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PRICING STRATEGY GUIDE



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BALANCING COST AND VALUE

The starting point of any price setting policy is the relationship between the cost of producing an item or service and its value to customers.

The cost represents what a business must invest - in materials, time, expenses, research & development - in order to deliver the product or service. The price is the amount of money the business reaps from selling the product or service. While the value, a rather less well-defined part of the equation, is the worth that customers themselves attach to the product or service.

Should the value of a product/service be higher; the price must reflect that. This is why a pricing policy should consider adding a percentage of the cost to price in order to produce profit and also factor in customer value.

Businesses should also assess the value of the benefits - quality, reliability, convenience, innovation, speed of delivery - they offer their customers before deciding on the true price of their products or services.

COSTS

Most businesses face two sorts of cost: fixed and variable.

There is little a business can do about fixed costs. They are the overheads it must always meet: wages, rental, loan repayments, hire purchase agreements.

Variable costs fluctuate. They hinge on the success of the business. The more it produces, the more costs it must meet in buying additional raw materials, in spending on delivery, in hiring extra people, in expanding premises.

The golden rule here is to make sure that the price exceeds those variable costs. That means each sale generates the money needed not only to meet fixed costs but also to contribute to profits.

PLANNING PRICES

The majority of businesses will need to tread a relatively thin line between cost-based pricing and value-based pricing. This is because, unless you happen to be a brand that has built its reputation on high cost innovation and premium quality, or on huge sales volumes, you will be competing for a broad(ish) range of customers.

Charge too little, and profits vanish. Charge too much, and, save in those cases where a business can demonstrate a truly unique business offering, customers vanish.

It is important to be sure of the type of customer you wish to attract and the level of pricing the market will tolerate. If a business is confident that its offering is distinct from its competitors and that its potential customer base will both understand and be willing to pay for that difference, however it may be defined, then it can afford to adjust its prices accordingly. If a business is operating in a price-sensitive environment, then it may choose to look only to adding a percentage increase on its costs to produce a profit.

PRICING TACTICS

There are a number of different pricing tactics that all businesses can employ to boost their profit margins. One of these is discounting; this may involve cutting prices to clear out old stock, or offering lower prices to customers who buy on a regular or bulk basis. Such orders will push up profits because they mean lower sales costs.

Businesses should beware, however, that repeated discounting does not encourage customers to regard them as a cheaper supplier: pushing up prices, perhaps to meet increased variable costs, may become more difficult in the future.

Loss leaders are products that are sold at a price that fails to generate a profit but are priced in such a way as to encourage the sale of other, maybe associated products, that are profitably priced.

Skimming is a tactic used by businesses that are fortunate enough to have products and services that are truly distinctive. The prices charged are high, reflecting the confidence the business has in the value of its product or service.

HOW TAYLORCOCKS CAN HELP

Pricing strategies can have a huge impact on the performance of any business, so it's vital that you have thought about yours in great detail and understand what your pricing strategy means for your profitability as a business.

For help with defining your pricing strategy, or to speak to a business strategy expert, contact Taylorcocks Chartered Accountants today.

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