Pricing Strategies: How To Price Your Products and Services

The primary goal of business is to make a profit. Many small businesses fail to do so because they do not know how to appropriately price their products or services. Pricing is the critical element in achieving a profit and is a factor that all firms can control. Before setting your prices, you must understand your product's market, distribution costs, and competition. Remember, the marketplace responds rapidly to technological advances and changes from competition. You must keep abreast of the factors that affect pricing, and be ready to adjust.

Retail Cost and Pricing
A common pricing practice among small businesses is to follow the manufacturer's suggested retail prices. The suggested retail price is easy to use, but it can cause problems. It may create an undesirable price image, and it doesn't consider the competition.

Competitive Position
Another approach is a strategy in which a firm bases its price on those of its competitor. A small retailer should compare prices with a similar store. Do not try to compete with a large store's prices, because they can buy in larger volumes and their cost per unit will be less. Instead, highlight other factors, like customer service. Customers will often pay more for merchandise if they get courteous service.

Pricing Below Competition
Many vendors have been very successful using this pricing strategy. Since this strategy reduces the profit margin per sale, a firm needs to reduce its costs and may do some or all of the following:

- Obtain the best prices possible for the merchandise
- Locate the business in an inexpensive location or facility
- Closely control inventory
- Limit the lines to fast-moving items
- Design advertising to concentrate on "price specials"
- Offer no or limited services

Pricing goods below the competition can be difficult to maintain. Why, because every cost component must be constantly monitored and adjusted. It also exposes a business to pricing wars. Competitors can match the lower price, leaving both parties out in the cold.

Prestige Pricing or "**Pricing Above The Competition"**
Prestige pricing refers to high markups and/or pricing above the market. Many consumers are willing to pay more for a product or service because it is felt the product or service is of higher quality or possesses brand or manufacturer prestige. Usually above-market pricing can be done only when the product is unique or distinctive, or when the seller or manufacturer has acquired prestige in the field.

This strategy is possible when price is not the customer's greatest concern. Other considerations important enough for customers to justify paying higher prices include:

- Service considerations: delivery, speed of service, satisfaction in handling customer complaints, knowledge of product or service, helpful and friendly employees
- A convenient or exclusive location
- Exclusive merchandise.

Price Lining
This strategy targets a specific segment of the buying public by carrying products only in a specific price range. For example, a store may wish to attract customers willing to pay over $50 for a purse. Price lining has many advantages including:

- Reduced errors by sales personnel
- Ease of selection for customers
- Reduced inventory
- Reduced storage costs, due to smaller inventory.

Consumer Psychology Toward Price
Whether they know it or not, most consumers develop mental attitudes about the price they are willing to pay for a product or service. There is considerable evidence that the importance of price in the decision to purchase varies from product to product and person to person.
There are numerous price strategies used by businesses to take advantage of customer pricing psychology. Several of the more common are listed below.

Multiple Pricing
This involves selling a number of units for a single price for example, two items for $1.98. This is useful for low-cost, consumable products like shampoo or toothpaste. Many stores find this a desirable pricing strategy for sales and year-end clearances. Also, this can be a strategy where the customer perceives quantity buying as involving greater savings. An example is an item that normally sells for 49 cents. Multiple pricing would change this situation to a two for 89 cents or perhaps three for $1.39 price. In general, multiple unit pricing is usually effective in increasing immediate sales. However, this pricing technique may not increase the rate of consumption of the product. People will buy extra units of the product and use them as needed.
Several factors ought to be considered when using multiple unit pricing. First, the multiple-unit price has to be easy to understand. Eight for 79 cents is usually less effective than simple multiples of two for 19 cents. Second, the bargain concept of multiple pricing is not usually effective over the $10 range. It is, however, very effective for items within the $1 range.

Odd Number Pricing
Odd number pricing refers to setting a price just below the psychological breaks in the dollar, such as a price is set at 49 cents or 99 cents rather than 50 cents or $1. Prices may be set at 19 cents or 49 cents or $19.95. This gives the psychological impression to the customer that the price is not 20 cents or 50 cents or $20, but less. Odd number

pricing is often avoided in prestige stores or with higher priced items. An expensive dress could be priced at $150, not $149.95.

Service Pricing

Every service has different costs. Many small service firms fail to analyze their services' total cost, and therefore, fail to price them profitably. By analyzing the cost of each service component, prices can be set to maximize profits and eliminate unprofitable services. Service Cost Components make up the total cost of any product or service. They include: Materials, Labor, and Overhead.

Material Costs
This is the cost of materials found in the final product. For example, the wood and other materials used in the manufacturing of a chair are direct materials. This would be included on a direct cost basis. However many service-based businesses use materials and supplies in the delivery of their services and often fail to include those material costs into their job bid or final customer pricing. Some times a business may include materials costs in their pricing but only at the actual costs paid by the business. Many service businesses "up-charge" their material costs by adding 20-50% to the price they pay so as to take into account time to order and pick-up product, waste and spoilage, and the holding or inventory cost to the business for materials used. A good way to know if you are up-charging an appropriate amount is to track all materials/supplies used in the business on a monthly basis and compare that cost to the total amount charged to customers for those materials/supplies during that month. Service businesses need to track materials used in each job even if they do not break those costs out separately on the customer's estimate or invoice. Your up-charge should be within 5-10% of the standard for your industry between wholesale and retail price for those supplies. For example a painting contractor might buy caulking for $2.00 a tube wholesale when the retail price charged to consumers is $4.00. When the painter estimates the price of materials for a particular job it should include estimated number of tubes of caulking at or slightly below retail price. Your charge to the customer for materials/supplies should be sufficient to cover unanticipated and/or minor costs to the business related to the purchase and delivery of supplies. This is also a fair and reasonable way to produce a little extra profit to help out the bottom line.

Labor Costs
This is the cost of the work that goes into the manufacturing of a product. An example is the wages of all production line workers. The direct labor costs are derived by multiplying the cost of labor per hour by the number of man-hours needed to complete the job. Remember to use not only the hourly wage, but also include fringe benefits. These include: social security, workers' compensation, unemployment compensation, insurance, and retirement benefits.

Overhead Costs
Any cost not readily identifiable with a particular product is overhead. These include indirect materials and indirect labor, such as maintenance, supplies, repairs, heat and light, depreciation and insurance. These are not charged to direct labor, but must be

included as a cost. Examples are clerical, legal and janitorial services and supplies. Insurance, taxes, rent, advertising and transportation are also overhead costs. Part of the overhead costs must be allocated to each service performed or product produced. The overhead rate can be expressed as a percentage or an hourly rate.
Adjust your overhead costs annually. Charges must be revised to reflect inflation and higher benefit rates. It is best to project the costs semiannually, including increased executive salaries and other projected costs. A cost lid must always be used in preparing a bid or quoting a job. Include shipping, handling or storage in the total material cost.

Figuring Costs And Profits For A Consultant Service
Pricing services, where your own labor or expertise is used, is different from pricing services that use materials and other labor. For instance, most consultants price their services by the hour. Senior consultants charge more for their time than do their less experienced counterparts. Remember to charge for an adequate number of hours. Travel time is usually listed as an extra charge.

It is unlikely that all of your time will be billed to clients. Therefore, hourly or contract fees must be set high enough to cover expenses during slow periods. That is why one-half of the total normal working hours for a given year are used in figuring overhead rates. Try to obtain long-term, monthly, or contract assignments when possible.

Summary

Your pricing structure and policy are major components of your public image and are crucial to securing and keeping your clientele. Pricing for service businesses may be more complex than retail pricing. However, the result is the same: cost, and operating expenses, and desired profit, equals the service's price. The key to success is to have a well-planned strategy. Establish your pricing policies, constantly monitor prices and operating costs to insure profit. Accuracy increases profits!