PRODUCT AND PRICING

Right Product, Right Price, Right On!

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The absolute fundamental aim is to make money out of satisfying customers.

—Sir John Egan

What's This Session All About?

In Session 7, you learned about researching and analyzing your market. You started by understanding what it is you sell (i.e., features and benefits). Next, you determined who your customers are. After that, you analyzed your competition's strengths and weaknesses, and compared them to your own. And last, you took a first look at the market potential for your product, and estimated what part of that market you might realistically capture.

Now, it's time to develop specific marketing strategies to help you meet your goals!

In this session, we'll look at the following topics:

Overview of marketing strategies. Sound marketing strategies are the key to business success. The marketing mix consists of the Four Ps: Product, Price, Placement and Promotion. These are the basic elements around which marketing strategies are built. This session discusses product and pricing. The next session will discuss placement and promotion.

Product strategies. It takes skill to present your products in a way that will make customers buy from you, rather than from your competitors. What products should you sell? How should you position them compared to competing brands? How should you package them? What sort of brand identity do you want? These are the sorts of questions this section will help you to answer.

Pricing strategies. Your products must be priced high enough to make a profit, but low enough to attract customers and build sales. All the information you gathered about your customers and competition will be very useful as we discuss pricing strategies.

Key Idea:

Marketing is everything you do to bring your products and your customers together.

Overview of Marketing Strategies

A **marketing strategy** is your plan for achieving your goals and objectives. It broadly describes how you plan to increase sales of your product.

A **tactic** is a specific action you take to support your strategy. You can look at the strategy as the "thinking" part of achieving your goals, and the tactic as the "doing" part. Thus, the marketing strategies and tactics you'll develop in your marketing plan will accomplish some of the goals you outlined in earlier sessions.

The example below will help you understand how goals, strategies, and tactics fit together.

Your marketing strategies will guide the elements of your **marketing mix: Product, Price, Placement,** and **Promotion.** If you research and analyze each of the Four Ps for your market, it will lay the groundwork for your marketing strategies and tactics.

Each of these elements will be discussed in detail in this session and in Session 9. First, let's take another look at two very important elements of marketing strategy: market segmentation, and target markets.

Green Thumb Plant Care

Goal	Strategies	Tactics (Action Plan)
To manage the weekly plant care for 20 offices by the end of the year	1) Become the premier plant care provider, by offering the following services: • Purchasing and delivering plants • Locating plants in the ideal place for plant health and office beautification • Watering, refreshing, repotting, and removal of plants	1a) Draw floor plan for each office 1b) Understand natural and artificial light and traffic patterns 1c) Develop plant location plan/review with office manager 1d) Plan weekly for plant purchases and delivery, and coordinate with office manager 1e) Schedule plant care (four offices per day) 1f) Touch base with office manager during each weekly visit to ensure great customer service
	2) Offer personalized customer service	2a) Conduct monthly meetings with office manager 2b) Remove dead and wilting plants and replace with plants that will grow and thrive 2c) Stick to an action plan to ensure customer satisfaction

In the last session, you defined market segments when you identified groups of customers with similar demographics and psychographics. The purpose of segmenting the market is to identify the customer group that's most likely to buy from you. That customer group is your target market. You may have more than one target market, and each may require different marketing strategies.

While developing your marketing strategies, think hard about the target markets you're trying to reach. You might be targeting several customer groups at one time. But microbusinesses usually find it much easier and more profitable to pick a primary target at first, and then expand from there.

How do you know if your target market's worthwhile? Here are some questions you can ask:

- Does it have clearly defined characteristics?
- Are there unmet or under-met needs your product will fill?
- Is it large enough to generate the level of profit you need?
- Does it have growth potential?

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I was working hard, but people acted like I was begging or something.

People felt like they could just hire me whenever they felt like it. That doesn't work for me. I'm like anyone else. I need to know what day I'm supposed to work, and what day you're going to pay me. I don't want to go door to door, not knowing whether I'm going to be working that day or not.

For them, it's no big deal. They can have me clean the office today, or let it go for another week. But for me, it's a very big deal. It's the difference between paying the rent on time, or getting into trouble with my landlord.

That's why I decided I'd had enough. I want to work according to a schedule. I'll come on this day, you pay me on that day, and we do it like that every week, or every couple of weeks. I want some stability in my life, like I used to have.

For eleven years, John Mette worked at a paper mill in Brewer, Maine, right on the Penobscot River. When it closed down, John made ends meet by cleaning offices across the river, in downtown Bangor. There were nine offices that hired him…but only when they felt like it.

This was hard on John, because he couldn't count on getting his money when he needed it. If the people he worked for were in a bad mood, or busy, they'd often tell him to come back the following week. Sometimes, if the person he usually dealt with were away, the person who'd been left in charge would refuse to let John clean. Other times, he'd be allowed to clean, and then told that he couldn't get paid until the person in charge got back.

John was flexible. After all, he didn't really have a choice about it. Unfortunately, the people John owed money to—like the phone company and the electric company and the landlord—weren't very flexible at all!

John wanted to have a formal deal with the businesses he worked for, so that he'd know exactly how much money he'd make each month, and exactly when the money would come in. He wanted to clean once a week, and get paid when he was done. And he wanted to be factored in to the operations of each business, so that when the owners were away, everyone would understand that John would be cleaning on the usual day and would have to be paid.

He knew that he did a careful, thorough job, and he knew that this made him valuable. He was sure that if he explained this to the firms whose offices he cleaned, they'd see it his way.

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Product Strategies

A product is something that's sold in order to satisfy customer needs. A product can be a service, too. Services deliver benefits like time savings, convenience, expertise, labor, or comfort. A product can even be a combination of a tangible item and the services that go along with it.

The first thing a business must decide is what products to offer. For the entrepreneur, this idea usually comes from a hobby, an area of expertise, or professional experience. The best product ideas are usually those that meet existing or new customer needs in innovative ways, improve upon an existing product, or improve its packaging or promotion.

This is an important point to remember. A great business idea doesn't have to be something that no one's ever done before. Some of the greatest innovations are those that leapfrog off of an existing idea.

For proof, look at Netflix. It's in the DVD rental business, which has been around for years. There's a wide variety of companies in this business, from the small neighborhood video shops to the giant Blockbuster chain. Netflix's innovation was in its delivery system: Why not save consumers time, by letting them rent and return DVDs through the mail? This slight improvement to an existing concept has created a wave of change in the movie rental business.

Don't intimidate yourself by thinking you have to create revolutionary new ideas. Research what has been done elsewhere, and figure out how to do it a little better, a little cheaper, or a little faster!

Your Product Line

A **product line** is a group of products or services offered by a single company. For example, a landscaping business might offer lawn mowing, weed pulling, planting, trimming, and tree cutting. All of these services make up the company's line of services.

A beauty shop's line might be haircuts, perms, nail manicures, and pedicures. A jeweler's might be bracelets, rings, necklaces, and pendants.

All businesses must decide how many products to offer, whether to add new products, how to position the entire product line, and so forth. They must also make sure that sure their lines make sense together. Would it be appropriate for a fine jewelry store to sell comic books? Probably not!

The **depth** and **width** of your product line is another important decision. When a bakery decides to offer different flavors and types of doughnuts (chocolate, glazed, powdered sugar), it's expanding the depth of its product line.

If that bakery branches out to other items (breads, cakes, and coffee), it's expanding the width of its product line.

As a microbusiness, it's very important that your product line be practical and manageable. Adding new products can be risky for a new business. That's why it is very important to revisit your goals before making product strategy decisions.

The example on the next page illustrates some product strategies and tactics for Green Thumb Plant Care. You'll see that after developing a marketing plan, they decided to extend their product line to include more than care of office plants.

Product Positioning

After you identify your ideal market segments, you must decide how to position your product within each of those segments. This means deciding how to portray your business to customers within those segments.

Your market research from the last session can really help you. Look back at your ***Competitive Analysis Worksheet*** in Session 7, and start thinking about where you want to position your products compared to those of your competition. Do you want to be of better quality? Higher priced? Lower priced? Do you want your product to look different? To have a different guarantee? Are you the market leader, or follower?

No matter what your positioning goal is, you must first understand your product, and then know how your competition positions theirs. Positioning may also be influenced by some of your other marketing decisions, like packaging and pricing.

To guide your efforts, you should write a **positioning statement** for every market segment in which you intend to compete. A positioning statement is a couple of sentences that explain exactly what you offer that your competitors don't. It tells people who you are, and why you will meet your customers' needs better than anyone else.

Of course, you can't write this until you know what your customers' needs are, and how your competitors are meeting them. Your market research collected raw information about who your customers are, where they live, how much they spend, and why they buy. Now, condense this information into short, clear statements that clearly describes, in as much detail as possible, your customers and their needs.

Once you've identified your customers' needs, you need to identify the most compelling reason for customers to do business with you, and turn it into a positioning statement so that it can guide your marketing and branding activities.

As you create your positioning statement, ask yourself if your product:

- Offers a benefit to your target audience that really matters
- Delivers a real benefit
- Truly separates you from your competitors
- Is unique and difficult to copy

Don't settle on the first or even the second positioning statement you come up with. Keep working at it until you're completely satisfied. Excellent positioning doesn't come easily. It demands that you look at a lot of information and think clearly. The better you understand your market and your customers, the closer you'll come to the perfect positioning statement.

Green Thumb Plant Care

Goal	Strategies	Tactics (Action Plan)
To increase profit 10% per year.	1) Offer a service that sells, delivers and creatively places profitable plant accessories	1a) Develop a partnership with key supplier of decorative plant pots/vases 2b) Obtain catalogues and pictures of plant accessories to show office manager 3c) Sell new pots and accessories for new plants when plant service begins for new client 4d) Show new pots and recommendations to office manager at quarterly meetings
	2) Offer profitable fresh-cut flowers and centerpieces for special occasions	2a) Develop a partnership with reliable and creative florist 2b) Obtain pictures of floral arrangements for special occasions (holidays, birthdays, congratulations, etc.) 2c) Remind office manager of up-coming special occasions at quarterly meetings and plan for delivery/placement of flower arrangements/center pieces 2d) Coordinate pricing/delivery with florist partner

Packaging

Packaging helps to communicate your product's image. It also serves the basic function of protecting products, and providing information about use, ingredients, quantity, and so forth.

Clever packaging design can also increase sales. By changing your packaging, you can reposition your product in the minds of customers, hit new customer segments, and find new opportunities.

Packaging changes can also free your business from regulatory oversight, reduce shipping costs, earn goodwill, and increase your access to overseas markets. Make your packaging decisions carefully!

If you sell a product, what kind of image do you want the packaging to communicate? Will your chocolate chip cookies be sold in plain plastic bags, or will you have professionally produced wrappers? Attractive packaging can often spell the difference between making or losing a sale. What kind of packaging will your target customer expect? What kind of packaging will help your product sell to target customers?

Services can also be packaged. A bookkeeping service, for example, might consider the importance of professionally produced business cards, letterhead, invoices, and brochures. Don't overlook the importance of presenting your service business professionally. As discussed earlier, marketing is everything you do to bring customers and your products together. Sometimes, the little things make a big difference!

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I didn't know a lot about contracts and things like that. I needed some help with that, so I could make sense when I talked to people. I felt like what I wanted was fair, but I had to explain it in a way where they'd agree.

A guy I knew from the mill said he'd gotten help from SCORE. He put me in touch with a counselor named Andy, who taught me a lot. There were two big questions: What do I offer people, and how much is it worth? Lots of people can clean an office, so why would they want me instead of someone else?

All I could really come up with is that I do a good job. I'm really cleaning, not just pushing the dirt around from one place to another.

That was a start, but we needed more. Andy brought in a professor to talk to me, who volunteers to help out small businesses with advice. He said I needed to do something different, and that I definitely needed to get contracts for my work.

Ted Falconi was a professor at Husson College, who specialized in small-business management. He told John that there were no "green" janitorial services in Bangor, and that this could be a good way to stand out from the crowd. He explained that federal and state offices had been switching over to GS-37 certification, which requires the use of environmentally safe cleaning products, and that larger companies were following suit.

He told John about studies that showed how these products had resulted in less absenteeism and unhappiness among workers, who often complained about the use of strong-smelling cleaners like ammonia and bleach. That meant that John could position himself not just as a janitor, but also as someone who could increase employee morale and productivity.

John would be offering a service that people didn't know much about, so he'd have to be prepared to explain why it was worthwhile. The first thing people were likely to say was that it would be too expensive. Professor Falconi had a chart showing that the cost was actually the same for most products.

There was more to it than using different chemicals, though. John could also change the way he did things. Instead of sweeping floors, he could damp-mop them. He could dust surfaces with a wet cloth, too. Studies had shown that these methods reduced the levels of germs and dust that make workers feel sick. He could also use a vacuum with a dust-trapping filter. By positioning himself as someone who was maintaining a healthy work environment, John could charge more than an ordinary janitor. Better yet, he could make the case that maintaining indoor air quality would require him to come in once a week!

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Service Enhancements

Service is one of the least expensive and best ways for small businesses to compete with larger businesses, because small businesses enjoy much closer customer contact than larger competitors. Customers would rather be treated like a valued friend than a number, and most are willing to pay a little extra for the pleasure!

Even manufacturers of the simplest, lowest priced goods can find ways to make their offerings more appealing with good customer service.

Branding Your Product

A **brand** is a name or symbol—or some combination of the two—that represents a product. Evian water, the Saturn car, the Bic pen, and STP motor oil are familiar examples of brands.

Your **brand identity** is how you choose to present your product to the world. It includes its benefits, its packaging, its advertising, and the services delivered along with it.

You can also look at brand identity as a promise. When customers see your name or logo, it promises them certain things. Each time you deliver on that promise, your brand is strengthened. Any time you break the promise, your brand is weakened.

It's not necessary to spent millions of dollars to establish a brand identity. And the best branding strategy in the world can't make up for a shoddy product, poor customer service, or a dishonest brand identity. A firm with a strong sense of what it stands for, that consistently meets or exceeds the promises it makes, will naturally develop a good brand image.

Brand image

Brand image refers to the associations that your brand evokes in consumers' minds. Remember: Consumers don't just buy products; they buy a concept of what the product will do for them.

You can look at it this way: brand identity is how you want to be seen, while brand image is how you *are* seen. However and wherever your company interacts with customers—and this includes advertising and word of mouth—*that* is where your brand image is established.

Branding strategy

Branding means telling the "story" of your business and your product in a compelling and colorful way—one that will give people reasons to buy your product instead of someone else's.

In a sense, branding is like running a radio station. If you think of yourself as a radio transmitter, and your customers as receivers, then branding is a lot like getting your signal through loud and clear, without any static.

Some small businesses make the mistake of thinking they don't need to have a branding strategy. The fact is, your business will naturally generate a brand image, whether you want it to or not! We don't believe that something so important should be left to chance…or worse still, to your competitors!

Creating your brand

A good way to begin creating a brand is to figure out what's at the core of your business. One possibility is to come up with a list of the words that come to mind when you think about your business, or your product.

Try to come up with ten such words of the top of your head. Then, try to narrow them down to one or two words that mean the most to you.

Simple service enhancements:

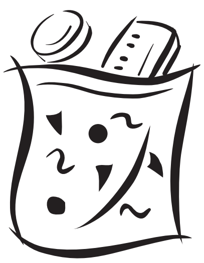
- Know your customers by name!
- Offer free or low-cost delivery (if you can afford it).
- Create a frequent customer reward program for your good customers who buy often (buy 5 and number 6 is free).
- Make sure your business hours are convenient for your customer, not just for you!
- Offer excellent product knowledge, free demonstrations, and free or low-cost installation.

If this doesn't work for you, try something else. Think of colors, textures…anything that strikes a chord with you. What matters is that you pinpoint your strongest emotions about what makes your product special. Once you've done this, you have something you can try to express to other people.

At the same time, you have to know what your customers want. Your brand identity has to be one that your target customers value, so a big part of building a brand is understanding where customers' desires and your abilities meet. It's not enough to make a promise; the customer has to value it, and you have to be capable of keeping it!

Consider these questions:

- What makes people buy your type of product? Is it a luxury or a necessity?
- What motivates your target customers? Are they looking for security? Are they worried about money? Are they pressed for time?
- What features do they value? Does your product's price, quality, freshness, flexibility, or ease of use attract them?



Choosing a brand name

The first step in establishing a brand is choosing a name for your company and product. What makes a good name?

- It should be eligible for trademark protection
- It should suggest product benefits (e.g., Mr. Clean, Whole Foods, or Beautyrest mattresses)
- It should fit the brand identity: Nissan Pathfinder (adventure), Round Table Pizza (cozy food for friends and families), Ding Dongs (snack food for kids)
- It should be easy to pronounce, recognize, and remember

Choosing a logo

Your logo is the graphic symbol of your brand. You can choose a logo that reflects or depicts your product, but you don't have to! Many firms use abstract logos, and let their reputation assign a meaning to it.

That said, the logo must fit your type of business. For example, a childcare center would probably choose pastel or primary colors, and use building blocks, teddy bears, or children in its logo. If they used bleak colors, and images like skulls or beer mugs, they'd be sending the wrong message to their customers!

It's a good idea to get lots of feedback on your logo before you do anything with it. Get as many opinions as possible, and take them seriously.

Here are some characteristics of a good logo:

- Simple and instantly recognizable
- Reproduces well in black and white, or in a smaller size
- Looks equally good on business cards, packaging, mailing labels, t-shirts, billboards, and faxes
- Includes your company name

Working with logo designers can be expensive and complicated. Fortunately, you can now get low-cost, professional-quality logo design online by visiting **LogoYes** (http://logoyes.com/).

In just a few minutes, you can build your own logo out of millions of possible design combinations. If you'd prefer to have your logo created by professionals, LogoYes has a design team that will create up to six logos for you to choose from, for a low fixed price. The offer includes two or three revisions, depending on how many logo options you request.

Their site has a 60-second demo that explains how do-it-yourself design works, as well as a portfolio of logos they've created.

Building your brand

Once you've thought about what your brand's promise is, and why your customers will value it, it's time to write your **branding statement**. For a small ice-cream maker, this might be: "Sarah's Ice Cream is about being happy, healthy, and free-spirited."

Once you've come up with a branding statement, make sure that this statement guides everything you do, so that your brand identity is clear and consistent.

Brand Management Tips

- Make sure your brand is promising something customers want.
- Keep it simple! Focus on communicating a few simple points.
- Remember that every interaction with a customer or client is an opportunity to communicate your brand identity.
- Involve your employees. Get them excited about your brand, and they'll communicate that excitement to others.
- Whatever your brand promises, exceed it!

Pricing Strategies

It used to be that price was the most important part of the marketing mix for many businesses. But today, competing on the basis of price is no longer the best option for small businesses. Globalized competition and the growth of "big box" stores like Wal-Mart have lowered prices for many goods to a point where most small businesses are simply unable to compete.

Fortunately, you have many other competitive advantages! Unique goods, high quality, and excellent customer service can make your business stand out in a crowd, and make price less of an issue for your customers.

Remember: Your goal is not to set a price that will make consumers want to buy, but to make a product that consumers will want to pay for!

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When Professor Falconi said people don't like to smell ammonia at work, that made sense to me. I didn't like the smell any better that they did! And when I thought about it, it seemed like that was the part of the job where I was always in a hurry to get done. If I wasn't dealing with those fumes, I could take a longer time and do an even better job. So that sounded good so far.

But it would take some work, so Andy and me came up with an action plan. I had to make a list of what products I used, and then find out what I could use instead. I had to describe everything I did to clean an office, and figure out how to do it better. I'd use the best method for each room…one thing might be good for the hallway, but not so good for the boss's office.

But the main thing was that I had to be a salesman. I had to tell the people how I was going to solve problems that they didn't know they had, and make them see that my price was fair.

Before he could figure out how much to charge for his cleaning service, John needed to know how much it would cost him to provide it. After he made a list of every product he used, Andy told him to go to Greenseal.org, where he found a list of GS-37 cleaners and janitorial products. From there, he was able to research prices and availability.

On a tip from Professor Falconi, he also looked at how much of each product he needed to use. For instance, if it took two ounces of ammonia to clean a bathroom, compared to four ounces of a citrus-based cleaner, then John would only get half as much use out of a bottle of the citrus-based cleaner.

Also, some green disinfectants took longer to work. John would have to think about how this would affect his overall cleaning time. Would he have to slow down, or could he

Things to keep in mind when considering your pricing strategy:

1. Pricing is an art, not a science.
2. The customer is the center of your business.
3. You operate in a competitive marketplace.
4. Your prices reflect your position in the marketplace.
5. Price is only one of the factors consumers use to evaluate products or services.
6. The biggest mistake you can make is to assume that the lower your price is, the better business will be.

simply switch over to another job until the disinfectant had done its job? In the end, John decided that he could damp-wipe office surfaces while waiting for the disinfectant to work.

For the most part, John found that the new cleaning products would cost about the same as the old ones. Some were a little more, but others were a lot less. His biggest expense would be a vacuum with a dust filter. A 10-gallon wet/dry vacuum with a top-rated HEPA dust filter was about $800. That was a lot of money, but it was also a central part of his new brand identity. It was the most obvious thing he could point to when trying to sell his service to business owners.

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Basic Pricing Concepts

Let's start by defining our basic terms.

- **Value** is what your customer believes the product is worth.
- **Price** is the amount you charge customers for the product.
- **Cost** is what you spend to produce your product.
- **Profit** is what's left over after you subtract costs from price

Note that price falls in between cost and value. That's as it should be, because pricing strategy means finding the point between cost and value that will enable you to meet your goals.

In pricing, cost is often called the "floor." You can't go below it, or you'll be charging less than your product costs you to deliver!

That makes value the "ceiling." It's the maximum amount your customers will pay, based on what they think your product is worth. Note that the highest price for a product in your market may not be the ceiling price! Your costs should be as low as your brand identity and business ethics permit, and your value should be as high as possible.

You can also look at price in terms of **sales units**. In a bookstore, a sales unit would be one book or one magazine. In a service business, a sales unit might be the amount that you charge per hour for gardening or carpentry.

Or it might be a flat rate for a specific job. For instance, if you charge $50 to clean a four-bedroom house, you'll be paid that amount no matter how long it takes you to do the work. If you're a fast worker, this will be very much to your benefit. If you're a slow worker, your hourly rate will go down. Either way, though, your price needs to earn you a profit, which means it needs to be higher than your cost.

Demand

Demand refers to the amount of your product that customers are willing and able to buy at a specific price. For instance, a customer who has $10 to spend might be willing to buy two pillows if your price is $5 per pillow, but only one if your price is $7 per pillow. Being able to afford the product is an essential part of demand; just wanting the product doesn't count!

Of course, many factors affect demand, including personal income, and the cost and availability of competing brands (direct competition) and substitute products (indirect competition). These factors vary from segment to segment. But as a general rule, higher prices lead to less demand, while lower prices lead to more demand.

Pricing Objectives

Setting your price begins with considering your pricing objectives. These objectives depend on a variety of factors, including your production costs, your competitive environment, and so forth.

Here are the most common pricing objectives:

- **Maximizing profits**. This objective leads you to pursue high short-term profits. It may result in lower long-term profits, and it may also attract competition.
- **Maximizing sales volume**. This objective may lead you to give up a certain level of short-term profits in order to attract customers, gain market share, or meet sales targets.
- **Return on investment**. This objective requires you to set prices that will allow you to reach a targeted return on investment.
- **Meeting or beating the competition**. This objective requires you to set a price that matches or undercuts those of existing competitors, or discourages new ones from entering the market.
- **Quality leadership**. Price often implies quality, so a premium price may support your business's brand image as the quality leader in a given market.

The Four Cs of Pricing

The marketing approach to pricing is based on the Four Cs:

- **Customers**. Knowing your target customers' income levels, lifestyles, and values is central to setting a realistic price.
- **Competition**. In the last session, you identified your direct and indirect competition. You determined how their prices, features, and benefits compare to yours. Also, you evaluated their strengths and weaknesses. You should take all these things into account when setting your price.
- **Company position**. Earlier, we talked about the positioning of your company relative to your competition. If you provide better service and higher quality than competitors, that means you offer greater value. This will appeal to people who place a higher value on service and quality. These customers are usually willing to pay a higher price.
- **Costs**. To set a price that will earn a profit, you must know your total variable and fixed costs. While you might occasionally sell below cost to clear an inventory surplus, you can't make a habit of it. Remember, you can't make a living selling at cost!

Calculating Your Costs

Before you make any decisions about what to charge your customers, you need to know what it costs to produce and deliver your product.

Basic cost concepts

Fixed costs stay the same no matter how many units are produced. For instance, the cost of a commercial oven remains the same no matter how many cookies you bake over the lifetime of the oven.

Variable costs change with the amount of products you produce. For instance, the amount you spend on sugar and flour increases with the number of cookies you make. That means these ingredients are a variable cost of making cookies.

Total costs are the sum of total fixed costs and total variable costs.

Break-even analysis

Break-even analysis pinpoints the level at which total revenue equals total cost. As the volume of units sold increases beyond this **break-even point**, a business begins to earn profits.

To identify your break-even point, you must first calculate your costs and your revenue.

Here are the basics of price calculations:

Total revenue = Price x Quantity

Total cost = Total fixed costs + Average variable cost per unit x Quantity

Understanding the terms:

FIXED COSTS

Also referred to as **Fixed Expenses**
or **Operating Costs**
or **Overhead**

Definition: Costs incurred regardless of sales

The break-even point occurs when:

Price x Quantity = Total fixed costs + (Average variable costs x Quantity)

Looking at the same equation a different way, the quantity needed to break even is:

$$\frac{\text{Total fixed costs}}{\text{(Price - Average variable costs)}}$$

The number that remains when you subtract Average variable costs from Price is called the **contribution margin**. So another way to look at this equation would be:

$$\frac{\text{Total fixed costs}}{\text{Contribution margin}}$$

What does all this mean in the real world? Well, let's assume you sell t-shirts, and that you charge customers $10 per shirt.

Your per-unit variable cost is $5.50, so you subtract that amount from the $10 price, and you end up with a contribution margin of $4.50 (Price - Average variable costs = contribution margin).

How many t-shirts must you sell to break even, supposing you have monthly operating costs (fixed costs) of $1,350? To find out, divide the total fixed costs by the contribution margin.

Again, the formula looks like this:

$$\frac{\text{Operating Costs}}{\text{Contribution Margin}}$$

So in this example, it would be:

$$\frac{\$1{,}350}{\$4.50}$$

$1,350 divided by $4.50 is 300, so you'd have to sell 300 shirts this month to break even.

Remember, the break-even point doesn't include any profit. Selling 300 shirts will only cover your fixed and variable costs. You'd have to sell more to earn a profit. After you reach your break-even point of 300 units, every unit you sell results in a profit of $4.50. (Remember: $4.50 is your contribution margin. It's the amount of money left after paying variable costs of $5.50 per unit, which still have to be paid for every unit sold.)

Let's return to the example, and find out what would happen if you lowered the price of your shirts to $9.00. First, determine the contribution margin:

$9.00 (price) - $5.50 (variable costs)
= $3.50 (contribution margin).

Next, determine how many units you must sell to break even:

$$\frac{\$1{,}350 \text{ (fixed costs)}}{\$3.50 \text{ (contribution margin)}}$$

$$= 386$$

Now, you must sell 386 units at $9 each, just to break even! Can you sell an additional 86 units at the lower price? Remember, a lower price usually means a higher demand!

Of course, you can also raise the price. How many units must you sell to break even if your shirts are $11 each?

$11 (price) - $5.50 (variable costs)
= $5.50 (contribution margin).

$$\frac{\$1{,}350 \text{ (fixed costs)}}{\$5.50 \text{ (contribution margin)}}$$

$$= 245$$

So at a higher price, breaking even takes fewer sales. But again, you run the risk of lowering demand when you raise your price.

There's another way to look at this issue. Perhaps you can reduce your costs to lower your break-even point. Can you think of ways to lower costs in the t-shirt example? How about less expensive shirt material, fewer ink colors, or lower labor costs? All of these are possibilities, but you need to take

What if You Aren't Breaking Even?

- Lower costs
- Raise prices
- Sell more

your brand identity into account when deciding. For instance, if one of your selling points is that you offer high-quality shirts, then using cheaper material could be a problem.

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It wasn't easy. I had to look up all the details, all the costs. I had to think about the time I spent cleaning, and how many times you can mop with one cleaner, compared to another. I never knew how much went into cleaning an office. Looking up one thing made me think of another, and I started to think I had the most complicated job in the world!

There was another big headache, too. Before, I could go and buy a big bottle of ammonia from any store in town. Now, I had to find these other cleaners. Some of them you could get in town, but only at one place. That meant I had to think ahead, or else buy a lot all at once.

And some cleaners you couldn't get anywhere, so I had to decide if it would work to get them in the mail. How reliable are the companies? And how much is it to mail a big bottle of cleaner? For some products, the mail could add a lot to the price.

Those were the kind of things I had to think about, and they were all new to me. I never had to think so hard about the stuff I used to use!

When John was done adding up his costs, he decided he'd need a loan of $1,800. That would cover the vacuum, promotions, and a few cases of green cleaning supplies. The next step was to do some market research, and find out how many businesses would be willing to pay for his service.

Andy and Professor Falconi had both said that once John switched over, he could charge a little more than he used to. After all, the most likely people to sign a contract with him were those who were interested in a healthier workplace, and John's service would have a high perceived value for them. Between that, the new vacuum, and the extra time involved in maintaining indoor air quality, Andy thought that John could add about 10% to his price.

But when John started researching what other green cleaning services were charging, he found that companies in Boston, Philadelphia, New York, and San Francisco were charging—on average—16% more for their services. And unlike John, they had direct competition!

John saw no reason why he couldn't charge the same amount…or even round it up to 20%, since he had no competition. Everything he read in the newspapers and on the Internet said that environmental services were booming, and he was lucky enough to be ahead of the curve in his own town. Why should he settle for just getting by, when he had a chance to earn some real money?

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Planning for Profit

So far, we've been talking about pricing from the standpoint of meeting costs. But in the long run, you'll want to do more than just cover your expenses. You'll also want to make a profit. You can do this by setting a specific profit goal, and then figuring out the price and units of sales it will take to meet that goal. You could also estimate, or forecast, a sales volume goal and then calculate the profits. This type of goal-setting is exactly what you need to think about as you move into the financial sections of your business planning process. A sales forecast is a vital planning tool, and a central element of your business plan.

Profit goals

Returning to our t-shirt example, let's say that in addition to covering your fixed costs of $1,350, you want to make a profit of $900. You know that at $10 per shirt, the first 300 items you sell will go toward covering fixed costs. How many more must you sell to get your $900 profit? (Remember the contribution margin: For each item sold at $10.00, $4.50 contributes to operating costs, and eventually to profits.)

You can calculate this the same way you calculated the break-even point:

$$\frac{\$1{,}350 \text{ (fixed costs)}}{\$4.50 \text{ (contribution margin)}} = 300$$

But this time, you substitute profits for fixed costs:

$$\frac{\$900 \text{ (profits)}}{\$4.50 \text{ (contribution margin)}} = 200$$

Thus, you must sell an additional 200 items to make your $900 in profit. This means you have to sell a total of 500 items to cover your costs ***and*** provide your profit goal.

Volume goals

The second way to plan for profits is to forecast an attainable sales-volume goal.

Getting back to our t-shirt business, let's say that selling 500 shirts is a little too ambitious at this stage in your business. Perhaps your market research has shown that a sales volume of 400 is more reasonable for a business the size of yours. What effect will this have on your profits?

At a sales volume of 400, you'd calculate profits like this:

Profit = (Sales Volume x Contribution Margin) - Operating Costs

- or -

Profit = (400 t-shirts x $4.50) - $1,350.00

- or -

Profit = $1,800.00 - $1,350.00

- or -

Profit = $450.00

Pricing Strategies

Once you've identified your pricing objectives, your costs, your break-even point, and your profit goals, it's time to look at pricing strategies.

You should understand each of these strategies, and the impact they'll have on your customers and competitors. Many entrepreneurs combine several of these approaches to reach the perfect pricing strategy.

Cost-plus pricing

This is the most common and simple pricing method, because it's based on the known factor of cost. Cost-plus pricing means totaling your fixed and variable costs, and adding a **target return** to determine your sale price. A target return is usually expressed as a percentage of total costs.

Cost-plus pricing ignores the impact of consumer demand on prices, as well as your brand identity and positioning. Thus, it can lead to a price that's out of sync with your market, or doesn't fit your branding objectives. Also, it's very easy to miss hidden costs! Cost-plus pricing works best in industries where demand and competition are stable.

Competition-based pricing

Businesses often alter their prices based on competitors' prices. This is particularly common in large, highly competitive industries like airline travel, soda pop, and crude oil. The risk here is that your competitors' cost structure might be significantly different from your own.

- **Follow-the-leader pricing** sets prices at the level of an industry's price leader.
- **Pegged pricing** puts your business's prices in line with industry-wide norms; it tends to occur in industries with no clear price leader. Businesses using this method might use the industry norm as a starting point, then offer a slightly higher (premium) or lower (economy) price to establish your position within the industry.

Going back to our $10 t-shirt example, let's assume your competitors charge $8 to $13 for shirts like yours. The lower price can be found in discount stores. The stores selling to upper-income families charged the higher price.

Thus, if you were trying to reach customers in the middle income bracket, you'd probably charge $9 to $11.

However, you also need to compare your shirt to other shirts sold in the same market. If your shirt is superior in quality, image, or appearance to a $9 one, you can justify a higher price.

Next, suppose you can't find anything that makes your shirt better than the one that sells for $11. If the $11 shirt sells well, you might want to set your price at $11 too, and compete for the same customers. Or you could set your price slightly lower, and give buyers an incentive to choose your product.

How do you know which is the right decision? Again, it goes back to knowing your costs, your desired profit, and your break-even point.

Value-based pricing

In this strategy, you base your price on your customers' perception of its value. The goal is to charge an above-average price, while leaving customers with the feeling that they've gotten a good deal.

Here are some reasons why consumers may pay more for your product:

- They like and trust you
- You were recommended by someone they like and trust
- You offer convenience or faster service
- You offer security or reduced risk
- Your products confer social status or distinction
- Buying from you aids a cause or supports a philosophy
- Your products are unique or artistic

Branding is central to creating perceived value, and perceived value is at the heart of value-based pricing.

Think about the headache tablets at your local drugstore. A name-brand tablet sits right next to a generic tablet that costs half as much, and yet the name brand often sells as well as—or better than—the generic. The two tablets have the same ingredients, in the same dosage. But the name brand is familiar; it offers security and confidence, and people are willing to pay extra for it. These brands' perceived value allows them to withstand competitive pressures.

Every branding choice you make affects the perceived value of your product, which in turn affects your ceiling price.

When dealing with certain customers, it's necessary to communicate your product's **value in use**. This refers to the overall savings that a customer will realize by paying a bit more for your product. Does your product last longer than a less-expensive competing product? Does it offer a savings in time or effort? If so, show your customer how paying a little extra in advance can save a lot down the road!

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I guess Andy said something about how Bangor wasn't Boston or New York, but I just tuned it out. In my mind, I was already spending the money, and I didn't want to hear about what was realistic. I just thought everyone would be so grateful to have this green cleaning service in town that they'd just fall at my feet.

But you know what? They didn't. I mentioned I was thinking of switching over to green, and most people seemed interested until I got to the price. At that point, all but one of the nine companies I worked for said they wouldn't pay that much.

So I decided I'd try some other businesses. Same story on both sides of the river. No one was willing

If you promise higher quality, you must deliver! If you don't, you will lose that customer AND your credibility.

to pay an extra 20%, environment or no environment.

I felt pretty bad. Pretty angry, too. I'd done all this work, gone to all these meetings, listened to all this talk. And the pay-off was that I had one company willing to give me a three-month trial, with no contract. That wasn't going to pay for the vacuum and the other stuff I needed. I was back to square one.

Andy explained to him that "premium price" doesn't mean you get to charge whatever you want. A premium price can only be as high as the customer's perception of the product's value. Most people are willing to pay a little extra to feel like they're making a difference, but if the price is too high, it outweighs the perceived value and they decide not to pay.

"Why didn't you tell me that in the first place?" John demanded.

"I did," said Andy. "But you didn't want to listen to me."

John started to feel angry, but then he realized that Andy was right. He'd gotten greedy, and had stopped listening to things he didn't want to hear. He had no one but himself to blame!

Now, he'd have to try again, with a new price and a better sales pitch.

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Retail pricing

Retail pricing is used when merchandise is purchased from a manufacturer or wholesaler, and then sold again to the end user. Although retailers don't produce the goods they sell, they still have overhead costs (rent, wages, utilities, and advertising). Their price must cover all the costs of doing business, and offer an acceptable level of profit.

Some service businesses also sell retail products (e.g., hair salons sell hair products, and mechanics sell automobile accessories). These businesses would use retail pricing for selling these products.

To get a retail price you multiply the wholesale price by a certain percentage (called a **markup**), and add that to the wholesale price. A retailer using a 25% markup might buy a t-shirt at $8, and sell it for $10 ($8 + $2). Many retailers double or triple the wholesale price.

Your markup is the difference between the price you pay for the product, and your final selling price. This can either be a percentage of the cost, or of the retail price.

For example, if your company were going to sell t-shirts, you could find your markup percentage by adding a percentage of the cost to the total cost of the goods:

Cost of shirt	$5.00
x 50% markup	.50 (50%)
= Markup amount	$2.50
+ Cost of shirt	$5.00
= Selling price	$7.50

If you wanted to base your price on a percentage of the retail price, you'd divide the cost of the product by the markup percentage:

Cost of shirt	$5.00
50% Markup	.50 (50%)
= Selling price	$10.00

The most common retail pricing strategy is to take a percentage of the retail price. However, you should understand how your competitors price their products, so you can be competitive.

Many retailers price their merchandise according to the suggested retail price recommended by the wholesaler. This is an easy way to determine prices. But the simplest retail pricing technique is called **keystoning**. This means doubling all your costs to arrive at your final selling price.

Cost of shirt	$5.00
Keystone	x 2
= Selling price	$10.00

The key to retail pricing is to make sure the pricing method you use covers your overhead, expenses, and profit. If your price doesn't earn a profit, you'll either need to raise it, or decrease your costs.

Penetration pricing

Penetration pricing means setting a low price at first, in order to enter a new market. It can be a better strategy than maximizing short-term profits, if you can sustain it long enough to reap the benefits.

Penetration pricing can create goodwill among new customers, which may lead to word-of-mouth sales, and it may also act as a barrier to entry for your competitors.

The downside is that your customers may reject your product when you raise your prices. Also, you run the risk that competitors will follow your lead by lowering their prices, which could lead to a price war. And price wars are usually not good for anyone but buyers!

Price adjustments

List price is the "official" price that businesses charge, from which they subtract any discounts. The list price is seldom the selling price; adjustments are usually made for trade or distribution channel partners, and for the final customer.

Businesses offer discounts to buyers who meet criteria that reduce selling costs. Here are the most common forms of discounts:

- **Quantity discounts** are given to customers who buy in bulk. This can be a powerful way to increase the amount of units you sell.
- **Trade discounts** are given to distributors or reps when they perform such marketing functions as advertising, promotions, or technical support.
- **Seasonal discounts** can encourage customers to make purchases during off-peak selling times, which helps to lower inventory levels when demand is down.
- **Cash discounts** are given to customers who pay for purchases by cash rather than credit. This encourages speedy payment of bills and minimizes accounts receivable, which can improve your cash flow.

Common Pricing Errors

- Basing price on current, artificially low overhead costs instead of anticipating how overhead might rise over time.
- Assuming that because you are the newest competitor on the block, you must have the lowest prices.
- Trying to compete head-to-head on price with larger competitors. Try instead to offer higher quality, or more attentive service.
- Basing prices on manufacturing costs instead of the value of your product to consumers, which may be quite a bit higher!
- Failing to include in the price an allowance for warranty costs, future service, research and development costs, cost of capital, dealer discounts, and sales commissions.
- Ignoring the way customer demand for the product will change at different price levels. Would sales volume increase if you lowered prices by 10 or 20 percent?
- Failing to use some form of **market skimming**, in which you enter a market with a high price until you have satisfied demand or attracted competitors, then lower the price gradually.

Making Price Fit Your Marketing Mix

No matter which pricing strategy you use, it must be consistent with the other elements of your marketing mix. Here are things to consider:

- **Product strategy.** Is your price in line with your customers' perception of quality? If not, consider lowering your prices, improving your quality, or educating customers.
- **Placement strategy.** Is your product's price consistent with the image of your distribution channels? High-priced, premium products should be distributed selectively, while economy products should be distributed intensively to maximize their availability to larger, price-sensitive markets. Are you using discounts as an incentive for your distributors?
- **Promotional strategy.** Is your advertising message consistent with your product's price level? If yours is a premium product, is your image one of quality and service? If it's an economy product, is your image one of value? Are your sales promotions undercutting your pricing strategy and profitability? Are coupons or price discounts encouraging only short-term business by fickle customers?

Pricing Tips

1. A product is worth what someone is willing to pay for it.
2. In successful businesses, products are priced to generate a profit.
3. "Loss leaders" are priced to generate traffic, not make a profit.
4. Price wars are never won!
5. Intuition can't replace product and cost knowledge.
6. Know your break-even point. It's where your profits start!
7. Start-up businesses usually can't compete on sales volume alone.
8. You must know how much it costs to make your product. You must also know your fixed monthly costs.

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When I went back over it, it wasn't hard to see why my sales pitch failed. All the reasons I'd come up with for why my business was a good choice, I'd pretty much forgotten to say.

I was trying to make things easy, so my pitch was simple: Pay me 20% more than you do now, and save the world. All the other stuff about employee morale, I never even had time to explain. It was just "Hey, here I am, I'm green, sign me up!"

So with Andy's help, I had to go through the whole thing again. What my product was, and why it was different. What were its features, and what were the benefits? Why should someone pay more for them? Not 20% more, but maybe 10% more. I had to show that I had the right product, at the right price, for the right reasons.

John started by going back to each of the nine companies he worked for. This time, he explained that he was switching over to less-toxic cleaning supplies, filtered vacuuming, and other cleaning techniques that would reduce indoor air pollution.

He described the studies that suggested that this would have a positive effect on employee health and morale. He also pointed out that hiring a green janitorial service could help the firm's branding and promotional efforts, especially given Downtown's changing image as redevelopment efforts progressed.

The price for his green cleaning services would be 10% higher, true, but he'd offer a three-month introductory period at the old price. His conditions were that he'd get a formal, signed contract for weekly cleaning, and be paid once a month.

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Pricing for Service Businesses

It can be difficult to estimate the costs for service businesses. In some cases, service businesses (such as childcare or catering) will have significant variable and fixed costs to consider. In other cases, the biggest expense is the owner's time (e.g., dog walking, or housecleaning). Doing a break-even analysis is difficult in these situations.

Service businesses must focus their pricing strategies on the ability and capacity of the owner, the requirements of the customer, and the competition. A limitation of a sole-proprietor service business is the owner's available time. How many hours can you work in a day? How many are you *willing* to work?

If you have a service business such as babysitting, gardening, or hauling, how can you make sure you are charging enough for your services to cover your time? Don't sell yourself short! You're providing a valuable service, and you should be paid for it.

We just learned how to set the price of a t-shirt. Pricing a service follows a similar method. First, you need to research what your competition is charging for the same service. Are they charging by the hour, by the project, by the load?

To illustrate service pricing, let's go back to the example of Green Thumb Plant Care. After researching the plant care market, they found there were two primary competitors in their area. Both competitors were using monthly pricing and billing for their services. *Competitor A* has been in business for ten years, and is charging $265.00 per month for weekly plant care. *Competitor B* has most of the business on the north side of town, has been in business two years, and charges $240 per month. Green Thumb Plant Care plans to focus on the underdeveloped south side of town, and plans to offer a rate of $240 per month for weekly service.

Just as in the t-shirt example, you'll need to make sure your pricing will cover your variable and fixed costs.

Green Thumb Plant Care - Proposed Pricing

Office Start Up: Customer pays initial payment of $200 for plant purchase, delivery and placement. Any dead or wilting plants will be replaced at customer expense.

Monthly Maintenance: $240.00 per month x 20 customers = $4,800/month

Monthly Revenue:	**$4,800**
Variable Costs	
Plants / Food	$200
Promotion	$200
Gas	$400
Misc. Supplies	$100
Telephone	$100
Total Variable Costs	**$1,000**
Fixed Costs	
Greenhouse Rent	$800
Truck Lease	$400
Accounting Expense	$100
Insurance	$200
Loan Payment	$300
Total Fixed Costs	**$1,800**
Revenue	$4,800.00
- Variable Costs	-$1,000
- Fixed Costs	-$1,800
Monthly pre-tax profit	**$2,000**

If Green Thumb meets its projections of 20 customers paying $240.00 per month, the monthly pre-tax income for the owner is $2,000 before taxes. If this isn't enough, the owner can revise the projected numbers. Can enough value be added to warrant charging $260 per month? How about $275.00? Can the variable or fixed costs be reduced? Is it possible to increase the number of offices being serviced to five or six per day?

As you can see, many changes can be made to meet income requirements. The first step is to start with a projection, and adjust it to the most likely scenario.

Pricing Tips for Service Businesses

- Success relies heavily on the reputation and expertise of the owner.
- Prices are most often based on an hourly rate, or a project rate.
- Rates can vary depending on customer requirements.
- Fixed costs will likely make up the largest expense categories.
- Start-up service businesses are often home-based to reduce expenses.
- Don't under-price your services to develop a client base. Always charge what the service is worth!
- Understand the "going rate" for your type of service (i.e. the industry standard).
- Most new customers will come through word of mouth, so budget time for networking and promotional activities.
- Not all hours of a workday are billable to your customers. (Some hours are needed for your general administrative, promotional, or bookkeeping work.) Will you have enough billable hours in the day to make the amount of money you want to?

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Once I explained the benefits, and showed people the value they'd get for their money, the response was good. A few people still weren't interested. But you know what? Those were the people where I had the most trouble getting paid before. So I wasn't sorry to say goodbye to them.

Everyone else was pretty much on board. A couple of them wanted to know would I still be getting things clean with the new chemicals. But I was ready for that. I asked the people who make the cleaners to send me their brochures showing what kind of germs they kill, and comparing them to the normal products.

At the end, I had agreements with seven companies. That meant I'd make about $2,000 a month to start. And remember, the contracts meant this was money I could rely on. I'd know when it was coming in, and I could make plans around it. And once I found other companies, I'd make even more. So things were definitely looking up.

Once he finished his business plan, John was able to get a loan through ACCION. He bought the vacuum, and stocked up on enough cleaning supplies to last him through his first three months of operations.

Since then, John's done well. He currently has cleaning contracts with 16 local businesses, which gives him just about as much work as he can handle by himself. Sometimes, he ends up hiring a couple of local kids to help him out on certain jobs.

I think a lot about growing my business…maybe getting a partner, and buying a second truck. Right now, I mainly want to pay off my debts, and put some money into savings. But I do like the idea of having people working for me, and being able to send them out on jobs instead of doing it all myself. I got this far, you know, so why not? The planning and paperwork were hard at the beginning, but now that I've been through it, it doesn't seem so bad. I'm kind of interested to see how much farther I can go.

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What You've Learned

In this session, you took the market research and analysis you've done up to this point, and began understanding how you can use that information to create marketing strategies. First, you looked at an overview of marketing strategies, and then you explored specific strategies for products and pricing.

Here are the main concepts you should understand after completing this session:

1. Packaging includes all the things that present your business to the public, from business cards and letterhead, to the way you look and act when dealing with customers.

2. To position your business, you must look at your competition and your customers, and consider issues like price, quality, and brand identity.

3. Every branding choice you make affects how customers perceive the value of your product, and this affects your ceiling price.

4. Your business will develop a brand image, whether you want it to or not! That's why you should plan your brand identity carefully.

5. Fixed costs stay the same no matter how much of a product you produce. Variable costs change depending on how much of a product you produce.

6. Break-even analysis can help you choose correct prices, and set realistic sales goals.