

PRICING YOUR PRODUCT OR SERVICE

Effectively pricing your product or service can be a challenge. The job can be made a little easier if you think of it in terms of a process consisting of four separate (yet on-going) phases. The phases are:

1. Establish a pricing strategy for the new product or services
2. Create a pricing policy for the new product or services
3. Assign specific price levels
4. Review and maintain pricing for existing products or services

Each of these phases will likely be restarted and reassessed several times during the effective life cycle of the product or service. This reassessment may be triggered by any number of internal/external factors including entering a new phase of the product life cycle, changes in the competitive or regulatory environment, changing market dynamics, and short term promotional initiatives.

Pricing Strategy

Your pricing strategy is simply a statement of what you are trying to accomplish with a given product or service at a given point in time. It must be consistent with overall corporate goals and objectives. Depending on the scope of your product line and the markets you serve, the pricing strategy may or may not be the same for all product lines and will likely require change over time as discussed earlier. It is the foundation for the decisions you will make in the other phases of the pricing process. Most pricing strategies will flow from one of two overriding objectives that you will establish for a particular product or service. They are:

1. Maximize revenue and profit or
2. Maximize market penetration

Your objective may then be fine tuned by attributes that intensify the intended effect, such as, penetration pricing, follow the leader pricing, loss leader pricing, cost plus pricing, phase-out pricing, skim pricing, etc. Development of the pricing strategy is usually the domain of senior management.

Pricing Policy

Pricing policy (aka pricing or licensing model) is the vehicle that companies use to calculate and communicate cost and what is included to the customer. To the extent that cost is equal to or less than the customer's perceived value, your ability to sell will be enhanced. The best pricing policies benefit the company as well as the customer.

Pricing policies are generally based upon a metric that is used to calculate cost for the product or service (one time or on an on-going basis.) Some common metrics include number of named users, number of concurrent users, power of the CPU, and transactions processed. Your target audience will often dictate the appropriate metric for your pricing model because it will make sense to them. For example, the financial services industry might better understand transaction count as a basis for calculating price than CPU size. They deal with transactions every day.

Although the right metric is probably the most important factor in an effective pricing model (makes it easier for you customer to equate what you are selling with value) there are several other principles that you should consider when developing a pricing model.

- The model should be easy to sell and explain to the customer making the sales job easier
- The model should be easy to administer for finance and customer service personnel
- The model should allow for predictable calculation of fees for the customer and predictable calculation of revenue for the company

Developing an effective pricing model is largely a function of how well you know your market and target audience. Product marketing (with some help from sales, customer support and professional services)

should drive the development of the pricing model and obtain approval from senior management prior to establishing the special dollar amounts charged for the product.

Pricing Specifics

Establishing the actual price point is dependent upon several factors that have been established earlier in this pricing process. Are you trying to maximize revenue and profits or expand the installed base? What are the corporate goals for margin on this class of product? What is the competition's price? What is included in the price?

When these factors are understood, it's time to pick some price points and do some modeling. To the extent that historical sales and pricing information is available, it should be used to analyze the effect of the proposed pricing. Forecasts and sales projections should provide a look into the future as well. The price points should be selected on the basis of business impact and how they deliver on the goals established in the pricing strategy.

Most importantly, your customers must be able to equate your price to the value they perceive. Please remember, however, that value (or the price the customer is willing to pay) is not solely a function of product functionality. There are other factors that enter into the customer's value equation. Some of those are:

- Pricing must be fair to both vendor and customer, proportional to actual value to customer, understanding that perceived value is user-specific.
- Value may have little or no relationship to software price.
- Users may realize value far beyond original vision.
- Value is a function of risks and benefits over time.
- Predictability adds value. (Stability, migratability, upgradeability)
- Risks include vendor viability, uncertain support costs.
- Value is composed of two components, intrinsic worth or perceived value (subjective), use-intensity in the organization (measurable)

This is a lot of words that simply say that customers do not buy on price alone. Failing to understand or price based on all the elements of value to the customer may result in overvaluing the product at the low-end, and undervaluing at the high-end.

Pricing recommendations should be made by Product Marketing in the form of a business case that demonstrates the ability of the proposed pricing to meet the goals and objectives of the pricing strategy within the framework of the agreed upon pricing model. The recommendation should be authorized by the appropriate members of the senior staff.

Review and Maintain

Once a new product has been priced, there will be periodic life-cycle events and market dynamics that will cause you to re-examine your current product or service pricing. Requests for review of existing prices may come from sales or finance or customer support, or be initiated by product marketing. There should be a mechanism in place that allows the company to move quickly through this review and determine if changes should be made.

Many companies have established pricing committees comprised of senior executives from sales, marketing, finance and support that review and decide upon pricing action recommendations brought forward by Product Marketing. It is the responsibility of Product Marketing to conduct the research and build a business case that supports their recommendations. Although this business case may not be as detailed as the original effort to price the product, it must take the committee through all the phases of the pricing process. Starting with the pricing strategy and ending with pricing specifics, the business case should examine what has changed and what action, if any, should be taken to keep the product or service on target with company goals and objectives.

In some cases, only the specific price points should change, leaving the strategy and model untouched. Other market challenges may dictate more radical action such as changing the pricing model. In all cases, the impact on the installed base must be examined as well.

The committee should have access to all pertinent information (competitive information, spreadsheets, etc.) that Product Management used to develop the recommendation. Ideally, Product Management will have provided adequate information for the committee to make an informed decision quickly but must be prepared to do additional research at the request of the committee.

Conclusion

Although pricing is primarily a tactical function, it is rooted in corporate strategy and is very important to your on-going success. It must be consistent with the corporate goals and objective and should be implemented in a manner that facilitates revenue generation. Pricing models that are out of touch with the market and you potential customers will at best slow the sales cycle and at worst, deprive you of revenue that you should have gotten. It does take time to do the job thoroughly, but it is well worth the effort.