IN TODAY'S ENVIRONMENT OF SKYROCKETING COSTS, DISTRIBUTORS NEED TO CONSIDER IMPLEMENTING INFLATIONARY PRICING

The right ERP software is critical to be able to implement inflationary pricing

THE NEW INFLATIONARY ENVIRONMENT

DEALING WITH INFLATIONARY PRICING

We are in a period of rapidly increasing costs across all sectors of the economy. Distributors need to evaluate various strategies to help them cope. Increasing prices to offset inflation is the most powerful tool you have at your disposable, but also the most dangerous if misused. In this article we look at how to increase prices most safely as well as other strategies that should be looked at.

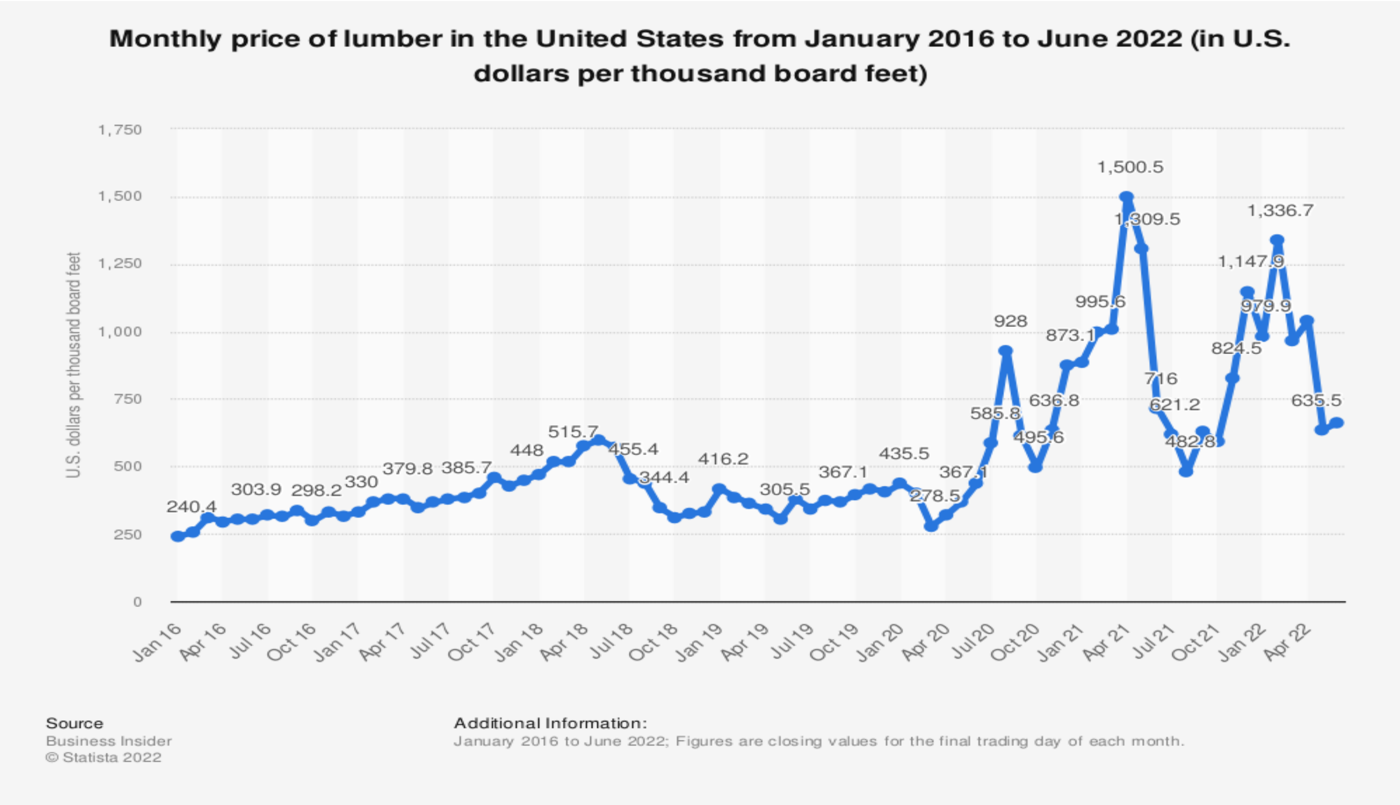
CURRENT INFLATIONARY ENVIRONMENT

For the last eighteen months, we have seen rapidly rising inflation. Contrary to the many false statements that this was going to be transitory, it looks like inflation will persist for some time. This is coupled with a period of declining growth worldwide. We haven't seen this "*stagflationary*" environment of rising inflation and declining growth for 40 years. To combat inflation the Federal Reserve will have to take very aggressive actions and raise rates dramatically; however, doing so will put a very heavy burden on the economy. There have been few indications that the Federal Reserve is willing raise rates aggressively and risk crushing the economy. So, this inflationary environment could continue for some time. To cope, distributors have to explore ways to do inflationary pricing.

CAUSES OF INFLATION

WHAT CAUSED THIS INFLATION?

The soaring inflation can be traced to several clearly definable causes. Public policy initiatives to limit the fossil fuel industry are causing energy prices to skyrocket, and these energy price increases affect most parts of the economy. Geopolitical crises such as the war in Ukraine and renewed lockdowns in China have also added significantly to the disruption. And the broken supply chain is leading to blockages everywhere. This causes cost volatility as costs increase quickly and unpredictably as shortages affect different goods. For example, according to Statista, US lumber prices spiked from historically around $250-350 per thousand board feet to over $1,500 in April 2021 then crashed back to around $400 by August 2021 then more than tripled in early 2022 and then fell again to around $700 most recently.



IMPLEMENTING INFLATIONARY PRICING

IMPLEMENTING INFLATION PRICING

Distributors are now finding they have no choice but to adjust their pricing to cope with these inflationary and cost volatility effects. The main challenges for any distributor seeking to implement inflation pricing are firstly being able to fully understand costs, and secondly to track the effectiveness of any pricing initiatives undertaken.

To track costs properly to products your software needs to have a comprehensive landed costs capability to correctly capitalize supply chain costs into a product's cost. To correctly track the impacts of pricing changes your system must have access to real-time data analytics and business intelligence. You need to be able to see alerts and scorecards that give you views by customer and by product. And you need to be able to drill down quickly to discover the root cause of changes. It cannot be overstated how important real-time data analytics and business intelligence is to successfully implement inflationary pricing programs.

Because price increases can damage customer relationships and have a significant impact on demand, they need to be carefully and selectively applied and continuously assessed. Then when implementing inflationary pricing, do it carefully and incrementally and consider the following guidelines.

SOME INFLATION PRICING GUIDELINES

Here are a few guidelines to consider when seeking to implement inflation pricing:

Targeted Price Increases

Price increases across the board can dramatically affect behavior causing customer demand to deteriorate quickly. As such, distributors need to implement price increases very carefully and selectively. Before settling on a price increase, you should look carefully at your profitability for your customers' also look at what price increases your customers are passing on to their end-customers. You also need to evaluate the total profitability of different products and product lines. Limiting price increases to only those customers or products where your margins are in the best position to sustain them can help offset demand deterioration.

Surcharges can also be used to make sure you allocate price increases correctly to the activities that give rise to higher costs, rather than across the board. For example, distributors that deliver using their own trucks should consider fuel surcharges and fees for rushed delivery or less than minimum order quantities.

SOME INFLATION PRICING GUIDELINES (Cont'd)

Establish Quick Decision-Making Processes

To succeed in periods of fast rising inflation, pricing changes need to be made quickly and evaluated continuously. Taking months to deliberate over a price increase that is then overtaken by rising inflation doesn't accomplish much. The key to success is for you to have real-time information on the supply chain cost increases you are incurring, full insight into your customer profitability and then to be able to quickly implement a price increase. Just as important as the ability to quickly implement a price increase, is the ability to react to the impact of a price increase on demand and make changes if needed.

Other Pricing Options

Many manufacturers that are selling directly to consumers are changing packaging sizes to avoid consumer sticker shock. Moving to a smaller package size but keeping the price the same seems to be one strategy that is now being widely used by manufacturers. This is not an approach that distributors can easily implement, but there may be ways to increase prices on small quantities of items, but to keep prices the same for a case or a pallet of the same products. Try making these kinds of pricing changes. Your software should be able to handle multiple units of measure (UOMs) and easily allow for UOM discounts.

SOME INFLATION PRICING GUIDELINES (Cont'd)

Evaluate Your Terms and Contracts

Another option to straight price increases is to change the terms you offer customers. For example, reducing the days of credit you offer and/or reducing the discounts or promotions you might offer could be more acceptable to your customers than an outright price increase. You might also consider charging a delivery fee and/or instituting restocking fees on returns of goods. While nobody likes these you can consider charging interest on overdue accounts receivable balances. You should also consider changing your contract terms to prevent locking in fixed prices which will hurt you as inflation rises.

Most Importantly, Evaluate Results

One of the most critical requirements to make inflationary pricing work successfully, is to continuously evaluate the effects of any pricing charges. You need to be able to see Customer and Product Scorecards, if sales to a customer or of a product line are down, you need to assess the pricing changes you made and quickly change them if necessary. This process must be managed continuously to also incorporate and react to customer feedback.

CONCLUSION

SUMMARY

We are in a challenging time of rising prices. There is likely no quick resolution to this, and things could get worse before they get better. Distributors that can implement inflationary pricing successfully will do well, leapfrog their competitors and position themselves well for the future. Distributors that don't take active pricing steps to deal with this environment will struggle and could fail.

The solution is to implement inflationary pricing with frequent and carefully considered pricing increases. This is hard to do, but the rewards are great. To put in place inflation pricing, you first need to have software that gives you full insight into your costs as well as real-time data analytics and business intelligence to evaluate the effects of the pricing changes you make. If your software doesn't have these capabilities, contact us to demo Accolent ERP's Cloud-based software for distributors.

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