MANAGEMENT
CONSULTANTS

STRATEGIC PRICING

A methodical approach

INTRODUCTION

- Private equity firms excel at driving value through cost optimisation and operational efficiency.
- However, many possess significant, untapped potential to drive value by developing greater proficiency and confidence in commercial optimisation, especially pricing strategies.

UNLOCKING HIDDEN VALUE

Today's fiercely competitive PE landscape demands a strategic approach to value creation, where optimised pricing can play a pivotal role in ensuring profitable growth.

Strategic adjustments in pricing can unlock significant value. Pricing is considered the most potent tool for boosting profits due to its direct impact on margins and its relative ease of implementation, compared to many other margin optimisation measures.

Most PE professionals will have heard the adage "price is the most important lever" but it is easy to forget just how much more powerful that lever is compared to volume – see figure below.

Illustrative example: How price increases can boost profitability by over 6x vs. volume growth

	Base case	Volume increase of 1%	Price increase of 1%
Revenue	£100.00	£101.00	£101.00
Costs	£85.00 Average profitability of the FTSE 100 companies[1]	£85.85 Increases to costs to satisfy higher volumes	£85.00 Costs remain the same as base case (no volume increase)
EBITA	£15.00	£15.15	£16.00
Profit vs. base case		+£0.15	+£1.00

x 6.7 more impact than volume for same change in base

[1] Average profitability of the FTSE 100 companies in 2023. Source: London Stock Exchange, Yahoo Finance.

ADDRESSING PRICING OPTIMISATION CONCERNS

Despite its acknowledged importance, pricing optimisation often gets sidelined in PE strategies due to several key concerns:

- Uncertain value
- Perceived risk of customer churn
- Competitive retaliation
- Limited capabilities to implement effective pricing change

However, these challenges should not overshadow the significant benefits of a well-executed pricing strategy. Forward-thinking firms willing to invest in capabilities and to obtain leverage from pricing not only accelerate value creation during the hold period, but also significantly increase exit valuations.

This five-step guide outlines a strategic approach to integrating pricing into private equity investment strategies. Developed by CIL's Pricing practice, it explores practical steps and considerations for unlocking potential value creation through effective pricing.

> **The single most important decision in evaluating a business is pricing power.**
>
> **Warren Buffett**

FIVE STEPS TOWARDS MORE STRATEGIC PRICING

1. Build price-position confidence pre-deal

Comprehensive pre-deal planning includes identifying pricing power and the resulting potential revenue growth and integrating this into forecasts. Doing so allows for strategic bidding and sharpens focus on critical areas for 100-day-planning. While not all funds excel in this area, those that do tend to develop a competitive advantage.

The impact of pricing strategies varies depending on several factors, including industry dynamics, segment positioning, and the existing level of pricing sophistication within the company. Understanding these complexities is essential for ensuring the realisation value.

Key takeaway: use the due diligence process to develop conviction about the value creation plan, with a focus on price position & pricing power.

> **Post-deal we have a strategy offsite with the management team to agree the three or four value creation priorities, beyond business as usual, that we will work on together over the next two to three years. These priorities could include better supporting the business with technology, entering adjacent markets and / or refining the approach to pricing.**
>
> Operating Partner, PE Fund

2. Early action for greater impact

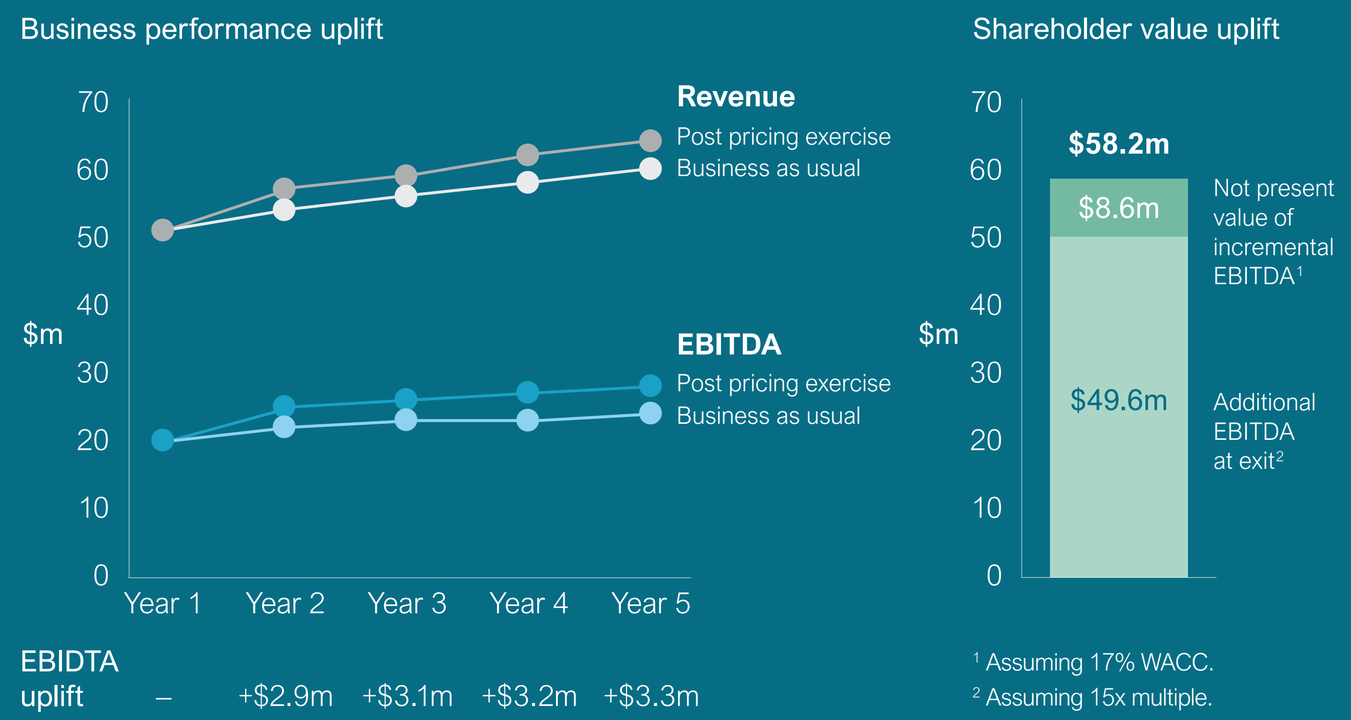
Time is money. Implementing an effective strategy early in the hold period meaningfully improves cash flow.

The advantages of early action extend beyond financial gains. Professionalising commercial teams early in the hold period gives them ample time to mature and develop a pipeline of continuous improvement initiatives.

Portfolio companies with a well-established pricing & commercial excellence (PACE) function demonstrate their maturity and potential for future growth, making them more attractive to incoming investors.

Key takeaway: act fast for maximum benefit, and seek to embed a culture of commercial excellence.

Case study: Increasing shareholder value by over $58m through early pricing optimisation



[1] Assuming 17% WACC.
[2] Assuming 15x multiple.

3. Partnering for enhanced expertise

Realising a company's full pricing potential requires focused effort. Management teams, despite their talent and motivation, will often lack the dedicated resources and specialised skills needed for comprehensive pricing market research and commercial excellence initiatives. This is especially true in the mid-market, where teams are lean and such skills are likely concentrated around the boardroom table.

This gap suggests collaboration with external partners who can offer bandwidth and expertise to accelerate pricing improvements and equip the portfolio company's management team with critical skills for long-term success.

Key takeaway: make use of external experts initially, then build PACE capability into the management team.

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4. Building an objective picture of value delivery

Excellence in pricing requires more than just maximising pricing power; it demands objective, unbiased customer research. This approach fosters a deep understanding of several key areas:

- Customer value
- Competitive positioning
- Effective market segmentation
- Nuanced communication of the value proposition

When portfolio companies struggle to increase prices, it is often because their decisions are based on biased and incomplete information. Insights from sales conversations are limited, as customers typically reveal only what they want the salesperson to hear.

Key takeaway: invest in professional, independent, market research to set prices accurately and justify them with compelling arguments.

Case study: Creating value through pricing for an infrastructure equipment-as-a-service provider

Challenge	We were enlisted by the new CEO of an infrastructure equipment-as-a-service provider to develop a new pricing strategy. Our objective was to achieve a sustainable increase in the client's margins while maintaining its growth trajectory.
Approach	Through comprehensive customer and market interviews, we uncovered untapped pricing potential and opportunities for sustainable margin enhancement. We then integrated the new pricing strategy within the context of a new product strategy to support the client's growth ambitions. We evidenced the value of the client's differentiation to customers and highlighted how pricing power varied by segment. With the new product strategy formulated and customer price lists established, we oversaw the implementation process, providing support during and after the market announcement.
Value	The new pricing structure delivered an approximate 15% EBITDA uplift without increasing customer churn. As a result, our client recouped their investment in the pricing exercise within eight weeks, tripling their initial target.

5. Ensuring effective pricing control for long-term value

Maintaining sustained performance requires robust pricing control, which relies heavily on data and processes. Most management reporting systems gather and present what is easy rather than what is useful. It is rare that they possess the necessary capabilities for effective pricing control.

Investing in data platforms that offer granular insights into price dispersion and customer profitability is essential, and typically delivers a high return on investment.

To maximise the value of this data, clearly defined roles and responsibilities within the commercial functions are crucial. This includes appropriate motivation, incentives, and a strong sense of ownership among team members.

A mature sales organisation is one that excels not only in acquiring new business but also in actively managing the profitability of existing accounts with the same level of dedication.

Key takeaway: invest in quality MI, systems and processes to enable scalability & repeatability.

> **Many value creation levers (e.g. implementing a new pricing strategy or new technology), require a solid foundation of a common data architecture, processes and basic IT systems. Companies with a fragmented technology and data ecosystem will need pre-work to put this foundation in place.**
>
> **Operating Partner, PE Fund**

CONCLUSION

Sophisticated, evidence-based pricing optimisation used to be the preserve of large multi-nationals but is increasingly becoming a source of competitive advantage for high growth mid-market businesses.

This shift presents both opportunities and challenges for private equity firms, emphasising the importance of strategic pricing as a key driver of value creation.

While some PE firms have adopted a more cautious approach to utilising pricing strategies, the landscape is shifting. Currently, it is essential to move beyond traditional methods and prioritise effective pricing as a significant lever.

While potential obstacles may exist, the potential benefits of pricing optimisation are undeniable and can be long-lasting. The sooner firms embrace strategic pricing, the sooner they can unlock untapped potential throughout the lifecycle of their portfolio companies.

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GET IN TOUCH

CIL brings clarity to complexity. We have extensive experience advising investors and management teams throughout the investment process, identifying opportunities for growth and providing value creation support.

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