

Ultimately there is no magic formula for establishing a perfect pricing structure. No single formula will work for every item or assure the maximum profit in every situation. A lot of things have to be taken into consideration. Therefore, everyone must approach the problem individually.

Price setting is not a guessing game. In order to price a product or service competitively - - which is obviously necessary if you want to stay in business - - you must have a real "feel" for the marketplace. This does not come easily. It is, therefore, imperative to do all the market research possible before setting any price range. Additionally, any price established must cover all of the requirements of producing and selling your products. Exactly what those specific items are depends upon the product itself but elements include:

- 1) **Direct costs** such as raw materials, supplies, merchandise, labor and time;
- 2) **Overhead costs** like production related tools, equipment, facilities, utilities, transportation, depreciation, etc. and nonproduction related marketing, advertising, storage, special fees, insurance, taxes, and bookkeeping; and
- 3) **Profit** for investment, savings, and expansion.

With all of this information in mind, there are a few more hints that might make the pricing process easier for you:

1) **Pricing low is a good strategy if items are:**

- a. widely used,
- b. usable for a long time,
- c. not very durable,
- d. used for only one thing,
- e. low-tech (not changed often),
- f. fast moving with a high turnover,
- g. a source of long-term profits,
- h. sold in a highly competitive market,
- i. part of a line of related products, or
- j. compatible with few or no services.

2) **Pricing high is a good strategy if items are:**

- a. rare or customized,
- b. outmoded rapidly,
- c. durable over many years,
- d. versatile, with multiple uses,
- e. high tech (changed and upgraded often),
- f. slow moving with a low turnover,
- g. sold in a market with little competition,
- h. a stand-alone product,
- i. compatible with sellable services, or
- j. an impulse or emergency item.

3) **Pricing low is a good strategy if a business wants:**

- whose unit cost will decrease with volume;
- a. to introduce a new capital-intensive product
 - b. a simple distribution system involving one distributor;
 - c. a large or mass market share buyers;
 - d. little or no use or promotional support through advertising and sales activities;
 - e. entry into a well-developed market;
 - f. entry into a mature, highly competitive market; or
 - g. easy market penetration.

4) **Pricing high is a good strategy if a manufacturer/distributor wants:**

- whose unit cost will increase with volume;
- a. to introduce a new labor-intensive product
 - b. a complex distribution system involving multiple levels of distributors;
 - c. a small, select market share of upscale buyers;
 - d. considerable use of promotional and support advertising and sales activities;
 - e. entry into an undeveloped market;
 - f. entry into a new or developing market; or
 - g. high profits for the short-term only.

5) Demand for products change when prices are raised or lowered:

- a. when substitutes are available;
- b. for high ticket items;
- c. for luxury goods;
- d. for highly durable items;
- e. for products that satisfy hard-to-fulfill needs; and
- f. for products that buyers can postpone buying.

6) Demand for product does not change when prices are raised or lowered:

- a. on products for which no substitutes are available;
- b. for low ticket items;
- c. when they are necessity goods and staples;
- d. for not very durable items;
- e. for products that satisfy easy-to-fulfill needs; and
- f. for products that buyers can't postpone.

Use this checklist to make certain that you have covered all the bases in establishing your prices:

1) Estimating Demand in terms of:

- a. the products/services customers shop around for;
- b. the products/services in demand at a high price;
- c. if customers expect a certain price range;
- d. the balance between price and quality in the market;
- e. products/services that are in greater demand at a certain time of the year and why.

2) Considering competition in terms of:

- a. their pricing strategies;
- b. your prices against theirs; and
- c. policies for selling higher, lower, or at the same price as the competition.

3) Pricing and Market Share in terms of:

- a. your present market share;
- b. your market share goals;
- c. the effect price changes will have on share goals; and
- d. if production capacity is consistent with market share goals?

Knowing how sensitive your target markets are to price change gives you an advantage over firms which use a reactive pricing policy, but there are other factors to keep in mind as well:

1) What are your pricing objectives?

Common pricing objectives include building or maintaining a market share, maximizing profits on your return on investment, meeting the competition, introducing new products, and increasing sales.

2) What is your break-even point?

This is important to know as you are establishing prices. It establishes the low end of your acceptable price range.

3) What are your profit goals?

These will impact upon the strategies you choose to use.

4) How do target market(s) see your product/service?

Do not guess. Use surveys, questionnaires, market research, etc. This knowledge helps you to establish the high end of your price range. It is often referred to as "what the market will bear."

5) What is a competitive price?

Since all pricing strategies are competitive, a major factor in establishing your price is knowing what the competition is doing. This does not necessarily mean that you are going to follow them. However, it does mean that you want to know what they are doing so that you can figure out how to defeat them in the market place.

6) What is the of product lines and inventory on price?

Sometimes you will have to flesh out a product line in order to meet competitive pressures or rather than carry the product forever, you decide to turn it over even at a loss. Inventory costs are a hidden burden on some businesses and can drive up short-term borrowing needs. Still other businesses find sales costs are the dominant factor.

7) How flexible is your pricing strategy?

Every industry has its own favorite pricing strategy and you should use your industry pattern as a guide.

There are also psychological factors involved in pricing. Retailers use "odd number" pricing - - \$499 rather than \$500 - - because the difference between the prices is perceived as being greater than one dollar. Psychologists even suggest that every number has its own psychological qualities that affect price perception. For example, the number 8 is round and symmetrical; soothing and calm, while the number 7 is angular and calls attention to itself. Consequently, in psychological terms, 8.8% financing may be more appealing than 7.7%.

Perceived value is another pricing factor. With manufactured goods, perceived value might be measured in terms of greater durability or longer warranty. It can be enhanced by packaging, advertising, and promotion. Determining perceived value will almost certainly require the use of market research.

Price can also play a major role in product or service promotion. Discounts and rebates help increase sales volume. There are even instances where a rise in price has increased market share. But keep in mind that promotional pricing is somewhat limited by government regulation. If a business advertises fantastic discounts, the customer's savings must be real. "Rain checks" must be offered for specially priced items that quickly sell out. Promotional pricing is important for introducing a new produce or service. However, remember it is easier to lower a price than it is to raise it. Selling below the competition may initially improve sales volume, but could end up costing the company a lot of customers when prices are raised.

Price changes can respond to shifts in the market, cost increases, or the need for more profit. But it is important to anticipate the impact of a price change with the following:

- 1) How will the sales force react?
- 2) Will the change have a noticeable effect on competition?
- 3) How will it affect distributors or dealers?
- 4) Will suppliers charge more if prices are increased?
- 5) Are there special government regulations to be considered?
- 6) How will customers react to a price change?

4) **Strategy in terms of:**

- a. how pricing affects sales/volume goals;
- b. how can pricing help gain new business;
- c. impact testing of price strategies on the market; and
- d. if strategies are in line with economic trends?

5) **Policies in terms of:**

- a. how the nature of the product affects its price;
- b. how method of distribution affects price; and
- c. how promotional policies affect price?

Also keep this pricing factors in mind:

$$PRICE = Image + Service + Product + Overhead + Profit$$

These influence pricing policies:

- 1) **Price sensitivity or elasticity.**
- 2) **Quality.** High quality and high prices often go together.
- 3) **Differentiation.** High differentiation requires high prices.
- 4) **Competition.** You must respond to competition.
- 5) **Service.** More services allows for higher pricing.
- 6) **Location.** Certain locations demand higher prices.
- 7) **Target markets.** High and low markets scare people off.
- 8) **Marketing.** Should be reflected in pricing strategies.
- 9) **Your business costs.** Pricing must reflect your business; not anyone elses.

$$Perceived Value to Customers = Product + Intangibles (service, quality, etc.) + Specialized Expertise.$$

The Northwest Oklahoma SBDC, located in Alva at NWOSU - - with offices at the Enid NWOSU campus and Guyman - - covers a large portion of Northwest Oklahoma.

OSBDC Regional Office
Northwestern Oklahoma State University
Alva, Oklahoma 73717
(580)327-8608
Bill Gregory, Regional Director
Jeanne Cole, Business Development Specialist

OSBDC/SCORE Satellite Office
Northwestern Oklahoma State University
2929 E. Randolph,
Enid, Oklahoma 73701
(580) 213-3197
Melissa Cole, Business Development Specialist
Bob Wilcox, SCORE Chairman

OSBDC-Guymon
118 NW 4th
Guymon, Oklahoma 73942
(580) 338-4357
Mark Aubrey, Business Development Specialist

Pricing As A Marketing Tool

Although not often thought of that way, pricing is often a marketing decision. It combines market research with financial analysis. For any business to be truly successful, it must price its products and services in such a way as to:

- 1) Allow a profit margin for the business,
- 2) Be competitive with other businesses, and
- 3) Suit the customer's budget.

Pricing is one of those areas that can either make or break a business. If the price is wrong, it won't matter if everything else is right. But how does one go about deciding upon a price?

There are two important factors to keep in mind when establishing a pricing structure. The first is the *price ceiling*; which represents the price that the market determines the product or service will successfully sell for. This identifies the top price customers will typically pay for particular goods or services. Market research and competitive analysis should be used to determine pricing trends and strategies of similar businesses. The second is *price floor*; which represents all of the costs associated with running the business. This is the price below which business cannot sell the product and still make the necessary profit.

Successful businesses traditionally operate somewhere between the price ceiling and the price floor; allowing a margin for returns, damage, sales, and discounts.



BUSINESS BASICS:

Pricing Your Product or Service

a product of the
Oklahoma Small Business Development Center
Northwestern Oklahoma State University
in coordination with the
Service Corps Of Retired Executives
and in a partnership program with the
U. S. Small Business Administration

This material is based upon work supported by the U.S. Small Business Administration (SBA) under Cooperative Agreement # 7-7770-0038-20. Any opinions, findings, and conclusions or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the U.S. Small Business Administration.



Copyright, 04/2005

developed by
OSBDC at NWOSU