

Setting the Right Price

The words “price” and “right” might make you think about the game show “The Price is Right.” However as a business owner, you know, or soon will figure out, that pricing is not a game.

“The landscape of closed businesses are littered with businesses that failed to get their pricing strategy right,” says Glenn Muske, the North Dakota State University Extension Service’s rural and agribusiness enterprise development specialist. “Some owners realized their mistake but did not correct quickly enough or sufficiently. Others just did not pick up on the signs that they were headed for trouble.”

Business owners often realize they have pricing issues at one of two times. The first is when the checkbook is empty. The second is during tax time and they have nothing set aside to pay the tax bill for the year.

“For some businesses, pricing issues do not show up quickly if they are using other sources of income, such as their family, to bolster the firm’s coffers,” says (Insert name and title) of (Insert county). “Typically, business owners in this situation think that the business will turn a profit in time.”

Often, business owners do little planning to set the best price point, or one that gets the maximum return, for the business. A good pricing strategy requires thoughtful consideration. Some questions you need to answer are:

- Who are the clients you want to attract?
- What is the image you want to display?
- Who are your competitors and how will they respond to various price points you might set?
- Are you dealing with a commodity good or a premium good?
- Can you distinguish yourself from the competition?

In answering these questions, you should keep in mind four primary pricing strategies that business owners often use:

- The first strategy is called “lowest price.” The advantage to this method is it is clear to the customer. However, the disadvantages are pretty substantial. First and foremost, customers in most cases are driven by factors other than price. Price may get someone in the door one time, but without a clear benefit, people probably will go back to business owners with whom they have a longstanding relationship. People switch for better products, services or customer service, not cost.
- The second strategy is pricing based on costs-plus. This involves calculating the cost to make your product, then adding a flat amount or a percentage for overhead and profit. This should avoid the problem of underpricing so that you run out of cash. But it doesn’t take the competition into account. It also does not take into account that you may have a premium product, offer an experience or provide another value-added element for which people will pay.

- A third method, related to the cost-plus method, is using standard industry markups. Industry markups should help ensure you make a profit, but they don't look at how competitive you might be. Related to this strategy is using a return-on-investment approach. Some of the same negatives mentioned before also would apply here because it ignores the competition. You want a return that covers not only your labor but your intellectual capital and the risk you are taking, and provides some level of a return on your investment.
- The last approach is value-based pricing. It basically is a combination of the other methods, along with an understanding of where your product sits, in the customer's eyes, in terms of a scale from being a commodity to being top of the line. The approach is meant to maximize your return.

Maximizing your return may mean your pricing is not the highest or the lowest. It is that which adds the most to your bottom line in the long term. The biggest difficulty is understanding what your advantage is and having the ability to maintain it.

“Pricing is part science and part art,” Muske says. “Getting it right is hard, but getting it wrong means a waste of your time and money, and perhaps the end of your opportunity.”

For more help with finding your price points, check with your local Extension Service office at [insert phone number and email address]. Also visit NDSU's small-business support website at www.ag.ndsu.edu/smallbusiness and sign up for the monthly newsletter. Or check out Facebook at www.facebook.com/NDSUextsmallbiz or Twitter at @gmuske.

Other resources include powerofbusiness.net and www.eXtension.org/entrepreneurship. The Small Business Administration and its related organizations, such as the Small Business Development Centers and SCORE, also can be valuable resources.

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