Driving Profitable Growth: How to Set Prices Throughout the Product Life Cycle

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In this series of articles, we have been looking at how Los Angeles and Southern California executives can drive profitable growth in their companies. Here, we conclude the three-part series with a look at the potential impact of economic downturns on profitability and how to achieve profitable pricing regardless of the economic environment.

Is Cost Cutting the Answer?

Economic downtowns and slow recoveries like the one we've been experiencing for some time now inevitably place pressure on corporate profit margins as revenues decline and raw material costs increase. In this environment, organizations often turn to cost-cutting measures to restore profitability, but is this really the best solution for boosting the bottom line? The answer is no as generally it's not possible to "save" your way back to prosperity. A complete analysis of customer and product profitability, coupled with the re-evaluation of pricing structures, can produce profitability improvements with little or no cost-cutting.

The first step is to perform a customer and product profitability (or CPP) analysis, which we discussed in detail in our first article in this series. A CPP analysis is a powerful tool allowing organizations to pinpoint profitability at the individual customer or product level. The output links prices and discounts, costs and cost drivers, and revenue data so key drivers for revenue along the value chain can be identified. Start by determining which of your customers are actually the most profitable for your company. In particular, have you fully assessed existing contracts and managed service commitments to maximize operational efficiency and minimize costs?

While sales volume and revenue often drive business decisions, experienced owners and CEOs realize that a lack of information about key customers and products can be fatal. This is why analyzing customer and product profitability can provide such valuable insights for an organization. Volume and revenue information alone is not sufficient to drive profitability. For example, unintentional accumulation of discounts and buyer concessions can undermine your company's intended pricing structure. A CPP analysis often reveals cash losses occurring on key customer accounts, which may cause sales activities to be inappropriately prioritized.

Pricing Decisions over Product Life Cycles

Managing the tradeoff between pricing and volume is a balancing act that evolves over time, affecting both new product launches and current product lines. Mature companies have multiple generations of products in the market, so product pricing decisions must be made in the context of the entire product portfolio — new product price changes can have direct implications on existing products.

Pricing strategies may require adjustments throughout the life cycle of any given product at three key phases:

1. Launch Phase **—** An analysis of pricing models and customer based-responses should be reviewed prior to establishing a new product launch price. The launch price should maximize the capture of value over the long term while working in harmony with the existing product portfolio.

2. Midlife Phase **—** Organizations rarely revisit the pricing structure for midlife phase products. This phase is considered a game changer, presenting both risk and opportunity, as it considers products that have gained stable market acceptance. Therefore, pricing changes during this phase should be made with extreme caution. Monitoring the market and anticipating triggering events will provide the details needed to determine whether pricing changes are warranted during this product phase.

3. Late Phase **—** Many companies instinctively move to lower pricing for late phase products, but this may actually be a great opportunity to *raise* prices. Customers are often insensitive to price increases on late phase products as they maintain a level of perceived comfort. Also, excessive markdowns can create the appearance of a better value for newer products, causing sales of late phase products to plummet. If raising prices during the late phase isn't an option, it's sometimes best to eliminate the product line altogether if it's no longer profitable.

Profitability can *and should* be planned for. Commitment by leadership to instituting a comprehensive pricing strategy, including performing a CPP analysis, can improve operating margins and boost profitability company-wide.

Concluding Thoughts

In the midst of a slow economic recovery like the one we've been experiencing for some time now, organizations often turn to cost-cutting measures to restore profitability. However, this isn't always the best solution for boosting the bottom line. Instead, start by performing a thorough customer and product profitability (or CPP) analysis. Based on this, you can then re-evaluate your current pricing structure, including making adjustments throughout the product life cycle at the launch, midlife and late product phases. An outsourced CFO services provider can help you perform a CPP analysis and re-evaluate your pricing strategies in light of the results.

About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 Ext 101.