Pricing Is The Hardest Marketing Decision

By Blair Entenmann, President, MarketingHelp!

Many executives frequently make big marketing decisions about product, place, promotion, and people.
But when it comes to pricing, they tend to agonize over the decision. They know that three out of four times, they are either losing a volume opportunity or leaving money on the table, but never know which.
A marketer needs a sound strategy and the appropriate tactics to make better pricing decisions. *Strategic pricing* decisions are those that define the company's pricing and value image in the eyes of the target audience, customers, and competitors. In pricing strategy, the key is being proactive to control your own destiny, rather than being forced to react to competitive moves. *Tactical pricing* is the day-to-day management of the pricing process.

Most companies establish a price for their products or services that enables them to meet competition (sales-oriented pricing) or to achieve certain profit objectives (profit-oriented pricing). In doing so, however, few take full account of five critical factors that should be considered when making *strategic pricing* decisions:

1. **Value to the Customer, Relative to Competitive Offerings**. In setting prices, you need to evaluate all the differentiating features and benefits of your product or service as a total package. Look at the key buying decision factors of your target audience. Are some factors more important than others? How does your company's product compare to key competitors? Do you have any significant competitive advantages that customers may be willing to pay more to get?

2. **Differences Between Market Segments.** In many industries, prices are negotiable. Price differentiation among customer groups is frequently an important key to profit. A wholesaler or distributor that buys in large quantities needs prices that are lower than the retailer in order to make a profit, and keep the end user price about the same as when the manufacturer sells direct to a retailer.

3. **Likely Competitive Reactions.** Companies court disaster when they make their pricing decisions without carefully taking potential competitive retaliation into account. You need to consider your competitor's cost structure, his past pricing behavior, market demand or lack thereof, the relationship of the product to others in the competitor's line, and the competitor’s capacity utilization. If you are market leader and raise prices, will your competition see this as an opportunity to improve their margins or to take business away from you? If you start a price war in a market (that you consider secondary to your business) that is a core business to a direct competitor, they will fight for survival.

4. **Real Costs and Profits.** Most companies use fully absorbed fixed and variable costs to determine product line or service type profitability and thus establish their basic price levels. In businesses with high fixed costs and/or unreliable allocation methods, this approach leaves much to be desired. We have found that contribution margin (sales minus all variable costs) gives a more realistic profit figure, making it easier to see which products need price increases or decreases to optimize volume and profits.

5. **The Company's Marketing Objectives.** If customer value, market demand, competition, and real costs are accurately assessed, the resulting strategic price levels should maximize profits. All these factors should be weighed against the company's marketing objectives. Management needs to assess a price change impact on the company's other products or services, the need for short-term profits against long-term market position, long-term customer relationships, and the importance of managing profits over the entire business cycle.

Careful consideration of these five factors can take some of the agony out of the process as you make pricing decisions. You will make better, more fact-based decisions about the hardest marketing decision there is -- pricing.

Blair Entenmann is President of *MarketingHelp!, a Grand Rapids based marketing firm specializing in helping clients catch and keep customers with better marketing strategies, programs and implementation. For more information, visit www.mktghelp.com or call 616-866-1198.*