AXHOLMEN
CONSULTING

Price optimization

– when analysis is mixed with psychology

By Milosz Tersmeden, Carl Fernholm and Oscar Andersson

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Axholmen's experience is that many companies have a large, untapped potential within pricing, where optimization is a lever for both growth and profitability. Deep understanding of the correlation between price, commercial model, packaging and purchasing decision is key but will not take you all the way. Psychological resistance in the organization, often driven by an exaggerated fear of negative customer reactions, is the most common reason for not reaching full potential.

A. DOES YOUR COMPANY HAVE A PRICING OPTIMIZATION POTENTIAL, AND WHAT IS IT?

Axholmen's experience finds that basically all companies have a potential to optimize pricing, but to what extent varies. Below are 6 common characteristics of companies with large potential:

1. An appreciated product that customers are willing to pay for, e.g. a clear ROI or qualitative benefit that the customers value
2. Small share of wallet, the products / services sold make up a small part of the customer's total cost base
3. Few equivalent substitutes exist on the market from price / quality perspective
4. The products and / or services provide value for the customer over time, not only at the time of the purchase
5. The price transparency is low on the market (competitors) and in the value chain (cost price), opportunity to price on value
6. The customer base is large and price is either not tailored to each customer segment and / or there is unmotivated price spread within each customer segment

For companies that fulfill one or several of the criteria to the left, there could be large potential, see Figure 1.

EBITDA-improvement of price optimization

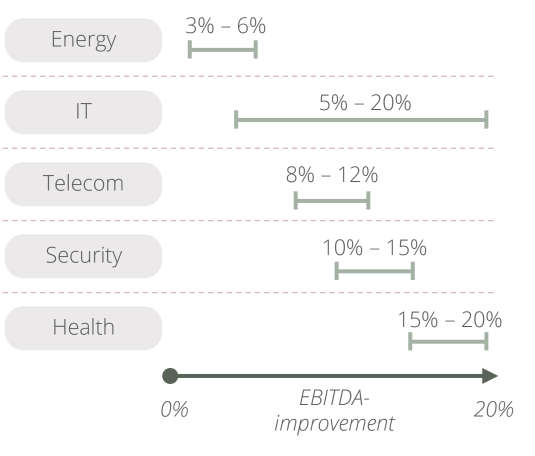

Figure 1: Examples of price optimization effects from a selection of Axholmen's reference cases

The positive effects in the example above are a combination of improved take rate / conversion / win ratio / retention and increased average profitability per deal as result of pricing optimization

B. *WHAT PRICING INITIATIVIES CAN BE USED TO ADRESS THE POTENTIAL?*

One area that often has untapped potential is price adjustments on existing customer base. There are several different types of price initiatives, where the common denominator is to have a clear rational for the customer in combination with right timing. This is exemplified below:

- Transition to a new commercial model like subscription at upgrade / renewal / up sale
- Revision beyond Inflation / index as result of increased delivery and / or production costs
- Revision of commercial terms where your products or services are enhanced and deliver higher value for the customer
- Reduction of historical discounts at call-offs or renewals with rational linked to market and product changes or harmonization per segment
- Discount reductions if the actual volumes the customer purchased are lower than agreed, where the rational is that the commercial terms for the discount are not fulfilled

When looking at initiatives for new sales it is important that the company gathers insights to understand what price level is optimal for each situation. Companies that get most out of optimizing new sales pricing are characterized by:

- Strong analytical ability, where patterns between price, packaging and demand in different segments can be identified
- Clear understanding of price elasticity in the market, and ability to differentiate prices based on product value and willingness to pay in different customer segments. Leverage customer insights, the customers often sit on the answers to what they value most
- Seeing pricing as something other than just a one-off, working continuously with a/b tests, business intelligence, etc. to ensure optimal pricing at any point in time
- Using discounts that do not erode long term profitability, but instead strengthen competitiveness at point of sales, e.g. offering one quarter for free instead of lowering the monthly fee

Axholmen has 14 years experience from commercial optimization within B2B, B2C and B2G in EMEA, North America and APAC. In this White Paper we share key insights that have helped our clients to reach substantial results.

C. DOES YOUR COMPANY HAVE THE COURAGE TO ADJUST PRICES?

In D. Kahneman's Nobel price awarded research, he identified that humans show 2,5 times stronger motivation to avoid pain / loss compared to achieve pleasure / winning. Sales professionals and decision makers are not more than humans, and naturally find the risks with changing prices as higher than the potential upside. The keys to create comfort and courage in the sales department when adjusting prices are carefulness and evidence through:

- Education to build awareness about the most common psychological pit falls
- Secure principles for when to terminate price initiatives if the desired effect is not achieved
- Use pilot tests in a limited but representative population of customers
- Measure customer reactions and effects from the pilot and use insights to scale up
- Work iteratively with adjusting initiatives and communication based on reactions and effects

Axholmen's experience is that the fear of negative reactions from customers often is exaggerated compared to what we see in the actual outcome. A strategy for objection handling and preparation for possible outcomes / reactions is key to avoid churn.

D. THEN WHAT, HOW DO WE REACH BEYOND A ONE-TIME PRICE ADJUSTMENT?

Optimizing prices is a marathon, not a sprint, and endurance and structure are needed to secure that the work does not stop at a one-time adjustment.

At Axholmen, we see 3 important pillars to achieve continuous price optimization:

1. Operationalize learnings and insights from conducted initiatives through structured ways of working and routines (e.g. for indexation, end of period contract handling, addressing historical discounts, etc.), secure hands-on support tools, updated sales support systems, and defined KPIs
2. Appoint someone with a clear responsibility for pricing that continuously follows up and drives the work forward (e.g. CRO or CSO)
3. Communicate success stories and effects early, where good examples and role models are visualized

Does your company want to understand more about your pricing potential? Contact Axholmen

Customer acceptance and churn at price adjustments

	Fulfill at least 3 criteria in chapter A	Adjustment	Customer acceptance (%)	Churn (%)
Reference case I	✓	3 - 20%	99%	0%
Reference case II	✓	0 - 15%	80-97%	2%
Reference case III	✓	3 - 25%	90%	0%

Figure 2: A selection of Axholmen's reference cases shows that acceptance rates differs cross cases, but churn can be avoided or limited if the initiatives are properly piloted and evaluated

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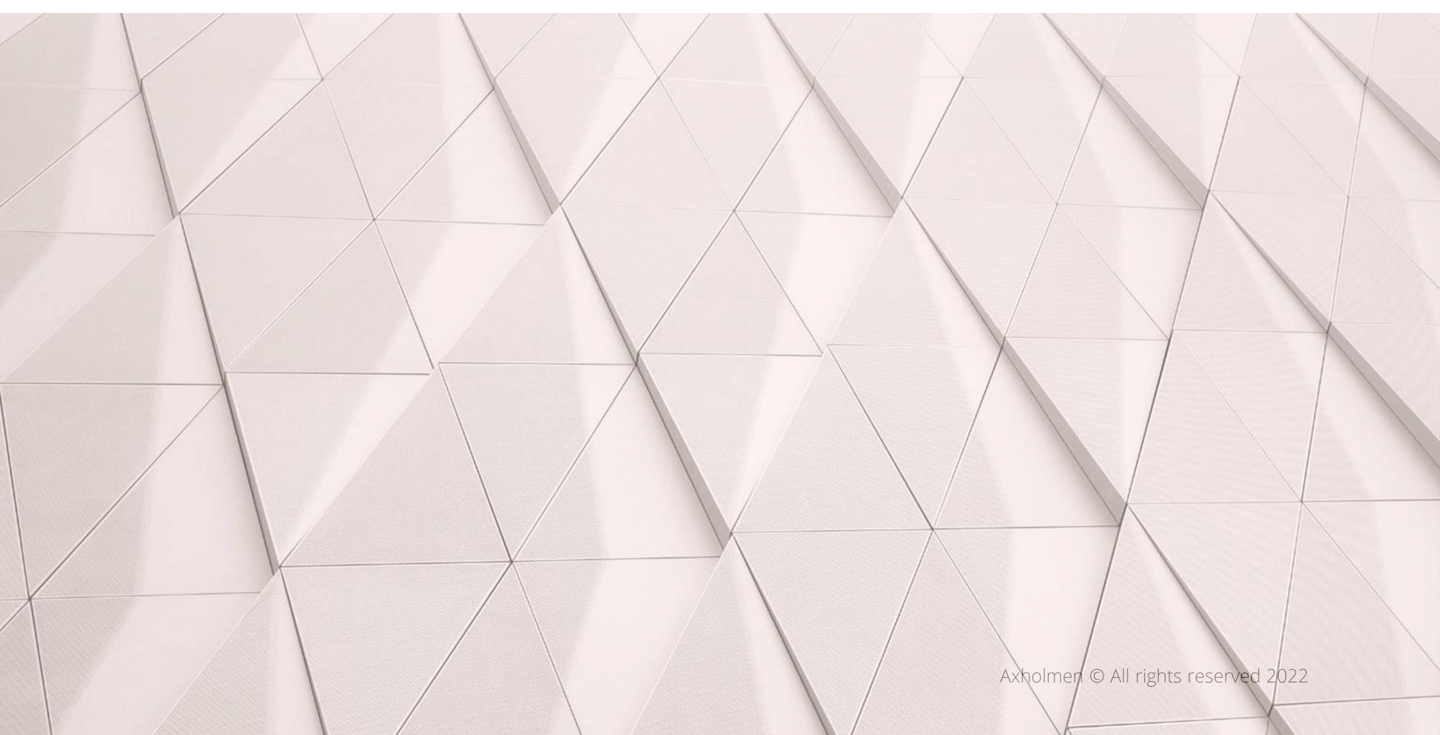

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