

SMALL BUSINESS AND
ENTREPRENEURSHIP

ESTIMATING COST
AND SETTING PRICE

What is the problem?

Pricing your product

Too high price

Too low price

Drive customer away

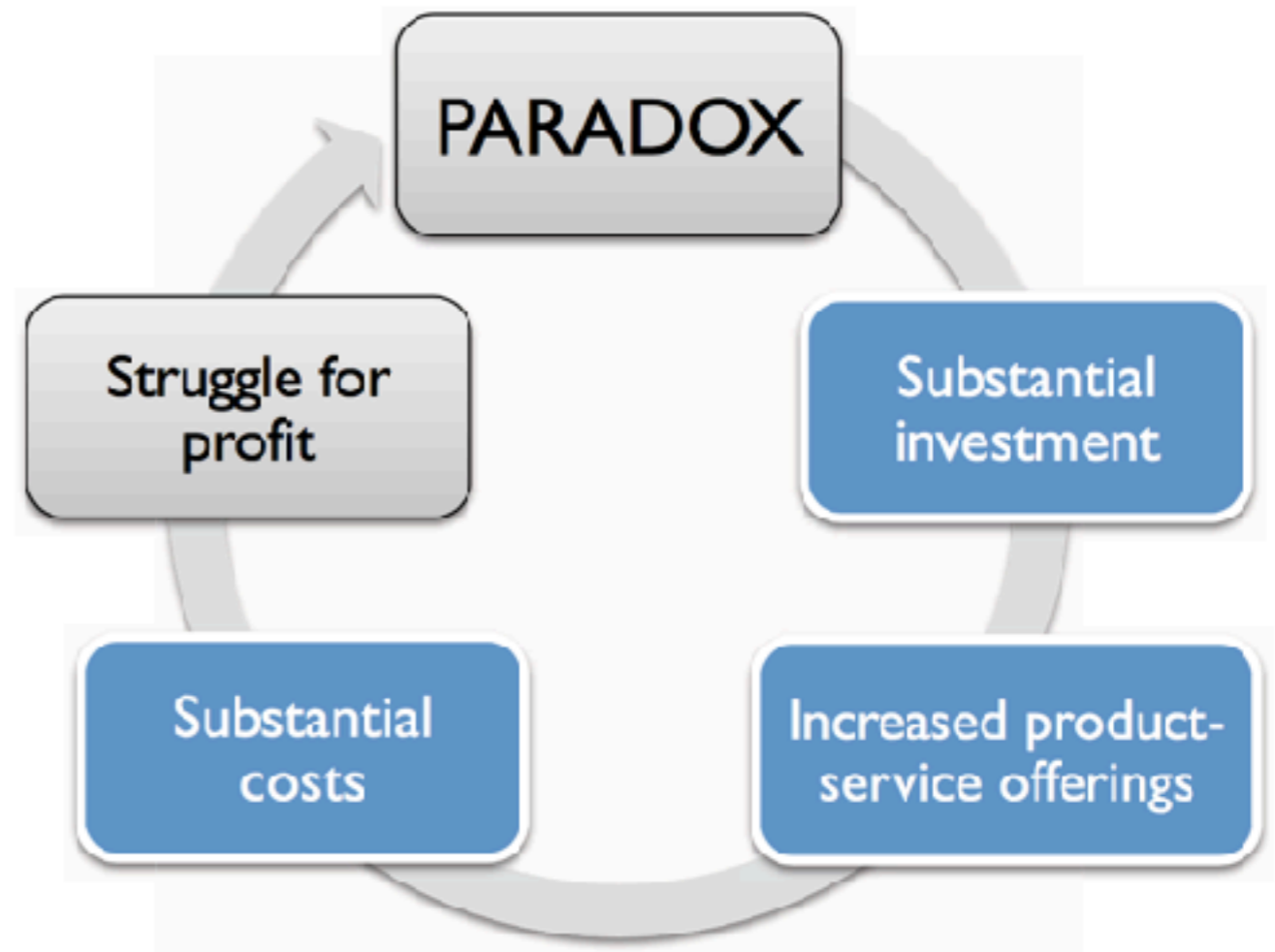
Limited profit margin

Negative effect on how customer perceives
the product quality

Pricing your service

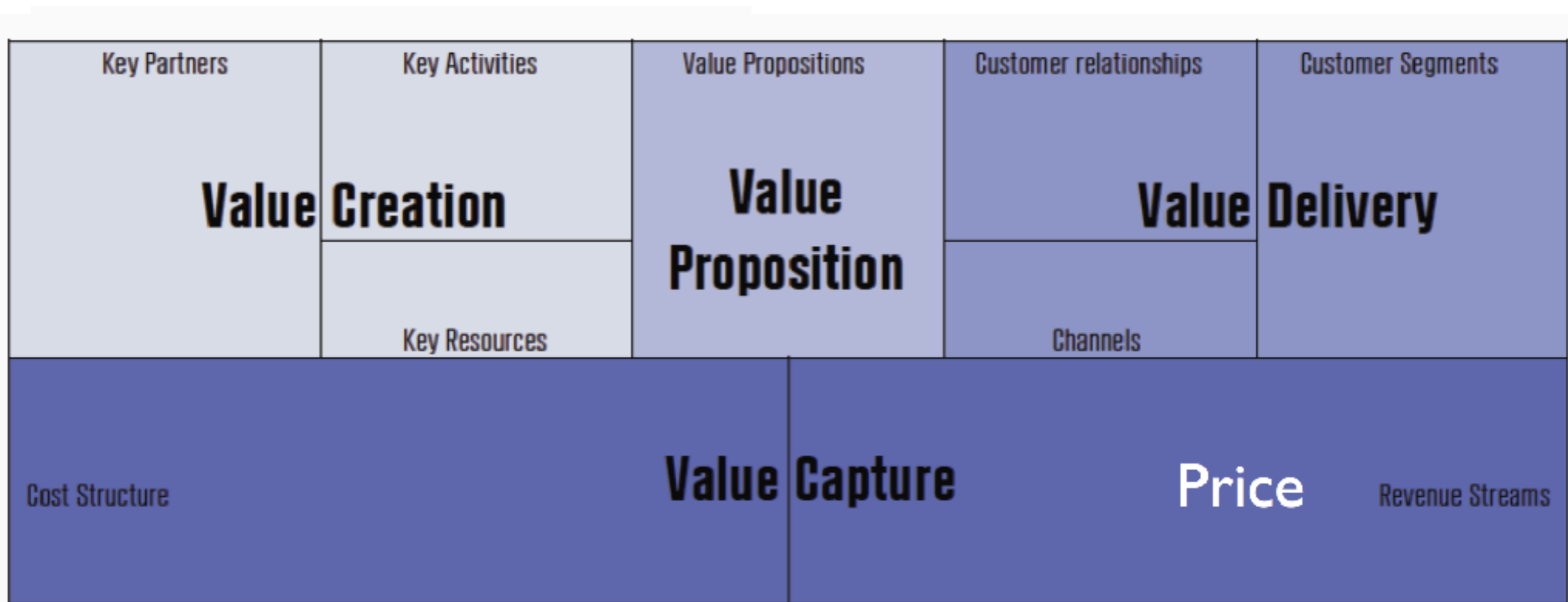
Characteristics	Challenges
Intangibility	Underpriced
Inseparability	Promised at performance levels that cannot be delivered profitably
Variability	Insufficient estimation of costs related to risks
Perishability	

Price is undermanaged



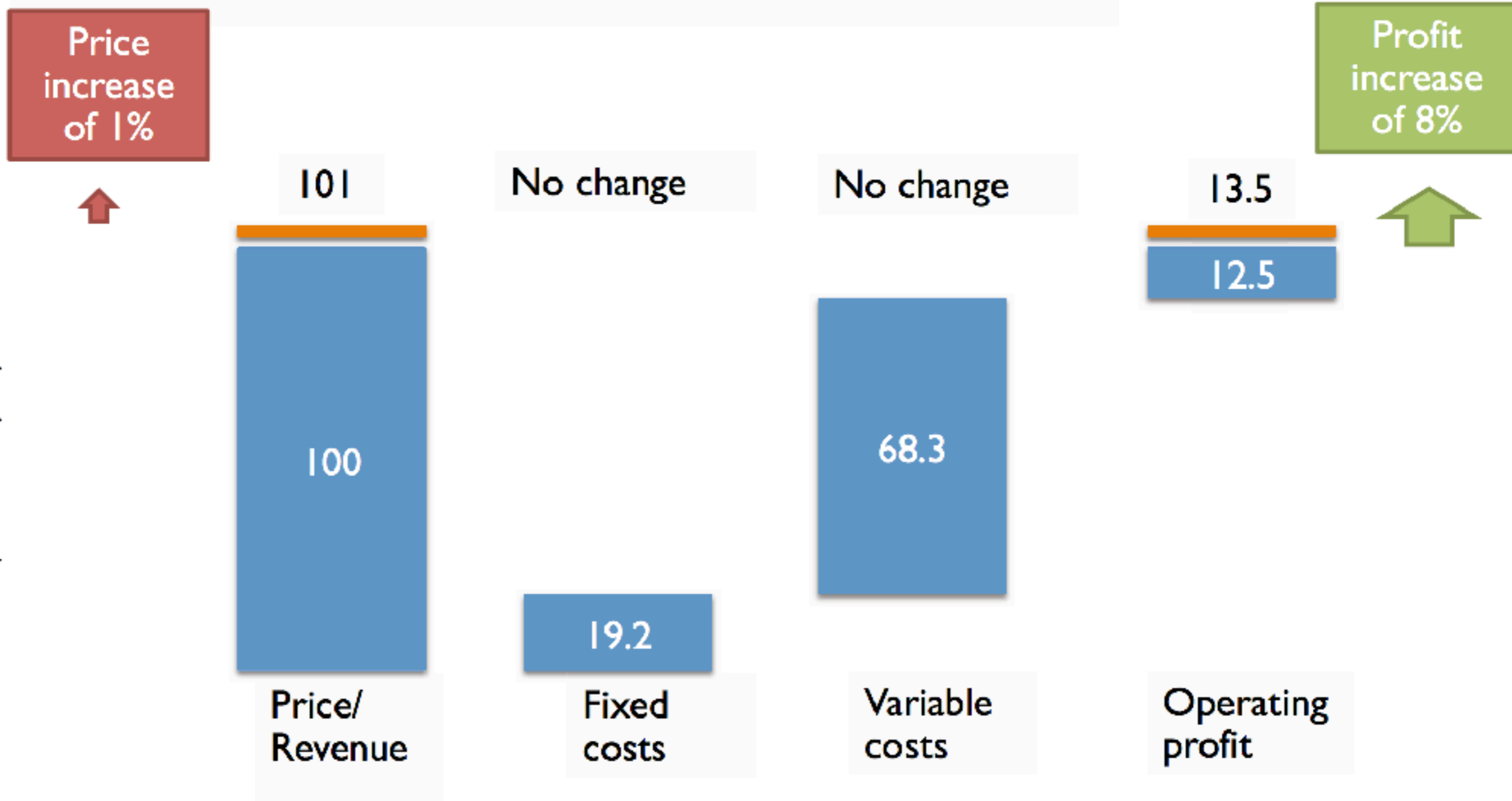
Why is it important?

Power of pricing



Source: Jiang and Hansen, 2016; Osterwalder and Pigneur, 2009

- Pricing has the highest impact on increasing profit



- Pricing has the highest impact on increasing profit

A 1% rise/decrease

Increases company profits by (%)

In price

8

In variable costs

4

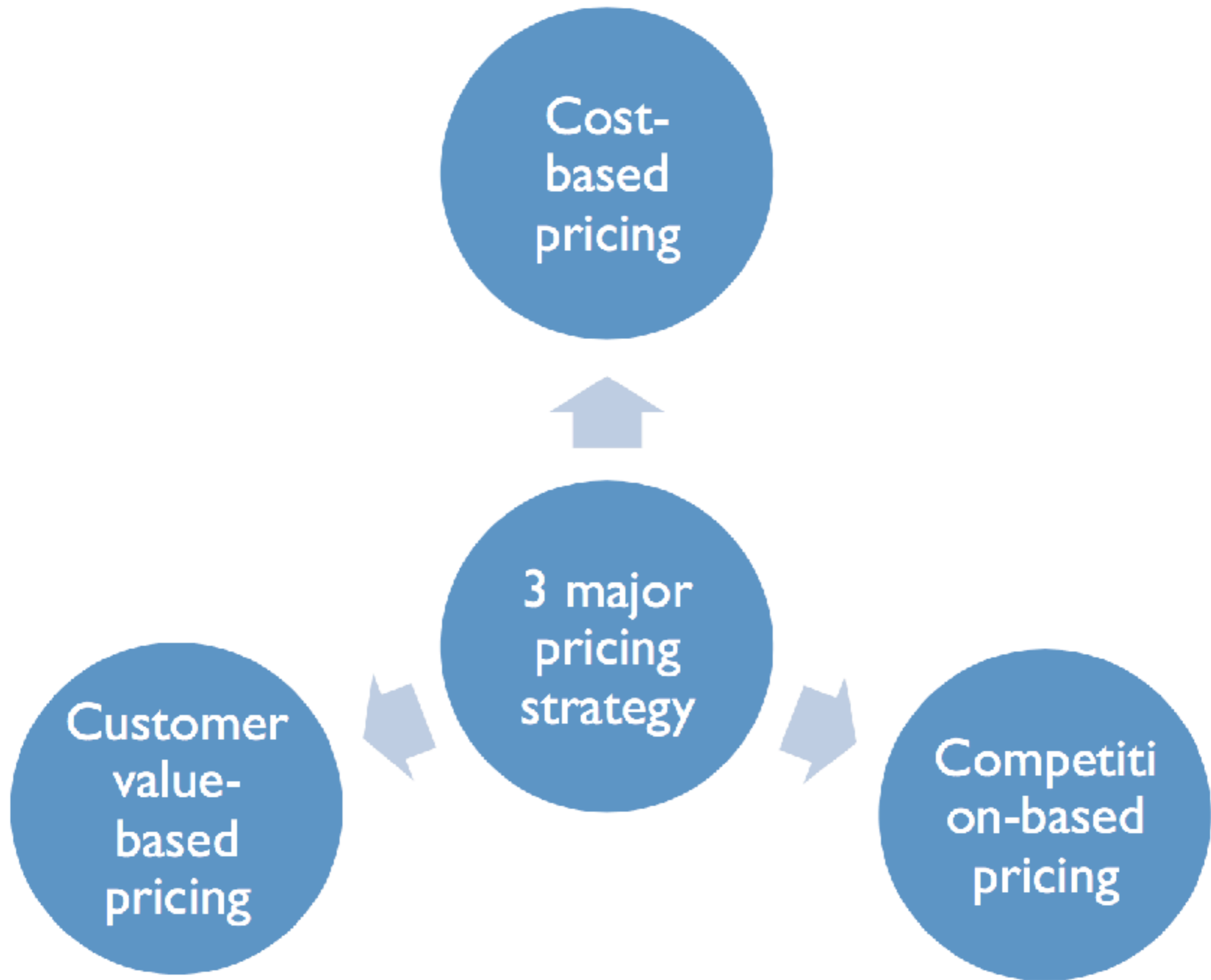
In sales volume

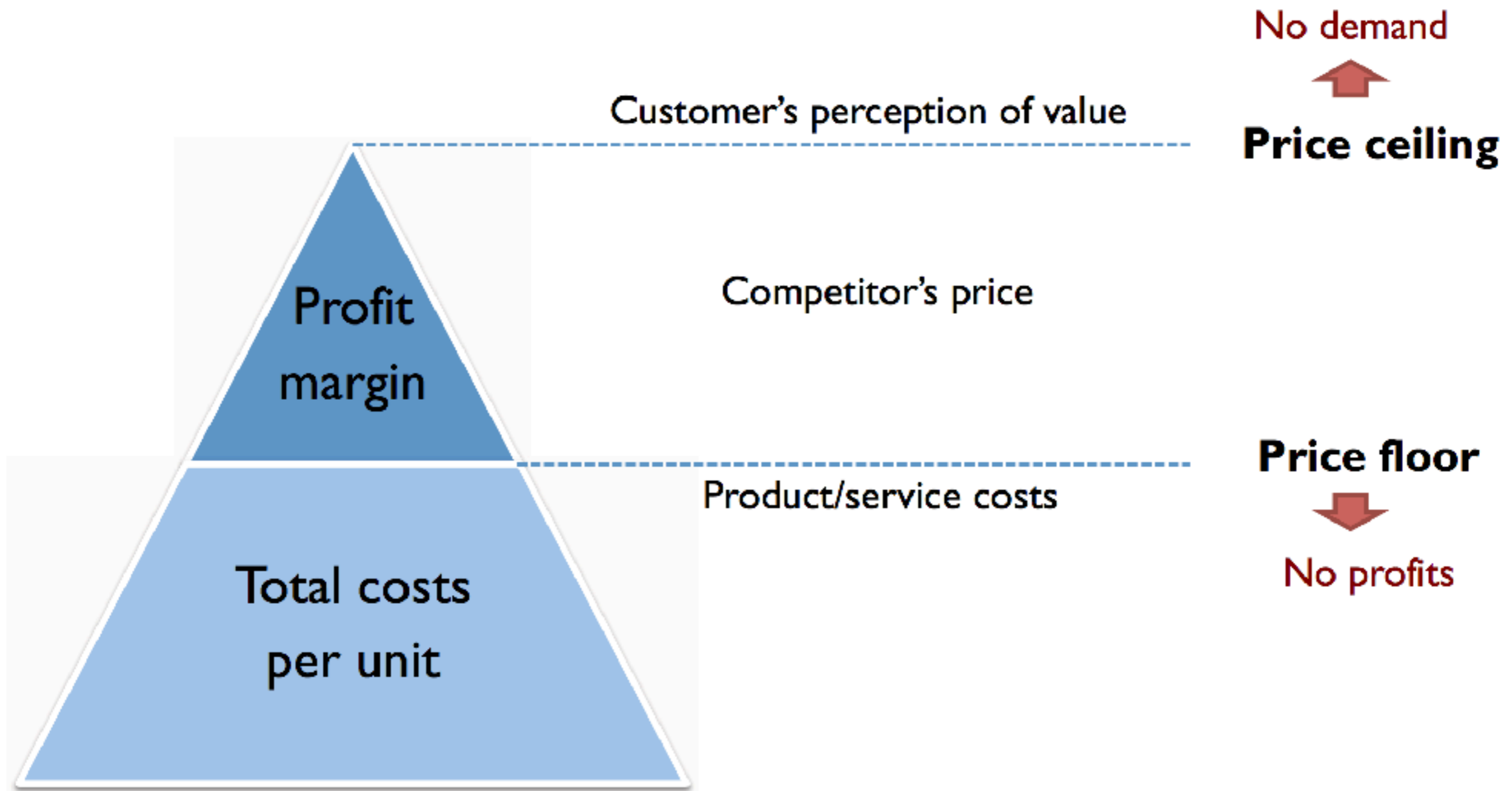
4

In fixed costs

3

What can be done?





Customer's perception of value

No demand



Price ceiling

Competitor's price

Profit margin

Price floor

Product/service costs



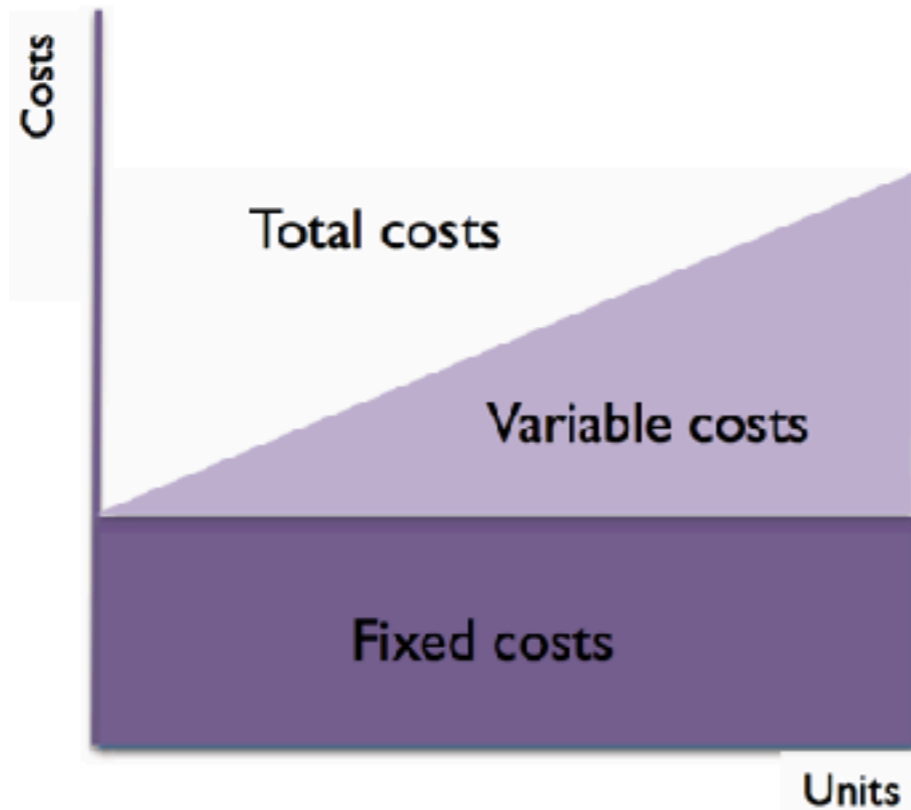
No profits

Total costs per unit

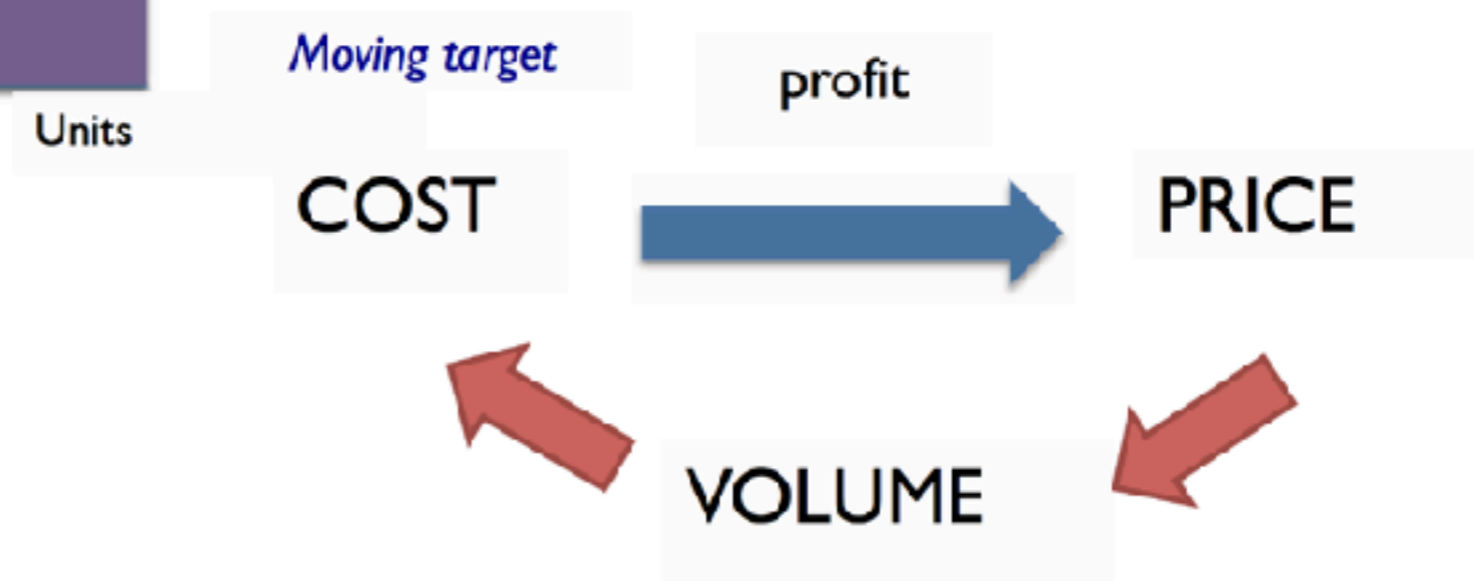
COST BASED PRICING

- Setting prices based on costs and desired profit margin
- Focus on seller's cost (price floor)
- The most common and simplest method of setting prices
- Data readily available
- Don't take demand and competition into account
- Produce sub-standard profitability
- Walmart, Ryanair

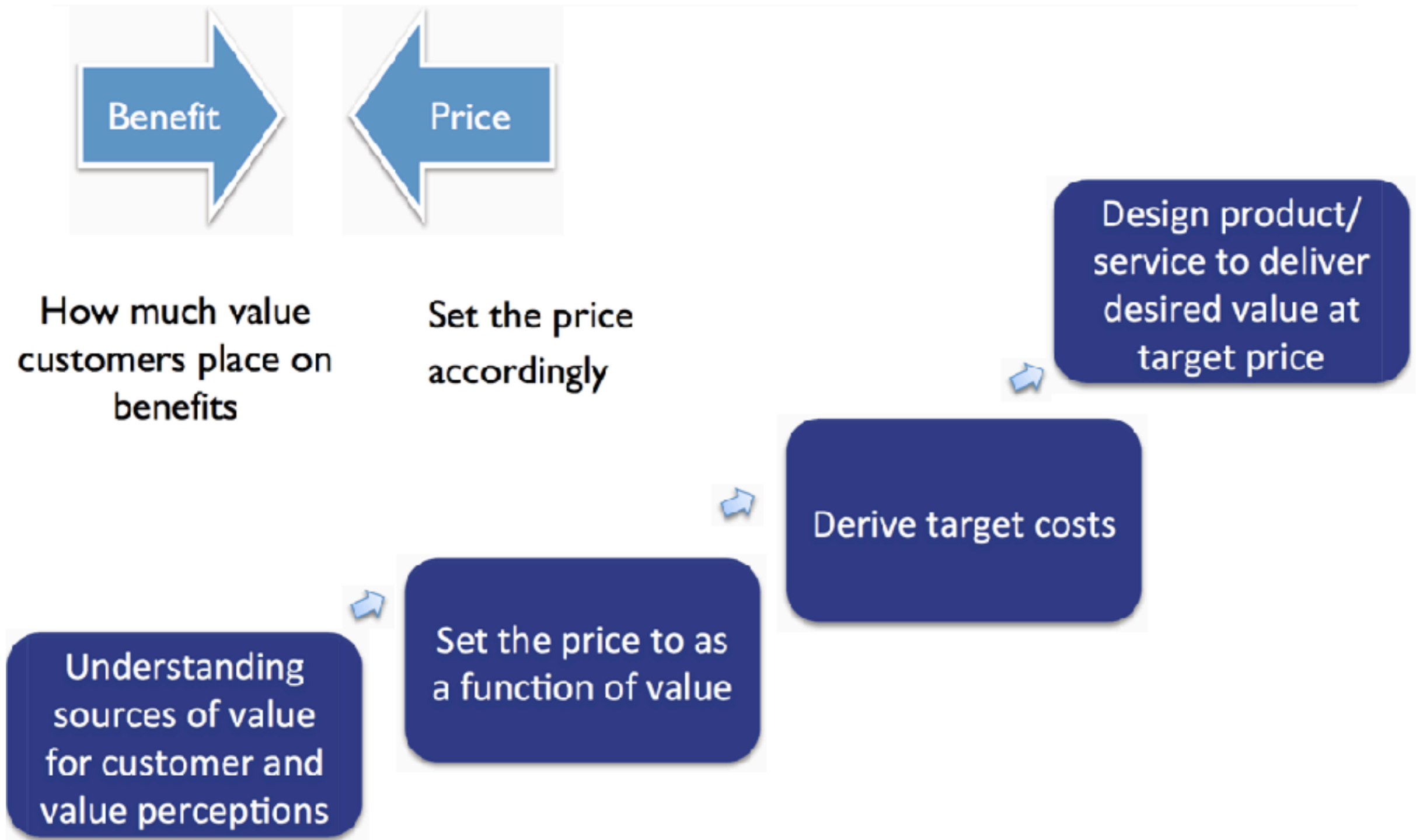
COST BASED PRICING



Assumption: One can first determine sales levels, then calculate unit cost and profit objectives, and then set a price



CUSTOMER VALUE BASED PRICING



CUSTOMER VALUE BASED PRICING

- Setting prices based on customer's perception of value (price ceiling)
- Take customer perspective into account
- Data are difficult to obtain and interpret
- Customer value is not a given
- Apple, Lufthansa, BMW

COMPETITION BASED PRICING

- Setting prices based on anticipated or observed price levels of competitors (price reference)
- Data readily available Low risk
- Don't take customer into account
- Lead to missed opportunity
- Gasoline industry

COMPARISON

‘Our ValueScan survey, covering more than 200 companies in both consumer and business markets, found that firms developing and effectively executing **value-based pricing strategies** earn **31 percent higher operating income** than competitors whose pricing is driven by market share goals or target margins’ (Zale, 2014).

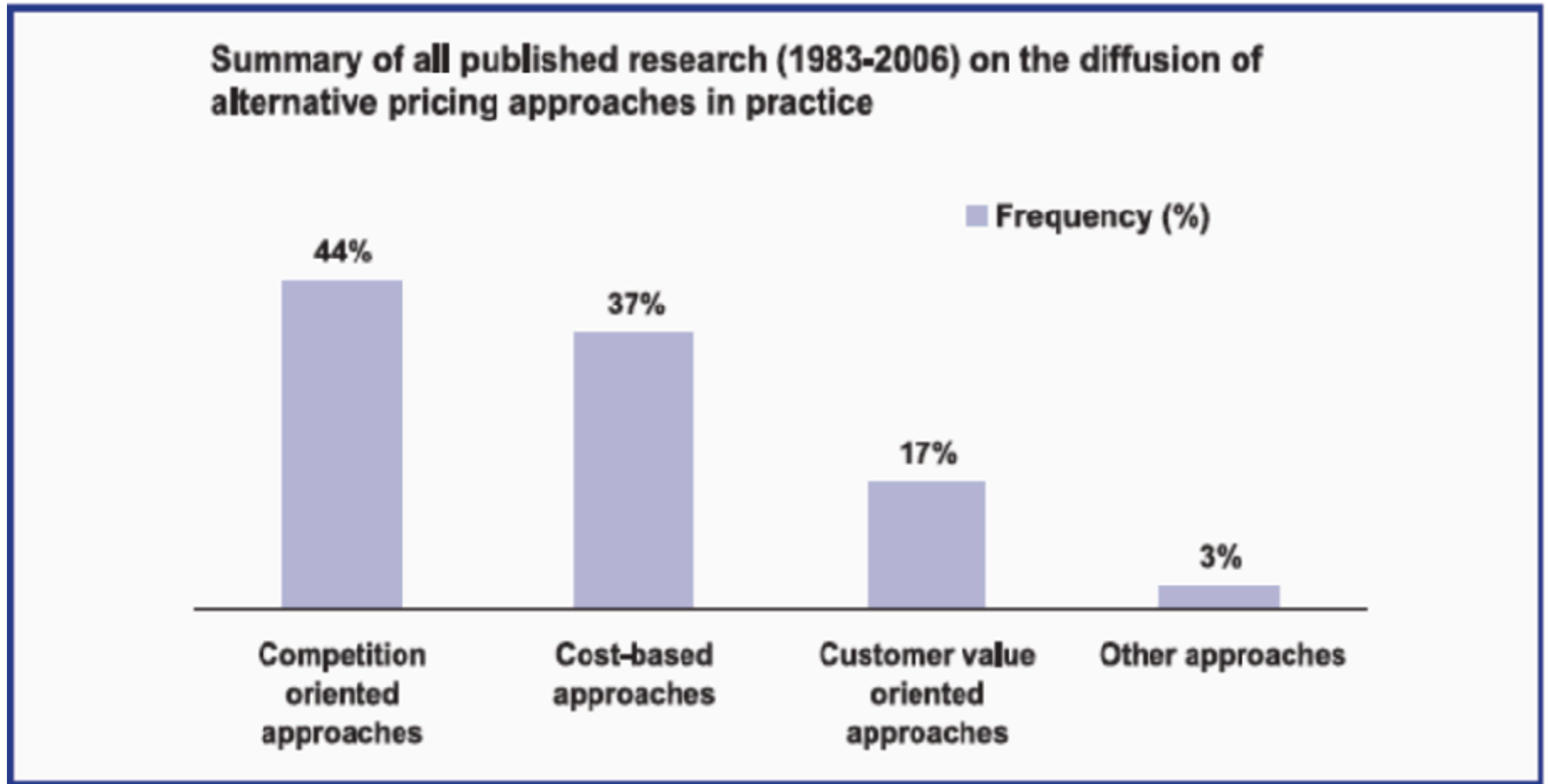
Cost-based pricing



Customer value-based pricing



ADOPTION OF ALTERNATIVE PRICING STRATEGIES IN PRACTICE



Source: Hinterhuber, A. 2008.

STRATEGIC PRICING



More market share **VS** Greater profit

PROFITABILITY => Pricing for profit

Making informed trade-offs between price and volume in order to maximize profits.

THANK YOU

**CUSTOMER VALUE-BASED PRICING
STRATEGY: IS IT YOUR CHOICE? IF NOT, WHY
COMPANIES RESIST?**

**SUPPLIERS - WHICH PRICING STRATEGY IS
RIGHT FOR YOUR BUSINESS AND WHY?
WOULD IT BE POSSIBLE TO HAVE MIXED
PRICING STRATEGIES?**

**CUSTOMERS - WHICH FACTORS BRING YOU
THE CUSTOMER BENEFITS (EG. PRICE, QUALITY,
PERFORMANCE, FINANCE, LOW RISK)?**