PRICING FOR PROFIT

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The Opportunity

Establishing a price for your product or service is one of the most critical decision making areas for a business. There is hardly anything that can compete with the profit impact of improved pricing. Volume growth, improved raw materials and other cost savings and any other profit generating opportunities that absorb management time are unlikely to compete with the leverage that pricing offers.

Typical pricing strategies used in every business result in hidden profitability being locked away. The opportunity for management is that the development of effective pricing strategies can result in substantial business growth and profitability without the need for additional investment in resources.

The ultimate goal of pricing is to strike the balance between what the business can earn and what the market can bear. Getting pricing right can create substantial value and maximise profitability.

Pricing By Default

Many businesses take an oversimplified “guestimate” approach to this all-important process by settling on prices strategies that “just works” rather than adopting strategies that maximise profitability. Often there is no one in the business who truly takes ownership of pricing. Everyone is more comfortable “working around it”, treating it as a given in their reality of the business. Pricing decisions are largely made by default or adherence to industry norms rather than through an artful understanding of the many options and leverage that they can offer.

Such reluctance can be partly attributed to the sense of uncertainty implicit in changing pricing. Mis-pricing on the downside can result in acute loss of profitability or alternatively if increased excessively, price the business out of the market. Too often pricing becomes lost in a maze of technicality, typically involving detailed and confusing costing information or complex discount and volume concessions.

Management’s preoccupation with the resources of a business, and an in-depth focus on costing behaviour, naturally engenders a cost-plus mentality when it comes to pricing. Another limiting influence is the belief that market-place rules; that everything must be constrained by demand, industry capacity and customer bargaining power. It is therefore not surprising that pricing is at the bottom of the pile in the armoury of resources available to a business to optimise growth and profitability.

Pricing Is About Value

The key to effective pricing decision-making is that it should be based on the value customers place on the product or service and not what it cost to produce. If you cannot clearly articulate the value you provide, how can you expect your customer to fully understand the value they receive. Value translates to higher prices and improved profitability. Customers choose the price they are willing to pay based on the value they perceive from your offering.

> *The Fluctuating Value of an Umbrella*
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> *Ever bought an umbrella recently? Why is its value different in dry weather compared to when its raining? The cost to make it for those different conditions is the same, yet the value we place on its use is quite different. When its raining we can clearly articulate its value, that is keeping us dry and we will pay accordingly. In drier conditions, its use and therefore its value is unclear, resulting in weaker demand that is more price sensitive.*

How is the value of your product/service perceived in the market place?

Issues to consider include:

- Costs as the basis for pricing should only be used to establish a price floor, not as the core for recovery plus
- Value based pricing should at least cover incremental costs
- Caveats to value –based pricing include competitor pricing where there is no differentiation and availability of a substitute product/service
- The perception of value can quickly change, therefore pricing strategies must be flexible if hidden profits are to realised.

Death By Discounting

Discounting is misunderstood and abused by most businesses and is spiralling out of control. Driven very much by the retail sector, buyer sentiment and behaviour is being radically changed to that of a discount culture where we now challenge and question what “full price” represents. It may maintain or marginally increase sales but it hurts profitability. Very few businesses improve profitability by discounting. For most businesses the financial metrics do not stack up, which can lead to the cannibalising of existing business resulting in oblivion. The open acceptance of continual discounting will lead to the death of businesses that cannot or do not adopt their way of operating to the changed environment.

Discounting is primarily a tactical strategy to address a specific market issue, however it can be effectively used strategically if it compliments overall business strategy and is effectively managed. *(Example: Airlines heavily discount prices in the low travel periods, such as January when business travel is at a minimum).* To do so effectively, the strategy must be consistent with the perceived image of the business in the market place. For example, Harvey Norman is a high profile and heavy user of promotional price advertising yet it is not considered to be a discounter, for in reality it is a premium pricer.

Discounting can damage branding and value. In the case of Myer, their continual practice of rolling discounts is devaluing their established image and brand value of quality, especially when compared to its major competitor (David Jones).

Discounting is fraught with challenges; therefore consider the following:

- Use discounting as an operational tactic to stimulate demand in short, sharp bursts
- Discount in quiet periods to increase business, not replace it.
- Be selective in using discounting to counter act competitive initiatives
- Do not discount your core business down market
- Reduce the features and services of your discounted offer
- Target your discount strategy to specific market segments where possible

Adopt A Multi-Price Mindset

Most businesses are handicapped by the way they view pricing; they approach it as a search for their product/service's "one perfect price". In doing so they are overlooking the opportunity of unlocking hidden profitability.

In reality for every product /service in the world there are at least two people who are willing to pay different prices. Therefore, to implement a successful pricing strategy that will deliver growth and profitability it is essential that customers be offered a variety of pricing options, which allows them to select the one that works for them.

Key strategy approaches (which are underpinned by a number of specific tactics) to consider are:

- Selling the same products to different customers at different prices (Differentiating)
- Selling the similar products to different customers at different prices (Versioning)
- Developing pricing strategies to activate dormant customers (Segmenting)

Don't Cut Prices - Develop A Profit Culture

Many people don't understand what profit is, as many confuse it with revenue and gross margin etc. Therefore if there are service issues or obstacles to generating the next sale, price-cutting is the standard mantra used by staff in dealing with customers. Unfortunately they are not aware of the impact their decisions can have on profitability.

It is essential as part of an effective pricing strategy that staff are educated on the impact their decisions can have on the business. Cutting prices doesn't hurt them it hurts the business. Guidelines to consider include:

- A clear definition of how low a price can go
- Price-cutting should be targeted and discrete
- Price-cutting should not block purchases from those willing to pay full price

Pricing is a complex issue that needs careful consideration and planning. However, some strategies can be quickly developed and implemented that will result in the unlocking of existing hidden profits in your business. The challenge for you is, will you maintain the status quo and muddle through or exploit pricing for the leverage potential it offers to grow your business and maximise its profitability.

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