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Surcharges: When to Use Them, When to Avoid Them, and How to Get Them Right

With tariffs and rising costs squeezing margins, more companies are turning to surcharges as a strategic tool to pass through cost increases and improve margins.. When used effectively, surcharges provide businesses with the flexibility to respond to macroeconomic shocks without making permanent price increases or damaging customer relationships. They are already common practice and, when fairly applied and justified, are often more acceptable to customers than direct price increases —making them a particularly useful tool for companies adjusting to the latest wave of tariffs.

> **Our recent engagement with an industrial manufacturer found that over 95% of customers encountered surcharges last year, with most finding charges up to 5% of the invoice acceptable**

However, businesses must be cautious, as poorly implemented surcharges can create customer friction, disrupt operations, and impact cash flow.

In this briefing, we'll explore:

- **The strategic uses of surcharges** and how businesses leverage them effectively.
- **Common pitfalls that lead to customer pushback**—and real-world examples of when surcharges backfire.
- **Best practices for implementing surcharges** that minimize resistance and protect brand trust.

Strategic Uses of Surcharges

Surcharges can serve different purposes – they should help businesses recover external cost increases that are clear and quantifiable, support pricing for premium services, or enforce terms. Three effective uses are:

1. To recover cost increases

Customers are generally accepting of surcharges tied directly to temporary external cost increases, such as tariffs, or to recoup fluctuating costs that are quantifiable and transparent to the customer. It's essential in these circumstances that businesses clearly communicate the surcharge origin, so customers understand it as a pass-through rather than a hidden price increase.

Manufacturers and distributors often implement tariff surcharges to manage fluctuating import and raw material costs, without making permanent price increases. Logistics and business services companies may deploy fuel surcharges when faced with fluctuating fuel costs, while many other businesses routinely apply processing fees or regulatory compliance fees to pass through mandated costs transparently.

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2. To capture value created from special services that customers request

Surcharges are valuable tools to cover costs from optional services that some customers recognize and are willing to pay for. For example, expedited shipping fees let customers choose faster delivery, while customization or setup fees ensure flexibility without burdening all customers with higher base prices.

3. To take advantage of information asymmetry

Some surcharges work because customers underestimate the likelihood of incurring them. For example, banks apply NSF (non-sufficient funds) fees, knowing most customers don't expect to overdraw their accounts. Airlines charge flight change fees, expecting travelers assume their plans won't change. Since buyers perceive these costs as avoidable, they face less resistance than blanket price increases, and provide the added benefit of encouraging customer compliance.

When Surcharges Backfire

While surcharges can be effective, there are scenarios where they do more harm because they erode customer goodwill or impact customer operations. Three common scenarios to avoid are when:

1. Customers cannot readily understand the reason for the surcharge

Lack of transparency leads to customer frustration and legal risk. When fees are not clearly explained or justified, customers may feel misled and push back—whether through complaints, chargebacks, or lawsuits. For example, several Washington, D.C., restaurants faced legal action after adding service charges of 5–20% without clearly disclosing the reason for the charge and where the fees were going. Many diners were caught off guard, assuming the charge covered gratuity, only to realize they were still expected to tip. The backlash not only led to lawsuits but also damaged customer trust and loyalty.

2. Companies are simply using surcharges to increase price

Customers will recognize when a surcharge is simply a price hike in disguise. This is particularly evident when the charge applies universally and lacks a clear expiration date. For example, a blanket 2% environmental surcharge on all invoices will be seen as an undisclosed price increase rather than a necessary adjustment based on external cost pressures.

3. Surcharges have unintended consequences for operations

Companies should also be thoughtful about whether implementing surcharges will inadvertently impact operations or cash flow. A credit card processing surcharge might push customers to switch to slower payment methods like checks, increasing administrative costs and delaying funds.

Even well-established brands can face backlash when introducing surcharges that disrupt customer expectations. Southwest Airlines, long known for its 'bags fly free' policy, recently announced a checked-bag fee. While this may boost short-term revenue, it risks unintended consequences—more passengers opting for carry-ons, slower boarding, and ultimately, reduced on-time performance and customer satisfaction.

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How to Implement Surcharges Without Backlash

While poorly implemented surcharges can frustrate customers, businesses that apply them thoughtfully can minimize resistance and maintain trust. The key is to ensure transparency, alignment with customer expectations, and a clear value proposition. Here's how to implement surcharges effectively:

1. Announce potential surcharges before they become certain

Customers are far less likely to contest surcharges when they aren't expecting to pay it. Waste management companies, for example, publicly publish fuel surcharge schedules linked to market rates. These surcharges only take effect if fuel prices rise significantly, making customers less likely to push back when they are first announced, but making it difficult for them to resist when fuel prices do rise significantly..

2. Ensure system and customer readiness

Invoicing systems must support surcharges at both the line-item product and invoice levels. A surprising number of companies don't have the functionality in their invoicing systems to deploy surcharges. Businesses that fail to prepare may face costly IT delays when they need to implement them.

Separately, companies with large customers that use Electronic Data Interchange (EDI) systems are vulnerable to implementation challenges if surcharges are not pre-approved or properly coded in systems and payment processing. Ensuring surcharge fields align with EDI standards and communicating changes in advance allows customers to adjust their systems accordingly.

3. Review terms and conditions

If contracts don't allow for surcharge adjustments, customers may refuse to pay. Companies should review their terms and conditions (both in contracts and on the website) to validate that they incorporate language that allows for flexibility to implement surcharges.

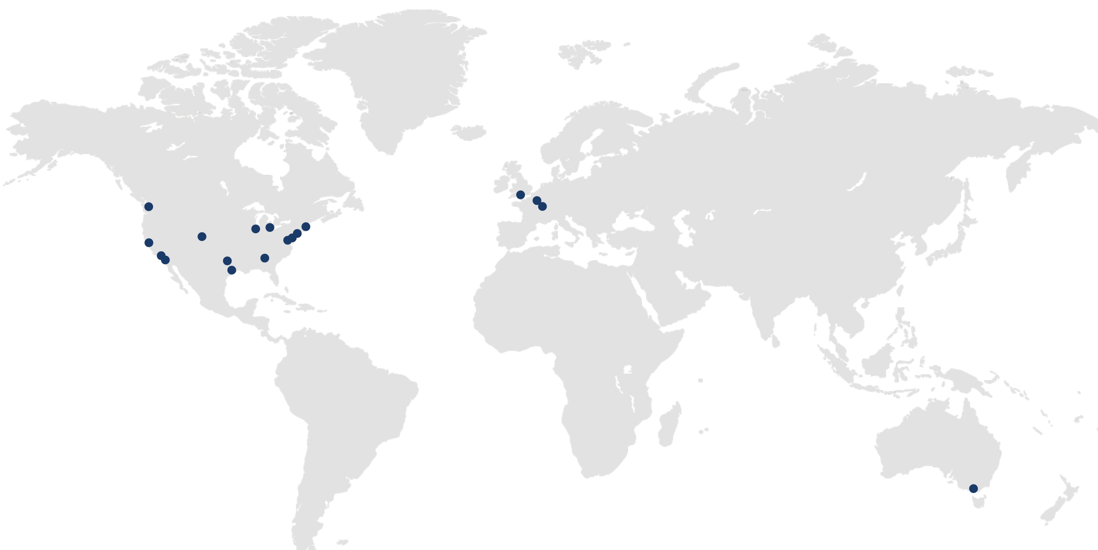
Surcharges offer a flexible pricing tool for customers to navigate tariffs and other macroeconomic shocks. They can also be useful in other situations, such as pricing premium services or encouraging compliance. However, poor implementation can lead to customer frustration, operational challenges, and payment delays. To be effective, surcharges must be transparent, carefully and strategically communicated, and backed by system readiness and contractual alignment.

Why Blue Ridge Partners?

Blue Ridge Partners is recognized as the most experienced, impactful and respected firm that is exclusively focused on helping companies accelerate profitable revenue growth. We have worked with over 1,300 companies worldwide on commercial model transitions, strategic pricing engagements and due diligence assignments. We are known for rolling up our sleeves, being pragmatic in our analyses and delivering tangible results that focus on the "how" of execution. Based on our significant experience we have amassed extensive knowledge of the issues that affect revenue performance.

For further information please contact us at info@blueridgepartners.com or visit us at www.blueridgepartners.com.

Our Locations



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