PRICING 101 FOR SMALL BUSINESSES

BY JON MANNING

> Many home and small businesses evolve from their owner's love and passion for what they do best. Their ventures may be driven by aspirations such as commercialising and profiting from a long-pursued hobby, to going freelance with the years of knowledge and experience gained while working for someone else.

Along the way, these business owners will expand their business acumen by engaging the professional skills of others (such as accountants and tax advisors), or they will acquire the necessary knowledge and skills themselves, by attending short courses and the like.

One of the hardest areas to acquire self-help or the help of others is with the pricing of a small or home business's products and services. Pricing is the most powerful component of the marketing mix, and can have a far greater impact on an organisations bottom line than any improvement in sales volumes, variable or fixed costs. Business owners neglect it at their peril, and unfortunately, many organisations do mismanage their pricing.

Perhaps one of the most powerful examples of the power of pricing is provided by the financial results of Continental Airlines in 2001. During that year, Continental carried 44 million passengers at an average ticket price of $US193 and the company made a loss. They would have made a profit had they achieved an average ticket price of $US195, a difference of just $US2, or a mere 1.04%.

There are two major areas where the pricing of products and services of a small or home-based business differ from that of a large corporation, such as Continental Airlines. The first revolves around the resources that go into managing the pricing process: large organisations can devote significantly more resources, be they human or technological, to pricing management. However, the second difference favours smaller organisations: there are fewer stakeholders in the pricing management and decision making process. SMEs and micro-businesses don't have to take a diplomatic approach to pricing, trying to appease departments such as Marketing, Finance, Legal, IT and Operations.

So how can small business owners get smarter about their pricing?

SETTING PRICES

There are a wide variety of pricing methodologies and pricing units. Pricing methodologies may include cost-plus pricing, market or competitive-driven pricing, non-linear or two-part pricing (commonly used by gas, electricity and telephone companies) and dynamic pricing (such as auctions), to name a few. Pricing units may include a price per hour or per day (eg for consultants), per page pricing (website design), per word pricing (freelance journalism) and so on.

How does one choose between all of these alternative methodologies and pricing units and set the right price? Unfortunately, there is no pricing laboratory: the real world is the only place you can test prices. There is however, one golden rule: understand the value your customer places on your product. If your customer gets more value from your product than what they pay for it, you are under-pricing and leaving money on the table. If you over-price your product relative to the value the customer places on it, the sale is unlikely to materialise. The objective of pricing is to match the price the customer is willing to pay with the value they obtain from your product or service, a paradigm increasingly being referred to as 'value-based pricing'.

PRICE CHANGES

There are good ways and bad ways to increase or decrease your prices, or to change your pricing methodology or pricing unit. Here are some suggested strategies:

- 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 of the product as well. Try to restrict free deliveries to a smaller radius (eg 100kms rather than 150kms);
- Condition your customers for a price increase, for example, with advance notice of forthcoming price rise, complimented by holding a sale at "never to be repeated prices";
- If you are changing your pricing methodology or pricing unit, 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 and unit 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, the customers 'reference price' or their price perception of your business will be higher than it would be had you introduced a product at the bottom of the product line.

OFFER SOLUTIONS, NOT BUNDLES

Several small and home-based businesses have found the quickest and most effective path to revenue improvement is to offer solutions, rather than bundles. Bundles are products that are offered together, at a price less than the sum of its parts, which generally leave customers with unsatisfied needs. Solutions on the other hand, exceed all the customers' needs and expectations. From a pricing perspective, solutions command a premium, while bundles must be accompanied by a discount, as the case study below illustrates.

MEDIACO CASE STUDY

MediaCo is a family-run micro-business, specialising in public relations management, freelance journalism (news and feature articles), website and e-newsletter creation and management, website usability analysis and educational materials.

Recently, the company needed to urgently submit a proposal to a repeat customer for a forthcoming marketing and publicity campaign, a customer they were sure was rather price inelastic and wouldn't be too receptive to higher prices.

MediaCo chose to offer their client several packages of services. The most expensive was priced at twice the anticipated price of the contract and offered the client a total solution for their requirements. Other packages were less comprehensive and cheaper for the client, while one piece of work MediaCo was not keen to perform was priced as an expensive, stand-alone piece of work.

What package did MediaCo's client choose? The client did not accept the high price for the stand-alone piece of work, an outcome the pricing of that piece of work sought to achieve. The client did however accept the most expensive package offered by MediaCo, thus doubling the revenue the company earned from this client (compared to the year prior), without a doubling of the volume of work.

CHEAP MARKET RESEARCH

Market research need not be expensive: every small and home-based business owner can and should do it. Ask your customers where else they shop for like or identical products or services. If you know your competition well, their answers will tell you whether your prices are too high or too low. Alternatively, ask your customers if they have seen the same or similar products at a different price, and if so where? You can also try playing 'The Price is Right' with your customers. Show them your products or describe your services and ask them to guess the price. You may find they put a higher value on your product than that quoted or shown on the price tag.

SEGMENT YOUR MARKET

By aligning the price of your product or service to the value your customer attaches to it, and undertaking some of the rudimentary market research suggested above, you might discover that different customers attach a different value to your product.

This provides an excellent opportunity to segment your market or customers, as one price does not always fit all. A market segment is a grouping of customers that share similar characteristics, such as the type of products and features they desire and the price they are willing to pay.

The simplest way for a small or home-based business to segment their market is by answering the following questions about their customer base, known as the '5 W's and a How':

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 like or similar answers to the '5 W's and a How' form a market segment, and should be targeted with unique products, features and prices. Airlines have been segmenting their market for over 30 years now, with business and leisure fares, as have fast moving consumer good companies (with different package sizes) and fast food restaurants.

DON'T BE AFRAID OF THE BIG GUYS

Don't panic if a large American fast-food chain sets up shop down the road from your own pizza bar or hamburger grill. Small and home-based businesses can compete against the big guys by shifting the battleground away from price. You should find that you can respond to non-price attributes of your product or service far quicker than any large competitor can.

Utilise your cheap market research to identify where and how market conditions and consumer tastes are changing, or where new niche markets may be developing. Small companies can respond to such changes far quicker than larger companies: you will be carrying far less inventory than the larger competition, and you should be able to change orders with suppliers with far greater flexibility.

THE POWER OF PRICING

Pricing is too important a function to be left to chance. It is however the most powerful tool in the hands of any large or small business owner. Small investments in pricing can yield big dividends. MediaCo, the media company in the case study above, achieved a 100% revenue uplift from one customer after spending just four hours reviewing their pricing. They continue to go from strength to strength as they apply their new found pricing power to customers, old and new. [WFH]

Jon Manning
Sans Prix Pty Ltd
jon@sansprix.com.au
www.sansprix.com.au