Consider Value, Costs When Pricing Products and Services

Many business owners struggle with determining how much to charge for their products and services.

“Business owners often feel guilty pricing at a level where they can cover the costs of production, including labor, as well as make a profit on the transaction,” says <u>(insert local name, title and county office)</u>. “So often, people discount the time involved or simply do not calculate all of the costs involved.”

The idea of capturing all of the costs involved is one aspect of pricing. It forms the bottom line:If you cannot make a profit in the long term, you maybe want to do something else.

“Yet pricing is more than just a bookkeeping task,” says Glenn Muske, rural and agribusiness enterprise development specialist for the North Dakota State University Extension Service. “There is also an art to pricing. If your price is based on costs alone, you are not recognizing the customer’s perception of value.”

Customers buy products and services for the benefit they offer. If that benefit is higher than what you charge, they buy and feel they got a good deal. If the two are equal, they may buy and feel the transaction was a fair exchange. If your price exceeds the perceived value, you won’t get customers.

Thus,highlighting the benefits of a product or service to increase the perceived value is vital. The better the owner is at promoting those benefits, the greater the potential profits for the business.

“Another method of pricing that owners often use is to base the price on what the marketplace charges,” says (insert last name). “However, the owner is not capitalizing on the perceived value by differentiating the product or service. Pricing based on what the marketplace charges may lead to lower profits or even a loss on every item sold if basic costs of production have not been considered.”

Another pricing tip is to segment the market when possible. Then price according to the different values that each customer group attributes to an item.

A related issue is when each item in a product line offers the same profit margin. Again, think of the value an item has to the customer. It rarely will be the same across your entire product line. In this case, you optimize profit when the price reflects the customer’s associated value and willingness to pay.

For example, you are selling jelly in 4-ounce and 16-ounce jars, Do you simply put a 25 percent profit markup on each one, or should you have a higher markup on the smaller jar? Why would you do the latter? Perhaps you are selling to the tourist trade and your customers would like to try four or five types of jelly instead of buying one larger jar. Remember, how you price an item should be based on its value.

One final reminder about pricing: Once you set a price, it should not remain unchanged for long periods of time. Costs change daily, and so does the value attached to a product. Good customer service will increase value. Also, gradual price increases are better because larger changes are more noticeable and tend to cause a drop in your customer base.

“Pricing is as much an art as a science,” Muske says. “You need to keep in touch with your market and the underlying costs of your product or service.”

For help in pricing your product and services, contact your local Extension Service office, go to NDSU’s Small Business Support website at www.ag.ndsu.edu/smallbusiness or visit the national eXtension website for entrepreneurs at www.extension.org/entrepreneurship.