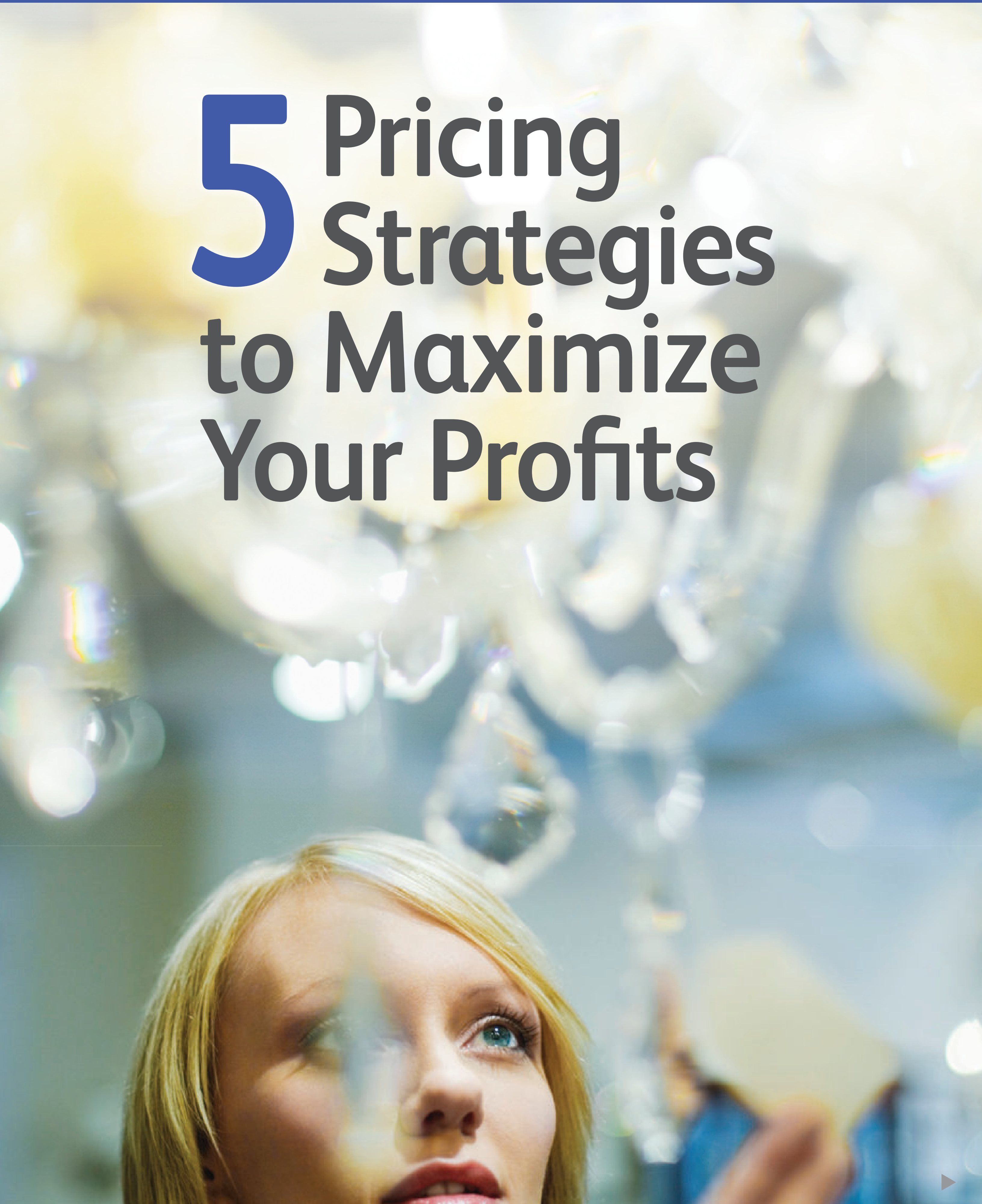
5 Pricing Strategies to Maximize Your Profits



Pricing may seem as simple as tapping a few buttons on a keyboard or slapping a price tag on an item in a shop, but businesses in the trenches know that the issue is a tricky one.

Pricing is essential to every business. Along with product, place, and promotion, price is one of "4 Ps" of every business's marketing strategy. And yet, fewer than 5 percent of Fortune 500 companies employ a full-time pricing manager[1] and small businesses almost never have anyone dedicated just to pricing. While pricing may seem simple, the fact is it can have more impact on your business's profitability than nearly any other element of your company.

The overall goal of any pricing strategy is to maximize the amount of revenue you achieve from every sale. Price too low and you leave money on the table, shrinking your profits. Price too high and you lose the sale altogether, an even worse outcome. It doesn't have to be a complicated nightmare. While many variables go into setting the ideal price, we'll distill the essentials for you in the following pages.

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5 Essential Pricing Strategies

There are dozens of approaches you can take when attempting to price a product, but a few strategies have proven more worthwhile than others.

However, there's no single pricing strategy that will maximize profits for any business. Almost all businesses should use every one of these strategies to some degree, drawing insights from one tactic and combining those data points with other strategic observations to arrive at an ideal price. Further, different products may require different strategic thinking when prices are set, based on a wide range of variables that we'll cover below.

Here are the five key strategies to work through to maximize profits when pricing any product.

1 | Use Cost-Based Pricing to Ensure Base Profitability

Pricing should always start here, as you take the time to work through the simplest method by which prices are set. Cost-based pricing models are relatively simple to build. Start by tabulating all the costs of production of the product – raw materials, labor, and other manufacturing costs, for example. If you're a retailer, just use the wholesale cost of the product. This is the product's variable cost. Now, determine the remaining costs that your company expends – rent, employee salaries, marketing costs; these are your fixed costs. This needn't be a complicated process. For most businesses, all of these numbers can be pulled from the balance sheet and other reports within QuickBooks.

Allocate a portion of your fixed costs across your entire production and add that figure to your product's variable cost. This is your breakeven price, the price at which, if you sell all of your products, your company won't make or lose money. Finally, simply add a percentage which you'd like to make over this cost. This represents your profit.

Cost-based pricing ignores a large number of key factors – demand for your product and competitive prices, to name just two – but it's an essential data point that gives you a baseline price, and an understanding of how low you can go and still stay in business. That said, pricing below the breakeven price remains a popular tactic with businesses that are attempting to rapidly build market share by selling at "can't pass up" prices. It's an often-dangerous strategy, but it can be a useful one if the business can absorb short-term losses and the owner is confident that prices can be raised later to cover the shortfall.

> Research has shown that when two similar items are priced the same, shoppers tend to buy neither product. Vary your prices at least slightly and total sales nearly double. [2]

2 | Use Competitive Pricing as a Guideline, Not a Benchmark

A major consideration in almost every pricing decision involves what competitors are charging for their products. But do you price higher than, lower than, or the same as the competition?

Competitive pricing is a complex topic that raises a number of questions for business owners to consider. The largest is one of customer perception.

Do you want to be perceived as a low-cost alternative or as a premium product? If you're pricing at a premium, does your product have the quality and prestige to back up the higher cost?

Many business owners often attempt to undercut the competition, recognizing that price is a key concern in many shopping transactions, but this is often a big mistake. Such tactics can quickly devolve into a price war, leaving all competitors racing to the bottom, decimating profits. Many businesses also make the error of presuming their product is a commodity (and thus not worthy of a premium price), when they could be marketing based on some unique aspect of the product.

Steve Ondich, Operations Manager for Commercial Forest Products, operates in what you might consider to be a true commodity: lumber and wood products. Lumber is very price-sensitive market, but Commercial Forest Products focuses on quality and fast fulfillment over cost. Says Ondich, "Our pricing is a simply a function of our target profit margin. We are interested in what our competitors sell similar products for but do not arbitrarily match their prices. Emotions can skew the perception of what your pricing should be. We started Commercial Forest Products in 2009 when the hardwood industry was shrinking. When we opened, we

were competing with a number of bloated companies that were on a downward spiral."

Commercial Forest Products was uninterested in competing based on price with companies that were on the verge of shutting down. Ondich says, "When we stopped engaging in turf wars over market share and started diversifying into areas that made sense for us, our business turned a corner."

3 | Make Value-Based Pricing the Core of Your Pricing Strategy

The essence of modern pricing strategy can be found in value-based pricing: Pricing a product based on its perceived value to the buyer. This tactic maximizes both your potential sales price and your realized profit, but it is also the hardest price to actually determine because it revolves around customer psychology, always a tricky subject.

Value is a subjective, individual issue, and it will change from buyer to buyer. In pricing scenarios where a product is priced individually – such as when bidding on an RFP or when hourly consulting rates are being set – you can use this to your advantage, offering multiple price levels based on your estimation of what each individual customer is willing to pay. But when you're selling products in a shop or on a website, you have to come up with a single price point for everyone.

Developing the true value-based price of a product takes time and requires knowledge about your customers. How do you develop

When Should You Consider Changing Prices?

Established companies have an additional challenge when it comes to pricing. Once you've already established your product or service is available at a certain cost, how do you change what you charge?

The good news is that once your product is on the market, you begin collecting data that can be used if changes are in order. Do customers pick up the product, look at the price tag, and walk away? Or do they buy so much that you run out of stock midway through the day? All of this is valuable information that might lead you to the realization that your product is overpriced or underpriced.

There's no formula for knowing whether a pricing change is in order. Generally that decision is made when changes take place in the market, such as when a competitor goes out

(CONTINUED ON PAGE 4)

this knowledge? Experimentation.

As a case in point, consider the case of Swiggies, a water bottle designed to be worn on the wrist. Inventor and entrepreneur Julie Austin had a difficult pricing challenge, marketing the product at a higher price than a regular water bottle but at a lower price than the CamelBak, a popular water-filled backpack. Her solution was to experiment. Says Austin, "I tried several different prices in different markets and just experimented with them until I found a price that worked. The funny thing is that when I priced it too low, it didn't sell. I actually sold more at a higher price. If something is priced too low, buyers think it's cheap."

4 | Use Price Anchoring to Encourage Higher-Priced Sales

With a solid understanding of how cost-based, competitive, and value-based pricing relate to your product, you can consider more advanced pricing concepts such as price anchoring.

All manner of businesses can benefit from the concept of price anchoring, which relies on some simple psychology to convince consumers that your products are a good value. The idea is simple: Set the expectation that the "normal" price of a product is high, and consumers will focus, or "anchor," on that value. If your product is less expensive, it may suddenly be seen as a bargain.

There are myriad ways to implement price anchoring. The most common is in the form of a sale. If the "regular price" of a product is $100, but it's marked down to $80, the consumer is immediately telegraphed that he's saving money. Some companies intentionally overprice their products so they can offer frequent, almost perpetual, sales, because the anchoring effect is so powerful.

5 | Understand the Odd Pricing Strategy

Everyone is familiar with the practice of ending prices in non-round numbers. $9.99, $28.95, and $1,289 are all common price points that we see all the time. But why not charge $10, $30, or $1,300 for these products? Because psychologically, the "odd" prices are perceived as much cheaper, almost unilaterally.

When Should You Consider Changing Prices? (CONTINUED FROM PAGE 3)

of business, the cost of raw materials goes up, or products can be made more cost-effectively. Pay attention to pricing on a continual basis and make adjustments before the market leaves you behind.

At ScanMyPhotos, a mail-based service which turns photo prints into digital files, the company decided to lower prices on its main product from $159 to $99. Originally a sale offer, the price change was made permanent after it was shown to increase sales a whopping 350 percent. Technological innovations were speeding up the scanning process and making the service cheaper for the company, so CEO Mitch Goldstone says he decided to pass the savings on to the consumer. As well, the lower price meant the service more readily "sold itself," so the company didn't have to spend as much on advertising.

On the flipside, Ryan Yung, project lead at Innonline Solution, a web development firm, made the tough decision to raise prices, doubling the company's hourly rate to help cover rising fixed costs. "We lost quite a lot of existing clients," says Yung, as the company shifted its focus on more sophisticated business clients who could pay higher rates, but the strategy worked. "With a bigger budget for marketing and less work, we can deliver awesome quality. We hit the same sales last month as we had before, but with double the profit." ■

To simplify a complex psychological phenomenon, odd pricing works because we consumers are in a rush, and tend only to consider the first few digits of a price, often dropping the cents portion of a price and tricking ourselves into believing the price is cheaper than it is. On a deeper level, research has shown that we are consciously aware that $9.99 and $10 are almost the same, but the brain quickly sets $10 as an anchor price (see strategy #4 above), then just as quickly makes the logical leap that $9.99 is lower than that anchor, thus convincing you that it's a bargain.

The impact of odd pricing is impressive. Today, some 90 percent of advertised prices end in the digits 5 or 9.[3]

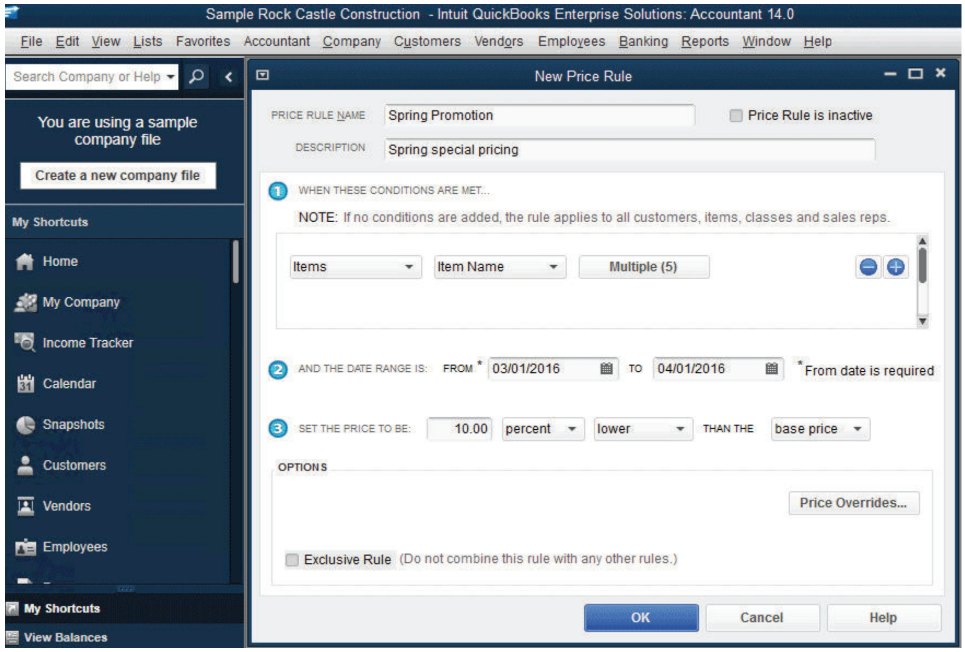
"Decoy products" also help upsell customers. Put an expensive item next to an even more expensive one, and customers will perceive the first item as a good value.

Using the QuickBooks Enterprise Advanced Pricing Add-On to Boost Profits

One of the biggest challenges of managing pricing decisions is the day-to-day management of product pricing. This isn't such a problem if you have a handful of SKUs, but what if you're a retailer with hundreds or thousands of products to manage? Manipulating the price on each of them becomes a full-time job.

Enter [QuickBooks Enterprise Advanced Pricing](), an add-on module for QuickBooks Enterprise that makes it easy to control, customize, and automate pricing decisions from within the QuickBooks interface.[4]

The heart of Advanced Pricing is its ability to create sophisticated pricing rules that give you fine-grained control over your pricing. With Advanced Pricing, you're able to set custom pricing based on multiple conditions being met, including the customer ID, the sales rep making the sale, the vendor from which you sourced the product, and much more. Adding to this power is the ability to set rules around the timing of price changes. If you want to have a holiday sale for the month of December, you can



tell Advanced Pricing to discount a group of products during that time. Prices automatically return to normal when January arrives. If you're attempting to determine a value-based price for your products, Advanced Pricing makes it easy to run any number of scenarios so you can determine the impact that varying price levels have on sales.

The tool is an incredible time saver for companies with large inventories. For example, many wholesalers and distributors not only have to manage a complex stock list but also have to follow pricing rules set by manufacturers who have arcane retail pricing restrictions and where costs are set based on the number of units sold.

> The Advanced Pricing Add-On, exclusively for QuickBooks Enterprise, lets you control, customize, and automate your pricing, right within QuickBooks.

Similarly, both service and product oriented businesses can benefit by Advanced Pricing's ability to set prices based on a class of customer. An auto repair shop may have one set of prices for regular consumers off the street, one set for municipalities who send school buses in for repair, and a third set of prices for work that's done on police cars. With QuickBooks Enterprise Advanced Pricing, it's easy to place customers into various groups and then let the software manage the price that appears on the invoice, rather than having to enter discounts manually and risk making a mistake. Advanced Pricing takes the complex concept of pricing and gives you the flexibility to create numerous price rules based on nearly any variable in your business. With Advanced Pricing, you'll devote less time to the day-to-day task of manually editing your price lists and more to the strategic issues of determining what your prices should be in the first place. ■

Notes:

1 http://sloanreview.mit.edu/article/is-it-time-to-rethink-your-pricing-strategy/
2 http://pss.sagepub.com/content/24/2/225
3 http://marketing-bulletin.massey.ac.nz/V8/MB_V8_N1_Holdershaw.pdf
4 Additional fees apply for the Advanced Pricing Add-On subscription. Requires QuickBooks Enterprise 14.0 with an active Full Service Plan and an internet connection. You'll automatically receive any new versions of our product that are released, when and if available, along with updates to your current version.

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