



## **Finance Factsheet: Building a Pricing Strategy**

In pricing your product or service you first need to decide whether to take a cost-plus or value-based approach. But having made this decision, there are many other factors to consider in relation to pricing.

This factsheet outlines the factors you need to take into account when deciding exactly what prices you are going to charge.

### **Two basic pricing methods**

The two basic methods of pricing products and services are:

- **Cost-plus pricing** - where you take the cost of producing your product or service and add an amount you need to make a profit
- **Value-based pricing** - where you charge a price based on the benefits your business offers customers and that you believe they are willing to pay.

### **Factors to consider**

Once you have decided which of these approaches is more suitable for your business, you need to consider the following:

- **What prices do your competitors charge?** You need to have a good reason to set your prices much higher or lower -if they are too much lower you will lose profits unnecessarily, if they are too much higher you will lose customers unless they can't get what you offer elsewhere.
- **What is the perception of your product or service -and what would you like it to be?** With some products and services, a high price contributes to a perception that what you are offering is of high quality and value.
- **Is there a case for charging different prices to different customers?** You could, for example, charge a lower price to customers who buy in larger quantities or give you a lot of repeat business.
- **Is there a case for charging lower prices to attract more customers?**



## Charging lower prices to attract more customers

The main ways in which you can use lower prices to attract more customers are:

- **Discounting** -where you offer specially-reduced prices, either for large orders or to sell old stock, though you have to take care that the discount is not so large that it causes customers to question your usual rates and makes them reluctant to pay the full price in the future
- **Odd value pricing** -where you charge £19.95 instead of £20, so appealing to those customers for whom price is all-important
- **Introducing a loss leader** -selling a product or service at a low or even loss-making price in order to attract customers who will buy other, more profitable, products or services
- **Penetrating** -starting at a low price to gain market share and loyal customers ahead of any competitors; it is the opposite of 'skimming', where you sell a unique product or service at a high price.

## Deciding whether to raise prices

In deciding whether to raise prices, you need to address two key questions:

- What effect will the price change have on the volume of sales?
- What effect will it have on the profit per sale?

Increasing prices may reduce the volume of sales, but it may also increase your profit.

You can hide price increases by introducing new higher-priced products or services and making the older cheaper ones obsolete. You can also reduce the quality of what you offer, and so the cost, while charging the same price.

Both tactics, however, run the risk of alienating your customers. Usually far better is to explain any price rises to your customers, perhaps promoting the benefits you offer at the same time. Remember: customers rarely buy on the basis of price alone.