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THE PRICING SPECIALISTS

Capitalising on Untapped Potential:
How to Assess the Earnings Upside from Pricing Due Diligence

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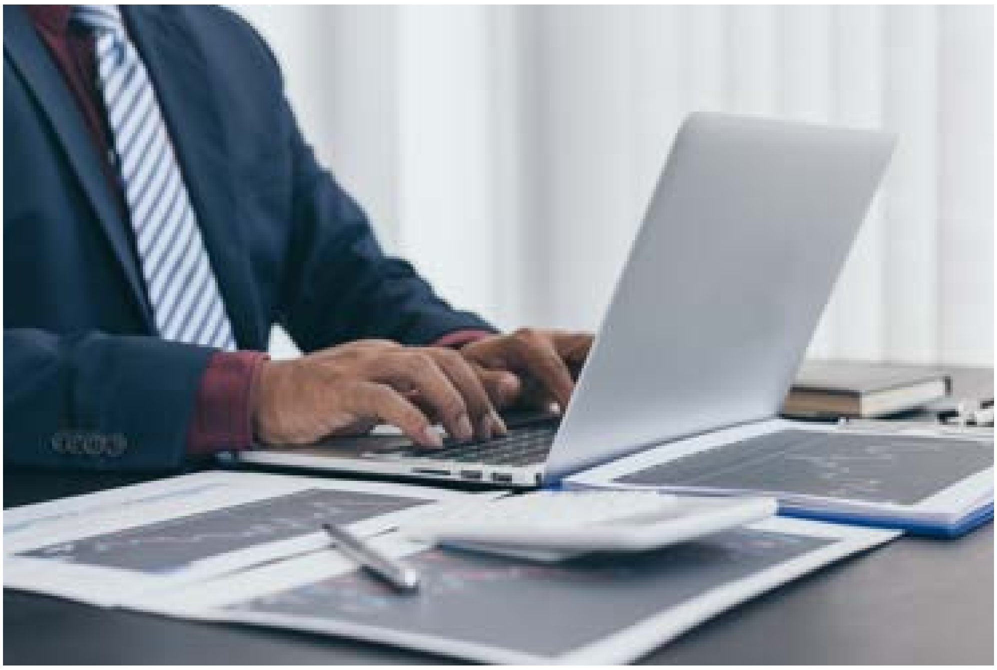
Our work with private equity firms shows that pricing can increase portfolio company EBITDA by 1%-7%, opening up a potential valuation uplift variance of 30%-120%. Yet a generally narrow and light touch approach to pricing due diligence means that private equity firms rarely assess the full upsides. So how can you dig further and deeper to capture the valuable, but still largely untapped pricing potential?



High interest rates are enduring and the economic outlook is still uncertain, making reliable earnings upsides a scarce commodity. So, It's more important than ever to assess the potential upsides within your portfolio, have a clear view on the levers of value creation available to you and how to capitalise on them. In this way, you can make fully informed investment decisions.

Pricing is a clear case in point. It opens up significant opportunities to boost EBITDA – a 1% to 7% uplift, depending on the business, its sector and its current margins. The result is a variance of 30% to 120% in the valuation upside. This needs to be assessed as it could make the difference between accretion and dilution at a time when value creation is so hard won.

SCRATCHING THE SURFACE

Yet pricing remains a surprisingly under-appreciated and under-realised opportunity for EBITDA improvement. Yes, private equity firms are ahead of the curve in incorporating pricing into their overall commercial due diligence. But the main focus tends to be undercharging in areas such as poorly targeted discounts. Plugging these value leaks would increase margins and earnings. But it's only part of the story. It misses the earnings uplift that could come from overhauling commercial (pricing) models in areas such as bundling and subscription, better understanding of customers' willingness to pay and gearing pricing to the value delivered rather than just 'cost plus'.

SHARPER DECISION-MAKING

Thinking more strategically about pricing within due diligence would open up a more informed view of the value EBITDA improvement opportunities after acquisition. This would in turn help to ensure that the true value of the company is assessed. The results could also provide the starting point for an executable plan following acquisition.

SIZE OF THE PRIZE

But the complexities that come with this more comprehensive approach to pricing due diligence can be daunting. As well as quantitative analysis, there would need to be a qualitative assessment of the strategic potential and how to deliver it. This calls for expert judgement and customer insight.

So what's the most effective way to evaluate the pricing upside? In our view, there are three key stages to developing an informed and verifiable foundation for pricing due diligence, which blends quantitative and qualitative insights:

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1. Pricing situation.
Assessing the external environment that drives pricing within a particular industry in areas such as markets, customers and channels ('pricing context'), how pricing is currently set in areas such as implementation and offers ('pricing solutions') and the target company's ability to deliver these strategies ('pricing capabilities').

2. Opportunities.
Identifying openings for improvement that come to light when assessing the misalignments between the pricing context, possible solutions and delivery capabilities.

3. Value synthesis.
Quantifying each opportunity based on associated financial returns, methodology and ease of implementation.

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This may sound like a lengthy undertaking. But experience has helped to develop an approach that can be both robust and delivered at pace. Here are the key priorities to consider at each stage:

PRICING SITUATION

To gauge the headroom for improvement, it's important to understand the target company's current pricing situation. The components that come together to develop this understanding fall into three main areas:

Pricing context:

- Assessing the market dynamics, competitor offerings and regulatory demands within the target company's sector.
- Assessing the customer segments in which the company operates and the price expectations within them.
- Determining why a customer chooses to buy from the company, the channels they use and the frequency of purchase, ideally with the support of a customer survey.

Pricing solution:

- Examining the pricing architecture, which includes the price structure, packaging, denomination and timing.
- Gauging the value being delivered by the product or service.
- Reviewing price levels, discounting and revenue streams.

Pricing capabilities:

- Reviewing the capabilities that govern price setting and execution across people, process, data and systems.

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OPPORTUNITIES

By understanding the pricing situation within the business and revealing the misalignments between the three key pillars of pricing context, solution and capabilities, you can identify potential gaps and opportunities for improvement. Examples include:

- Moving to value-based pricing to bring charges closer to the value received or perceived by the customer or their willingness to pay.
- Improving monetisation through steps such as moving to a subscription model to increase openings for upselling and improve protection against undercutting by competitors.
- Optimising discounts to avoid the risk of value leakage and ensure offers are targeted at the right customers at the right time.

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Value synthesis

The value of pricing upside opportunities can be quantified by bringing together data and analytics (quantitative) with sector expertise and judgements (qualitative). Each of the opportunities can then be mapped to the associated financial returns, the complexity of assessing the upside EBITDA improvement and the complexity associated with achieving this. Together, these inputs can help you evaluate the true value of the company and define a roadmap of pricing, which can be put into place as soon as the acquisition happens.

Time to put pricing front and centre

Pricing should be at the forefront of due diligence rather than a peripheral consideration. The prize is a material boost in valuation. The risk is undervaluing the target or losing out to a more price-savvy competitor. The process is complex. But with an informed and systematic approach, the results can be revealing, rewarding and robust.

Let's talk

To find out more about the pricing upside and how to build it into due diligence evaluations, please feel free to get in touch.

Get In Touch

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