

ESSENTIALS OF ENTREPRENEURSHIP AND SMALL BUSINESS MANAGEMENT

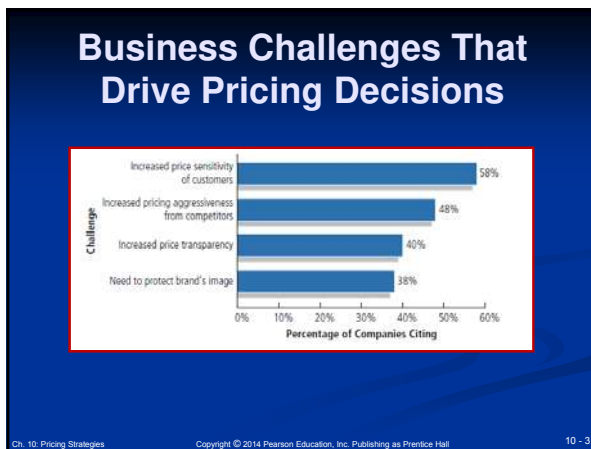
Chapter 10: Pricing Strategies



Pricing

- Is governed both by art and science.
- Requires balancing a multitude of complex forces.
- Influences every aspect of a small company.
- Is an important signal of a product's or service's value to customers.
- Involves both math and psychology.

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Price Conveys Image

- Price sends important signals to customers: Quality, prestige, uniqueness, and others.
- Common small business mistake: Charging prices that are too low and failing to recognize extra value, service, quality, and other benefits they offer.
- Understand the target market and identify how much customers are willing to pay rather than how much to charge.

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Competition and Pricing

- Must take into account competitors' prices, but it is not always necessary to match or beat them.
- Key is to differentiate a company's products and services.
- Price wars often eradicate companies' profits and scar an industry for years.
- Best strategy: Stay out of a price war!

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Focus on Value

- The "right" price for a product or service depends on the value it provides for a customer.
- Two aspects of price:
 - ▶ Objective value
 - ▶ Perceived value – determines the price customers are willing to pay.
- Value is not synonymous with low price.



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Dealing with Rising Costs

- Add a surcharge
- Explain the reasons behind price increases
- Focus on improving efficiency
- Consider absorbing cost increases
- Modify the product or service to lower its cost
- Eliminate discounts, coupons, and freebies



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Dealing with Rising Costs

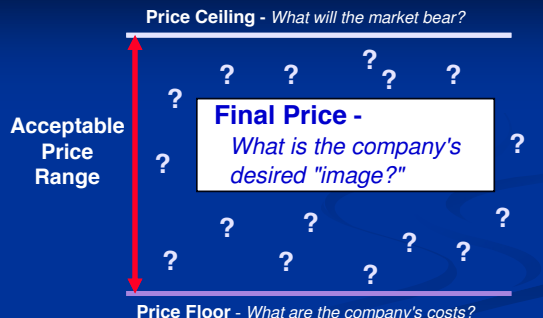
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- Diversify your product line
- Anticipate rising costs and try to lock in prices of raw materials early
- Emphasize the value of your company's product or service to customers
- Differentiate your product or service
- Use cheaper raw materials
- Raise prices incrementally and consistently



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What Determines Price?



Price Ceiling - *What will the market bear?*

Acceptable Price Range

Final Price -
What is the company's desired "image?"

Price Floor - *What are the company's costs?*

FIGURE 10.1

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Introducing A New Product

Three Goals:

1. Getting the product accepted
 - ▶ Revolutionary products
 - ▶ Evolutionary products
 - ▶ Me-too products
2. Maintaining market share as competition grows
3. Earning a profit



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Introducing A New Product

3 Basic Strategies:

- ▶ Market penetration
- ▶ Skimming
- ▶ Life Cycle Pricing



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Pricing Techniques

- Odd pricing
- Price lining
- Leader pricing
- Discounts (Markdowns)
- Bundling
- Geographic pricing
- Dynamic pricing



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Customized or Dynamic Pricing

A pricing technique in which a company sets different prices on the same products and services for different customers using the information that it collects about its customers.



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Pricing Techniques

(continued)

- Optional-product pricing
- Captive product pricing
- Byproduct pricing
- Suggested retail prices
- Follow-the-leader pricing



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Follow the Leader Pricing

- Match competitor prices.
- A “me too” pricing policy.
- Robs a company of the opportunity to create a distinctive image in its customers’ eyes.



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Pricing for Retailers: Markup

Dollar Markup = Retail Price - Cost of Merchandise

Percentage (of Retail Price) Markup = $\frac{\text{Dollar Markup}}{\text{Retail Price}}$

Percentage (of Cost) Markup = $\frac{\text{Dollar Markup}}{\text{Cost of Unit}}$

Example:

Dollar Markup = \$30 - \$14 = \$16

Percentage (of Retail Price) Markup = $\frac{\$16}{\$30} = 53.3\%$

Percentage (of Cost) Markup = $\frac{\$16}{\$14} = 114.3\%$

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Below-Market Pricing

- Attract a sufficient level of volume to offset the lower profit margins.
- Trim operating costs by eliminating extra services such as:
 - ▶ Delivery
 - ▶ Installation
 - ▶ Credit granting
 - ▶ Sales assistance
- Risky!



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Pricing for Manufacturers

- Direct costing and pricing
 - Absorption costing
 - Variable or direct costing
- Breakeven



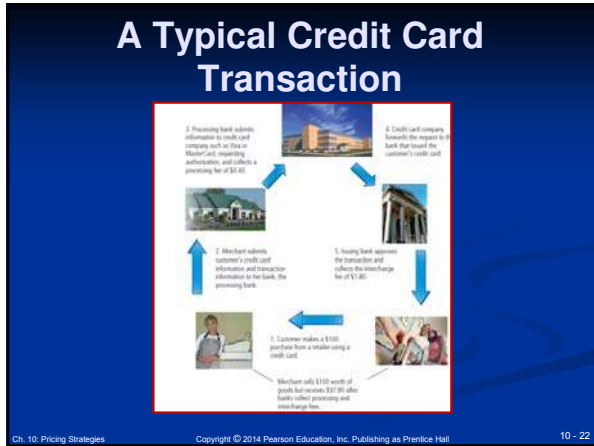
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Consumer Credit


- Credit cards – typical consumer has 7.7 credit cards.
 - ▶ Research: Customers who use credit cards make purchases that are 112% higher than if they had used cash.
 - ▶ On a typical \$100 credit card purchase, cost to business = \$2.20
- Installment credit
- Trade credit



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E-Commerce and Credit Cards

- About 0.9% of online credit card transactions are fraudulent.
- Steps:
 - ▶ Use an address verification system
 - ▶ Require a CVV2 number
 - ▶ Check customers IP addresses
 - ▶ Monitor Web site activity with analytics
 - ▶ Verify large orders
 - ▶ Post notices on Web site that your company uses anti-fraud technology
 - ▶ Contact the credit card company or bank that issued the card



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Conclusion

Pricing techniques impact every aspect of a company including:

- Image
- Customers
- Cash flow
- Profits



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