PROFESSIONAL PPS PRICING SOCIETY™

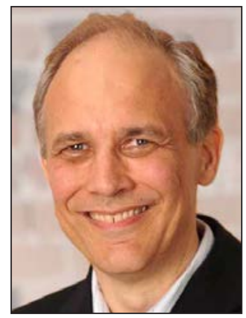
October 2018

Pricing Advisor™

Contents

A Pricer's Guide to Navigating Tariffs

The topic of tariffs has recently gained momentum throughout the pricing space, and specifically in industrial and manufacturing markets. To help pricing professionals grapple with some of the complexities of tariffs, and view them as an opportunity to evaluate cost structure and explore opportunities to tighten up pricing processes, in this article, the author has outlined a 3-Step Process to help guide price adjustment decisions and strategy. Author Paul Hunt is the president of Pricing Solutions and a frequent PPS presenter, instructor, and contributor. He can be reached at phunt@pricingsolutions.com.



by Paul Hunt

Tariffs are a hot topic in industrial markets. Companies are trying to manage the 25% tariffs on steel and 10% tariffs on aluminum, going into effect later this year, while product exceptions are still being determined. Many organizations are looking to finance and pricing teams to help assess the situation, alleviate internal uncertainty and provide realistic options to maintain profitability. To help pricing professionals grapple with some of the complexities of tariffs we've listed a 3-Step Process to help guide your price adjustment decisions and strategy.

Step 1: Understand the Impact of Tariffs

Successful manufacturers constantly manage their capacity and production mix to optimize operational efficiencies and profit at the portfolio level. However, as tariffs disproportionally impact different products, it becomes critical to have a more granular view of how changes in cost impact overall profitability. A classic tool in the pricing toolkit is the price waterfall analysis. Visualizing the impact of tariffs on your waterfall could help guide decisions related to price changes and production allocation.

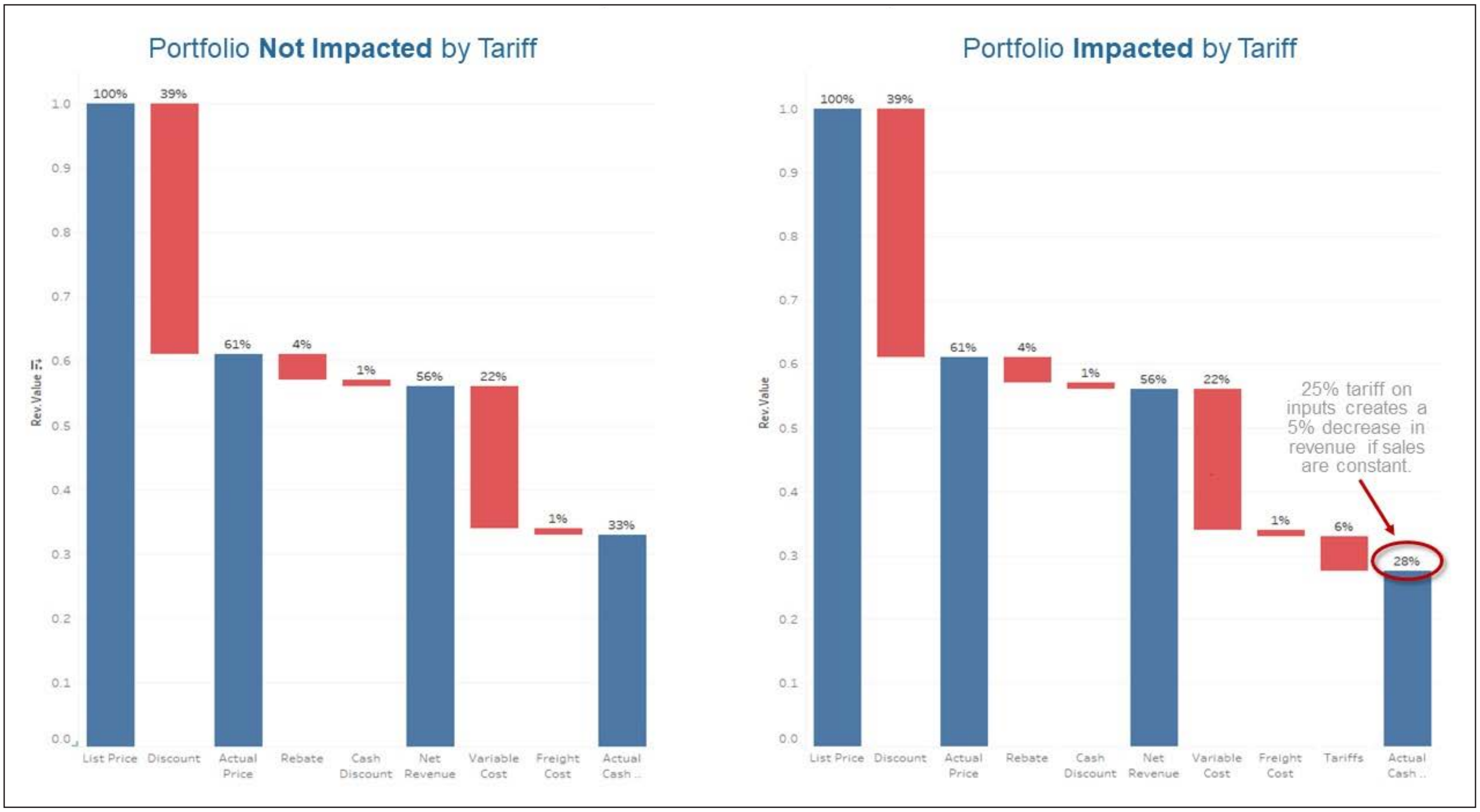
Figure 1 is an example of a price waterfall that looks at the portfolio impacted by tariffs and the portfolio that is not impacted by tariffs. In our example, we measured 'actual cash received' or pocket price vs. list price to understand the effect of tariffs. **On the waterfall charts, we can see a pocket price of 33% on the portfolio that was not impacted by tariffs vs. 28% on the portfolio that was impacted by tariffs.** We can also visualize the various levers that could be pulled to mitigate the impact of tariffs. We can't stress enough the importance of having clear visibility into all the options at your disposal to make informed business decisions.

➤ CONTINUED on 3 ➤

PPS Happenings

Click on event graphics below or go to the PPS website at PricingSociety.com for more information on programs and events.

Figure 1: Price Waterfalls



Step 2: Measure the Impact of Cost Changes

When costs are changing it is important to understand how they impact profitability. A great tool in your arsenal is the financial breakeven analysis. The financial breakeven analysis allows you to model what could happen to volume, price, and margin as your cost structure changes. In the scenarios below we illustrate how cost and price changes could be analyzed to mitigate the impact of tariffs.

Scenario 1: Maintaining Profitability Through Increased Sales

Using breakeven analysis, we can see that a tariff that increases your variable costs by 7.5% would require a 10% increase in

➢ CONTINUED, next page ➢

Figure 2

Baseline Cost & Margin Structure	1. Impact of **7.5%** increase of variable costs due to tariffs	2. Price change required to mitigate the impact of tariffs
Price $ 10.00 Var. Cost $ 5.50 $CM $ 4.50 %CM 45% Units 5000	Price $ 10.00 Var. Cost $ 5.91 $CM $ 4.09 %CM 41% BE Units 505 BE % 10%	New Price $ 10.41 New Var. Cost $ 5.91 $CM $ 4.50
Breakeven Sales Formula Incorporating A Change in Variable Cost (% Breakeven Sales Change)	$\dfrac{-(\$\Delta P - \$\Delta C}{\$C\ M + (\$\Delta P - \$\Delta C}$	P = Price C = Cost CM = Contribution Margin

sales volume to maintain current levels of profitability based on the margin structure of the business.

Scenario 2: Maintaining Profitability Through Price Adjustment

The breakeven analysis also shows us that if volumes are expected to remain flat then the cost of the tariff would need to be passed onto your customers through a 4% price increase to maintain current levels of profitability.

Step 3: Select the Optimal Option for Mitigating the Impact of Tariffs

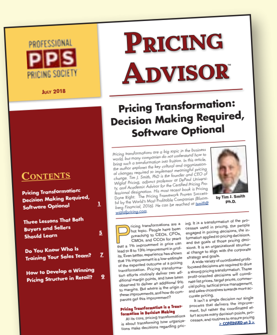
Knowing how to structure and execute price increases requires a targeted approach with a well-planned communication strategy to ensure success. When it comes to tariffs you will likely have several ways to pass along the price increase. Possible options include:

1. **Develop Tariff Surcharges** – surcharges are flexible and a can be a powerful tool for executing temporary price adjustments.
2. **Tighten Discount Policy** – establish new or enforce existing pricing guardrails to limit discounting, especially on products that are directly impacted by tariffs.
3. **Adjust List Price** – although more of a permanent fix, list price adjustment sends a signal to your customers and the market that you are confident of your value proposition and intend to protect the integrity of the business.

Knowing how to structure and execute price increases requires a targeted approach with a well-planned communication strategy to ensure success.

Once you select the best approach for your business it is time to get your sales team on board and fully trained on how to communicate and execute your tariff strategy.

Instead of looking at tariffs as a burden to the business we encourage you to view them as an opportunity to evaluate your cost structure and explore opportunities to tighten up your pricing process. Changes in market dynamics also allow you to connect with customers and reinforce the value you deliver. Making price adjustments are never easy but with internal commitment and organizational alignment, your company will continue to succeed through these uncertain times. ❖



The Pricing Advisor™ is the monthly member newsletter of the Professional Pricing Society. If you have feedback regarding this newsletter or want to contribute an article, please email: editor@pricingsociety.com.

Editor: ....Rebekah Wortman, PPS Marketing Publications Editor

Publisher:............. Kevin Mitchell, PPS President

For all other inquiries, including subscription and PPS membership information, please contact:

Professional Pricing Society
3535 Roswell Road, Suite 59
Marietta, GA 30062 USA
Tel: +1.770.509.9933
Web site: PricingSociety.com
E-Mail: contactus@pricingsociety.com