10 DAYS TO ...

LAUNCH YOUR NEW BUSINESS

Pricing Methods

PAUL BAKER

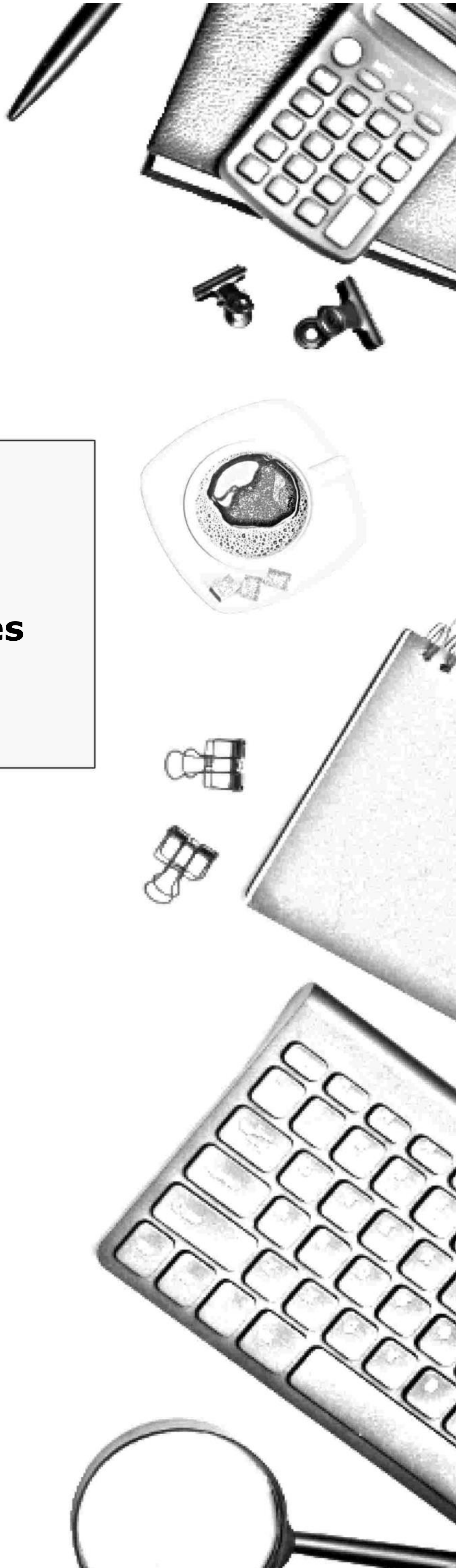
There are dozens of pricing methods you can use; here are just some of them.

For most businesses the pricing methods we show in Section 1 will be the most applicable, however we have included many more pricing methods for you to look at and possibly try if you wish in "Section 2."

Notes:

Section 1

The Right Pricing Strategies For Most SME Businesses



(Don’t Use) Cost Plus Pricing!

This is the ONE pricing strategy which SHOULDN’T be used; we have included it here because this terrible method of pricing is used most often by SME businesses and it’s killing literally 1000’s of businesses all over the world every year!

Of all the pricing methods, the simplest to implement is cost plus pricing, which is probably why it is used so often.

Your end price is worked out by adding up all your costs (wages, office space, utility bills, supplier costs – everything) and then adding a healthy dollop of profit on top to reach your selling price.

On a very basic level, if you sell 1000 units a month, your monthly costs are £50,000 and you want £5,000 a month profit, then you set your monthly sales total at £55,000 and your product will cost £55.00, which is £55,000 / 1000 units.

Costs + Profit = Sales Price.

Whilst this method sounds great on the surface of it, dig a little deeper and you will discover why it is possibly one of the worst pricing methods you could possibly use.

Notes:

It is usually a *very* poor way to price your goods or services because:

1) It ignores the *value* element of the services you provide, which is what customers really want from any transaction. **Consumers rarely want the lowest price possible; they want the best VALUE.**

2) It is impossible to accurately work out your costs because there are likely to be so many overheads you will forget to include, even for those businesses with the best accountants

3) It assumes your customers are willing to pay the amount you ask

4) It doesn't look at the pricing elsewhere in the marketplace

5) In a service industry, you may be getting paid for what you know rather than giving the customer a physical product. What price do you charge when you are charging for what you know? What price do you put on the knowledge inside someone's head if there are little or no costs involved?

Notes:

Do not use this pricing method as anything more than the loosest possible guide to the **absolute MINIMUM** price you should be charging, and ONLY use it when deciding the price of physical, tangible goods.

Cost Plus Pricing is ok as a starting point only. DO NOT use this method of pricing for service-based industries.

Notes:

Service-Based Pricing

Working out the pricing for a service-based industry is even harder than pricing a physical product because you are getting paid for what you know.

The biggest downside to service-based industries is the customer doesn't leave you holding anything physical in their hands.

A great example of this is carpet fitting. For the price of a few blades a carpet fitter can earn many hundreds of pounds every single day because of what he knows.

Sure, the customer has been left with a well-fitted carpet, but they can't actually hold the results in their hand (and a great result is <u>*expected*</u> anyway.)

The fitter gets paid well based on the knowledge in his head, but this leads to a reduced perception of value because the prospect or customer hasn't received a physical item in their hand, a touchable product.

Another example is hair dressing. Sure, you have got to buy top quality scissors etc but once you have bought your equipment the rest is profit!

Notes:

Pricing a service-based industry on the value you provide is trickier than pricing a physical product, which tends to be led by unit cost.

Getting your pricing right in a service-based industry means valuing your time and expertise, and accurately weighing up customer perception (how much the customer thinks your services are worth to them.)

There are many ways you could be *pricing more* for your service-based product.

? Perhaps you have earned more qualifications than your competition

? Perhaps you hold an official accreditation which is only held by the top 1% in your industry (this would be a great way to increase your value and your prices)

? Perhaps you may have a list of celebrity clients who will help raise your profile.

When pricing your services, you should start by identifying the benefits your service offers to customers, and attribute a value to each of those benefits.

None of us are able to do everything.

Notes:

If we could all do what those in the service industries can do there would be no service industry at all.

None of us have universal knowledge about everything and none of us have the time to learn to do everything either. Not everyone can make websites, not everyone can cut hair, not everyone can clean carpets.

To get a sense of the market value of the services you provide, ask your customers what they are willing to pay, and why. Also have a look at your competitors and see what they are charging.

- Who provides the best service in your area?
- What do customers expect for their money?
- How much do they value qualifications and experience?

Get feedback on your own service standards too, to see how you compare with the market.

Notes:

Value Based Pricing

This pricing model has the potential to bring you the greatest profits, but it's also the hardest to get right because it involves accurately pricing based on gauging the VALUE your prospects place on your goods or services.

When setting your prices, the one major mistake many SME businesses make is they set costs as the top priority and then base their prices based on their costs.

YES! Knowing your costs is essential to your pricing, but you also need to know what VALUE your product or service has to your target market.

Value based pricing starts with the value your customers place on your services based on the power of your company’s positioning.

In other words, with value-based pricing you charge what your customers are willing to pay based on the value of the benefits you have provided to them during the sales presentation.

Notes:

I know many people (myself included) who have travelled many miles from their home all over the U.K to go to a store in Southampton which sells expensive, high quality running shoes.

What makes this store unique, as opposed to your average sport shoe shop, is that every salesperson really knows what they are talking about!

That’s it!

That’s the huge amount of VALUE they provide. YES! Even knowing what you are talking about adds a huge amount of value to the business!

CRAZY I know but that’s just the way it is!

They measure your feet *properly*, they check your gait and weight properly, and put all this information together into a snazzy computery type thing to get the perfect running shoe for you.

People are prepared to travel extensively and pay handsomely for this type of excellent service.

Notes:

They brand their products effectively and customers don't mind paying extra for the added value the store provides, which in this case is higher quality products, better customer service, trust, reliability of service and so on.

I often travel many miles to a fairly expensive Chinese restaurant where they welcome me by name and serve incredible food every single time I go there.

These businesses offer a ton of value and charge accordingly … are you?

A FANTASTIC way to price your goods or services is to offer your product at a *higher* price than your competitors but really learn to drive home the value your product offers through your positioning.

This pricing strategy hasn't done Apple any harm has it?

Brands which sell luxury or high-ticket items often do this, and so should you.

I was one of the most expensive carpet cleaners in my area, and my positioning was such that no-one who was concerned with saving money would even bother to pick up the phone and call me for a quotation because it would be a waste of their time (and mine.)

Sure, it has certainly cost me some cheap work for those consumers who want something for nothing, but that's fine by me.

I would always rather do one job at £100 than two at £50. Half the work for the same amount of money … what's not to like?

Your customers will not pay you good money unless you give them excellent reasons why you are worth the extra amount.

This means you will need to put in the effort to learn and constantly refine how to properly sell your services and demonstrate how the added value you offer equals or exceeds the price you quote, and this has got to be done well before you even mention the price in your quotation.

ALWAYS COMPETE BASED ON THE *VALUE* YOU CAN PROVE YOU PROVIDE TO YOUR CUSTOMER, NOT ON PRICE.

EXAMPLE:

Notes:

Say I run a plumbing service. A simple one-man band. There are 3 plumbers competing for the same work: ABC Plumbers, 123 Plumbers and XYZ Plumbers.

They have all quoted £2000 to replace your boiler; who would you go with?

Before you can decide who to pick you probably need a little more information right? For customers to be able to choose you over the competition, they need more information about you and what you stand for.

Firstly, ABC Plumbers were late to the quotation with no apologetic phone call, and you had to chase them 3 times for the quotation. On top of that, the guy was surly. ABC Plumbers have provided you with no added VALUE and were a risky investment, so, quite understandably, you rule them out.

So, you are left with 123 Plumbing and XYZ Plumbing. Remember both boilers are the same price, so based on price alone there is no reason for the consumer to choose one over the other.

XYZ Plumbing offers just the boiler and the fitting … nothing else.

Notes:

However 123 Plumbing are super smart … they have looked at how they can add value to their services and charge extra accordingly, so they offer the customer a range of extra VALUE options.

123 Plumbing offers:

The basic package at £2000

Or

For just an extra £200 the customer gets:

- A free service in a year (VALUE £65 COST £15)
- A "free" 7 year warranty (VALUE £300 COST £30)
- Free call outs for the first year (VALUE £200 COST £30)
- A "free" bottle of wine as a thank you

The customer gets over £550 in value for very little extra spend and the customer can sleep at night knowing they are protected.

The business also makes a hefty wedge more profit on the sale. Smart right?

As a consumer, which would you go for? Who has added the most value? Doesn't that make the decision-making process much more interesting?

Notes:

Perception Pricing

How you price your product will impact how your business is perceived, both by your customers and your competitors.

Think about the kind of clientele you want to attract. Do you want to cater for a small group of high-paying customers, or offer a low-cost, one-size-fits-all product with mass appeal to the less affluent markets?

When choosing where to spend their money, Price Perception plays a crucial role. Perception Pricing is about the image your customers have in their heads about your company and your pricing.

In other words it's their perception of your business and your prices.

You may know you're cheaper than your competitors, but if Joe Public perceives you are more expensive, perhaps due to a flashy website or the expensive van you drive, then the price you actually charge is almost irrelevant.

If you give the impression you are the cheapest, you will exclude those who actually *want* to pay more for better quality goods or services.

Notes:

People looking for a Rolex won't be happy with a Casio, even though they both tell the time.

Customers usually know roughly the price they are expecting to pay, and if you have got it right, your price confirms the customer's evaluation and you may well make the sale.

If your price is too high you maybe won't get the sale *unless* you have provided a ton of value into the deal (since the customer will believe they will get better value elsewhere.)

If your price is too low (as is often the case with smaller businesses) the customer may still buy elsewhere for peace of mind because they may believe your products or services to be inferior in some way due to the low price.

Low prices are a massive turn-off for many, and it's not only those who can afford better quality goods or services who believe that either.

After all, the saying is "cheap and nasty" for a reason.

Notes:

Perception pricing is all about *your prices* telling a story about what the customer can expect from you.

Most consumers don't expect to get the highest quality of *anything* for peanuts … conversely people don't expect to spend a huge amount of money on rubbish either.

How you price your goods or services will help determine how your business is perceived, both by your customers and your competitors.

Notes:

Competition Based Pricing

Generally, it's important to know roughly what your competitors are charging, but it is ***vital*** you do not constrain yourself by it.

Competition based pricing starts with an analysis of your competitors and market conditions and sets the prices accordingly.

It's effective in one way because it takes into account market conditions (the so-called "going rate.") If customers are currently buying a competitor's similar product for £X amount of money, this tells you that this price of £X is what they're willing to pay.

To find out what your competitors are charging, just give them a call and ask them to quote. Obviously if you have a van out front with your business name on it, ask them to quote somewhere else, like a friend’s house or business address or hide your van round the corner!

Generally it is unwise to quote too much higher or lower than your competition UNLESS you have added a HUGE amount of value to your services or you have a good reason to do so.

Notes:

Don’t feel constrained by the prices other businesses are charging.

You can still charge more for your goods or services than your competitors if you can prove beyond doubt the value your services provide is equal or greater than the increase in price you are asking the customer to pay.

The higher the price tag, the more *value* you will need to demonstrate to the customer to justify it.

Notes:

Level Based Pricing

Creating a level-based pricing system is one of the greatest ways to increase your profits the world has ever known, and this is something you should be looking at implementing into your business RIGHT NOW!

For example, all car manufacturers create a level-based system in their cars … the more luxury you want, the more you pay.

You can start with the basic models, then the next model up has electric windows and satnav, the next model up has heated seats, and so on.

The best thing about level-based pricing is that it rarely costs a lot of money to implement a level-based pricing scheme and the costs of running a level-based system to SME's is usually very low.

Consider adapting your products or services to suit the needs of particular customer groups. This might involve offering economy, standard and premium versions like they do on trains.

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This is what Walt Disney does at their theme parks with their "Fast Track" ticket where you can skip the queues and jump straight onto the rides. Most customers will not go for it but there will always be some who are prepared to pay a premium for it.

Such an approach (market segmentation) can build loyalty and see customers progress to higher price points as their circumstances and needs change.

Can you do something similar in your business?

A great way to add money to every order is to start quoting based on different levels of service, or different packages.

A classic case study for level-based pricing is air travel. The thinking goes that the top pricing bracket – First Class – exists primarily not to generate a profit, although undoubtedly some will go for the most expensive package, but to make the middle pricing bracket – Business Class – look more attractive by comparison.

For example, a first class return to Hong Kong on British Airways will set you back around £5,500 – a hefty sum no matter how you look at it.

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By comparison, a business class return is “only” about £3,000 – almost half the price. Never mind that an economy return is just £700 – just think of all the money you’d be ***saving*** by going business class!

The plane is travelling to Hong Kong anyway so they need to make as much money as they can whilst adding value to their services.

Or think about Apple's iPhone. They (currently) have 16 Gb, 32 Gb and 64Gb memories and you pay a substantial amount more for the largest memory size than you do for the smallest, despite the miniscule increase in production costs (if any.)

Almost every single business could and should introduce some sort of level-based pricing.

Level based pricing isn’t about playing mind games with your customers– it’s about offering the customer choices.

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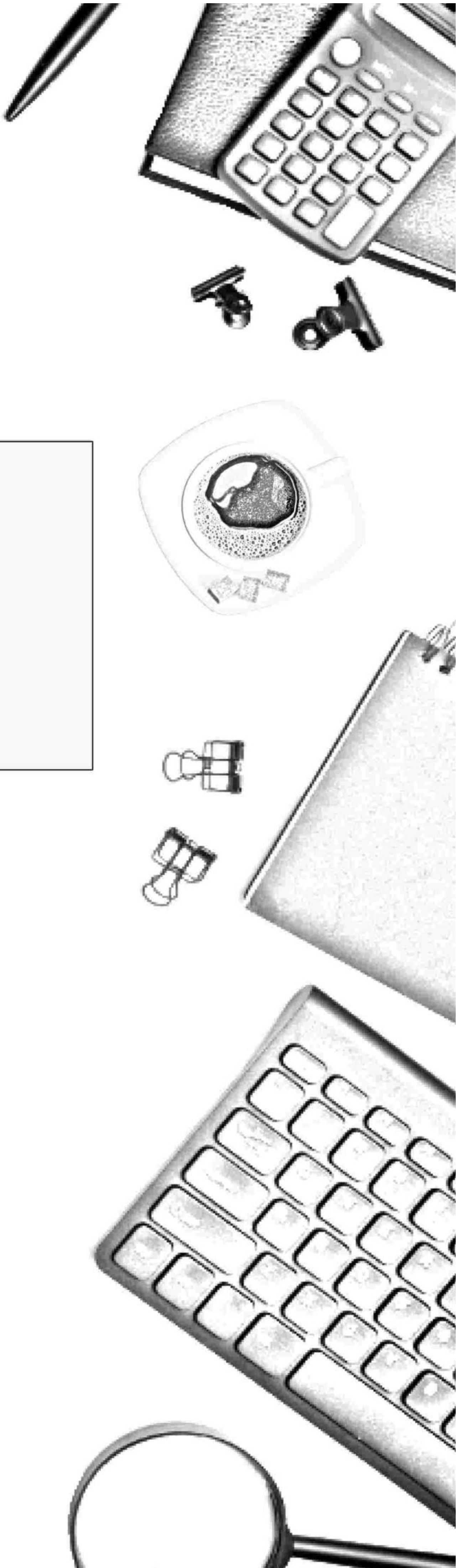
Section 2

Other Pricing Methods



"EASY" PRICING

An “easy” price, like £25, may sound more acceptable to the customers ears than £26.15.

ECONOMY PRICING

With economy pricing, the prices are low because a minimum amount is spent on marketing, promotion, quality of service, product quality, and so on.

PSYCHOLOGICAL PRICING

Psychological pricing is there to evoke an emotional response instead of a rational one. The company is forcing the customer to think a certain way about the price.

For instance, instead of putting the price as £100, the company will put it as £98.99, giving it the perception that the price is less than £100 whereas actually, the difference is too less to be considered.

Notes:

BUNDLING

Bundling is when the price is lowered when multiple products are bought at the same time as opposed to buying each item individually.

For example, pay for 10 coaching sessions upfront and pay less per session, or buy a sandwich, juice and crisps meal deal.

PRICING OPTIONAL PRODUCTS

This pricing strategy is when businesses keep the price of the main product low, but the price of extra products or services needed to use the main products are priced high.

This is done to attract the customers because of the low prices, but then eventually they end up paying more because the optional products are somewhat necessary to buy.

For example, an office laser printer may be priced cheaply, but the replacement toner cartridges charged at a higher price.

Notes:

PRICING FOR PROMOTIONS

Promotional pricing is very common these days, and almost every other business is using promotional pricing.

This includes giving discounts, free coupons, buy one get one free offers and gift vouchers. This is used to get rid of old stock, promote new products or just generally be ahead of the competition.

Even though it is an old strategy, it is highly effective at driving sales which is why it is still the most widely used strategy today, though it is difficult to offer consistent promotions without diminishing the value of your product in the consumers eyes.

PRICING AS PER GEOGRAPHIC LOCATIONS

Geography of an area greatly affects the availability of a product. For instance, fruits are not equally available all around the world and are therefore priced differently.

For example, where mangoes are not grown and imported, the price for them will be higher than other fruits.

Notes:

VALUE PRICING

Value pricing is when the price of a product is reduced because the business is under threat from external factors such as competition and recession.

A good example of this would-be fast-food chains like KFC and McDonald's, who have introduced their value meals because they are facing a lot of competition.

This is NOT to be confused with adding VALUE to your services.

PRICING OF PREMIUM PRODUCTS

Customized cars are priced higher because they are giving a lot of extra value to the customer. Luxury rooms in hotels are priced higher because of their premium nature.

A high price tag screams high quality, high status. Contrary to what business owners so often believe, a premium price may actually encourage people to buy from you and it will have the added bonus of screening out those who cannot afford your services too.

This can be applied to anything. I mean … which cake is the better quality? One costing £0.99p, or one costing £140.00?

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Which car is the better car ... one costing £900 or one costing £50,000?

LOSS LEADERS

The hardest part of selling is to attract new customers into switching from existing suppliers without a good reason.

Sugar and flour have long been used as staple commodities to lure customers into supermarkets, in the hope that, once there, they will make more purchases.

Used with care, loss leaders are a good way of getting noticed, particularly when targeting new customers.

SKIMMING

If you have a unique product or service, you can sell it at a high price. This is known as skimming - but you need to be sure that what you are selling is unique otherwise you may just price yourself out of the market if there is credible competition.

Notes:

PENETRATION PRICING

This is the opposite of skimming - starting at a low price and gaining market share before competitors catch up with you. Once you have a loyal customer base, you should be able to find ways to raise prices later.

PAYMENT STRUCTURE

There are many ways you can structure your pricing which not only makes it more appealing to potential customers, but also more profitable for your business.

Let's say you own a business designing websites for freelancers and small businesses. One pricing structure would be to charge £500 upfront for a website and two years' hosting. Or you could charge £30 per month over two years. This means less upfront costs for your customer and will actually generate more revenue: £720 as opposed to £500, though of course this increase will be eroded by inflation.

Subscription pricing is becoming more and more popular with the rise of online services. For customers, it means less immediate outlay, while businesses can benefit from regular, predictable income, and more "tie-in", meaning your customers remain engaged with your business for longer.

Notes:

The only disadvantage to subscription pricing is that it carries more risk than prepayment. If a customer goes out of business halfway through your contract you will lose that revenue.

LOCATION, LOCATION, LOCATION

Varying prices according to where your products are available is a tactic loved by supermarkets, and not without merit.

One reason given is that customers pay extra for the convenience and it’s a price many are prepared to pay.

Credibility-Building Price

Sometimes there are clients who you really want to work with, who are high-profile but have limited budgets e.g. in the non-profit sector.

You can decide to work for them for a lower or no fee, but negotiate with the client for you to receive increased visibility and promotional opportunities around the work you are doing for them, so it builds your credibility.

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For example, you could offer to paint the walls of your local hospice for cost price, on agreement you can become a “Friend of X Hospice” and you can put their logo on your marketing as a supporter.

The hospice could also put your details on their website as a supporter and you could also ask the hospice manager to give you an outstanding testimonial you can use in your marketing.

Alternatively, say you are an artist and you decorate a café for nominal costs, ensure you take every opportunity to take lots of photos, get testimonials, put the photos on your website, and so on.

You could also ask the café owner to put you in touch with their other café owner friends who would then pay full price for your services.

Extra Features Price

Have you got similar products or services at different price points within your range with extra features?

For example, a ring in gold or a ring in silver have different prices, a ring with diamonds in the same collection has a different price point again.

Notes:

All three rings may be very similar, but due to added features each get their own price point.

Fixed Project Budget

Often a project has a total given price, which is often divided in different stages with according fees i.e. 30% deposit upfront, 50% at the creative stage, 20% at the delivery stage.

A fixed price works well if you are efficient and experienced because you know how much time things really take by keeping clear time sheets over the years, you work with a more experienced client (so you won't be wasting too much time in meetings, discussions and revisions) and you work closely together at the beginning to scope the project into a clear design brief, and both adhere very strictly to deadlines.

If the above doesn't apply, then be careful and include at least 10% contingency in your budget.

Retainer

This is a recurring (monthly or quarterly) fee for a certain amount of often standardized work e.g. a graphic designer books a

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photographer for 2 days per month, every month of the year, to ensure a lower but reliable rate.

A retainer can be useful if you work with larger clients who give you regular work, so that you don't have to get confirmation of each small new project. It can also be useful for the reliability of work and income.

Beware: Retainers can be withdrawn at any time unless a clear contract is in place.

HOURLY RATE

Few prospects will ask you to do work based on hourly rate unless you can fix it in advance, since this is too risky for the prospect.

You may be able to give parameters of the work, say £500-£600, but even this may cause resentment if the actual job comes in at the upper end of the range (£600) even though the actual cost based on £ per hr may well be £700 or above.

From the prospects point of view, they may be annoyed you have charged them the maximum you have set.

Alternatively, you might settle on £40 an hour to clean a 4 bed house thinking it will take 3 hours. But how long will the job *actually* take to complete? What if you have to move furniture too;

Notes:

how much longer will that take? If you're a pro, you can probably estimate fairly accurately, but it could cause the buyer unexpected problems if it takes longer than expected.

REVENUE TARGETS AND PROFIT MARGINS

Two techniques for deciding how to price your services are setting *revenue targets* and *profit margins*. These methods start at the *end result* and work their way back.

With a revenue target, you decide how much you want your business to earn in a certain period. You can then determine how many jobs you need to do and at what cost, and price each individual product accordingly.

Deciding based on profit margin is similar but uses the product rather than the overall business. This is easier for many businesses.

Decide how much profit you'd like to make on each product and price accordingly. Make sure that you make some allowance for the other cost factors on your end such as labour costs, overhead costs and so on.

Notes:

FREEMIUMS

You have probably seen the freemium model at work on-line. This is when you buy some software on-line where you are offered a free version of a digital product and also a premium version that has more features.

You can also offer a free digital product which then advertises other premium products. Customers can get a taste of the value the product offers firsthand with the free version, leading them to purchase the "paid for" premium version.

This model can be used by most businesses if you get creative … for example a carpet cleaner could offer to clean a small area for free then, if they are happy, offer to clean the remaining area at full price.

DECOY

The decoy method offers a handful of similar services at different price points. One or two of the products or services are "decoys." You don't actually expect to sell them in high volumes, but their higher price offsets the lower price of your *target product*.

Notes:

It makes your target product appear cheaper than it really is to the customer when compared to the higher priced items.

This allows companies to sell their services at a perceived "lower price" without actually lowering the price.

I use this tactic a lot in my carpet business. I would take in a handful of carpet swatches to show the customer, but there was always one particular line which offered tremendous value for money for the customer, and great profits for me too.

The "middle of the road" (lower) priced carpet, which was great value to the customer but high profit margin for me, was made to look even better value because I bought in more expensive carpets for the customer to look at too.

In other words, the product I wanted the customer to buy was cheap relative to the more expensive products.

That said, YES! It was still the right carpet for the customer, so we are not doing anything underhand … we are just channeling the customers attention to a particular line which is right for her, and for us as a business too.

Notes:

ANCHORING

Anchoring means setting a price as a benchmark which then re-sets the customer's perception of its value and appropriate price. The customer sees this "anchor" price first, and it sets their expectations.

An example of anchoring is Starbucks charging £3 for a cup of coffee. If customers are used to the anchor price of £3, a coffee shop can position itself as the anti-Starbucks (a local place, etc.) and charge £2 per cup. Or, a coffee shop can stress its higher-quality beans and charge £3.50 per cup.

Anchoring is just about one product in comparison to another.

HOW WOULD YOU LIKE TO PAY?

Sometimes, the method of payment is as critical as being competitively priced. Offering agreed time periods in which to settle a balance is one way to incentivize purchases, particularly on higher-cost items.

Allowing payments to be made online, by card, by telephone and on-line banking are standard options every business should offer.

Notes:

Section 3

Common Pricing Pitfalls

Common problems with pricing can include:

SIMPLICITY

Complicated price-points and over-wrought conditional discounts lead to customer confusion, anger and loss of business.

If a prospect can't understand your pricing or feel they have been misled they will mostly likely walk away quickly, fearing a scam.

VAT

Many business-to-business (B2B) services state their prices exclusive of VAT, assuming their customers will be VAT registered.

With VAT currently at 20%, the increased cost can be a bitter pill to swallow for businesses which are not VAT registered.

Make sure you state clearly if your prices are inclusive or exclusive of VAT. The best way to do this is to split out the basic price and the additional VAT, to make the cost crystal clear for all involved.

Notes:

BASKET SHOCK

Adding extra charges at the last stage of purchase is a particularly rotten tactic, used commonly in the travel industry.

State the total price of your product or service at all times throughout the buying process, or risk losing the trust of your customers.

ADVERTISE MONTHLY, CHARGE ANNUALLY.

If your promotional material states a certain monthly charge, make sure you bill monthly. £10 per month is a fairly incidental cost, but if your customer then finds out they will be billed £120 upfront, they may feel misled.

Notes: