PRICING STRATEGY WORKSHEET

SMART SALES KIT

Purpose

The purpose of this tool is to help you understand the considerations for establishing a price for a product. The determination of product pricing is the responsibility of the Product Manager, but many departments in a firm will want to influence this process, particularly Sales and Finance.

Pricing is a numerical form of product positioning. The way a product's price is set determines:

- **Who will buy your product?**
- **Which competitors you will encounter**
- **How, or if, negotiations will occur**
- **How customers will perceive your product's capabilities and quality**

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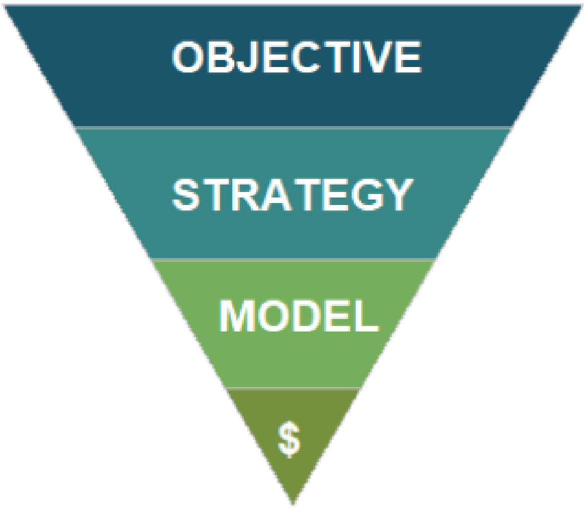
The Pricing Pyramid

One process to follow when setting a price is to use the Pricing Pyramid, depicted below:



Here is a brief explanation of the layers in the pricing pyramid:

- **Pricing Objective:** The philosophy under which you define a strategy, build a pricing model and set prices.
- **Pricing Strategy:** Influenced by your pricing objective, the plan for determining the optimal pricing model and price.
- **Pricing Model:** The implementation of your pricing strategy.
- **Price:** The amount paid by a buyer to purchase your product.

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Setting a Pricing Objective

The top of the pricing pyramid begins with setting an objective that defines what your pricing will accomplish. Many possible objectives exist, and some are on conflict with each other. Here are some common pricing objectives:

- **Maximize profitability**
- **Maximize revenue**
- **Maximize market share**
- **Reinforce brand perception**
- **Stabilize the market**
- **Achieve Return-on-investment**
- **Become the price leader**
- **Create product interest**
- **Discourage entry of new competitors into your market**

Ideally, choose one primary pricing objective.

Choosing a Pricing Strategy

The next level of the pricing pyramid is to define a strategy for achieving your pricing objective. While there are many strategies for pricing products, some common approaches are discussed below.

- **Cost Plus:** Setting price based on your understanding of measurable costs, plus percentage uplift.

- **Competition-based:** Setting price based on what your competitors are charging.

- **Value-based:** Setting price in relation to the value your product delivers.

Of these three approaches, value-based pricing is usually held in the highest esteem, but quantifying value is sometimes difficult and it requires constant monitoring. An advantage of this approach is it creates beneficial pressure to keep the product's value proposition high.

Another pricing strategy is to set price based using a Price and Quality/Differentiation matrix:

		Quality/Differentiation	
		Low	High
Price	Low	**Economy**	**Penetration**
	High	**Skimming**	**Premium**

Here is detail for each of the boxes referenced in the matrix above:

- **Economy:** Low frills pricing enabled by keeping marketing and production costs to a bare minimum. Economy pricing is appropriate when a product is a "Cash Cow" and marketing for the product category done by competitors provides adequate awareness.

- **Penetration:** Initially setting prices artificially low to gain market share, then increasing price once share targets are achieved. Penetration pricing is appropriate when the threat of competition is imminent and the opportunity to lower production costs comes as a result of volume sales. This strategy's appeal increases as the market potential grows.

- **Skimming:** Setting a high price initially because of a market of product advantage while recognizing that the advantage is not sustainable. As competitors respond and supply of competing alternatives increases, prices must come down to remain competitive. Skimming is appropriate for pulling profits from market segments that are not sensitive to price.

- **Premium:** Setting prices high because of significant product differentiation or brand perception. Premium pricing is appropriate when substantial and sustainable competitive advantages exist.

Selecting a Pricing Model

With a pricing objective set and strategy chosen, you will now select a system for pricing your product or product family. As you do so, consider how any of the following criteria should factor into your pricing model decision:

- **Market Maturity:** Immature markets allow for greater pricing flexibility because no other company or product has set the pricing bar. As markets mature, pricing pressure is created and a loss of pricing flexibility occurs.

- **Product Category:** Highly innovative, breakthrough products have fewer pricing barriers than incremental products which have a pricing history in past versions or releases.

- **Demand:** One of the most obvious and simple influencers on pricing to understand. High demand allows for higher pricing, and conversely, lower demand pushes prices down.

- **Value:** The perception of benefit above the cost of the product. In other words, price is what the buyer pays, but value is what the buyer receives. Value is subjective and influenced by image, word-of-mouth, etc. Providing superior value allows for setting higher prices and it is an excellent defense against commoditization, but difficult to measure.

- **Competition:** Establishes an upper-limit on price. You should always anticipate how competitors will respond to your pricing actions, and likewise have a response planned to their pricing actions. The more highly differentiated your product is, the greater pricing latitude you will have.

- **Quality/perception of quality:** Higher prices tend to signal higher quality, making buyers less price sensitive. When quality cues are absent, sellers can use price to signal quality, but over time, the market identifies the true quality leaders and will pay more for their products.

- **Differentiation:** Perhaps the most important criterion in this list. Highly differentiated products are less price sensitive and enjoy some degree of protection against commoditization.

- **Brand premium:** Your brand is your Trustmark and buyers will connect at an emotional level with brands they have come to trust – this is known as brand equity. If you have a lot of brand equity, you can charge premium prices for the products you sell under your brand. Like reputations, it takes time and hard work to develop great brands. Guard your brand, for just one integrity failure can bankrupt it.

Some common pricing models are:

- **Per unit**
- **Per user**
- **Per usage**
- **Per unit of infrastructure**
- **Subscription**

Pricing Your Product

The final step in this pricing process is to set the price for your product. Test your pricing against real sales scenarios. Recognize that it is difficult to optimize pricing for all market segments. Attempt to find the pricing equilibrium that won't cause you to leave money on the table for pricing too low, but also not lose deals because the pricing is too high.

Compare your pricing to the competition to ensure it accounts for positioning and functional differences. Help your sales team understand these differences and how they factor into your pricing.

Finally, it is critically important that the market "gets" your pricing. Make sure it is easy to explain and understand.