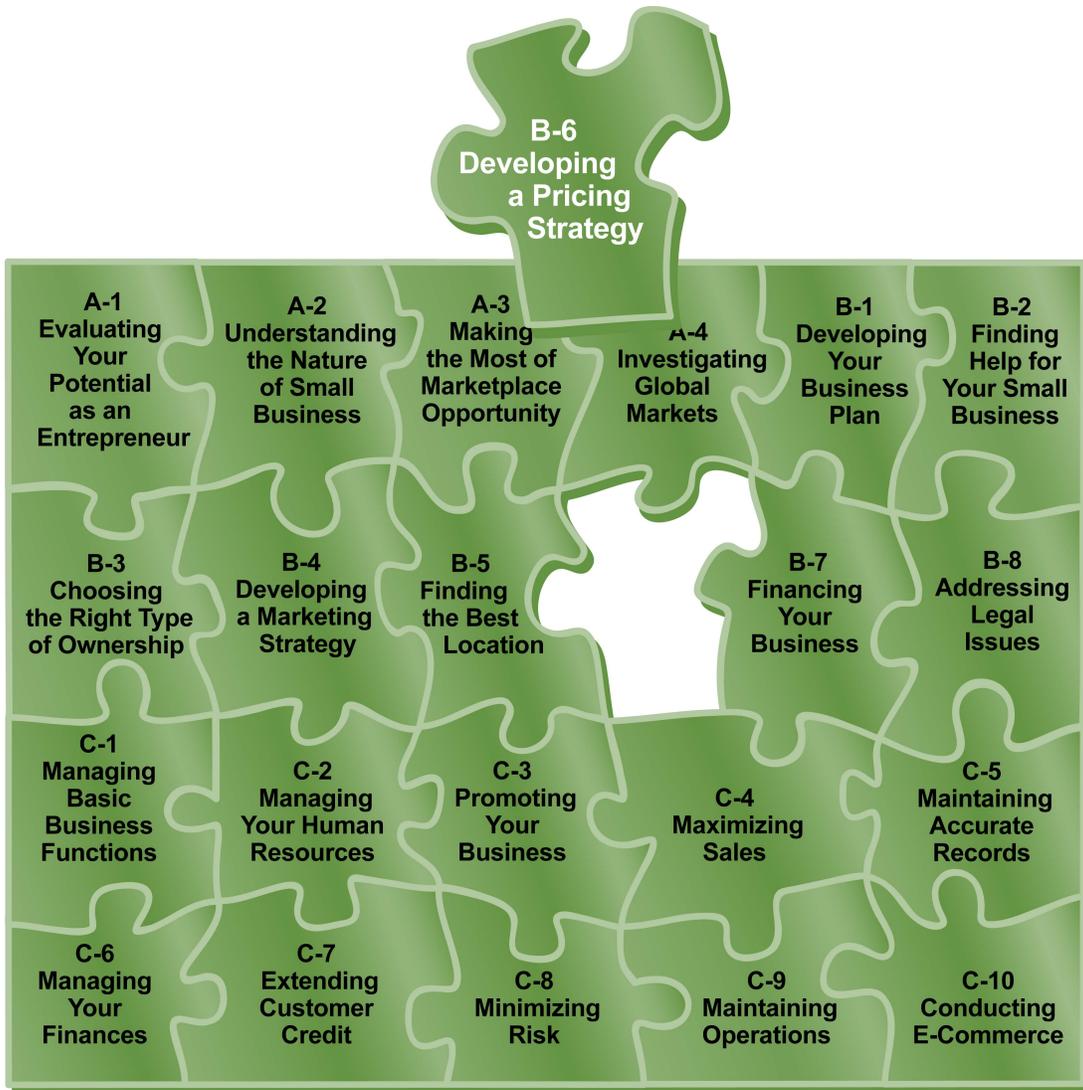


PACE

Fourth Edition

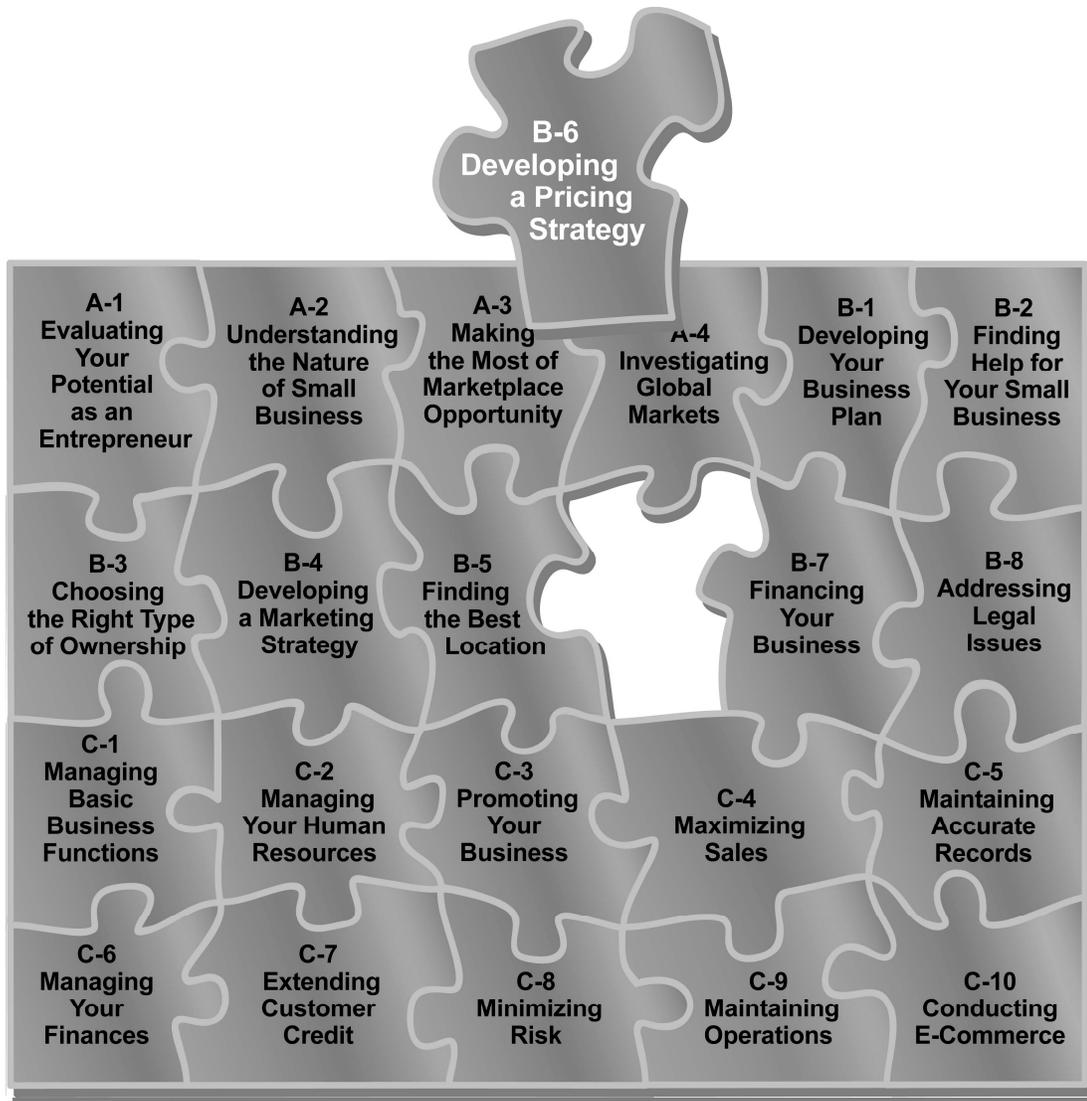
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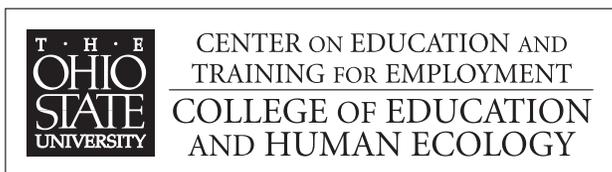
PACE

Fourth Edition

Program for Acquiring Competence in Entrepreneurship



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Foreword

I am pleased to introduce you to the Fourth Edition of the Program for Acquiring Competence in Entrepreneurship (PACE). PACE represents our continuing effort to respond to the needs of the education and business communities. At no other time in history has understanding entrepreneurship been as important. For one thing, promoting entrepreneurship carries the societal imperative as small businesses as a whole contribute much to the growth and renewal of regional and national economies.

When first published in the late 1980s, PACE properly emphasized that entrepreneurship was based as much on sound planning as having products and services that were responsive to the marketplace. Through its various revisions, PACE continued to focus on the general importance of planning and managing the startup of a small business.

The current PACE edition represents a necessary break from past versions in both its format and some content. For one thing, the text format has been substantially changed from paragraphs to a series of related sections with subheadings. This change allows readers to have greater accessibility to the information, whether it is delivered via a printed booklet or a technology-based approach. And the format allows the instructor/facilitator to have greater flexibility in selecting content to accommodate the needs of various audiences and settings.

In terms of the content, PACE continues to emphasize the importance of planning and managing of a small business. But it now includes a renewed emphasis on meeting customer expectations. Any business cannot exist without a comprehensive understanding of who receives its products or services. In this sense, PACE introduces the topic of conducting e-commerce. Until recently, the entrepreneurial horizon may have been limited to serving local customers only. The advent of the Internet offers the promise of serving many more customers, but not without the accompanying challenges.

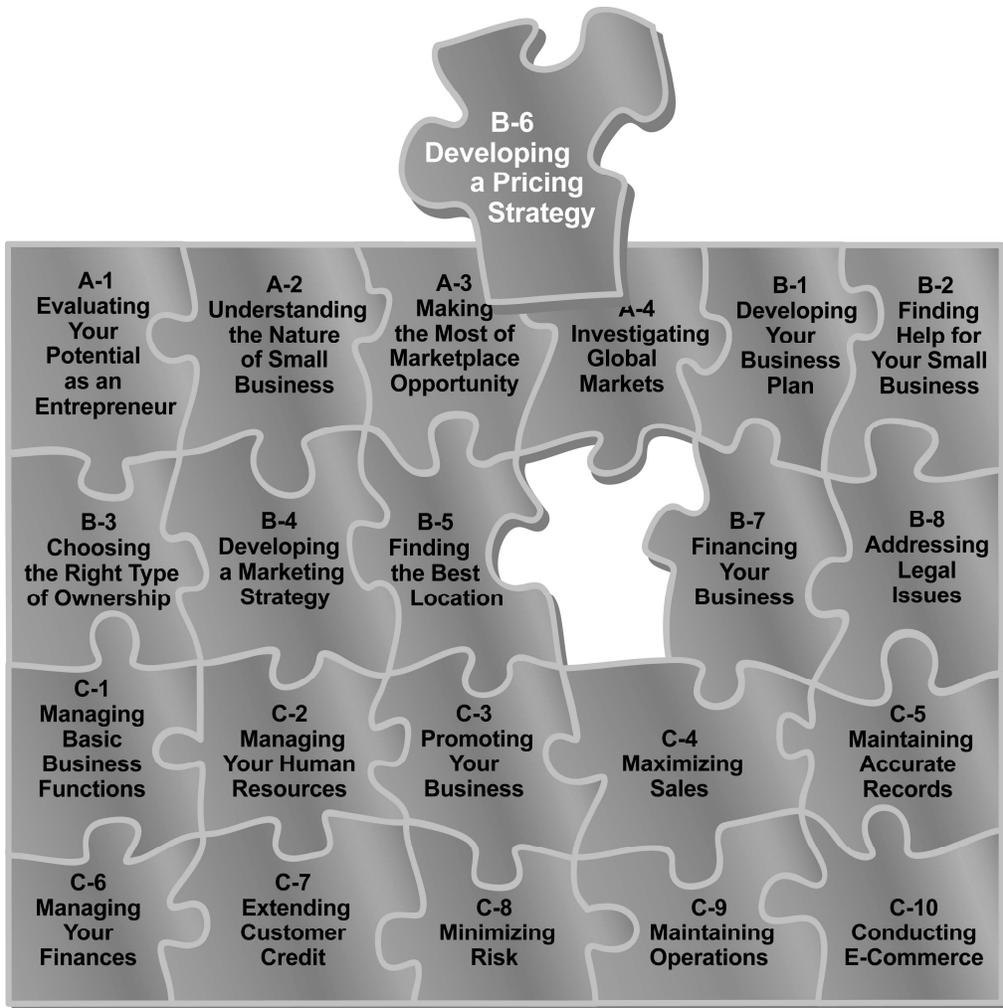
This edition was supported in part by a grant from OSU Extension and in partnership with OSU South Centers – Piketon. We hope that PACE will provide you with the understandings necessary to help you to achieve your entrepreneurship goals.

Ronald L. Jacobs
Director
Center on Education and Training for Employment

Overview

Introduction

Pricing is the determination of the most lucrative and reasonable amount of money to ask for your goods or services. The price that you set directly impacts your bottom line. Consider the factors that affect your profit margin and the influences in your marketplace in order to establish a price that maximizes your profit.



Continued on next page

Overview, Continued

Rationale You want to offer a product that consumers find to be a better value than the competition offers based on pricing.

Objectives By the conclusion of this module, you will be able to:

- Explain how pricing fits in to the total marketing mix.
- Describe the factors that affect pricing including:
 - variable and fixed costs
 - supply and demand
 - stages of the product life cycle
 - various mark-up strategies.
- Describe pricing incentives and how they affect sales.
- Relate how competition impacts your approach to pricing.
- Define the role of product image on pricing.
- Identify the best pricing strategy for your own business.

Relevant NCSEE standards This module aligns with the following National Contents Standards for Entrepreneurship Education (NCSEE):

- L.35 Establish pricing objectives.
- L.36 Select pricing strategies.
- L.37 Set prices.
- L.38 Adjust prices to maximize profitability.

More information on the NCSEE is available at: http://www.entre-ed.org/Standards_Toolkit.

Continued on next page

Overview, Continued

Topics

The topics in this module are:

| Topic | See Page |
|--|-----------------|
| What Is Pricing? | 4 |
| Part I – Factors Affecting Your Pricing Strategy | 5 |
| • Variable and Fixed Costs | 6 |
| • Supply and Demand | 9 |
| • Stages in the Product Life Cycle | 11 |
| • Mark-Up Strategies | 14 |
| Part II – Pricing Incentives | 16 |
| Part III – Competition | 18 |
| Part IV – Product Image | 20 |
| Part V – Developing Your Own Pricing Strategy | 21 |

Exhibits

The exhibits in this module are:

| Exhibit | See Page |
|--|-----------------|
| Demand, Supply, and Equilibrium Curves | 10 |

Before you begin

After reviewing the above objectives for this module, determine whether you can already meet those objectives and consult your instructor if you can.

What Is Pricing?

Introduction

Pricing is one of the four Ps of the marketing mix. Each “P” represents an component of the product that impacts its consumption in the marketplace. These four components are:

| Component | Description |
|-----------|---|
| Price | Ask consumers to pay an amount that represents the actual value of the product and is acceptable to them. |
| Product | Create a product that meets consumer needs. |
| Promotion | Advertise the product in a way that allows consumers to appreciate its value. |
| Place | Make the product available to consumers. |

The four components each deal with a different aspect of the marketing mix.

Example: Consumers are interested in buying motor scooters to get around town as an alternative to driving a car. The challenge with pricing is to arrive at an amount attractive to consumers that also strengthens your bottom line.

- *Price* – If a motor scooter dealer charged \$1,000,000 for a scooter, nobody would be interested in buying one. On the other hand, if the dealer asked just \$100, he or she would sell thousands of scooters without even trying. In either case, the dealership would go out of business due to poor pricing.
 - *Product* – Motor scooters are popular items. The variety of scooters is growing as consumers look for the scooter that they find most appealing.
 - *Promotion* – Promotion of the scooter tells potential buyers about the different styles and colors available.
 - *Place* – Making scooters readily available to consumers is vital to sales.
-

Part I

Factors Affecting Your Pricing Strategy

Introduction

The price you receive for your product must be higher than the cost of producing and distributing it, or you'll lose money on each sale. For this reason, always coordinate pricing with other factors when setting the price for your goods or services.

Factors in pricing

When determining how to price your product, consider these factors:

- variable and fixed costs (total cost)
 - supply and demand for the product
 - its stage in the product life cycle
 - distribution costs
 - mark-up strategies.
-

Pricing band

You have some degree of flexibility with pricing. The pricing band is that range in prices at which your product or service might sell for a profit. The range depends on market conditions and product life cycle stage.

Range – At the low end of the range is the cost you incur to produce the product, and at the high end is the price that consumers perceive as a poor value and where they become discouraged from buying what you're offering.

Optimal price – The price most profitable to you lies within this pricing band. Consider the costs involved in doing business before deciding what price to charge.

Types of costs – The two categories of costs that make up the total cost are variable and fixed. Figure the best price for your product as follows:

$$\text{Total cost} = \text{Variable cost} + \text{Fixed costs}$$

Variable and Fixed Costs

Variable costs Variable costs are costs that vary with the quantity of goods and services produced. Expenses change in direct relation to the volume of production.

Example: When you customize the motor scooters to sell at your dealership, you obtain the parts from an outside vendor. The cost that you incur when assembling the product depends on how many you plan to produce. Your cost to produce the scooters varies depending on how many scooters you will assemble and how many parts you have to buy from the supplier.

Fixed costs Fixed costs are costs that do not change, regardless of production. They are constant at all volumes of production.

Example: With enough parts bought to customize the number of scooters scheduled for production, you are ready to begin. The costs associated with this part of the business are office space, warehouse, utilities, salaries, etc. These expenses are always the same and do not change depending on how many scooters you produce.

Paying for fixed costs – Since you know what to expect with fixed costs, you can allocate these expenses into your pricing over the period in which they will be incurred. Knowing the fixed costs of regularly scheduled bills like rent, utilities, and salaries allows you to apply accounting methods that cover your costs with the level of production for a certain period of time.

Maintaining consistency – The price that you decide to charge for your goods or services should be consistent over the long term. Set a price that covers fixed costs over an extended period such as a year, and then allocate these costs to the volume of business expected over that period of time.

Note: When projecting fixed costs, add a specific amount to your anticipated expenses in order to provide a margin of error. This safety net will cover incidental costs arising from inaccurate information or unpredictable conditions.

Continued on next page

Variable and Fixed Costs, Continued

Total cost of doing business

After you've determined the variable and fixed costs, add them together to arrive at the total cost of doing business. You have to price your goods or services above the total cost in order to make a profit, but not so high that you discourage customers from making the purchase.

Key point: Set a price for your product that covers your total cost while generating the highest profit possible.

Note: This figure is also called the *floor price*.

Example

Determine whether you will realize a profit from selling customized scooters based on the following numbers for a time period of one year:

| Type of Cost | Amount |
|---|-----------|
| Variable costs for each scooter | \$1,000 |
| Fixed costs for rent, utilities, salaries, etc. | \$500,000 |
| Number of scooters for sale | 500 |

$$\begin{aligned} \text{Fixed cost per unit} &= \text{total fixed cost/number of units sold} \\ \$1,000 \text{ per scooter} &= \frac{\$500,000}{500} \end{aligned}$$

$$\begin{aligned} \text{Floor price} &= \text{variable costs plus fixed costs} \\ \$2,000 &= \$1,000 + \$1,000 \end{aligned}$$

Based on this figure, you consult with accounting and decide what to charge for each scooter. You can either make a sound decision with a reasonable profit margin, or you can try to make a huge profit and see what happens.

Continued on next page

Variable and Fixed Costs, Continued

**Example
(continued)**

Trying to make a huge profit

You set the selling price at five times the floor price, or \$10,000. Your profit margin would be the selling price of \$10,000 minus the floor price of \$2,000, for a profit of \$8,000 per scooter sold.

Most consumers in your market refused to pay \$10,000 for a scooter. You only sold ten units in a year. With such a huge profit margin, you spent:

\$500,000 on fixed costs

\$1,000 times 500 for a total of \$500,000 in variable costs

\$1,000,000 in total costs over the year

The total income from scooter sales was ten units sold at \$10,000, for a total of \$100,000. The amount of money lost was \$900,000, due to overpricing the scooters.

Making a reasonable profit – What do you think a reasonable selling price for the scooters would've been? Think about your own product and develop a range for pricing that would be fiscally sound and an acceptable profit margin to you.

Supply and Demand

Introduction

The pricing band is that range in prices at which your product or service might sell for a profit. The pricing band in which your product will be profitable is determined not only by the costs incurred but also by sales volume. Find the ideal production level in order to price your goods or services at a point where sales volume and profit per unit combine to produce the maximum profit.

Demand curve and pricing

In most cases, the demand for an item increases as the price of the product decreases.

Exceptions

Inelastic demand – There are some products with inelastic demand for which a decrease in price does not trigger an increase in demand. These goods and services are not affected by pricing.

Example: The demand for insulin is inelastic. If the price of insulin drops, the diabetic using it will not buy more than prescribed.

Luxury products – These items are also an exception to the typical price/demand relationship. Even a severe price reduction does not increase the demand for the luxury product.

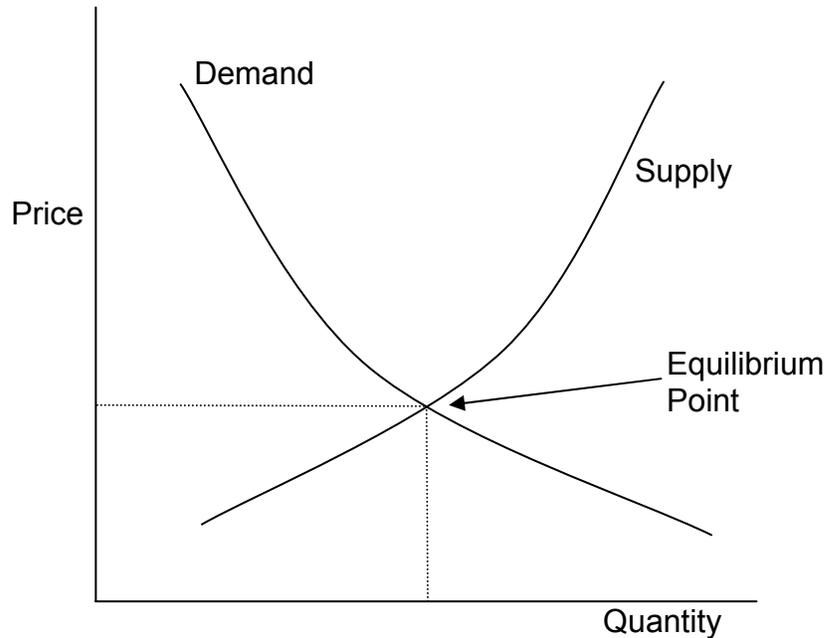
Example: A baby grand piano costs \$12,000. When the dealer reduces the price by half to \$6,000, it doesn't cause anybody to buy a baby grand piano who wasn't already planning to buy one. The demand stays the same as before the price dropped.

Continued on next page

Supply and Demand, Continued

Exhibits

The graph below illustrates the relationships between product demand, product supply, and the equilibrium point for pricing.



| | |
|-------------------|---|
| Demand | Depicts the quantity of goods that consumers want. Shows the typical relationship between consumer demand in one product category and the price. It illustrates that as price decreases, the quantity demanded increases. |
| Supply | Depicts the total supply of goods in one product category. It shows that as prices increase, suppliers are willing to supply more product. Assuming that production costs per unit don't increase at the same rate as the selling price, the profit margin increases along with the selling price. <u>Rationale:</u> The increasing profit margin motivates suppliers to produce more goods or services. |
| Equilibrium Point | Combines the demand and supply curves. Note that these two curves intersect at only one point. This is the equilibrium point that marks the ideal production level. |

Stages in the Product Life Cycle

Introduction The influence that price has over the purchasing decision also depends on the position of the product in the product life cycle. The life cycle identifies the competitive stages that an item will undergo over time.

Rationale Knowing where your product is in its life cycle helps you develop your product strategy.

Four stages The four stages of the product life cycle are:

| Stage | Title | Description |
|-------|--------------|--|
| 1 | Introduction | The product is new and unique, so pricing has the least amount of influence during this stage. |
| 2 | Growth | Competition begins to duplicate a product that has proven to be successful. |
| 3 | Maturity | The product is widely available and has numerous competitors. |
| 4 | Decline | The market demand decreases for the entire product category. |

Stage 1 – Introduction The product is new and unique, so pricing has the least amount of influence during this stage. Generally, people who want to be on the cutting edge buy the innovative product at this early stage. The mass market won't purchase a new item until it has been proven.

Pricing – During the initial stage of the product life cycle, pricing is heavily influenced by the price of the product being replaced. But the business owner has a great deal of flexibility in setting the price.

Strategies – There are two dominant pricing strategies at this stage, either the penetration or the skimming approach.

- **Penetration approach** – pricing a new product in such a way as to capture a large segment of the market for the new product.
 - **Skimming approach** – pricing a product in such a way that usually attracts the early adopters.
-

Continued on next page

Stages in the Product Life Cycle, Continued

Stage 1 – Introduction (continued)

| If business owners want to... | Then they will price the product... |
|--|---|
| capture as much market share as possible | low and adopt a “penetration” approach. |
| generate as much profit per unit as possible | high and adopt a “skimming” approach. |

Stage 2 – Growth

Competitors begin to duplicate the product after it has proven to be successful. They differentiate their items based on the requirements of a particular target market.

Pricing – Pricing becomes more important as businesses compete to give consumers the best value. A quality image in packaging, promotion, and product features justifies a higher price.

Stage 3 – Maturity

The product is widely available and has numerous competitors. Consumers have widely accepted the product as a permanent fixture in the marketplace, and there is little doubt about the appeal of the product. The consumer is knowledgeable, and there is little difference between the products available.

Pricing – Pricing plays a significant role in the decision to purchase the product at this stage. If two products are basically the same, consumers base their decision on price. It’s essential to adopt a price point acceptable to consumers.

Cutting prices – Cut-priced producers enter the market during the maturity stage. They attempt to draw customers away from the original product with lower-quality goods or services at a reduced price. But by promoting their differences and higher quality, established businesses can fend off such attacks with higher promotional budgets.

Note: The success of these warring parties in swaying consumer opinion determines the longevity of this stage of the product life cycle.

Continued on next page

Stages in the Product Life Cycle, Continued

Stage 4 – Decline

The market demand decreases for the entire product category during the decline stage. In order to maintain profitability, business owners must pay close attention to profit margins and costs. They usually decrease their promotional budget in declining product categories and reinvest in high growth items.

Pricing – Businesses slash the price of the product to the lowest possible point. The acceptable pricing band is at its narrowest at this stage.

Termination – When the product is no longer profitable, the business owner stops offering the product to consumers all together.

Mark-Up Strategies

Introduction

One way to establish the price of your product is to use a mark-up strategy. This is done by adding a percentage to the total cost of goods sold. It is important to keep in mind that the mark-up should cover all operating expenses, as well as profit.

Example: You are going to sell bottled water. Your cost is 50 cents per bottle. You decide to mark up the price by 50 cents or 100%. You will sell the water for \$1.00 per bottle.

| | | |
|--------------------|---|------------------------------------|
| Cost of goods sold | = | \$.50 per bottle of water |
| Mark-up % | = | 100% ($$.50 \times 100\% = .50$) |
| Cost + Mark-up | = | Selling Price |
| $$.50 + $.50$ | = | \$1.00 |

Standard mark-up

You can use a standard mark-up percentage on all products. This form of pricing is practical when it's difficult to evaluate between alternatives.

Standard mark-up – You will mark up every item 100% regardless of cost.

Example: You own a convenience store and you mark up all items by 100%, whether it is a bottle of water or a candy bar.

Example: Bottle of water

Cost $$.50 + 100\%$ mark-up = \$1.00 Retail price

Example: Candy bar

Cost $$.25 + 100\%$ mark-up = \$.50 Retail price

Continued on next page

Mark-Up Strategies, Continued

Variable mark-up Another option for businesses offering a wide variety of products, each with a different appeal to consumers, is the variable mark-up system. The percentage of mark-up varies between products because customers apply different criteria for determining the value of different items.

Variable mark-up – You will mark up beverages by 100%, but food items you mark up by 75%.

Example: Bottle of water

Cost \$.50 + 100% mark-up = \$1.00 Retail price

Example: Candy bar

Cost \$.50 + 75% mark-up = \$.875, round up to \$.88

Impact of pricing on mark-up

If pricing is a major factor that customers consider when evaluating which product to buy, the mark-up should be narrow. In this case, watch the item carefully and make adjustments to pricing as necessary.

Note: If price is not as important in the decision-making process about which product to select, you can apply a higher mark-up on the item.

Part II

Pricing Incentives

Introduction With accurate information about the conditions that affect pricing, you have a great deal of flexibility in pricing tactics.

Strategic discount A common form of rapid price change is the strategic discount. You can apply this discount for a variety of reasons and with an assortment of end results, most commonly an increase in sales.

Note: Don't make the decision to discount your product hastily. Discount pricing sends a signal to the marketplace of which the interpretation by consumers isn't easy to control.

Determining your objective There are many situations in which a strategic discount will increase sales. You can use the strategic discount for a variety of objectives such as:

- attracting new customers to the market
 - increasing usage of the product by existing customers
 - taking customers away from competitors
 - discouraging existing customers from switching to the competition
 - encouraging customers to buy now instead of later
 - discriminating between different types of buyers
 - using the low price of one product to sell another product in the same line.
-

Communicating with consumers With the wide range of objectives that you can achieve with discount pricing, the impact of the discount will depend on how you communicate it to consumers. Make communicating with potential and existing customers a priority when developing your pricing strategy.

Evaluating the strategy Maintain the effectiveness of the discount by continually measuring its effect on sales and adjusting your strategy as necessary.

Continued on next page

Pricing Incentives, Continued

Common types of pricing incentives

Tactical discounts – A tactical discount takes the form of a temporary price reduction that increases the perceived value of the product to consumers.

Quantity discounts – A quantity discount reduces the price when customers buy large quantities of a particular item. This discount strategy is practical because many of the overhead costs involved in producing goods or providing services are reduced when spread over a greater number of units sold.

Example: A service call costs the appliance repair shop \$50 to make when the repairperson starts from the shop and returns there. But making several calls in the same geographic area during the same time period reduces the cost of gas and time spent driving back and forth by 15%. By scheduling calls back-to-back, the service provider can afford to charge less and still make a healthy profit on each call.

Cumulative discounts – A cumulative discount is similar to the quantity discount. It encourages consumers to continue to buy from one supplier over an extended period of time. This discount becomes more valuable the longer the customer remains loyal to the supplier.

Example: An oil change specialist offers drivers one free oil change after a driver gets four oil changes at that location.

Trade discounts – The trade discount is a reward offered by a wholesaler to the retailer for pushing a particular item to the public. It encourages the retailer to feature the product to consumers. Giving a trade discount is sometimes the only way to work your own product into the distributor's stock or list of services that they offer.

Note: This discount strategy is similar to a cash discount, an upfront price reduction to the retailer. It encourages them to replace their existing line with your own product.

Cash discount – The vast majority of sales are made on credit. The retailer buys the product on credit and pays the manufacturer after selling it. Offering a cash discount for making the payment before it's due gives the retailer an incentive to pay the manufacturer for the product as soon as possible.

Note: This discount often takes the form of a percentage off the total amount due.

Part III

Competition

Introduction

The options available to consumers of goods and services provide them with the freedom to choose the most desirable product based on factors like pricing. Whenever the consumer is able to choose among alternatives in the marketplace, the supplier of goods or services is facing competition.

When setting the price for your product or service in the face of competition, the price you determine will affect your product or service's place in the market. Your price should consistently reflect your company's image.

Example: Are you offering a superior product? If so, your product should be priced at the high end of the pricing band.

Perspective

Depending on which side of the fence you're on, competition may be considered either good or bad, or sometimes both.

| If you're the... | Then competition is... |
|-------------------------|--|
| seller | <p>bad because the consumer may choose the other product. In order to stay in business, your product has to be superior in the customer's mind. This fact makes your job more difficult and costly.</p> <p><u>Note</u>: Even in light of the added work and expense to beat the competition, it can also propel the quality of your goods and services to new heights.</p> |
| consumer | <p>good because it ensures that the business owner offers high-quality goods and services at reasonable prices.</p> <p><u>Note</u>: Competition may also force the entrepreneur to invest time and money in research and development that ultimately benefits the consumer.</p> |

Continued on next page

Competition, Continued

Monopolies

When there's only one supplier in the marketplace, that business has a monopoly. They can charge exorbitant prices without worrying about quality.

Example: You're the only motor scooter dealership in a small college town. When the students return in the fall, you have a run on scooter sales and you charge high prices since there is no other place to buy scooters. However, when a competitor moves in, you have to rethink your pricing and other strategies in order to be competitive with them.

Question: Can you think of any monopolies in the United States?

Direct vs. indirect

There are basically two types of competition.

| Type | Characteristics |
|----------|--|
| Direct | Different varieties – different brands – of the same product. <u>Example:</u> You can purchase motor scooters made by several different manufacturers such as Honda, Suzuki, Vespa, etc. |
| Indirect | A variety of different types of products similar to the original – that is, different categories of product. <u>Example:</u> Besides motor scooters, you may consider buying some other mode of transportation such as a car, motorcycle, bicycle, etc. Indirect competition also includes dissimilar products or services that compete for the same consumer dollar. Items most affected by this type of indirect competition are luxury items. <u>Example:</u> When gasoline prices rise, consumers have less disposable income to spend on luxury items. |

Part IV

Product Image

Introduction The image of your product affects how much you can charge for it, and conversely the price that you charge affects its image. Consumers not only buy an item based on how it functions, they also rely on its image to indicate product quality.

Example: If a product is priced lower than similar products offered by competitors, consumers will assume it is of lower quality.

Note: Image causes consumers to perceive a certain product value in terms of status, luxury, engineering, craftsmanship, reliability, etc.

Targeted consumers Manufacturers target specific groups of consumers by projecting a product image that the desired audience finds appealing. This image is as much a part of the item as its physical makeup.

Example Mercedes Benz has a long-standing reputation for producing cars with the best safety features, the finest engineering, and the most skilled craftsmanship. Because the automotive company projects a very powerful image of high quality and luxury, consumers expect to pay a high price for it.

When Toyota introduced the Lexus brand, consumers knew very little about this new brand of entirely untested cars. Since Lexus was the most expensive Japanese car on the market, potential buyers thought it was equivalent in quality to the Mercedes Benz – the price indicated the quality of the product.

Integrity in pricing Since consumers often choose the most expensive product, assuming it's of the highest quality, businesses might charge high prices to make their own products look good. But if customers buy a mediocre product at a high price, they'll be disappointed in its value and never buy the product again, resulting in poor sales in the long run.

Bottom line Sell your product at a price that more than covers your cost and adjusts to market demand. Calculate the fixed and variable costs, and determine a reasonable profit margin.

Part V

Developing Your Own Pricing Strategy

Introduction

Developing the most effective approach to pricing is important to your marketing program and resulting sales. Determine which pricing strategy is most appropriate for your own situation after carefully evaluating each factor related to the pricing strategy.

Choosing a pricing strategy

The following table describes how to choose a pricing strategy that will be most effective for your own business:

| Step | Action |
|--|--|
| Phase One – Evaluating Marketplace Conditions | |
| 1 | Identify the needs, wants, and desires of consumers. |
| 2 | Determine your market position. |
| 3 | Assess your competition. |
| Phase Two – Analyzing Your Financial Situation | |
| 4 | Conduct a complete cost analysis. |
| 5 | Prepare product or service line financial statements. |
| 6 | Assess existing and future operations. |
| Phase Three – Communicating with Parties Involved | |
| 7 | Communicate with close partners including: <ul style="list-style-type: none">• employees• distributors• retailers. |
| 8 | Communicate with buyers and users. |
| Phase Four – Following Up on Results | |
| 9 | Monitor the results of your pricing strategy. |

Step 1 – Identify the needs, wants, and desires of consumers

This is the most fundamental step in any comprehensive marketing program. The results of your evaluation defining customer expectations will allow you to determine the value that they place on the goods or services that you plan to offer in the marketplace where they do business.

Continued on next page

Developing Your Own Pricing Strategy, Continued

Step 2 – Determine your market position

Establish exactly where your business stands in the marketplace. The answers to the following questions will clarify your position:

- What do consumers think of your goods or services?
 - Is your product a viable alternative to the other items offered?
 - What are the strengths and weaknesses of your product?
 - Is your offering vulnerable to attack by competitors? If so, from which direction and which tactics are they likely to use?
-

Step 3 – Assess your competition

Examine the activity of your competition up close. Take the following measures to evaluate what they're presently doing and the overall path that the market is taking:

- Leave your own place of business and visit the major points of distribution in your area.
 - Observe your competitor's marketing mix, and compare their pricing strategy to your own.
 - Evaluate the competition's promotional effort and the means they use to attract customers.
 - Identify any new products or improvements to existing products that your competitors are offering to consumers.
-

Step 4 – Conduct a complete cost analysis

Analyze the costs involved in doing business. Use this data to align pricing with expenses, and set a reasonable profit margin.

Note: This analysis helps reduce the risk of low or negative profitability.

Step 5 – Prepare product or service line financial statements

It's very important to know the exact contribution to profitability of each item in the line of goods and services. This knowledge allows you to determine the role that each product plays in overall business operations.

Key point: Prepare these statements in fine detail in order to develop a complete and accurate understanding of profit centers.

Continued on next page

Developing Your Own Pricing Strategy, Continued

Step 6 – Assess existing and future operations

Just as important as your ability to analyze cost and profit structures is your ability to track them over a period of time. Your management information system must be capable of:

- providing accurate and timely financial information
 - growing with the company
 - adjusting to inclusions and subtractions from the product line.
-

Step 7 – Communicate with employees, distributors, and retailers

Bring the people who will ultimately implement and adhere to your pricing strategy into the communication loop. Your business will benefit when these associates buy into changes and have a complete understanding of the rationale behind the moves you make.

Step 8 – Communicate with buyers and users

These people are the ones who evaluate your goods or services and make purchases based on the value that they perceive in the product. If they consider price changes unreasonable, you risk alienating them and losing them as customers.

Step 9 – Monitor the results of your pricing strategy

Determine whether your pricing strategy is helping you achieve your specific goals. It's crucial to monitor your program and track the results against your targeted objectives. If your tactics are not meeting your established goals, modify your pricing strategy to get back on track.

Key factors

Consider both costs and market conditions in order to set a profitable pricing structure. Price is a cue to consumers about product quality and ultimately determines the profit margin for each unit sold.

Carefully evaluating your product's or service's place in the market gives you a starting point to determine your pricing strategy. Is your product new to the market? Is your product in a declining market? Evaluate your company image and ensure that pricing reflects this image.

Example: Are you positioned as the best in the market? The best value in the market? Or the cheapest? Many factors affect your price. Make sure that you thoroughly evaluate the factors to ensure you are pricing for profitability.

PACE

Program for Acquiring Competence in Entrepreneurship

Fourth Edition

Cluster A – Exploring Entrepreneurship

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