

Hi ,

## Setting the right price!

'Price is what you pay, value is what you get' (from the great Warren Buffet). This assertion offers subtle but distinct differences in perspective, profound even; because you often hear "that's good value".

It's all about perspective (and creating it), and the ability to position yourself appropriately in the eyes of your clients so that they believe you provide good value and that they are willing to pay the price (that you set) for it.

**"Never be frightened to take a profit. Better in your pocket than theirs."**

*Michael Levy – motivational author and poet*

## What's the goal?

One should have a clear pricing strategy – defined objectives - and a pricing model that ensures the business will be healthy, profitable and meeting its business objectives. And the other key outcome is so that the consumer has the positive value perception in mind – not the price barrier. Remember, in the four tenets of marketing (product, place, promotion and price), price is the only one that makes you money, the rest are costs.

Firstly, like most planning exercises, one needs to establish their pricing objectives. So what could they be? Maximising current profits (often a price increase will help here)? Survival mode (tough market conditions)? Increase your market share through "penetrative pricing" (lower pricing to grow the client base and using economies of scale as an example to generate the profits)? Product leadership and creating a higher "position" through superior quality and higher pricing? Or go for a more common theme, which is competitive pricing and maintaining parity with your competitors. Whatever the current focus is, it can be extremely lucrative for one to review the pricing program and evaluate the "elasticity" of your pricing model to determine if there is a more profitable option (though this may not necessarily be a short term answer for achieving the desired result).

**"The general who wins the battle makes many calculations in his temple before the battle is fought. The general who loses makes but few calculations beforehand."**

*Sun Tzu – Author (the Art of War) and military strategist*

## How do you know what price?

When considering the pricing objective one must understand the market conditions, the trends, look at the current and future demand for your product/service, your value proposition and the positioning you would like "to own" in the minds of your clients. Other factors to consider are consumer sensitivity levels (due to the above factors, and also the market/industry you're in) and distribution or your sales channels – these will have a significant impact on setting pricing levels (eg: we all know now it's often cheaper to buy on line).

This is all great, but how do you actually establish the right price? It's only now that I will refer to the actually inherent structures involved with pricing – why? Because many times business often set a price based upon a cost and % mark up model or copy some one else, rather than establishing clear objectives that will be considerably more lucrative for the business.

## The methods:

As I mentioned the most common and elementary method is the mark up pricing. Following is a simple costing method (meaning it doesn't cover

everything): establish a cost per unit = total cost of production ÷ volume of production then add a % mark up on to the price. For example: cost of goods and all direct costs for producing those goods for a month are say \$3000 (total cost of production). The production volume is 30% (of total production) for widget 1 = \$1000 (volume of production). In that month you produced 50 x widget 1 items = \$20 cost per unit. Now add on a percentage, eg: 35% = \$27 (Obviously one has to allow additional margins for the supply chain, ie: distributors and retailers). Incidentally this is the same method that service firms often use to calculate their fees (or initially anyway) – using a multiple (often 3 or 4 X) of the employees' wages. Fairly simple really and although this method is extremely usable, it doesn't provide the lucrative benefits of a more value orientated approach.

Before I explain the perceived value method, I will touch on other common methods used today. There is a common theme (particularly with the big players) to use value pricing – charging low prices and using volumes (two techniques are EDLP (every day low pricing) and high-low pricing – keeping prices higher than normal, and running regular promotional discounting campaigns). Other methods are auction pricing and parity or going rate pricing (charging the same as competitors).

## Perceived value

Perceived value pricing is based upon the notion that customers will pay the perceived value of the product or service (not necessarily what its actual value is.) This is achieved through brand development, communications and creating the "enhanced perceptions" in the consumers' mind (and thus the ability to realise more profits through greater perceived value). Of course you have to be able to deliver the value and all the benefits that you are "creating" otherwise the profits won't materialise. But perception is reality, isn't it?

The other (longer term) benefit to the business is increased brand equity, and no more tangible an example than the recent acquisition of Trademe by Fairfax. Analysts discussed their view of the "true value" but the perceived (read market) value was significantly greater. (Well done Sam!)

## How do I know if I'm creating the perceived value?

Ask your customers. Simple as that, survey, talk to them, get feedback on their views about what they think about your business, products and services. You will then know their purchasing decision processes and why they buy – from that, one can develop plans and enhance the perceptions in the minds of their customers in their decision process.

**"Make your product easier to buy than your competition, or you will find your customers buying from them, not you."**

*Mark Cuban - Billionaire Internet Entrepreneur*

Your level of success is only limited by yourself.

Best wishes

Vaughan

