



JUMP START

As Cheryl prepared to open her spa, she was overwhelmed with the choices she had to make. In addition to a wide array of spa services, there were many products to choose from, including skin care, aromatherapy, and nail products, among others. Sergio recommended that Cheryl consider what products and services other spas in the area were offering. She might want her product mix to be a little different from her competitors. After determining what she wants to offer, Cheryl would have to decide who to purchase from and how to price the services and products. What suggestions do you have for Cheryl's product mix?

GOALS

Describe and define the importance of product features, branding, and positioning

Explain how to price products or services using various methods

KEY TERMS

product mix, p. 108

market share, p. 109

©Diego Cervo, 2009/ Used under license from Shutterstock.com



The Product

Once you have determined what kind of business you will run, you will need to make decisions about the products that you will sell. Over the past 50 years, consumers have become more educated, and competition has increased to include the global market. This has led to a change in the U.S. market, from being a product-driven market to one that is consumer-driven. The marketing concept is the belief that the wants and needs of customers are the most important consideration when developing any product or marketing effort. The marketing concept can give small businesses an advantage over larger businesses because small businesses can be more responsive and more flexible when trying to satisfy customer needs.



TEAMWORK

Working with team members, make a list of products and services you would offer if you were opening an extreme sporting goods store. Make a list of the features of your products and services. Write a positioning statement that differentiates your business from your competitors.

Identify Your Product Mix

The different products and services a business sells are its **product mix**. In a consumer-driven economy, entrepreneurs realize that sometimes they must include products in their mix as a convenience for customers even though they may not be profitable. This will give the appearance to customers that the store has everything they need. It has been found that, often, a small percentage of the product selection makes up the majority of the sales revenue.

Select Product Features

In addition to identifying your product mix, you will have to select product *features*, which are product characteristics that will satisfy customer needs. Every product has features. Features include color, size, and quality. They also include hours, warranties, delivery, and installation. You will need to consider your target market when selecting product features.

Consider Branding, Packaging, and Labeling

Making your product stand out from all the others in the market is a challenging task. *Branding* is the name, symbol, or design used to identify your product. The package is the box, container, or wrapper in which the product is placed. The label is where information about the product is given on the package. The brand, package, and label that you choose for your product will help differentiate it from others on the market. When you see the Nike name and “swoosh” symbol, for example, you know about the quality of the product you have selected.

Position Your Products or Services

Different products and services within the same category serve different customer needs. For example, both Hyundai and Jaguar sell automobiles, but these two products are positioned very differently in the marketplace. *Positioning* is creating an image for a product in the customer’s mind. Businesses position a product in a certain market to get a desired customer response. Product features, price, and quality may be used for positioning. Jaguar’s pricey cars are positioned for the person wanting high quality and status. Hyundai positions its product to satisfy a need for an inexpensive family motor vehicle. Examining the competition’s positioning strategy can help you determine the best positioning strategy for your target market.

CheckPOINT

Why are product features, branding, and positioning important?

Price

The price is the actual amount a customer pays for a product or service. Prices you charge must be low enough so that customers will buy from you and not from your competitors. To earn a profit, though, your prices need to be high enough so that revenues exceed expenses.

Set Pricing Objectives

Before you can select a pricing strategy, you will need to establish objectives for your pricing program. What is the most important thing you want the price to do? Examples of price objectives include

- Maximize sales
- Increase profits
- Discourage competition
- Attract customers
- Establish an image

Consider the Return on Investment

When setting pricing objectives, you may want to consider your return on investment. Investment refers to the costs of making and marketing a product. The *return on investment (ROI)* is the amount earned as a result of the investment, usually expressed as a percentage. Entrepreneurs must identify the percentage return they want from their investment. The target percentage in the beginning may be lower than it will be as the business grows. If you invest \$5,000 in your smoothie stand and you want a 15 percent return, you need to price your product so that you will earn \$750, since $\$5,000 \times 0.15 = \750 .

Determine the Market Share

Market share is a business's percentage of the total sales generated by all companies in the same market. For example, if people in a specific community normally spend \$1,750,000 a year on gourmet food products and a gourmet food store's sales are \$192,500, its market share will be 11 percent.

$$\begin{array}{rclcl} \text{Amount of sales} & \div & \text{Total market size} & = & \text{Market share} \\ \$192,500 & \div & \$1,750,000 & = & 11\% \end{array}$$

Your market share will depend on the level of competition in your market. You can increase market share by lowering prices. Advertising and promotion campaigns that attract more customers can help too. You also can network with potential customers. *Networking* involves establishing informal ties with people who can help your business grow. Attending trade association meetings and other gatherings can provide good networking opportunities.



©iofoto, 2009/ Used under license from Shutterstock.com

What factors must be considered when setting a price for a product?

Price a Product

Once pricing objectives have been determined, the next step is to determine the possible prices for products. There will usually be more than one price that can be charged for a product. Pricing may be based on demand, cost, or the amount of competition.

Demand-Based Pricing Pricing that is determined by how much customers are willing to pay for a product or service is called *demand-based pricing*. Potential customers are surveyed to find out what they would be willing to pay. The highest price identified is the maximum price that can be charged.

Cost-Based Pricing Pricing that is determined by using the wholesale cost of an item as the basis for the price charged is called *cost-based pricing*. A *markup price* is the retail price determined by adding a percentage amount to the wholesale cost of an item.

Sometimes business owners purchase too much of a particular item and want to sell more of it quickly. To do so, they mark down the retail price of the product. A *markdown price* is a price determined by subtracting a percentage amount from the retail price of an item. You should be careful not to mark down an item below its cost. You do not want to lose money.

Competition-Based Pricing Pricing that is determined by considering what competitors charge for the same good or service is called *competition-based pricing*. Once you find out what your competition charges for an item, you must decide whether to charge the same price, slightly more, or slightly less.



Business Math Connection

If Luisa Ramirez, a gourmet food store owner, buys artichoke hearts for \$1.77 a can and wants to add 40 percent to the wholesale cost, what would the retail (markup) price be? If Luisa usually sells olive oil for \$10.50 a bottle and wants to mark down the price 20 percent to try to sell more olive oil, what would the markdown price be?

SOLUTION

Use the following formulas to calculate retail price.

$$\begin{array}{rclcl} \text{Wholesale cost} \times \text{Percentage markup} & = & \text{Markup amount} & & \\ \$1.77 & \times & 0.40 & = & \$0.71 \end{array}$$

$$\begin{array}{rclcl} \text{Wholesale cost} + \text{Markup amount} & = & \text{Retail price} & & \\ \$1.77 & + & \$0.71 & = & \$2.48 \end{array}$$

Use the following formulas to calculate markdown price.

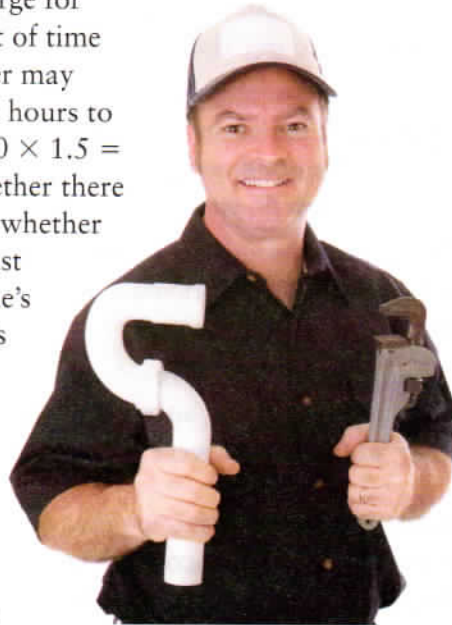
$$\begin{array}{rclcl} \text{Retail price} \times \text{Percentage markdown} & = & \text{Markdown amount} & & \\ \$10.50 & \times & 0.20 & = & \$2.10 \end{array}$$

$$\begin{array}{rclcl} \text{Retail price} - \text{Markdown amount} & = & \text{Markdown price} & & \\ \$10.50 & - & \$2.10 & = & \$8.40 \end{array}$$

Price a Service

When setting the price for a service, it is important to consider not only the cost of any items used in providing the service but also the amount of time involved and anything that is included with the service.

Time-Based Pricing The price to charge for services can be determined by the amount of time it takes to complete the service. A plumber may charge \$100 per hour. If the job takes 1½ hours to complete, the labor charge would be $\$100 \times 1.5 = \150 . A service provider must decide whether there will be a separate charge for materials or whether the materials will be included. A hair stylist charges a set amount to highlight someone's hair. The amount includes the hair stylist's time as well as all of the supplies used for the highlighting. Some service providers will negotiate the price. This is often done with legal services and construction projects.



©Lisa F. Young, 2009/ Used under license from Shutterstock.com

Bundling Services can be *bundled*, or combined under one price, rather than making the customer pay for each individual part of the service. Airlines use bundling when they charge a passenger for a ticket. The price includes not only the transportation, but also any food and beverages served in flight, the services of the employees who check in passengers, and baggage handling.

How is pricing a service different from pricing a product?

Pricing Techniques

It is important to set the right price for your products and services. Pricing can make or break a business. Different techniques may be used to set prices at different stages of the business.

Introductory Pricing As a product is introduced into the market, sales will be low, marketing costs will be high, and little if any profit will be made. Two introductory pricing techniques are price skimming and penetration pricing. *Price skimming* is used when a product is new and unique. A high price is charged to recover the costs involved in developing the product. Then as more competitors enter the market with similar products, the price is dropped. *Penetration pricing* starts out with a low introductory price with the goal of building a strong customer base. The low price also discourages competition.

Psychological Pricing Pricing based on the belief that certain prices have an impact on how customers perceive a product is called *psychological pricing*. Techniques used in psychological pricing include the following.

- *Prestige pricing* is selling at a high price in order to create a feeling of superior quality and social status.
- *Odd/even pricing* suggests that buyers are more sensitive to certain ending numbers. Studies have shown that prices ending in odd numbers are perceived to be bargains while those ending in even numbers suggest higher quality. For example, a shirt that sells for \$29.99 sounds like a bargain compared to one that sells for an even \$30.00.
- *Price lining* involves offering different levels of prices for a specific category of product based on features and quality. A jeweler might offer three price lines of diamond necklaces and display them in different cases so that shoppers can go straight to the price level they can afford.
- *Promotional pricing* is offering lower prices for a limited time to increase sales. This type of pricing is temporary, and prices will return to normal when the promotion ends.
- *Multiple-unit pricing* involves pricing items in multiples, such as 10 for \$10. This type of pricing suggests a bargain. People will buy more items than they would if they were priced individually.

Discount Pricing Pricing that offers customers a reduced price is *discount pricing*. It is used to encourage customers to buy. Markdowns are a type of discount pricing. Other discount pricing strategies include the following.

- *Cash discounts* are offered to customers to encourage early payment of invoices. When this is done, the terms of an invoice will include the amount of the discount, the number of days in the discount period, and when the invoice is due if the discount is not taken. For example, terms of “2/10, net 30” mean that a 2 percent discount may be taken if the invoice is paid within 10 days. If no discount is taken, the net or total amount of the invoice is due within 30 days of the date of the invoice.
- *Quantity discounts* are reductions in price based on the purchase of a large quantity. This is also called a volume discount. Sellers offer quantity discounts because they reduce their selling expenses.
- *Trade discounts* are reductions on the list price granted by a manufacturer or wholesaler to buyers in the same trade.
- *Seasonal discounts* are used for selling seasonal merchandise out of season. For example, barbecue grills are in high demand in the spring and summer months, but not in the fall and winter. Manufacturers offer discounts to customers who purchase grills out of season.

CheckPOINT

What pricing objectives are most important to a new business?
