

3. **Enforce what's already in the contract.** Many companies put price increase contingencies in their contracts but don't regularly enforce them and may not even be aware of them now. Check the contract terms for each customer, estimate the value of enforcing them, and equip employees with the relevant data and scripts to have a difficult conversation with confidence. Particularly for terms that might have been waived during the pandemic, alert customers now to avoid nasty surprises down the road.

4. **Consider indirect increases.** Besides direct price increases tied to inflation indexes, B2B companies can pass on surcharges for fuel, expedited shipping, inventory holding, and longer payment terms. Customer behaviors that cause profits to leak away from the list price — such as rush orders and small orders — should be tightened up. The average industrial company loses over 6% of revenue through off-invoice discounts and leakage, according to a global sample analyzed by Bain and Pricefx. Set a firm policy for when you will allow deviations from preferred terms and what you will require in return.

5. **Adjust the product mix.** During a period of inflation and supply shocks, what a company makes can be even more important than who it sells to. It's critical to have a current SKU-level view of profitability, not just a customer-level view. Just as firing bad customers makes sense, so does dropping some marginally profitable products.

Bringing Customers and Sales Reps On Board

Companies committed to taking bold pricing steps will want to first quickly assess their inflation exposure. Typically, the CFO runs this exercise, building a comprehensive analysis of where the company makes money today, at the customer and product level, and how profits would shift under different inflation scenarios.

Establishing this baseline puts the company on solid footing to take the right pricing actions. Rather than trying to solve the entire problem at once, it pays to sequence which customers and distribution channels to tackle first. The food manufacturer mentioned earlier selected two channels and roughly 20 critical SKUs out of thousands, then extended those actions to the rest of the portfolio, giving 90 days' notice of the coming price hikes. Other leading companies have set priorities based on customer profitability or contract renewal dates.

Companies with a direct salesforce face an additional challenge. Most sales reps will avoid uncomfortable pricing conversations with customers if they can. They will need clear data and scripts to use with their accounts, as well as account-specific targets, incentives consistent with the new strategy, and interim coaching for those who go off track. Sales reps should feel supported in doing the right thing for the business.

With a nuanced, tailored pricing plan in place, companies will not only improve their position during heavy inflation, they'll build the capability to adjust prices quickly whenever it's warranted.

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