Is the price right?

Getting the price right can be a complicated matter. Too low and you may be swept off your feet with demand; too high and you might not sell anything. But there is also a “dead zone” in the middle, says Jon Manning of pricing consultancy Sans Prix.

“You can be too cheap for the quality conscious and too expensive for the value conscious. One of the big consulting companies estimated that 80 to 90 per cent of all new products are incorrectly priced. But if you spend a bit of time exploring your prices are chances are you can make a more informed decision.”

So how do you find the right price? Most SMEs base prices on costs and their competition, or in the case of some professional services, by sticking close to a price determined by the market. Whatever way a business sets its prices, it needs information and some kind of strategy. Research need not be complicated or expensive. Cheap and simple methods include checking the prices of competitors in person or through the Internet, or asking people who come into your store what they think of your prices.

Your image is relevant too. Some business may set high prices for branding reasons, whereas others may set prices low to achieve volume.

“You’ve got to align your price with your positioning in the market,” Jon says. “So if you price yourself high but it’s a poor quality product you may actually be offering a rip-off product or a false economy product. If you are competing at the bottom end of the market where you are nice and cheap, those customers will go to you one day for price and then they’ll go to someone else if they’ve got a better price. So there’s probably an argument that there’s more loyalty at the premium end of the market than there is at the cheap no-frills end.”

Goldilocks pricing

If you have a line of similar products then remember that they may be competing with each other. An example is a small, medium or large coffee at a cafe. Raising the price of one size of coffee could shift sales to another. You can maximise your profitability by not necessarily pricing according to the difference in size.

“For example, if you have a 100, 150 and 200mL cup of coffee and your margin is better on the middle product, you can set the prices at $1, $2.50 and $3 instead of $1, $2 and $3.”

Keep in mind that people tend to avoid extremes and so will tend to favour the middle option rather than the large or small.

Knowing your customers

The big opportunities for maximising revenue are in aligning price with value, Jon says. If a customer perceives a product to be worth more than you are charging for it, then the opportunity is there to raise prices.
Customers may have a less clear view of what the price of a service should be. This can be to the advantage of service-based companies.

“They are non-tangible and non-standard, they don’t roll off a production line at 125mL or 50 grams,” Jon says.

This can make it difficult for customers to compare the price of one business’s service to that of another. Rather than just deciding that you are over-priced based on a competitor’s price, a customer may instead base their perception of your value on their experience of your service. So the fact that you have friendly staff or immediate availability may give your service greater value in their eyes.

“People are also less sensitive to changes in quantity than they are changes in price,” Jon says. “So if you increase the price of a chocolate bar from $1.20 to $1.30 people will notice that. But if you drop the weight down from 60 grams to 55 grams and hold the price they are less responsive to that change in size.”

But different customers have different values, and this is where market segmentation comes in. The simplest way for small businesses to segment their market, Jon suggests, is to ask six questions:

- Who is making the purchase?
- Where does the customer purchase?
- What does the customer purchase?
- When does the customer purchase?
- Why does the customer purchase?
- How does the customer purchase?

Customers with similar answers to the five questions form a market segment and can be a target for specific products, services and prices.

Clever business people will also adopt a long-term strategy to pricing. This means not just considering your next price change, but how your competitors will respond, and how you will change prices after that.

“It may be a sale at June or Christmas or it may be a whole new pricing paradigm for the business, but in either case you need to be aware of what your next move is going to be.”

Changing prices

There are good ways and bad ways to increase or decrease your prices, or to change your pricing methodology. Some strategies Jon suggests include:

- Increase prices and increase value – offer your customers something extra when you next increase your prices, such as more generous terms and conditions or enhanced after-sales service.

- Conversely, if you need to reduce prices, reduce the value attached to the product as well. For example, restricting free deliveries to a smaller distance.

- Condition your customers for a price increase, for example with advance notice of a forthcoming price rise, complimented by holding a sale at “never to be repeated prices”.

- If you are changing your pricing methodology, show your customer how, based on their recent purchase history, they will be affected by the change. If necessary, guarantee that they will pay no more than under the current pricing methodology for a transitional period.

- Finally, if you are introducing new products or services, do so at the top of your product range, rather than at the bottom. Not only will the revenue outcome be more positive, but the customers price perception of your business will be higher than it would be had you introduced a product at the bottom of the product line.