Think Marketing by Susan Henken and Patricia Huff

Pricing: The Final Frontier

Sometimes pricing your products seems like an adventure into a strange new world. The process can seem too com plicated for anyone but a rocket scientist to comprehend. Our goal is to bring this process back to Earth for you by explaining some pricing basics.

How do you price your product now? Answers from businesses can vary from "less than our competition" to "the highest price my customer will pay." Either tactic has a negative side that can cost your company customers and profits. Because most of you are too busy to be rocket scientists in the pricing galaxy, we developed this series of steps to help you understand pricing - no space ship required.

1. DO YOUR HOMEWORK

Know Costs: There is no substitute for thoroughly understanding your product costs and the variability of those costs - that means the resources used to create, produce and market your product. Unless you know all your costs by product and by customer you could be losing, rather than making, money with each sale.

Understand Market Value: Realistically compare your company's product to your customer's expectations and perceptions. You must also understand your competition and trends in your target industry.

Set Objectives: Once you have a thorough understanding of your costs it's time to explore two of the ways your company can set pricing objectives. Generally, pricing philosophy is based on company goals such as:

Sales Growth - For a variety of reasons, such as immediate expansion needs, a company may set sales growth as an objective. When selecting this as an objective, it is critical to remember that higher sales do not automatically produce higher profits. In fact, sometimes the cost of expanding sales volume, such as increased costs of production, distribution or customer service, becomes so great that profits actually decrease.

Profit Growth - Frequently, corporate goals such as a targeted return on investment or a profit maximization philosophy necessitate a "pricing for profit" objective. Be sure you take both short and long-term profit goals into account when implementing this objective. Also, study the implications of each pricing change on the health of your business.

2. SELECT YOUR STRATEGY

It's now time to select your pricing strategy based on your costs, company objectives and the perceived market value of your product. Although strategies can become quite complicated and detailed, the following list discusses basic options most companies find useful. Your choice depends on an internal assessment of your company's objectives and an objective analysis of the market in which you compete.

Cost-Based Pricing:
Definition: Price is based on a product's total fixed and variable costs.
Example: Typical pricing in commodity markets. For example, a commodity-type raw product such as steel is priced using a standard formula based on cost.
Caution: If you use this exclusively, you must be able to stay in business with a very low profit margin. In non commodity businesses, this option should be only one aspect of the total product pricing strategy.

Demand-Based Pricing:
Definition: Price depends upon your customers' perception of your products' value and the level of demand for your item. Your product must provide a unique benefit to your target market.
Example: Your product has prestige appeal so it can be priced in a range well above the cost of production. For

example, luxury cars and gourmet food have prestige appeal.
Caution: Success depends on your knowledge of your customers and your market. You must have an uncanny skill for accurately estimating customer demand to avoid disappointing sales results.

Competition-Based Pricing:
Definition: Price is set in relationship to your competition's prices. In some cases this may be below cost and is usually indicative of a product that has no competitive edge.
Example: You are caught in an industry "price war" where all products must compete on the basis of price or risk losing their market share.
Caution: Your company's long-term goals may be sacrificed in the interest of competitive pricing. Also, you are at the mercy of the larger companies in your industry that can afford short-term losses in order to play this expensive game of war.

Value Pricing:
Definition: Gives your customer more quality for less than they expected to pay.
Example: Used when you want to gain market share, position your product with customers, or obtain market acceptance of a new product.
Caution: Product quality must be consistent and your company must operate efficiently for this to be an effective strategy. Using this strategy means that you understand your customers and competitors very well. In addition, you may find it difficult to raise prices to more profitable levels once your initial distribution goal is achieved.

3. TEST YOUR PRICING THEORY

Pricing your products is almost as complex as rocket science but not quite as predictable. At best, your product pricing is based on information that can change daily or even hourly. For that reason, it is critical that you test the validity of your pricing strategies with a small customer sample or market segment and evaluate your pricing periodically to adapt to changing market conditions. .