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Pricing through the pandemic: Getting ready for recovery

Building new pricing discipline, flexibility, and capabilities now can create long-term competitive advantages.

by Alex Abdelnour, Todd Babbitz, and Stephen Moss

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In many industries, radical shifts in costs, demand, and supply availability have snarled previously predictable market pricing mechanisms. The most effective companies are adapting to their customers' immediate and changing needs while they consider longer-term implications.

Based on our research and experience from past economic crises, the most resilient companies put in place practices during the downturn that prepare them to succeed when the recovery comes. While these lessons are clear, they don't take into account the unprecedented nature of the current public-health crisis, which is a complicating factor that needs to be considered.

Pricing is a crucial part of an organization's rapid revenue recovery strategy. For pricing leaders, the three most important areas to focus on are: being creative in meeting customer needs while preserving value, driving strong pricing discipline, and investing boldly in capabilities for the future.

1. Be creative in meeting customer needs
Forward-thinking companies find more creative ways to meet customer needs than simply dropping the price. They preserve value while remaining flexible, and build long-term customer loyalty as a result of short-term concessions and exceptions due to COVID-19. Key actions include:

Adjusting terms and conditions. Flexible terms can make customers more willing to make purchases. For example, a few weeks into the coronavirus outbreak, several manufacturers with healthy balance sheets extended their customers' payment terms to help them manage cash flow. Companies in many industries can find opportunities like these—including: adding terms to provide protection from volatile costs, reducing behaviors that raise costs or recoup the costs of those behaviors, or improving payment flows. For example, many companies are lowering cost to serve by reducing delivery speed or frequency, or by fulfilling orders through alternate channels.

Providing temporary offers. How companies adjust prices and communicate the changes to customers can impact near-term performance and the prospects for a strong recovery. Many companies reflexively slash *list* prices in a downturn, for example, but flexing discounts while holding list prices constant is often better at stimulating demand. Temporary discounts or promotions can safeguard the perceived value of a company's products and services and may be less likely to stimulate price wars, putting the company in a stronger position when the market recovers. Instead of explicitly raising prices as the recovery takes hold, which may spark customer objections and competitive responses, a company can simply reduce discounts or end promotions.

During the last downturn, for example, some professional-services firms were not disciplined when providing discounts on their hourly billing. On some contracts, they set a "fixed rate" on all matters, with no reopener. Nearly a decade later, many of these contracts were still in place, while overall market rates had accelerated rapidly.

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Aligning payments with customers' business situations. Many companies restructure payments during a downturn to help address specific customer pain points, by helping them preserve cash through deferred payments, for example. Some move to recurring-revenue or subscription models, or lower up-front fees to reduce customers' near-term outflows. Some commercial real estate companies, for example, are currently offering to base at least part of rents on a share of sales to ease the burden on tenants. During past downturns, many customers asked service firms for fixed- or capped-fee arrangements, which provide greater cost certainty. Others sought agreements based partly on performance or outcomes rather than time and materials. Some of the most successful outsourcing firms met customer needs by backloading or amortizing transition-associated fees over the life of the agreement rather than billing as expenses were incurred.

Adjusting products or services to meet changing needs. Many businesses adopt defensive postures during a slowdown, focusing almost exclusively on their existing customers and therefore miss opportunities as other companies double down on their pursuit of new business. The most effective companies evaluate customer preferences and buying patterns to understand how each customer segment will be affected by the downturn, choose prospects more efficiently, and tailor messages and prices accordingly. This can help them to tailor a new offering for new customers. For example, a seller of premium office furniture, which pivoted to the home-office furniture market, now offers a 30 percent discount on work-from-home solutions, free shipping, no-contact delivery, and an "ergonomic consultation" with each purchase.

In other circumstances, it can help to make unbundled or "skinny" offers that give price-sensitive customers only what they truly need. Where research reveals that a customer does not value an additional service, the company can eliminate it or shift to a lower-cost approach, helping sales teams focus more keenly on what customers value most. One form of unbundling is to offer digital or self-service options at lower prices for targeted customer segments. During the current crisis, in fact, customers' preference for digital sales interactions has more than doubled.

2. Drive a strong pricing-discipline mindset

In this era of unprecedented challenges, suppliers that emerge from the crisis in a good position will likely be those that take a "through-cycle" view of their customer interactions and pricing policies. This requires discipline from sales teams to strike the right balance between capturing value through pricing and being sensitive to and meeting customers' changing needs. In a sharp downturn, that discipline may slip.

While every company may need to give on price in certain situations, the most successful organizations build better pricing discipline in a few ways:

Tighten the governance for discounting and approvals. Clear pricing guidelines and escalation processes become more important in challenging market conditions. More companies are now investing in "deal desks" to accelerate quotations, review requests for exceptions, and prioritize strategic investments in the most valuable clients over less-differentiated discounting practices. A cross-functional value council, described in our

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previous article, can provide a balanced strategic perspective, think through pricing trade-offs, and understand when and how to shift tactics as market conditions change.

Identify pockets of lost value. The pricing function should actively monitor customer-level profitability and review pricing policies to identify the pockets of lost value that needlessly eat into the bottom line. That includes carefully monitoring volume discounts, rebates, and cash discounts to make sure they're earned and evaluating whether prices and fees account for cost to serve (such as freight and sales support).

Increase support for contract negotiations. During a downturn, the stakes rise for incumbents and challengers alike as they negotiate with large customers. Buyers may be more price sensitive, and newcomers tend to be more aggressive. To hold their position, incumbents need a rich and detailed understanding of their positioning and value compared with competitors. We recommend that they reexamine their own industry's shifting economics and their suppliers as well. With increased volatility in raw-material costs, it can be increasingly important to model supply, demand, and cost dynamics for primary raw materials and lock down beneficial contractual terms and conditions. This is critical to offering sellers protection when their costs change, such as through the incorporation of index-based pricing, pricing formulas that take into account shifting market conditions, and contract reopeners triggered by market changes.

Monitor and actively manage pricing policies and decisions. During a slowdown, companies should review their pricing policies more frequently and adjust them as conditions change. Without this extra attention and quick action, every step in a transaction can destroy profits. For example, some companies have revisited their minimum-order-quantity (MOQ) threshold and adjusted it downward to account for lower demand. At the same time, they have stepped up enforcement of pricing policies such as margin floors, freight charges (by using system flags added to their quoting system), and stricter exceptions management. Others are monitoring win-loss and renewal rates to evaluate the impacts of tighter policies and separate isolated incidents from trends, reducing the likelihood of misinterpretation leading to overreaction.

Understand the strategic impact of pricing decisions. When contemplating bolder moves, companies engage in "war game" exercises to play through the strategic consequences of pricing decisions. For instance, a smaller player may need to take into account that efforts to win market share could trigger a price war with deep-pocketed rivals. These decisions require careful consideration, planning, communication, fortitude, and in many cases, legal and public relations counsel to minimize risks.

Frequently review sales force incentives and price realization targets. Our B2B decision-makers survey indicates that more than 80 percent of B2B companies have adjusted incentives in response to COVID-19, through changes to quota levels, short-term bonuses, or increases in fixed or variable incentives.[1] Striking the right balance on incentives, however, requires careful analysis and frequent attention. If incentives to realize price targets are not in place, for example, excessive discounting may allow profits to "slip out the door." Introducing incentives around a price-quality metric can help ensure healthy margins.

3. Invest boldly in capabilities

In our experience, some of the most thoughtful pricing leaders take advantage of slowdowns to invest in the future. They build pricing excellence by making cost-effective advances in three main areas:

Build value-selling capabilities. The pandemic is forcing many B2B sales teams to work remotely. Our B2B decision-maker survey indicates that remote selling is now the norm, with 96 percent of B2B companies responding that they have shifted their go-to-market (GTM) model during COVID-19.[2] Nearly two-thirds believe the new model is just as effective or more so than the previous one, and

1 Global B2B decision-maker response to COVID-19 crisis," May 2020, McKinsey.com.
2 Ibid.

Sales reps need new tools to shape customer conversations to focus more on value and less on price.

many believe that these sales-model changes are here to stay. In this environment, sales reps need new tools and new skills, in particular those that position and articulate value in a virtual environment.

Many companies have accelerated the conversion of in-person value-selling training materials into a combination of online video modules, gamified programs, and testing. They are taking advantage of their stay-at-home sales-rep model to build skills that are often overdue. To help sellers preserve and capture value through price, companies are investing in remote education on the technical features and benefits of their products compared with their competitors, including how to develop a quantified value proposition, value articulation, and selling the value at the right price despite market pressures.

Upgrade advanced analytics for better insights. The current crisis has brought about a significant change in market demand and price sensitivity. Pre-COVID-19 understanding of market dynamics and customer willingness to pay is likely less accurate now. Companies that update their algorithms to develop analytically driven, statistically rigorous, and near-real-time assessments of pricing dynamics, win/loss rate, and customer willingness to pay are much more likely to capture the value from pricing. Coupled with access to good data should be a commitment to using it, a discipline that's crucial these days to avoid making often costly snap decisions based on anxiety or "stories from the field."

Strengthen the pricing talent bench. The leaders of the most resilient firms are now asking how their talent and tools enable pricing excellence and how they can close gaps.

For organizations that have been struggling to add the right resources and capabilities in the midst of globalization and the war for talent, the crisis presents a unique opportunity to bolster the commercial organization with seasoned and sophisticated talent that may otherwise be difficult to obtain.

Beyond external talent, changes to the GTM model of many companies have suddenly freed up a number of internal candidates who have deep market and customer expertise to become agents of change for better pricing discipline and increased adoption of pricing analytics. A global distributor facing a significant drop in revenue decided to digitize a significant portion of its GTM approach. This increased its field sales-territory coverage and allowed a shift in resources toward analytic pricing support for sales reps.

Emerging stronger

More than 20 years of McKinsey research shows that most high-performing companies pursue their strategies consistently through economic cycles—including agile, precise, and disciplined pricing. Top pricing leaders look at the world through "strategic bifocals," keeping a close watch on near-term resilience while pursuing long-term goals in order to emerge stronger when the recovery begins.

By **Alex Abdelnour** is a partner in McKinsey's Atlanta office; **Todd Babbitz** is a specialist in the Chicago office; and **Stephen Moss** is a partner in the Denver office.