BUILDING A HIGH-PROFIT BUSINESS MODEL

Executive Overview for:

The Philosophy Behind How You Should Price Your Products and Services

"Pricing policies and practices depend heavily on whether your product or service is a commodity oriented offering with a price marker that clearly exposes the price range within a product category or if your company offers a custom, proprietary or uniquely differentiated product where the customers assign value on it based on what their level of need (pain) is for solving a problem. The pricing policies are very different for these two very different categories of solution offerings. We will look at the difference between commodity pricing and proprietary product pricing.

What I have observed over many years is that a "cost up" approach to pricing is used for both. The client goes into great detail in "knowing their costs" but spends very little time understanding the "level of value" a customer will pay for a unique solution that solves a problem and relieves pain. A healthy price is the single, most effective way of increasing profit. A well thought through pricing strategy that pushes the envelope in maximizing revenue, while sometimes a little scary, is the key to good profit margins. Pricing increases provide a one-for-one ratio with profitability.

The summary comment is to do everything possible to move your product or service from commodity to proprietary through product performance outcomes and service differentiation. After that, always cost your products accurately ***but*** *price your product based on an accurate assessment of what the market will bear to solve a particular problem and relieve pain.*

The customer will never tell you that you are low based on the price/value relationship. You have to push the envelope to determine where a competitive or alternate product can provide the customer with a better value proposition…take as much time in understanding the price/value relationship your product or service provides a customer as you do understanding your costs." - YourBoard.US

1. The core philosophies around how to best price your product to achieve superior profits.

The Pricing of Your Product

Pricing philosophies can vary significantly. The more a product offering tends toward a commodity, the more there is, generally a "price marker" that becomes the benchmark. A gallon of gas, 2 x 4's, a pound of hamburger, usually have prices that are well known. People can move from one location to another to get a better price and the products themselves are all thought to be comparable in quality and identical in performance. People may pay a little but not much more for better service.

The further you move away from "commodity products," the more opportunity you have to value and price your products with no "price markers."

There are some companies with pricing philosophies that, even when dealing in very unique, proprietary, non-commodity products develop the cost of their product and then mark it up based on what is thought to be a fair and competitive price. The problem is that what is thought to be fair varies to a large degree with the buyer's needs and requirements. With proprietary (engineered type products) each client's buying and specifying influencers may have a different idea of value based on their specific need for a solution.

How many times have you seen something that you would love to buy? Subconsciously you have assigned a "mental price range" that you would pay for this item. Generally, if it is on the high side of your mental price range, or a little higher you will still consider buying it. On the other hand, I would guess, on many occasions you would have paid more then what you were told the price is. It really all depends on the intensity of your personal need or desire for the item.

I have always felt you should price on the high end of the legitimate range and then be creative in ways to move the price down that range once you determine what the customers "real need and desire" is and the competitive alternatives available. You can always come down in price but can never go up.

A very important philosophy to follow is: Develop your true cost, and then price your product/service in the marketplace depending on the value that is placed on it. Again, cost your product or service based on the realities of cost; but price it on where the market places the value, not on a standard mark-up.

Proprietary (engineered or highly differentiated products) can in many cases be negotiated. There may be no List Prices. Everything is custom and priced accordingly. Part of pricing a custom product or service is knowing how much the market will bear or how much value a particular customer "pain" will place on it.

Customizing the scope of the product or service and knowing roughly how much value is perceived by the potential buyer will allow your margins to rise quickly. This is especially true in custom services, engineered products, software and consulting services. Remember, every extra dollar you get in price drops to the bottom line.

Just as an example: If you were going to price your product or service at $100.00, and you added 5% to the price, it could roughly double your profit. Never give up an opportunity to add one, or $100 or $1,000 more dollars on a non-commodity product or scope of work. You won't believe how much incremental profit you can drop to the bottom line.

Summary on Pricing

I worked with a company that provided consulting services around a proprietary software. They would work up the cost for the hours for Engineering, Travel, Installation and Training and then add profit at a standard percent. I suggested they add 10% more than their traditional mark-up. At first they hesitated, but then they did it and did not get any push back. They couldn't believe they had been giving up an additional 10% profit. They never lost a piece of business based on price. They had to negotiate a few times but never lost any business and improved their profit significantly.

The simple philosophy is to know your costs and then price your product or service solution based on what the market will bear or, in other words, based on the value your customers will place on your solution. Don't try to guess what that value is but instead find out what it is when you get to high and have to walk some of it back.

With commodity-oriented products where there are known "price markers" there is only a slight premium you might be able to generate due to service or location. This is never at the beginning of the relationship with a customer but only after they have become accustomed to your "highly differentiated" quality and service. Commodity prices are somewhat set within a narrow range. Your profit improvement must come through direct cost and overhead expense reduction. New technologies, new processes, outsourcing supply chain etc., are things that must be looked at to improve the cost structure in order to improve the profit structure on commodity products. The market price on commodities is generally set by the market within a tight pricing range.

The reason we always harp on product and service differentiation is because the further you can move your product or service solution away from a commodity product mentality toward a differentiated proprietary mentality, either through product performance outcomes or service uniqueness, the better chance you have of increasing the price and making it stick.

Differentiation = increased pricing opportunities = increased profits.