

The price is right for success

by Bruce A. Love

*P*rice determination is an important weapon in the arsenal of the entrepreneur. The prices you set can have a significant impact on your bottom line. Prices set too high will discourage sales. Prices set too low will threaten profits. Understanding the intricacies of pricing strategy is therefore essential for the success of your business.

*F*actors influencing price come from internal strategic objectives and external forces in the market environment. Internally, business owners can choose pricing strategies to maximize profit, maximize sales, or capture market share. Outside factors, such as the level of competition, the maturity of the product, economic factors, and the psychological behavior of customers will also play major roles when establishing price.

*A*ccording to basic economic theory, demand for most products increase as prices decrease. Business owners therefore expect to sell more if they reduce prices. If the objective is to sell more, and gain market share and brand awareness, keeping your price low may be a good strategy. This is sometimes called a market penetration strategy. Lower prices, however, can lead to lower profits, and potentially lower revenues if not done properly. If your focus is to maximize profits, you will carefully consider your costs to produce the product, and price it accordingly to achieve profits on each sale.

*C*ompanies in established industries often price goods and services relative to existing competition. The chosen price can be higher or lower than those charged by other businesses. If you choose to price higher than the competition, the difference in price should be accompanied by changes in the way the product is packaged, distributed, or promoted, to rationalize your higher price.

*S*ome businesses seemingly defy economic principles. For instance, Ben and Jerry's sell quarts of their ice cream for twice as much as other name brands sell half gallons containers. Devotees of B & J's will justify paying the higher prices by claiming it is a superior product. Assuming this is true, in terms of the marketing mix, they have chosen to use their "product" to make their brand distinctly different. However, the tactic used by B & J's goes beyond product differences. Extremely creative promotional efforts targeting the psychology of the consumer enable B & J to price their ice cream higher. In the mind of the consumer, higher price equates to higher quality and therefore the product becomes more desirable because of higher price. This is a classic example of what is called prestige pricing. Such pricing is intended to appeal to wealthier consumers (and those who want others to think of them as wealthier or more sophisticated). The social missions of B & J's also appeal to many consumers. They typically donate a portion of profits to various social concerns.

*W*hen launching new products, companies have important price decisions to make. Innovative high-tech products are typically priced high initially to try to recoup development costs. Once competition learns of successful product introductions, they descend as sharks in a feeding frenzy, in hopes of getting a piece of the action. The company that originally introduced the product can then gradually lower prices to remain competitive. This is a price-skimming strategy. It is the strategy of choice when consumers exist who want to be the first on their block to own new gadgets. With it, companies "skim off" sales from customers willing to pay top dollar, before lowering the price and skimming off the next layer of willing customers.

*O*bviously, some pricing strategies are opposite from one another. Knowing the needs of your company, and the mindset of your customers is essential to implementing the best pricing strategy for your products.

Love Consulting
600 Oakmont Place
Roaring Spring, PA 16673
814-224-2651

articles@loveconsulting.com

© 2004 Love Consulting