

## Pricing in a pandemic *(from McKinsey article, May 2020)*

Demand is volatile right now, creating a variety of pricing challenges. Companies that **focus on long-term value** rather than short-term gain are best positioned to meet them.

The crisis is exerting sudden and unprecedented pressures—sometimes up, but more often down—on demand and pricing. In many sectors, from air travel to durable goods, sharp drops in demand, excess capacity, and heightened price sensitivity are converging to drive down prices and destroy value. Clients are asking for discounts and contract renegotiations, while some competitors are making aggressive pricing decisions. In other sectors, from shipping and groceries to medical supplies, demand has risen to levels no one could have anticipated, putting upward pressure on prices.

In both scenarios, companies need to **sustain value** to both survive the crisis and protect their employees' livelihoods. Companies must also **be flexible and creative** to support clients in this tough time and work with them to weather the crisis together.

We expect that the companies who emerge in the strongest positions will be those now taking a long term view of their relationships with clients and the communities where they do business. In the midst of the worst health crisis in more than a century, they will be at their best, addressing clients' pain points with flexible payment terms, unbundling, and one-off promotions.

### Managing unprecedented variability in demand

Each company faces a unique array of challenges today; no single approach or solution will suit them all. It can be helpful to consider pricing challenges in three main market scenarios:

#### 1. Companies experiencing a sharp and unprecedented drop in demand

Sectors directly affected by social distancing and government isolation guidelines, such as airlines, hotels, and food service, are acutely impacted. As they struggle with decreased demand, they also have excess capacity and heightened price sensitivity. These companies are facing requests for steep discounts as their competitors scramble to attract the few remaining customers, often at prices well below cost. **Focus on maintaining cash reserves and preserving key assets and talent** to survive the crisis and fight another day. **Serving a few bargain-hunting customers at a loss is rarely a route to long-term success.**

#### 2. Companies/teams experiencing an explosive increase in demand

Some companies/teams are now rushing to expand capacity, including those that provide critical products and services, such as medical supplies, shipping, and cleaning, and those whose products are highly sought after by people confined to their homes, from toilet paper and canned food to audio headsets, video conferencing, and home entertainment. While this may seem like a rare opportunity to generate outsized profits, perceptions of price gouging could have serious reputational and legal consequences. **Do not raise prices sharply on essential goods or services**, or ignore contracts in order to take advantage of an emergency.

### 3. Companies with muted or ‘lumpy’ demand

Some sectors, such as home improvement, landscaping, and consumer electronics, are not as directly affected by COVID-19, but are feeling the impact of a general slowdown, or moderate uptick. Many of these companies have opportunities to take near-term pricing actions that preserve and build value – but they should avoid certain pitfalls.

Despite this “day and night” variability across sectors, we believe companies of all kinds should focus on a set of actions—and things to avoid—as they contemplate pricing actions.

#### Five things to get right during the pandemic

##### 1. Make sure that every pricing action is legal, ethical, and community-minded

A humanitarian crisis is not the moment to sharply raise prices on essential goods or services. Certain types of collaboration with competitors and other marketplace responses may be governed by antitrust or unfair-trade laws. The backlash could be severe, including reputational problems and legal action. Any significant price increase should genuinely reflect increased costs.

##### 2. Take a long-term view of client relationships

Reinforce trust by tracking key clients’ evolving needs and standing by them during their toughest times. Tailor offerings and contracts to new situations. Providing incentives for loyalty can also strengthen relationships, while decreasing the temptation to switch to a (cheaper) competitor.

##### 3. Strengthen value-focused messaging

Client price sensitivity may change markedly. The most effective suppliers will show empathy and be able to explain how much value they provide compared to the next-best alternatives. The sales force may need updated training in negotiation, value selling, and pricing. If demand is slack and in-person sales calls are not feasible, this may be a good time to reinvest in skill building.

##### 4. Create ‘flex’ in pricing

Rather than lock in long-term, highly discounted arrangements that might impact the business in the recovery, explore ways to unbundle offerings, offer one-off promotions, flexible payment terms, credit for future purchases, or other techniques that align the pricing to near-term needs while providing flexibility for the future.

##### 5. Establish a commercial ‘value council’

A cross-functional team can take a long-term view to avoid panic pricing and develop clear guidelines and objectives, particularly for large and strategic deals. They may look at what is being given away for free, for example, and at contract terms that are not being enforced. In addition, by regularly interacting with teams across the business, this cross-functional team can gather up-to-the-minute information about changes in the marketplace.

#### What to avoid

### **Assuming that every demand problem can be solved with pricing**

In times of crisis, buyers may hold off on purchases because they feel uncertain or their needs have shifted in meaningful ways. For example, offering concert tickets for free at the moment will not fill venues. In many sectors, deep price cuts may not increase sales – and can unintentionally destroy value rather than build it.

### **Slashing prices without considering other options**

The manner in which price reductions are made can make a big difference in a company's ability to sustain and build value over time. Rather than cut standard rates, companies may want to consider temporary promotions, non-monetary discounts, or discounts that help build volume.

### **Taking advantage of clients**

Near-term shortages may make it feasible to raise prices sharply, but this is unlikely to serve the company well over the long run and could lead to legal action and penalties, in addition to the reputational damage.

### **Attacking competitors' key accounts without preparing for a sharp response**

Before making any strong competitive moves, leaders should understand their company's position in the marketplace, anticipate competitors' likely reactions, and plan how to respond. Price cuts may be easy to replicate, and they can change buyers' long-term perceptions of brand value.

### **Next steps**

Seek opportunities which **preserve and sustain value**, making each major decision in the coming months with an eye on the **longer-term implications** for the company and its employees, customers, communities, and suppliers.

Look for win-win scenarios to support both clients and employees at a difficult time, remaining flexible and focused on preserving lifelong relationships.

Each of us now has opportunities to show **courage, compassion and wisdom**. While no one knows how long this crisis will last, leaders can begin preparing now for the recovery, including using downtime to build capabilities and improve pricing processes. An unwavering focus on **value** can help organisations avoid extensive cost-cutting exercises which, in the long run, could do more harm than good.