MODULE 3 – PRICING FOR PRODUCTS

FOR A PRODUCT-BASED BUSINESS, SELECTING THE RIGHT PRICING STRATEGY IS CRUCIAL FOR ACHIEVING BUSINESS GOALS AND SATISFYING CUSTOMERS. HERE ARE SOME COMMON PRICING STRATEGIES:

Cost-Plus Pricing:

Description: This strategy involves adding a fixed percentage markup to the cost of producing a product.

Advantages: Simple to implement, ensures all costs are covered and a profit margin is achieved.

Example: If a product costs $50 to produce, a 20% markup would set the selling price at $60.

Value-Based Pricing:

Description: Pricing is based on the perceived value to the customer rather than the cost of production.

Advantages: Can lead to higher profit margins if the product is highly valued by customers.

Example: A luxury watch might cost $500 to make, but if customers perceive it as worth $5,000, it can be priced accordingly.

Competitive Pricing:

Description: Setting prices based on competitors' pricing for similar products.

Advantages: Helps maintain competitiveness in the market, simple to execute.

Example: If competitors sell a gadget for $200, a business might price their similar gadget at $190 to attract cost-sensitive customers.

Penetration Pricing:

Description: Initially setting a low price to enter a competitive market and attract customers quickly.

Advantages: Can rapidly increase market share and customer base.

Example: A new streaming service might offer a subscription at half the price of established services to attract subscribers.

Skimming Pricing:

Description: Setting a high price initially and then gradually lowering it over time.

Advantages: Maximises profits from early adopters willing to pay more.

Example: New tech gadgets often start at a high price, which is reduced as newer models are released.

Psychological Pricing:

Description: Setting prices that have a psychological impact, such as $9.99 instead of $10.

Advantages: Can make products appear cheaper and increase sales volume.

Example: A product priced at $99.99 is often perceived as significantly cheaper than $100.

Premium Pricing:

Description: Setting prices higher than the market average to create a perception of superior quality.

Advantages: Attracts customers looking for luxury and exclusivity, higher profit margins.

Example: High-end fashion brands often use premium pricing to signify exclusivity.

Economy Pricing:

Description: Keeping prices low by minimising costs to attract price-sensitive customers.

Advantages: Appeals to cost-conscious consumers and can lead to high sales volume.

Example: Generic or store-brand products in supermarkets.

Bundle Pricing:

Description: Selling multiple products together at a lower price than if purchased separately.

Advantages: Increases sales volume, moves inventory, enhances perceived value.

Example: Tech companies often bundle hardware and software together.

Freemium Pricing:

Description: Offering a basic product for free while charging for premium features.

Advantages: Attracts a large user base potential to upsell premium features.

Example: Many software companies offer basic versions for free and charge for advanced features.

Geographic Pricing:

Description: Adjusting prices based on the geographic location of the buyer.

Advantages: Accounts for differences in market conditions, costs and willingness to pay.

Example: A product might be priced higher in affluent areas and lower in less affluent ones.

Dynamic Pricing:

Description: Continuously adjusting prices based on market demand and supply conditions.

Advantages: Maximises revenue by aligning prices with market conditions in real time.

Example: Airlines and hotels often use dynamic pricing, adjusting rates based on demand and availability.

By carefully selecting and combining these strategies, a product-based business can optimise its pricing to meet business objectives, compete effectively and satisfy its target market.

PRICING FOR SERVICES

SERVICE-BASED BUSINESSES HAVE DISTINCT PRICING STRATEGIES TAILORED TO THE NATURE OF INTANGIBLE OFFERINGS. HERE ARE SOME COMMON PRICING STRATEGIES FOR SERVICE-BASED BUSINESSES:

Hourly Rate Pricing:

Description: Charging customers based on the number of hours worked.

Advantages: Simple to track and bill, aligns costs with the time invested.

Example: : Consultants, lawyers, and freelancers often charge an hourly rate for their services.

Flat Rate Pricing:

Description: Charging a fixed price for a specific service regardless of the time taken.

Advantages: Predictable for clients, simplifies billing.

Example: Web designers might charge a flat fee for creating a website.

Project-Based Pricing:

Description: Setting a price for an entire project based on its scope and complexity.

Advantages: Provides clarity and budget certainty for clients, allows for comprehensive project planning.

Example: Marketing agencies often charge per campaign or project.

Retainer Pricing:

Description: Clients pay a set fee regularly (e.g., monthly) for ongoing services or availability.

Advantages: Ensures steady cash flow, fosters long-term client relationships.

Example: Legal firms or IT support companies often use retainer models.

Value-Based Pricing:

Description: Pricing based on the perceived value of the service to the client rather than the cost to deliver it.

Advantages: Can lead to higher profitability if clients perceive high value.

Example: A branding consultant may charge more if their service significantly enhances a client's market position.

Tiered Pricing:

Description: Offering different levels of service packages at varying price points.

Advantages: Appeals to a broader range of clients with different needs and budgets.

Example: Software as a Service (SaaS) companies often provide basic, premium and enterprise plans.

Subscription Pricing:

Description: Charging a recurring fee for continuous access to a service.

Advantages: Predictable revenue, encourages customer loyalty.

Example: Streaming services, gym memberships and online education platforms often use subscription models.

Performance-Based Pricing:

Description: Fees are contingent upon the results or outcomes of the service.

Advantages: Aligns the interests of the service provider and client, can justify higher fees for successful outcomes.

Example: Marketing agencies might charge based on lead generation or sales increases.

Bundled Pricing:

Description: Combining multiple services and offering them at a single price, usually lower than the sum of individual prices.

Advantages: Enhances perceived value, encourages clients to purchase more services.

Example: An IT company might bundle network setup, securityand maintenance services.

Dynamic Pricing:

Description: Adjusting prices based on demand, competition, or client's willingness to pay.

Advantages: Maximises revenue, adaptable to market conditions.

Example: Consultants might charge higher rates during peak seasons or for urgent projects.

OVERCOMING THE FEAR OF INCREASING PRICES

To determine how many customers you can afford to lose if you double your prices, you can use a simple formula. This formula will help you calculate the breakeven point, where your revenue remains the same despite the loss of some customers due to the price increase.

New Customer Count = Old Revenue

New Revenue per Customer

This can be rearranged to find the maximum percentage of customers you can afford to lose:

Maximum Percentage of Customers to Lose = 1 – Old Price New Price

New Revenue per Customer New Customer Count = New Revenue per Customer Old Revenue

This can be rearranged to find the maximum percentage of customers you can afford to lose:

Maximum Percentage of Customers to Lose= 1 – Old Price New Price
Maximum Percentage of Customers to Lose= 1 – New Price Old Price

STEP-BY-STEP EXAMPLE CALCULATION:

Current Revenue:

Assume you currently have 100 customers.

Each customer pays $50.

Current revenue = 100 customers * $50 = $5,000

New Price:

New price = $50 * 2 = $100

Revenue After Price Increase:

We need to determine how many customers we can afford to lose and still make $5,000

New Customer Count Calculation:

Let xX be the new number of customers

Revenue equation: 100x=5000100x=5000

Solving for xX: □=5000100=50x=1005000=50 customers

Maximum Percentage of Customers to Lose:

Initial customer count = 100

New customer count = 50

Number of customers lost = 100 - 50 = 50

Percentage of customers lost = 50100×100=50%10050×100=50%

Summary

If you double your prices from $50 to $100, you can afford to lose up to 50% of your customers and still maintain the same revenue level of $5,000

Verification:

Original revenue: 100 customers * $50 = $5,000

New revenue with price increase: 50 customers * $100 = $5,000

Conclusion

You can afford to lose up to 50% of your customers if you double your prices and still maintain the same revenue. This calculation ensures that you are aware of the breakeven point, where your revenue remains constant despite changes in the customer base.

THE IMPACTS OF DISCOUNTING IN YOUR BUSINESS

Discounting, while often used to attract customers and boost sales, can have several negative impacts on a business:

Erosion of Profit Margins:

Discounts directly reduce the amount of profit made per sale. This can significantly impact overall profitability, especially if not offset by a substantial increase in sales volume.

Perception of Value:

Frequent discounting can lead customers to perceive the product or service as lower quality or less valuable. This can damage the brand's long-term reputation.

Customer Expectations:

Regular discounts can create an expectation among customers to wait for sales rather than purchasing at full price, which can lead to irregular sales patterns and cash flow issues

Erosion of Profit Margins:

Discounts directly reduce the amount of profit made per sale. This can significantly impact overall profitability, especially if not offset by a substantial increase in sales volume.

Competitive Pressure:

Continuous discounting can spark price wars with competitors, further eroding profit margins across the market.

Impact on Loyal Customers

Existing loyal customers might feel undervalued if they see new customers getting better deals, leading to decreased loyalty and potential churn.

Example: Impact of a 2-for-1 Special

Let's use a simple example to demonstrate the impact of a "2 for 1" special offer on the number of sales needed to maintain the same revenue.

Initial Conditions:

- Original Price per Unit: $50
- Cost per Unit: $30
- Initial Sales Volume: 100 units
- Original Revenue: $50 * 100 = $5,000
- Original Profit: ($50 - $30) * 100 = $2,000

Discount Offer: 2-for-1 Special

Customers pay $50 and receive 2 units.

Effective Price per Unit During Promotion: $50 / 2 = $

Profit per Unit During Promotion: $25 - $30 = -$5 (a loss per unit)

Calculating Required Sales Volume to Maintain Revenue:

Let's find out how many units need to be sold under the 2-for-1 special to match the original revenue of $5,000.

Revenue Needed: $5,000

Revenue per Sale During Promotion: $25 per unit

To find the number of units needed to match the original revenue:

New Sales Volume = Original Revenue Effective Price per Unit New Sales Volume = Effective Price per Unit Original Revenue

New Sales Volume = 500025 = 200 Units New Sales Volume = 255000 = 200 Units

Since each sale involves 2 units (because of the 2-for-1 deal):

New Customer Count=2002=100 customers New Customer Count=2200=100 customers

Calculating Required Sales Volume to Maintain Profit:

However, the promotion results in a loss per unit, so let's calculate the number of units required to maintain the original profit of $2,000.

Profit Needed: $2,000

Loss per Unit During Promotion: -$5

To find the number of units needed to offset the loss and achieve the original profit:

New Sales Volume to Cover Losses=Original Profit Loss per Unit
New Sales Volume to Cover Losses=Loss per Unit Original Profit

New Sales Volume to Cover Losses=2000-5=-400 units New Sales Volume to Cover Losses=-52000 =-400 units

Since the result is negative, it indicates that achieving the original profit is not feasible with the 2-for-1 deal, as every unit sold results in a loss. The business would need to increase the sale price or find cost savings to achieve the desired profit.

Summary

Offering a 2-for-1 special can significantly impact a business's revenue and profitability. To maintain the same revenue, you would need to sell twice as many units. However, since this particular discount results in a loss per unit, maintaining profitability is even more challenging, highlighting the potential downsides of such discounting strategies.

NOTES SECTION