1.
What is pricing?

2.
Why does it matter that I choose the right price?

3.
Can you explain what 'supply and demand' is and why do I need to understand it?

4.
Is there a tool that can help me understand how to set a price and make a profit?

5.
What are the 3 main components of the pricing process that I need to understand?

6.
How can I find out what my customers are willing to pay?

7.
What are some of the ways that companies use to establish their pricing?

8.
What is the best way to set prices for my business?

9.
How do I set pricing based on value?

10.
How can I create value in my product or service to justify my prices?

11.
How does my selling strategy impact my pricing strategy?

12.
How do people think about prices and how does this impact my pricing decisions?

13.
What are some pricing techniques that will make my customers buy?Do I need to know?

14.
Why do some prices appear more attractive to customers than other prices?

15.
How can I increase prices and how often should I increase or decrease my prices?

16.
How can I sell different versions of my product to different customers at different prices?

17.
When should I run a sale or promotional price?

18.
What are some of the options I have when setting my prices?

19.
Is charging high prices unethical?

20.
Is "free" ever a good idea?

# 1.
# What is “Pricing”?

## The Basics

Pricing is a very powerful and important business decision. That is because your pricing is the reflection of everything you do in your business. Nothing else defines a brand or company more than its pricing. For example, do you sell high-priced luxury products or services or do you sell lower priced items for customers worried about price?

Your pricing represents an important business decision - how will you make sales and earn profits while telling your customers the value of your brand or company. Price is the method of turning how many items you sell into how much money you will make. On one side, you may decide to price your products lower, knowing that you will have to sell more of them to make the amount of profit you want. On the other side, you could charge more for your product and sell less items to make your profit goal.

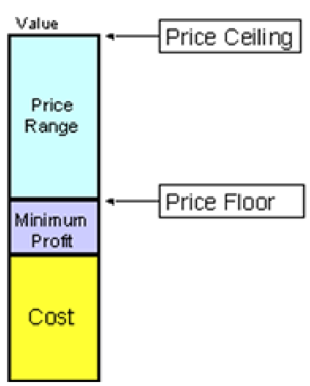
Pricing is affected by the process of balancing supply and demand in the market. Supply is how much of something you have, and demand is how much of something people want at a certain price. Put the two together, and you have supply and demand. If there are not a lot of options for people to buy your product or service someplace else, then the supply is low and the demand for your product will likely be high. If there are a lot of similar products like yours to choose from, then supply is high and demand for your particular product may be lower. Your price will reflect the amount someone is willing spend for your product or service.

## Tell Me More

Pricing describes what value people expect to get for the money they spend on your product or service. Everything in your business process justifies that value. In the normal business process, you build a product/service with features that your target customer needs. Your marketing communicates those features to the target customer and explains why those features are important. The sales process encourages customers to buy your brand. Customer service makes customers happy after they purchase by treating them well. Everything in this business process – making, marketing, selling, and customer service - works to justify why you can charge the price that you do.

Simple pricing decisions are typically made between a price floor (the lowest price you can set and still make enough profit) and a price ceiling (the highest price that you can reasonable charge without losing the customer to a competitor). The graphic below shows this price range:

Most price decisions happen within a price range from the price floor to the price ceiling. This means that your product/service's price should fall somewhere in this range - between "It's too much for me to pay" and "I can't make any money at that price."



## Glossary Terms from this Section

**Marketing –** the process of reaching your customers and showing them why they should buy your product or service.

**Supply and demand –** Supply is how much of something you have, and, demand is how much of something people want at a certain price. Put the two together, and you have supply and demand.

**Price floor –** the lowest price that achieves the business's profit objectives

**Price ceiling -** the highest price that people will pay for a product/service and still continue to make sales

## For More Information Related to this Topic See

- What are some of the ways that people use to establish their prices? *9. Pricing*
- Is there one way that is the best way to set prices for my business? *9. Pricing*

## Additional Tools Available

Price Setting Worksheet

# 2.
# Why does it matter that I choose the right price?

## The Basics

Pricing is the most important decision a business owner can make. Price is so important because it represents the amount of value an owner thinks a customer will see in their product/service, and what they think customers will be willing to pay for that product/service.

Prices must be competitive if a business is to succeed over time. Charging too much for a product or service may keep customers from even doing business with you. On the other hand, a business must take care not to price items so low that customers see the items as low quality. Customers tend to believe that they get the quality that they pay for.

A business does not want to cut its prices so much that the business does not make enough profit to survive. And, if the prices are too high, fewer products will be sold, which means the owner is probably losing money. Therefore, pricing is a delicate balance. It is important to choose a price that has the right combination of making sales and making profit.

## Tell Me More

Research has shown just how powerful small changes in your price can be for a business. There have been two significant studies done on this topic. The first study was done by the senior pricing team at McKinsey and Company and the second was done by the pricing experts at AT Kearney, both well-known global consulting companies. The studies interviewed over 2,500 large and small companies all over the world. They found that making changes to your price makes the biggest impact on the amount of profit you make. Other business decisions, such as cutting costs or selling more items, did not increase profits as much as changing prices did. The studies proved that making changes in your pricing is the fastest and most effective way for companies to grow profits.

The studies also showed that small price increases of just 1 or 2% translated into big increases in profit. This means that, when you are thinking about making a pricing change, think about making a small change. Annual pricing changes that increase your average prices by as little as 1 percent can make a big impact. Small price increases can bring in higher profits and they may be better accepted than large increases.

Managing your pricing is the most effective way to increase profits. And, small price increases can bring big rewards to your profits – with lower risks.

## Glossary Terms from this Section

**Competitive pricing –** prices that are within the range of prices charged by your competitors

**Profit drivers –** those key financial variables that influence your ability to make money. The top four are: variable cost, sales volume, fixed cost and prices.

## For More Information Related to this Topic See


- Can you explain what is 'supply and demand' and why do I need to understand it? *9. Pricing*
- Is there a tool that can help me understand how to set a price and make a profit? *9. Pricing*

- What are the 3 main components of the pricing process that I need to understand? *9. Pricing*
- How can I find out what my customers are willing to pay? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*
- How can I increase prices and how often should I increase/decrease my prices? *9. Pricing*
- How can I sell different versions of my product to different customers at different prices? *9. Pricing*

## Additional Tools Available

Pricing Setting Worksheet

Price Comparison Worksheet

# 3.

## Can you explain what 'supply and demand' is and why do I need to understand it?

## The Basics

Supply is how much of something you have, and, demand is how much of something people want at a certain price. Put the two together, and you have supply and demand. These two forces work together, as they are equally effected by changes in pricing. In most cases, when the supply of a product goes up, the price of a product goes down. And when the supply of a product goes down, the price of the product goes up.

Some examples of supply and demand:

- A decrease in the demand for ice cream in the winter will cause its price to fall.
- A high demand for candy and dry fruits at Eid-e-Fitr can result in a limited supply and a higher price.
- A high demand for wood and coal in the winter can result in a limited supply and a higher price.
- The increase in demand of clothes during the two Eid holidays would decrease the supply and cause higher prices.

This concept is important to understand because you must realize that, for every change in pricing you make, there is an impact to the supply and demand.

## Tell Me More

Research has proven that as the price of a good rises, the amount of that good available will also rise. More companies will become interested in being in a specific business as the profitability of that kind of business increases. That same research also showed that the quantity available of a product will decline as the price of the product decreases. This is likely because businesses are less interested in selling products that have low to no profit.

Here is an example: Imagine that right now the weather in Qandahar is perfect for growing pomegranates, so pomegranates farmers will deliver a huge crop. This means an increase in the supply of pomegranates. Because there are so many pomegranates for sale on the market, the farmers have to reduce the price of their pomegranates in order to sell all of them. However, imagine that next year, there is a terrible drought. The amount of pomegranates produced is reduced dramatically. Because the demand for pomegranates from consumers stays the same, but there are fewer pomegranates to sell, farmers can raise the price of their pomegranates.
When setting the price of a product, a business owner must try to guess what the demand for that product will be. Sometimes, businesses will use price changes to try to increase the demand. For example, if you own a clothing store, you might put a dress on sale for 50% off. You hope that this will increase the demand for those dresses.

Let's look at another example: Let's say that you have a favorite mantoo restaurant you visit often and that they make a mantoo that you love more than any other - and that mantoo costs 160 AFN today. Now, imagine that your favorite mantoo place has a new deal: they will deliver your favorite mantoo to you at noon and 6 PM every day, and that each mantoo is only going to cost 16 AFN, no matter how many you buy. But you can't share the mantoo - you are the only one that can eat them.

In the beginning, this would be a great deal; you love their mantoo and they are very cheap, priced at only 16 AFN. However, very quickly, you would get to a point where you were tired of mantoo - but you might keep buying them because of the cheap price. Eventually, you would be so sick of mantoo that you wouldn't buy anymore, no matter how much they cost.

In this example, your demand for mantoo decreased over time to a point where, finally, the mantoo had no value to you at all. So how does this reflect supply and demand? When you were buying lots of mantoos every day, the restaurant had to make a bunch of them (increase supply) to keep up with your demand. Now that you don't want any more of the mantoos, they have less demand, so they must decrease their supply.

Businesses have to manage their supply and demand effectively. It is easier to manage supply than it is to anticipate demand, but there are times when sudden changes in demand can be hard for companies to handle. These sudden changes can cause big problems with the supplies of goods, causing large surpluses or causing a shortage.

A surplus is when you have more supply than the market needs. A shortage is when there isn't enough supply of a certain item to fill the demand. If you were baking a cake, and the recipe called for three eggs and you only had two, then you would have an egg shortage, since the available supply (two eggs) wouldn't be enough to satisfy the demand (three eggs).

Judging supply and demand is a difficult task for anyone, but the more experience you gain in your business and the more time to take watching what happens with supply and demand in your industry, the better you will get at making good guesses to predict it.

## Glossary Terms from this Section

**Shortage** – when there is not enough supply to meet what is needed

**Supply and demand** – Supply is how much of something you have, and, demand is how much of something people want at a certain price. Put the two together, and you have supply and demand

**Surplus** - when you have more of an item than is needed

## For More Information Related to this Topic See

- What is market research and how do I do it? *6. Marketing*
- Is there a tool that can help me understand how to set a price and make a profit? *9. Pricing*

## Additional Tools Available

Inventory Count Worksheet

# 4.
# Is there a tool that can help me understand how to set a price and make a profit?

## The Basics

The best way to choose a price that enables you to make a profit is to understand something called your "break-even point." This is the point where the money you make in sales becomes greater than your costs. After this point, you will begin to make a profit. Knowing your break-even point is important because it tells you how much revenue (sales) your business must generate to cover your expenses. Anything above this amount provides you with extra cash to reinvest in your business or pay off any debts.

For instance, suppose that a woman makes and sells stylish purses. Once she sets the price for her purses, she can calculate her breakeven point. She will learn how many purses she must sell to earn enough money to cover all of her costs. If she decides to lower her price, she will have to sell more purses or find a way to lower her costs. If she raises her price, she will have to sell fewer bags to break even. By knowing this break-even point, she has an important piece of information to help her decide what price she should charge.

To calculate the break-even point, there is a simple formula called a break-even analysis - which helps you understand how your profits will change as your revenues change. It is used to forecast your break-even point in any given situation. This is important because you want to be sure that any proposed changes you want to make to your prices are at least neutral to your profits, and, ideally, will increase them.

You can use the Break-Even worksheet or Excel spreadsheet tool included in this program to help find your own break-even point.

## Tell Me More

A break-even analysis explores the relationship between expenses and revenues. Revenues are the amounts that you receive for selling your product/service. Expenses are your operating costs. There are two types of expenses involved in the break-even calculation:

1. **Variable expenses** – these are costs that are linked directly to your revenues, such as raw material costs. These costs will change depending upon how much sales you have. As your revenues go up, your variable expenses will go up. If your revenues go down, your variable expenses will go down. The more product you sell, the more money you must spend on materials to make your product. Shipping fees might be another example of variable expenses that will increase or decrease with your revenue numbers.
2. **Fixed expenses** – these are the costs that will remain the same even when your revenues rise or fall. For example, your rent is a fixed expense, as it will not change with the number of products you sell from day to day. Your utilities not used in the production process are other example of fixed expenses.

To do a break-even analysis, you will have to identify both types of expenses that you have. The goal of a break-even analysis is to identify the impact of different prices and different sales volumes on your profits. This process is the best way to identify at which price your business will begin to support itself by generating profit.

**The break-even point formula looks like this:**

Break-even point = fixed costs / (average price per unit – average cost per unit)

"Fixed costs" in the formula will be the total fixed costs you have for the period of time you are interested in, for instance monthly or annually. "Average price per unit" is your estimated average price of the products or services you mostly sell. “Average cost per unit” is the average variable cost of that average product or service. Using the formula above, let’s imagine that a woman has just opened a store to sell purses and bags that she produces. Her fixed costs to operate the store are 40,000 AFN a month, and her average price for one of her purses is 1,500 AFN. It costs her 700 AFN to make each bag (her variable cost per bag), which leaves 800 AFN of margin. (Margin is the difference between the price you sell something for and the cost of that item.) Divide that 800 AFN number into 40,000 AFN (her monthly fixed costs) and we learn that she must sell 50 bags a month to break even. Every bag that she sells over that number is generating a profit.

Now suppose our bag shop owner wanted to sell fewer bags per month, yet still cover her monthly expenses. She might decide to raise her prices and sell the bags for 2,000 AFN each, which would result in her breaking even when she sold just 30 bags per month. (The break-even point calculation is 40,000 divided by the new 2000 AFN price minus the 700 AFN variable cost per bag, or 1,300 AFN). Or maybe the owner wants her bag on the arm of every woman on the street, so she decides to lower her price to sell more purses. If she lowered the price to 1,200 AFN, she would break even after selling 50 bags (the break-even point calculation here is 40,000 AFN divided by 500). You can see how the number of bags she must sell raises and lowers depending upon where she sets her price.

Another way to use the break-even analysis tool is to look at what happens when you raise or lower costs. If our bag store owner thought that she might only be able to sell a few bags per month but she didn’t want to raise the prices of her bags, she would have to reduce her costs. Using the formula, she can figure out by how much she needs to lower her costs. Perhaps she could source certain bag materials from a cheaper vendor or find another shipping company. In this way, she could reduce her costs per bag and reach the break-even point sooner.

The break-even formula doesn’t rely on projections or guessing. Instead, it uses hard data to give you real answers about the future profitability of your business.

## Glossary Terms from this Section

**Break-even point** – It is the point where your revenues surpass your costs and you begin to make a profit. It’s also the point where any new price or new volume generates the same level of profit as was achieved at the original price or original volume.

**Expenses** -- your operating costs.

**Fixed expenses** – these are the costs that will remain constant even when your revenues rise or fall.

**Margin** -- the difference between the price you sell something for and the cost of that item.

**Revenues** -- the amounts that you receive for selling your product/service.

**Variable expenses** – these are costs that are tied directly to your revenues, such as raw material costs.

## For More Information Related to this Topic See

What is market research and how do I do it? *6. Marketing*
How do people think about prices and how does this impact my pricing decisions? *9. Pricing*
Why do some prices appear more attractive to customers than other prices? *9. Pricing*

## Additional Tools Available

Break Even Analysis Worksheet

Pricing Setting Worksheet

Price Comparison Worksheet

# 5.

# What are the 3 main components of the pricing process that I need to understand?

## The Basics

When trying to set prices, there are three parts of the pricing process that you should consider:

- How people think about prices
- How economic forces effect pricing
- How specific strategies that you can use will change people's buying behavior

Understanding how people think about prices is important because people are not always clear and truthful when asked about what price a buyer is willing to pay and what price a seller will settle for. In fact, some businesses often set a selling price and then don't plan to sell it at that price. For example, think about buying something in the market. You might see apples selling for 100 AFN/kg, but, you start negotiating with the seller and end up paying 75 AFN/kg. In this case, you need to know what the seller was thinking. Most likely, he wanted to sell you his apples and was willing to work with you to make a sale. This insight into his pricing thinking helped you buy at the price that was right for you.

The amount you can charge for something is also effected by economic forces. You will need to understand the finances behind producing your product or offering your service in order to set a price that will make you a profit. You must also understand forces such as supply and demand. Whether or not there is a lot or a little customer demand for your good/service, as well as whether this is a lot or a little of that good/service available (supply) will impact how much you can charge.

There are also strategies for setting prices that you can use. These tactics includes all the pricing actions that you take to change the price. Different pricing strategies, such as discounts, can help you attract more customers and make more profits.

## Tell Me More

How people think about prices: Only by understanding how your customers think, can you make the right pricing decision. Sometimes people have emotional responses to certain prices. For example, something priced at 199 AFN seems a lot less expensive than something priced at 200 AFS. Even though the price is only different by one Afghani, emotionally a customer may consider 199 AFN a much better deal.

Another well-known way a customer's emotions may affect her feelings about prices is called "buyer's remorse". In this situation, a customer just purchases something and, then immediately regrets making the purchase. It could happen with a big decision, like buying a new car, or it could be a small decision, like paying to change your hair color at the salon. Businesses need to understand that this reaction is very normal and then take steps to make sure that their customers remain happy and avoids buyer's remorse. For example, a new car dealer could offer a free 2-year maintenance program with a purchase of the new car, so the car buyer feels more comfortable with any possible issues that may occur in their new cars near future. And the hair salon could offer the customer a money back guarantee, to make their customer feel at ease with their new color choice.

**How Economic Forces Effect Pricing**
The pricing theory states that the price for any specific good/service is based on the relationship between the forces of supply and demand. Supply is how much of something you have and, demand is how much of something people want at a certain price. Having a big demand for a product when there is a little supply of it will impact how much you can charge for that item.

Having too much supply but not much demand from customers will also have an effect on pricing. For example, prices of vehicles dramatically fell in Afghanistan for the overall economy experienced a weakening phase due to reduced military spending by international forces and the security transition. The reason was that the supply of cars was way more than the number of cars people would be willing to buy, because their purchasing power had declined due to the economic forces. Many car sellers stopped importing additional cars because there was not enough demand. Other economic forces, such as how much the item costs, will change what you can charge for a good or service. You would not want to routinely set prices lower than what it costs you to make a product.

Understanding where your break-even point is will help you to identify the point where any price lower will result in you losing money.

How Specific Strategies You Can Use Will Change People's Buying Behavior
The pricing tactics includes all the pricing actions that you take to change the price. There are many, many pricing tactics, but two of the most common are specially-reduced prices and loss leaders.

Offering specially-reduced prices can be a powerful pricing strategy. You may decide to reduce your prices for a short time to influence how customers behave. For example, a bakery could offer a 20% discount on bread to attract new customers; a grocery store could advertise 10% discount if customers buy 5 or more cans of soup; a restaurant could offer a 25% discount at lunch time to bring in more business during that time of day. Always be sure that the reduced price generates enough revenue to at least break-even with the original price and volume. If you discount too much or too often, customers may question your full-rate pricing or see you as a cheap option, making it difficult to charge full-rate prices in the future.

Another pricing tactic is advertising a very low price on one product to draw in new business, as people see that one low price and believe that all your prices may be low. This product/service is called a loss leader. A loss leader involves selling a product at a low or even loss-making price. Although you may not make a profit selling this product, you could attract customers who will also buy other, more profitable products from you. For example, your local grocery store will advertise a low price on a litre of milk. It's their hope that this low price on milk will bring you into the store and you'll buy other items, such as cereal or fruit that have higher profits.

## Glossary Terms from this Section

**Break-even point –** It is the point where your revenues surpass your costs and you begin to make a profit. It's also the point where any new price or new volume generates the same level of profit as was achieved at the original price or original volume.

**Buyer's Remorse -** A situation where you have just purchased something and, then, soon after, you regret that decision.

**Loss Leader -** A product or service that is intentionally priced low in order to draw people in with the hopes that they will also buy other, higher priced items at the same time.

**Pricing Tactics -** All the pricing actions that you take to impact the price.

**Supply and Demand –** Supply is how much of something you have and demand is how much of something people want at a certain price. Put the two together, and you have supply and demand.

## For More Information Related to this Topic See

Is there a tool that can help me understand how to set a price and make a profit? *9. Pricing*
How can I sell different versions of my product to different customers at different prices? *9. Pricing*
What is pricing? *9. Pricing*
When should I run a sale or promotional price? *9. Pricing*
What are some of the options I have when setting my prices? *9. Pricing*

## Additional Tools Available

Break-Even Template

# 6.
# How can I find out what my customers are willing to pay?

## The Basics

Willingness to pay is the maximum amount an individual is willing to spend to buy a product or service. It is important to try to find out how much a customer will pay for your product or service. If you charge over that amount, you won't make the sale.  If you charge less than that amount, you are missing the opportunity to make more money on the sale.

How to estimate a customer's willingness to pay is one of the most difficult pricing decisions in running a business. First of all, each customer has a different willingness to pay. You have to realize that and be willing to pass by certain customers who have a willingness to pay that is less than you should be charging. Walking away from business is hard to do – but, if you are focused on making money, it is something you need to learn to do.

Understanding people's willingness to pay also takes market research, as you need to ask consumers/customers a lot of questions to find out what motivates their purchasing behavior.

## Tell Me More

There are several ways to determine a customer's willingness to pay. Not every one of these options will make sense for you.  Choose those that fit best for your situation and experiment to see how different approaches work for you.

**Option 1:** Look At the Competition.
If you know what your competitor is charging, then you have an idea of the potential customer's willingness to pay. It does not mean you should charge what that customer is currently paying, but this gives you a good starting point.

**Option 2:** Talk to Your Customer.
When researching pricing for an existing customer, you can talk to your customer in an honest way. You can explain to them all the elements that go into your product/service and highlight that the only way that the current business relationship can make economic sense to you is to charge a certain price. You can say you don't want to lose them as a customer, but, that, unless your price is XX AFN, you cannot continue to provide the service they need and still make money. This honest approach may enable you to see the client's willingness to pay. Of course, it works best if you have been working together for a while and that they respect and value your abilities. It also works best if there are not a lot of direct competitors and that if you lose this business, your profits will not suffer – as they would have been unprofitable for you to continue with.

**Option 3:** Ask for Feedback on A Price.
A more difficult approach, but one that works well, is to ask the client at what price does the product/service become too expensive to them. Tell them that you are trying to establish pricing where you will deliver a high-quality product/service at a price that enables you to profitably run the business. See what they say. You may be surprised.

**Option 4:** Have an Open Conversation on Prices.
This approach means having open conversation with a customer about the profitability of doing business with them. You tell them that, only if they are willing to share with you what they are willing to pay and what product/services they really need, can you deliver the correct mix of product/services at the price they are looking for. Many of the features that customers ask for in products or services, and you are providing, may not be critical to them. For instance, customers might ask you for ten different package sizes of tea in your shop.

But having all those different sizes means that you have to have more products on hand which may increase your costs. If you have an open conversation with your customers, you may find that they really only need three choices of package sizes. Once they see what some of these extra features cost, they may be willing to give them up. You can then quote a lower price, with fewer features or services – but with everything that the customer actually needs.

A good way to find out what the most important features or services are is to survey your customers. Give them a list of all your features or services and give them 10 points to assign among all your services, with them awarding more points to the features they care about the most. This gives your client a chance to rank the importance of each of the services that you provide. The ones that are given the most points are the things that are most important to your customers, the lower ones are less important. Then you can develop a price that has just the features they need. It may be that your price will go down – that will make the client happy. It may be that you can stop providing some services that are high cost to you, but the client didn't want.

**Option 5:** Talk About a Price Increase.
There will be times when you have to increase your prices. For new customers, this may not be as big of a problem. But you may worry about losing your current customers. It is a good practice to talk to your current customers about price increases, but tell them that the price increase will happen in the future. For example, you could announce that a price increase for your services will take effect in 3 months and see what reaction there is. If the customer is very unhappy about the increase, you might offer that if she signs a new 1 year contract before the price increase, she will get the current price for one more year, but at the end of that year, the price will be going up. Using these sorts of techniques helps customers become comfortable with price increases and still keep them buying from you.

You should link any price increase to facts that are relevant to your customer, so that their willingness to pay is increased when they see the reason for the increase. Airlines tell us that fuel charges are up 10% and that's why the fare is going up 10% and we accept the increase. If labor costs are up by 5%, people understand that if your product/service uses a lot of labor, costs will be increasing for you and you will likely have to increase your price to cover those increasing costs. Understand too that when your costs go down, you should make a small price decrease. You should not take advantage of when costs go up to increase your price and then hold them at the high level when costs go down. This fair practice builds the trust of your customer and makes it easier for you in the future if you have to increase prices again.

**Option 6:** Offer Discounts.
Another pricing strategy if you set a new list price and customers complain is offering discounts to some customers for specific reasons. If you want to get new customers, you could offer a "new customer discount" good only for new clients. You could give a discount of 6000 AFN, provided they sign a contract at the regular full price for at least 2 additional projects. Or you could offer a "satisfied customer discount" of 3000 AFN if the client is pleased with your work (it was delivered at least one day before the deadline, etc.) But only offer discounts if you get negative reactions about your new list price. If your current clients do not complain or you can win new clients at the list price, you will have discovered a new reference price (a price that customers consider reasonable to pay). This price may still be below their willingness to pay, but you will now have better information on their pricing decisions.

## Glossary Terms from this Section

**Market Research** - The activity of gathering information about consumers' needs and wants.

**Reference Price** - The price that consumers anticipate paying or consider reasonable to pay for a product or service.

**Willingness to Pay -** The maximum amount an individual is willing to hand over to buy a product or service.

## For More Information Related to this Topic See

- What is market research and how do I do it? *6. Marketing*
- Can you explain what is 'supply and demand' and why do I need to understand it? *9. Pricing*
- Is there a tool that can help me understand how to set a price and make a profit? *9. Pricing*
- What are the 3 main components of the pricing process that I need to understand? *9. Pricing*

## Additional Tools Available

Price Comparison Worksheet

# 7.
## What are some of the ways that companies use to establish their pricing?

## The Basics

**There are many strategies that companies use to set their pricing. The five most popular approaches are:**

- **Price to cover costs –** when companies set their prices based on their costs. They add up all their costs and add a little extra for the profit.

- **Price to meet the market –** when companies let the marketplace set their prices. They see what prices are being charged for other products and match their prices to fit in.

- **Price to close a deal –** when companies set prices to the level that gets a customer to buy. This gives all the pricing power to the buyer.

- **Price to gain market share –** when companies set low prices because they want to grow sales. The idea for this technique is that by setting lower prices, the company will win more of the customers and will have a higher volume of sales, even if they make less on each individual sale.

- **Pricing to value –** when companies set prices of products or services in terms of their value to the customer. Many companies see value-based pricing as the best option.

The first four pricing strategies are all reasonable approaches to setting prices and many companies use all four, and often at the same time. However, each of these techniques can have a negative result which is why value-based pricing is often seen as the best approach.

## Tell Me More

**Option 1:** Price to Cover Costs.
This the most widely used pricing process, as it is the most simple to do. In this strategy, you set the price of your product/service to cover all your costs and add a 'reasonable' margin in order for you to make money. Businesses will always make money this way. But, the problem is that your customer does not care about your costs. They only care about buying something at the price they want to pay.

Plus, this approach hides an inefficiency in your business. Let's imagine that you set your selling price based on the total cost of running your business. In this case, you have a very high monthly rent for your office. Should that high office rent cost be passed on to your customer? Do they really care that you have an expensive office? The answer is: No, they don't care. In this example, your high office rent prevents you from setting the correct price to be competitive in the market. According to pricing research, most companies in business today use the price to cover costs approach in setting prices because it is the easiest option to execute, even though it may not be the most effective option.

**Option 2:** Price to Meet the Market.
In this approach, companies let the market set the price. They look to see what everyone else is charging and then they pick a similar price. In most cases, companies won't lose any business by pricing this way. But, there is a problem. Businesses don't sell to markets - businesses sell to customers. And customers behave differently when faced with choices. They often surprise us by buying a more expensive product when a cheaper one is available. Think about the Apple iPhone or a Chanel make-up. In both cases, certain consumers are willing to pay more than the average market price for a phone or car. In the end, market-based pricing is just lowering the price to make the sale – which is not the best path to profitability.

**Option 3:** Price to Close the Deal.
Setting whatever price you have to in order to make a sale may seem like a good strategy but it could create problems for you. When you price simply to get a customer to buy, sends a sign that your prices are flexible and it encourages customers to negotiate for even lower prices. And time and after time, they will always expect a deal before they buy.

The 90 Afs Stores are a good example. Since customers expect all products to be low, any increase in price would likely cause unhappy customers. Customers come to always expect a lower price. Using the price to close the deal approach undermines your consumer's confidence in your prices and often leads to sacrificing profit you could have gotten with a different approach. In the worst case, you might be forced into a price that is too low to generate a profit.

**Option 4:** Price to Gain Market Share.
In this approach, the price is set low to take sales away from a competitor. Companies that use this strategy are willing to make less money on each individual sale because they are betting on making more sales overall. This approach may sound like a good idea because the more market share you have, the more money you are making. But your competitors may respond quickly by lowering their own prices and then all you have is a price war, where every company drops prices again and again to attract customers by being the lowest. This pricing strategy will likely decrease the profits of all companies in the market. For example, a large beverage company introduced soft drinks to the market. The company started providing soft drinks at 3 AFN lower than other producers. Many grocery stores began buying and selling the cheaper drinks. After a while, the new company gained a larger market share. A couple of companies made losses, but one company was more financially capable. It also lowered its prices and managed to keep its market share. The example shows price wars take away profits from all competing companies.

**Option 5:** Pricing to Value.
After reviewing all four of the above options, many businesses have concluded that the better way to set prices is value-based pricing. In value-based pricing, the company starts by identifying the customer and then works back to find the right product to meet that customer's need. When they find the products (or services) customers want the most, then they identify the customer's willingness to pay for that product or service. And then finally, the company sets the price in terms of value that product has to the customer. A local taxi company saw the need for women to commute to work or move around the city. The company had done an initial survey with many working women and knew there was a need for safe and reliable taxis in Kabul. The taxi company had found the women would be willing to pay up to 30 AFN in each ride in return for safer and trustworthy taxis. So the company put a higher prices on the rides based on the extra value (safety, trust, reliability) that the women would receive.

## Glossary Terms from this Section

**Market Share -** The percent of the total market that your business accounts for.

**Price War -** A situation where all companies are competing solely on price.

**Value-based Pricing -** Setting your price based on the perceived value it provides your customer.

**Willingness to Pay -** The maximum amount an individual is willing to hand over to buy a product or service.

## For More Information Related to this Topic See

- Is there one way that is the best way to set prices for my business? *9. Pricing*
- Is there a framework I can use to help me to understand how to do value-based pricing? *9. Pricing*
- How can I create value in my product/service to justify my prices? *9. Pricing*

## Additional Tools Available

Product Cost Template

Value Based Pricing Worksheet

# 8.
# What is the best way to set prices for my business?

## The Basics

Value-based pricing is the ideal way to price, but learning how to do it takes time as your pricing skills develop. Pricing to value means viewing products in terms of their value to your customer. You can discover how your customer values your product or service by asking a lot of questions. For example: "What is it about my product/service options that will attract new customers?" Or, "What unique feature can I offer so that I can price my product/service to offer consumers a good value and I can make a reasonable profit?" At the heart of good value-based pricing is the concept that people are willing to pay for something they value and they are not willing to pay for something they value very little.

## Tell Me More

**To get started on a value-based pricing approach, you first ask questions that focus on the ideal customer and their needs and then end with determining costs.  The questions are asked in this order:**

- Who are my ideal customers?
- What value can I provide them that sets me apart from my competitors?
- What price are they willing to pay for that value?
- At what cost can I produce this product?

**This approach is very different from a cost-based pricing model. In the cost-based pricing model, you start out by identifying the product and its cost and then at the end, try to identify a customer who will buy the product you created.  This process looks like this:**

- What is my product?
- How much does it cost?
- At what price should I sell it for?
- What value will it create?
- How can I find customers for this product at this price?

These two approaches represent the exact opposite way of trying to set the price for your product. Cost-based pricing starts out with the product and ends up looking for a customer to buy it. In value-based pricing, you start with identifying the customer first and then work back to find the right product to meet that customer's need. Both processes are used today, with the value-based approach being more preferred, but it is more difficult to achieve.

Using value-based pricing takes time to master. Most companies start out with cost-based pricing and, over time, move to value-based pricing. One reason is that a company must do research to find the data to guide value-based pricing. You need to understand that many things affect a person's perception of value. In fact, each of us has different measures to determine if the product/service provides us with value or not. Some of the things impacting value are:

- Your competitor's price affects how consumers value your product. You may read about an airline changing their price, only to see a similar price from a competitor appear right away.
- The characteristics of a product relative to your competitor affects value. This means you need to understand how your product measures up to its competition and how your target customers value the differences - and then price it accordingly. For example, if you are running a small guest house and a competitor offers free breakfast and you do not, you may find that your customers value that free breakfast highly and

will no longer stay at your guest house unless you reduce your price or offer a free breakfast.

- Branding can help differentiate your product and create value. Investing in building your brand may mean that people trust your product/service and are willing to pay more for it. BARG Continental has spent hundreds of thousands of Afghanis to communicate that they offer family meals at great prices.
- **Convenience can affect value –** "Finest Stores" charge higher prices for their products because they provide easy access to products at convenient and secure locations.
- The perception of quality can provide value. For example, some people might value German engineering for Home Appliances and they would place more value on a Siemens vs. a Turkish-made product.
- A specific feature of a product can create value. A mobile phone with a camera or video chat capabilities can add value to the phone, allowing the manufacturer to charge more.
- Providing better service can create value. Serena Hotel charges higher prices for its relatively better service and security measures.
- The customer's income level affects how they value a product. As their income increases, consumers are generally willing to pay more. And, as income decreases, people are less willing to pay more.

How do you define or create value? There are many ways to do this. Here are a few:

- **Offer enhanced services –** You could offer a higher level of service than competitors. For instance, "786 Pharmacy" offers 24 hours/day delivery for any medicine. Or, if you own a parlor you could offer a free haircut with every bridal make-up session. By offering enhanced service to your customer, they will see the increased value in buying from you.
- **Provide insurance –** many customers don't like to take risks. If you sold a product, such as silk woven in Afghanistan, you could provide photo documentation of the weaving. In this way people are sure they are getting the real thing. This has the effect of reducing their purchasing risk, which can become very important when making a big purchase, like for a car or a refrigerator. Khalid Lemar has dramatically grown its Kabul market share after increasing their mobile warranties from 6 months to 1 year.
- **Allow buying on credit –** Some customers may value being able to buy something today but be able to pay for it in the future. For instance, you might give your best customers 30 days credit to pay you. Or, if you own a small grocery store, you might allow your best customers to sign for their purchases each day and only pay you at the end of the month.

Understanding that different customers place different values on the same product or service is the most important concept in value-based pricing. Once you accept this idea, then you can better understand the process of discovering how to use value to set prices. It is not about finding a single perfect price number, it is about creating strategies designed to capture the value each customer sets for your product or service.

## Glossary Terms from this Section

**Cost-based pricing –** setting pricing based on the product or service costs

**Value based pricing –** setting pricing based on the value of the product/service to your customer.

## For More Information Related to this Topic See

- What is market research and how do I do it? *6. Marketing*

- Is there a framework I can use to help me to understand how to do value-based pricing? *9. Pricing*
- How can I find out what my customers are willing to pay?*9. Pricing*
- How can I create value in my product/service to justify my prices? *9. Pricing*

## Additional Tools Available

Product Cost Template

Value Based Pricing Worksheet

# 9.
# How do I set pricing based on value?

## The Basics

There is a framework you can use to help you set prices based on value. The author of this framework is Tom Nagle. He believes that there are 5 actions you need to take to do value-based pricing correctly and they are:

- Understand what drives sustainable value for your customers
- Create value for your customers
- Communicate the value that you create with tangible and intangible benefits
- Convince customers that they should pay for the value received
- Capture the value with the right pricing

## Tell Me More

Some business owners look for an easy way to set a price for their products or services. They may just decide to start with the cost and add on an extra percentage to cover their fixed costs and profit. Saying - "I'm going to price it at my cost + 25% profit."

But those simple approaches to pricing are rarely the best way to maximize sales and profits. Sometimes they can result in a price that is too high for customers to agree to. Sometimes those ideas can result in prices lower than what you could have successfully charged, losing you money. One way to manage that complexity is to follow these suggested 5 actions.

**Step 1:** Understand what the key value drivers for customers are. Key value drivers are those specific factors that make a customer buy. Make sure you know what features customers value the most. For example, if you know that a certain customer values 'on time' delivery, you can develop a program that delivers your product on time all the time, and price it accordingly.

**Step 2:** Create value for your customers. Once you learn what your customers value, make sure that your company delivers the products and services your customers want and need. There are many ways to create value for your customer, for example, offer enhanced benefits or reduce the risk of buying. Follow up with them regularly with questions to uncover any issues. Avoid the urge to take shortcuts, and take all the steps that ensure your customers are satisfied.

**Step 3:** Communicate the value you create. Talk regularly with your customers and explain the tangible features and tangible benefits of buying from you. Tangible features and benefits are readily apparent and can be measured. For instance, you might share that the food that you serve in your restaurant is locally grown and is healthier to eat. Some benefits are not readily apparent, such as the prestige of wearing a designer brand. You will want to also communicate these intangible benefits to your customers too.

**Step 4:** Convince customers that they must pay for value. If your company is creating value and ensuring that your customers recognize that value, have confidence when you ask for prices that reflect that value.

**Step 5:** Capture value with effective price tactics. Effective tactics include recognizing when you have an advantage, understanding your competitors' pricing, recognizing which products drive a customer's decision and which products are just extras that fill out the shopping basket, and getting something in exchange for any reductions in price that you make.

## Glossary Terms from this Section

**Intangible benefits** -- a benefit that your product or service can offer that might not be apparent, such as the prestige of wearing a designer brand/mark dress or suit.

**Key Value Driver** - That factor that each customer has that influences their specific purchasing decision.

**Tangible Features** – A feature that your product/service has that is easily apparent and can be measured, such as a bag made of 100% local leather. A feature is what a product or service is.

**Tangible Benefits** – A benefit that your product/service can offer that is easily apparent and can be measured, such as a blanket that keeps you warmer. A benefit is what a product or service does.

## For More Information Related to this Topic See

- What is market research and how do I do it? *6. Marketing*
- Is there one way that is the best way to set prices for my business? *9. Pricing*
- Is there a tool that can help me understand how to set a price and make a profit? *9. Pricing*

## Additional Tools Available

Value Based Pricing Worksheet

# 10.
# How can I create value in my product or service to justify my prices?

## The Basics

Creating value takes time and effort, because it requires market research into your customer's needs and wants as well as a deep understanding of your own capabilities. Creating value comes from learning this information and using it to set a price that meets those needs and is sustainable over time.

For example, if you own a private school, you have to understand what factor do parents think is the most important for them. Is it: the content of the curriculum, the level of expertise of the teacher, the number of hours of instruction, the time of day for the instruction, etc. Only once you see what is important to your customer can you develop your service offering and start to think about how to price it.

Suppose you find out that the level of teacher's expertise is the # 1 most important factor in deciding who to hire to tutor their children. This means you need to ensure you have only the best qualified teachers in your business. To find and keep these highly qualified teachers, you may have to pay them more than the average. This may mean you will need to charge higher prices than the average to your customer. This is an example of how the value creation process works to influence your pricing.

## Tell Me More

**Here are 5 steps you can take to better understand how to set value-based pricing:**

**Step 1:** Understand what drives value for your customers. Talk to them, survey them, and watch their actions and reactions. Learn what is important to your customers and what opportunities you have to help them.

**Step 2:** Understand your value proposition. The value customers receive is equal to the benefits of a product/service minus its costs to them. This means you need to understand what value your product/service creates for your customers. For example, if you provide an online shopping option for your line of women's clothing/shoes, this provides customers a way to save their time while buying your product.

**Step 3:** Identify the type of customers where you can create more value than your competitors. Different customers will have different opinions of your value compared to your competitors. For example, If you run a kindergarten, your customers may be willing to pay you more if you have pick and drop services.

**Step 4:** Create a win-win price. A "win-win" price means that both you and the customer "wins." The customer feels like she is receiving value but you are also maximizing your profit. Satisfied customers that see a high value in your offering are usually willing to pay more, while unsatisfied customers will leave, even at a low price.

**Step 5:** Focus your time and money on your most valuable customers. Spend your sales time and marketing funds on the customers that you can best serve and that will provide the greatest value in return. Also, spend your time on developing solutions that serve your best customers or can attract more customers that are similar to your best customers.

Your customers are the life of your business. They are the source of current profits and the foundation of future growth. These 5 steps will help you find more ways to grow your business by better serving your best customers.

**Here are some questions you can ask to help you throughout this process:**

- At what price would my product become too inexpensive for me to make money?
- At what price does my product become so cheap that the consumer questions its value?
- At what high price would my consumer stop buying?
- At what price would your product or service be expensive, but the customer will still buy?
- At any new target price, would I still make a profit?
- How much business can I afford to lose to any price increase and still make enough profit?
- How can I segment the market and offer different prices to different customers?

**If your customers are other businesses, ask:**

- How are you helping your customer grow their business and make it more profitable?
- How are you removing surprises for the customer?
- How are you helping your customer reach their sales or profit targets?
- At what price does my product become so cheap that my customer questions its value?
- At what price would this customer stop buying?
- How are you helping your customer reduce their risk?
- At what price would your product or service be expensive, but the customer will still buy?
- At any new target price, would you still make a profit?

Each of the above questions is aimed at gathering more information to best establish your value proposition – and help you use value-based pricing to grow your business.

## Glossary Terms from this Section

**Survey** - A formal research tool to gain insights from customers to help you make better decisions.

**Value Proposition** – This reflects the value that customers receive from buying your product/service at a particular price. It is equal to the benefits of a product/service minus its costs to them.

## For More Information Related to this Topic See

- What is market research and how do I do it? *6. Marketing*
- Is there one way that is the best way to set prices for my business? *9. Pricing*

## Additional Tools Available

Grow Your Business, Serve Your Best Customers Checklist

Value Based Pricing Worksheet

# 11.
# How does my selling strategy impact my pricing strategy?

## The Basics

There are two kinds of selling strategy: direct selling and indirect selling. Direct sales means going straight to your customer and selling them your product. You can phone the customer, see them face to face or even use email. The communication link between the company and the prospective customer is direct.

With indirect selling, a company does not directly contact the customer but uses some type of middle-man. The middle-man could be a reseller, a commissioned independent sales agency or even another distributor.

The direct sales business model may be time-consuming or costly and can be intimidating to some. The benefits of direct sales are that you have control over how your product is sold and priced to your customers. You have a high level of influence on your customer and know exactly how your customer feels about your product/service because of the direct communication. Because of this interaction, you can establish your pricing with more certainty – and there are no middlemen between you and the customers, where each layer may be adding their cost to get to the final product's price.

A benefit to the indirect sales strategy is that the company can expand its geographic reach without having to hire additional sales people. Another benefit to an indirect strategy is that the middle-man that you use may already have warehouses, logistics systems, trucks, etc. to get the product in the hands of the consumer. The most challenging part of indirect distribution channels is that you need to trust another person or organization with your products and all the interaction with the customer. This includes at what price your product will be sold to the consumer.

## Tell Me More

Selling directly to your customer allows you to interact more with your customer, but it may cost you more in terms of both time and money. Using a channel sales approach (sometimes called the indirect sales channel), where you use others to reach your customer, allows you to take advantage of their relationships, but it does not offer as much control over the final price to the consumer.  Neither way is perfect, and making this decision is important - as it will impact your pricing decisions.

Many business owners prefer more control over the marketing and pricing of their product, so they sell directly to the customer to make sure they understand their customers' wants and needs. For example, if you are a dressmaker, you might want to have your own store, where people come in to your store and have their dresses perfectly made/tailored to their needs. In this case, you decide on the price to your customer.

In some other cases, especially for a small business or a company with limited funding, indirect sales may be a better option. Why? Because rather than having to sell your product yourself or having to manage a store (with all the costs of rent, labor, etc.), you can rely upon resellers or affiliates to get your product to the consumer.

For example, let's say you are a farmer with a crop of mushrooms that you decide to sell to a third party who will then transport them to market for sale to produce sellers.  This may make more economic sense for you as you don't want the costs of running a produce stand or dealing with angry customers if you run out of mushrooms. However, you are no longer in control of the final price of your tomatoes. You sell your mushrooms to a middleman at a specific price, then you lose control over the final price. And, it could mean that the middleman and/or the supermarket makes more profit on the mushrooms than you do.

In some industries you may not be able to choose which selling strategy to use; the industry may dictate the approach.  In other industries, you may be able to use multiple strategies. If you are able to make a choice in strategies, here are five questions you should be asking yourself:

**Question # 1:** What is the Best Way to Spend My Money?
The cost of selling direct can be high.  Not only do you have to hire and train sales people, but you also have to spend money on rent, utilities, employee salaries and benefits. In the indirect method, you are spending your money on other areas, such as product development or advertising.  Calculate the break-even point on the cost of selling direct vs. indirect to help you understand the impact of each strategy.

**Question # 2:**  How Much Customer Interaction Do You Need?
Finding a customer that is willing to buy is hard. Building a relationship that will ensure they continue to buy takes time and money. Distribution partners provide your company with a much larger reach, but you need to balance the benefit of being able to use that partner's existing relationships against your need to hear direct customer feedback – especially in the early days of your business when customer feedback is vital. You need to weigh the long-term impact of losing the direct interaction with customers versus the ability to have a larger number of people selling your product.

**Question # 3:** How Long Do You Have?
Building your own sales team or making sales by yourself takes time.  It takes time to meet customers, qualify targets, build relationships, and establish enough customer trust to actually make a sale. If you use a distribution partner that is already selling similar products to your target audience, you can get to market faster.

**Question # 4:** How Much Complexity Do You Want to Deal With?
The direct sales process is simple, as you deal directly with your customer. The indirect process may have you dealing with many middlemen, with each one being able to give you something different, such as more geographical reach.

**Question # 5:** Is Owning the Customer Relationship Important to You?
In the direct sales approach, you own the relationship with your customers. In the indirect approach, your distribution partners may control those relationships and, therefore, if they stop doing business with you, some of your customers may leave as well. So, you need to consider if this a business risk that you can live with. You also must accept that you will have much less control over your distribution partners than you would over your own salespeople. Perhaps you should also ask: Do you have enough control over your distribution partners to comfortably achieve your business objectives?

## Glossary Terms from this Section

**Direct Selling -** Going straight to your customer and selling them your product.

**Indirect Selling -** Using someone else to sell to your customer; the company does not directly contact the customer but uses some type of go-between.

**Indirect Sales Channel -** The succession of points through which a product must pass to get from the creator to the end-user. It most often refers to the intermediaries between the manufacturer of a product and the retail stores that sell it to consumers.

**Middlemen, Go-betweens, Resellers, or Affiliates -** Companies that take on the role of getting your product to market by providing services such as transportation, warehousing, selling and in-store merchandising.

## For More Information Related to this Topic See

- Is there a tool that can help me understand how to set a price and make a profit? *9. Pricing*
- How can I find out what my customers are willing to pay? *9. Pricing*
- Is there one way that is the best way to set prices for my business? *9. Pricing*
- Is there a framework I can use to help me to understand how to do value-based pricing? *9. Pricing*
- How can I sell different versions of my product to different customers at different prices? *9. Pricing*

# 12.

# How do people think about prices and how does this impact my pricing decisions?

## The Basics

When you are trying to establish your pricing, it helps to better understand what people think about prices. These thoughts/beliefs have been developed through years of being exposed to the buying and selling process from an early age. People gain their pricing thinking from all types of interactions from daily life. We learn at an early age that some things are too expensive and beyond our reach. We learn that some prices are set to be followed and some prices are set to be negotiated. Every day we see there are many options of products being sold at various prices. For example, we may go into the supermarket with our parents and see many boxes of cereals, some with added ingredients - such as raisins or nuts, and all are being sold at different prices. In this way, we became accustomed to paying more for something that we value more. Understanding how people think about prices will help you choose the right price for your product/service.

## Tell Me More

There are four key insights that researchers have shown have the most impact on how we think about prices.
**Insight # 1** – We have references in our mind when we look at prices.

**This is the situation where the buyer sees a difference between the actual price paid and what they consider is a reasonable or fair price for the product. When faced with this pricing reference, buyers are often willing to pay more than they originally thought they would, because the reference price has been set for them. Some examples:**

- "The sofa was 70,000 AFN, today it's only 50,000 AFN"
- "Their sofa is 70,000 AFN, ours is only 50,000 AFN"

When a reference price is used, research has shown that the order of the presentation of the prices influences a customer's buying decision. This research shows that when prices are listed in descending order (high price to low price), people formed higher reference prices than those that saw them in ascending order. You often may see this example of this effect on a hotel or airline website, where the highest prices come first. In the new car business, you often see the most expensive car right by the entrance to the car showroom so you see it (and its high price) first.

In real estate, many brokers will show you the most expensive property first. These sales professionals understand that, if they put a high price in your mind, then you may be willing to spend more to get the exact product you want.

Some marketers argue that new products should be priced low at the launch to induce trial and build market share. But, if the low initial price lowers the buyer's reference price, it will impact repeat sales in a negative way. Many studies have shown that a seller should first establish the product's regular price and then promote the discount as a temporary price cut. Otherwise, the low reference price will undermine the product's perceived value later on. Practically, a shop keeper may say "The cost of a pair of shoes is usually 3000 AFN, but I will sell it to you for 2000 AFN.

**Insight # 2 –** When it is difficult to compare prices, we often use other factors to decide what to buy.
This describes the situation where businesses purposely make it hard for consumers to make any reasonable comparison of prices. When there is confusion in prices, buyers often move to other ways of making the purchasing decision – such as relying on the strength of brand name or the ease of purchase delivery.

Examples:

- A furniture store may offer a sofa for "Only 7,000 AFN down and 1,000 AFN per month and a discount if paid off before the new year". It's hard to know how much you will end up paying for the sofa, so you may look for a brand you know or trust and end up paying more.
- A gym may offer a membership program for "just $1 a day". In this way, while the price sounds low and reasonable, the gym makes it hard for you know how much you will pay for your annual membership.

**Insight # 3** – We often equate high price with high quality.
This describes the situation, often before a purchase, where consumers think that a product or service has low quality because it has low prices – and it is of high quality because it has high prices. Buyers are usually less sensitive to a product's price to the extent that a higher price signals high quality.

- Examples: luxury goods companies, such as Apple, SONY, and Lexus, etc. charge very high prices for their goods, because of their many years of delivering high quality products and service.

**Insight # 4** – We pay more if a lot of time and care goes into the making of a product.
This describes the situation where people are willing to pay more for something because of the high amount of time or labor involved in making the product. Generally, people will pay more for something that requires more effort to produce – even if the product itself isn't any better. The general thinking is that, if a person has spent a lot of time and effort making a product by hand, they should be rewarded for that effort. Research has shown that buyers are less sensitive to a product's price when a higher amount of labor was used because it signals higher quality.

Examples:

- We may be willing to pay more for custom-made clothes or hand-made jewelry
- Customers may be open to paying more for a handmade rug that is considered one of a kind, rather than buying something standard

## Glossary Terms from this Section

**Perceived Value –** The value that people assign to a product or service.

**Reference Price** - The price that consumers anticipate paying or consider reasonable to pay for a product or service.

## For More Information Related to this Topic See


- What are the 3 main components of the pricing process that I need to understand? *9. Pricing*
- How can I find out what my customers are willing to pay? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*
- How can I sell different versions of my product to different customers at different prices? *9. Pricing*


## Additional Tools Available

Price Comparison Worksheet

# 13.

# What are some pricing techniques that will make my customers buy?

## The Basics

By understanding your costs and break-even point as well as what your customers are willing to pay for the value of your product or service, you are able to choose the best daily prices for your products. However, there are a few special pricing strategies you might consider using in special circumstances: Skim pricing, Dynamic pricing, and Penetration pricing.

In skim pricing, you set very high prices to start, even higher than the value you deliver is worth. You can only use skim pricing for products with high demand. This strategy allows you to make extra profit off of those customers who are willing to pay extra for something that it scarce or brings a high level of status. In dynamic pricing, the prices change often depending on the situation, such as level of demand, kind of customer, or time of day. Fruits and vegetables that are almost out of season are a good example of dynamic pricing. With dynamic pricing, you have the ability to earn the maximum amount of profit, but it requires a lot of work and research to get right.

In penetration pricing, you deliberately set your prices lower than the value of your product or service so that you can gain a lot of market share quickly. You might do this to keep competitors out or to establish yourself as the market leader. This is only a short term strategy as it is not financial sustainable. In some countries, this type of pricing is not allowed.

Each method has its pros and cons and each method works well in certain situations. In fact, most companies will end up using one or more of these options as a product/service develops and grows over time. The most difficult decision is to decide when and how to use each method.

## Tell Me More

Skim pricing describes the situation where prices are initially set very high to "skim" revenue, like you skim cream from the top of the milk. This process involves setting your price higher than the value that it could deliver to potential customers. Why would you do this? First, the higher profit you will earn for serving the upper price tier of the market may make up for not targeting the larger number of customers in the middle price range. Next, you will be sending a message to your consumers that you are "the" premium product in the market and have priced your brand accordingly. Also, there may be a case where some people, often called early adaptors, are willing to pay more for a product just to be the first to own one. Seeing the long lines of people at Apple stores buying the latest iPhone is a good example of this strategy.

Skim pricing works best when:

- The product's high quality supports the higher price
- Enough buyers want the product at that price
- Consumers are not very clear about its value compared to the alternatives
- The cost of producing a small volume is not high
- Competitors should not be able to enter the market easily

Dynamic pricing refers to the situation where there is a constant change in pricing between the buyer and the seller. This means that the price of goods may be changing according to the level of demand, the type of customer, weather conditions, and time of day, etc. Seasonal grocers, airlines, and hotels all use dynamic pricing. Seasonal grocers change the price of that day's fruits or vegetables depending on the season they are in, the possible absence of alternative groceries, or shifts in market demand. Hotels may vary the prices based on day of the week, special events occurring in the city or the season of the year.

Dynamic pricing requires a lot of research and sometimes powerful computers to constantly assess a lot of information in real time. Companies that use dynamic pricing look at several data points:

- The first factor is competitor's prices. They want to know what the competition is charging right now.
- The second factor is how are your customers responding to the current price?
- The third factor is how much supply is there?

Dynamic pricing tries to find pockets of opportunity, where the change in price can make the highest profit margin or sell the most products to make the most money.

Penetration – this is the situation where you deliberately set prices below the customer's perceived value to quickly obtain market share. While penetration pricing may result in high initial sales, it may not always contribute to a sustainable and a profitable business. This approach may also attract legal issues, especially if it results in driving a competitor from the market by selling at or below the cost of the good or service. In some countries selling below your cost is illegal.

Penetration pricing works best when:

- The consumer is sensitive to small changes in price
- The product's value can easily be judged by the customer
- The threat of a competitor's product is strong and a low price may keep them out
- There is a large portion of "want to" buyers who cannot buy at a higher price and this price will get them to buy your brand
- You have the capacity and financing to produce the new, higher volumes

Be aware that a low price may only prevent competitors from entering the market for a short time.

How do you choose the right methodology for your business? It comes from an understanding of where your product is in its life cycle, as the market response to pricing is usually not the same in each phase.

The four phases of the traditional product lifecycle are: Introductory, Growth, Maturity, and Decline. Skim and Penetration pricing work best in the first two stages, while Dynamic works best in the first three. Penetration works best in the first and last stage.

## Glossary Terms from this Section

**Price Skimming -** When a product is first sold at a very high price and then gradually lowered over time.

**Dynamic Pricing -** A pricing strategy when the price changes depending upon the situation.

**Penetration Pricing -** A pricing strategy which sets prices deliberately lower that the value of the product or service in order to gain market share and pressure competitors.

**Early Adaptors -** People who buy immediately when a new product/service is first introduced.

**Product Lifecycle -** Each product goes through 4 stages of its life - introduction, growth, maturity, and decline. Good business managers know that pricing methodologies will change as the product evolves through each stage.

## For More Information Related to this Topic See

- What is market research and how do I do it? *6. Marketing*
- How can I find out what my customers are willing to pay? *9. Pricing*
- How can I create value in my product/service to justify my prices? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*
- How can I increase prices and how often should I increase/decrease my prices? *9. Pricing*
- How can I sell different versions of my product to different customers at different prices? *9. Pricing*
- When should I run a sale or promotional price? *9. Pricing*

# 14.
# Why do some prices appear more attractive to customers than others?

## The Basics

Pricing is all about understanding a customer's "willingness to pay". Research has shown that buyers are rarely honest when asked how much they are willing to pay for an item, and, given that one of the goals of sales and marketing is to raise the customer's willingness to pay to reflect the product's true value, consumers are rarely truthful when asked about prices.

So, because buyers may not tell you truthfully what they will pay for an item and you don't want to price our product too low, you must try to understand how people think about pricing so that you can determine the right price for your products or services. You should try to understand the mind of your customer.

Customers generally see price on a sliding scale, like this one below:
If the price is seen as . . .
"Too Low" ←Reasonable→ "Too High"
Buyers may think. . .
"Something must be wrong" "That is reasonable" "I won't pay that amount"
If your customer thinks a price is too low, they will likely think that there is something wrong with your product. If they see the price as too high, they won't see the value and won't buy at the high price.

Research has shown that certain prices have a bigger impact on consumers thinking than others. There are 5 tactics that businesses can adopt to take advantage of this research:

1. Reduce your price by 1 AFN or one dollar so that your price ends in a "_9 AFN" or a "$___.99". In some cases, a price ending in a "9" or ".99" will seem much less expensive than the price that is one AFN or one dollar more
2. Round number pricing. In some cases, having a price that ends in a round number will be more appealing to customers because it just "feels right." For example, an item priced at 3,000 AFN may sell more than the same item priced either as 2,960 AFN or 3,070 AFN.
3. Buy one, get one free. This pricing technique appeals to the attraction of getting more of something for free. Even if the price is not truly that cheap, the customer often perceives that they are getting a discount.
4. Placing an expensive product next to a standard product. By placing two similar products beside each other, with one having a slightly higher price and higher level of quality, customers will often choose the more expensive option because they will value it more.
5. Visually highlight the change in prices. By showing a product's previous price beside a newly reduced price, people will be more likely to buy as they think they are getting a deal.

## Tell Me More

**Here are why these five tactics often work:**

1. Reduce your price by 1 AFN Afghanis or 1 cent in dollars (i.e. - reducing the left digits by one hundred AFN or one dollar) – this involves using pricing that ends in "99" and ".99." The left digit is reduced from a round number by one (AFN or dollar). We come across this technique every time we make purchases, but we don't pay attention. For example, your brain processes 300 AFN and 299 AFN as different values: To your brain sees 299 AFN as equal to 200 AFN, and since 200 AFN is much less than 300 AFN the customer is more likely to buy. Why is this tactic effective? It is because of how our brain sees numbers. Nine-ending prices will be perceived to be lower than a price one Afghani higher if the left-most digit changes to a lower level (e.g., 300 AFN to 200 AFN), but not as much if the left-most digit remains unchanged (e.g., 350 AFN

to 349 AFN). The conclusion is, if you want to increase purchases of your product/service, convert zero ending prices to nine ending prices.

2. Round number pricing – this is the opposite of #1 above. This tactic involves making all numerical prices into rounded figures, i.e., 3,070 AFN is converted to 3,000 AFN. Research has shown that round numbers (e.g., 3000 AFN) are more easily processed by our brain and they encourage a reliance on a consumer's feelings when they are compared to non-round numbers (e.g., 3,070 AFN). These non-round numbers are less easily processed by our brain. This means that rounded numbers "feel right" because the purchase is being driven by feelings and the rounded price is processed more quickly by our brain. For example, a study showed that consumers were more likely to buy a product when it was priced at 5,000 AFN - rather than 4,960 AFN or 5,060 AFN or 4,960 AFN or 5,060 AFN – Because it was easier to process.

3. Buy one and get one free. This is a pricing tactic in which customers pay the full price for one product or service to get another for free. The motivation here is simply greed. Once a customer comes across the free offer, their normal pricing logic gets set aside and their focus is only on making a purchase to get the free item. This technique has been widely adopted, so, businesses should get more creative with their offerings:

- Buy one and get 50 percent off on your next purchase.
- Purchase one and get four bonus coupons valued at 600 AFN each, for free.
- Buy one, get two for free.

4. Placing an expensive product next to a standard product. This involves offering two similar products simultaneously, but making one product's price much more attractive than the other. This is a game of choice for the customer, who must choose between two products that are similar, but have different prices. This strategy works well with fashion brands. For example, a retail store might place side by side two wedding dresses with one dress having slightly higher quality and a higher price. The goal is to make customers pick the more expensive one, because this is a special occasion.

5. Visually highlight the change in prices. When you offer a sale price with a previous price side by side with a new one, you make the sale price more attractive because customers feel they are getting a bargain. To make this pricing tactic work most effectively, change the font, size, and color of the new price. According to pricing research, simply changing the font, size, and color of the new price and placing it a little bit away from the previous pricing will increase the likelihood of a purchase. This is because customers see the new price as cheaper and a better deal than the previous price.

## For More Information Related to this Topic See

What are the 3 main components of the pricing process that I need to understand? *9. Pricing*
How can I find out what my customers are willing to pay? *9. Pricing*
Is there one way that is the best way to set prices for my business? *9. Pricing*
How do people think about prices and how does this impact my pricing decisions? *9. Pricing*

# 15.
# How can I increase prices and how often should I increase or decrease my prices?

## The Basics

There will be times when you will need to raise your prices, while still offering the same value that you have always done. The price increase process can be difficult and contains a lot of risk of losing or angering your customers. However, there are many instances when you need to increase your price to stay in business. For example, if the costs of making your product or providing your service goes up, you will need to consider adjusting your price to maintain your same level of profit.

When you do decide to increase price, your price increase should be reasonable - you don't go up 8% in one day. You may need to communicate to your customers why you are raising prices. If your business relies on a few large customers, you should tell them that, unfortunately, their current price is too low and there needs to be a reasonable increase over a reasonable period of time or you cannot afford to stay in business. You may want to work with them on a plan to slowly raise prices over time, such as taking the price up 2% every three months for one year. You should explain that, for you to stay in business, you must make a profit and, right now, their business with you is resulting in a loss. If they walk away, then you lose a customer, but you lose one that is not profitable, so that is still a good business decision. If the client is marginally profitable, the price increase could be smaller or made over a longer period.

When increasing your prices, try your best to plan ahead so that you can choose the best timing. You may also explore adding something extra that doesn't cost much but would add value to the customer. Changing how you offer your product – a different size or products bundled together as a set – might also be a way to set a higher price that is not as noticeable to the customer. Below are several strategies for increasing prices for you to consider.

## Tell Me More

**Here are 11 tips for increasing your prices without, hopefully, losing customers:**

1. Pick the best time. The best time to raise prices is when you are sure that your customers are satisfied with your product or service. If you're planning a price increase, be especially diligent about proving your worth in the months before you announce the increase.

2. Add extras. Customers are far more likely to accept higher prices if they're getting something extra in the bargain. Consider what you could throw in with your current product or service that would cost you little or nothing, but would have higher perceived value to the customer. For instance, if you own a store you could offer free gift-wrapping for a limited time.

3. Reduce sizes. Restaurants often use this tactic to improve profits. They keep the menu price the same, but they reduce the serving sizes slightly, hoping that customers don't notice. You can do this for almost any retail product, from cosmetics to candles. However, if customers do notice, this tactic can backfire. If you're worried, consider reducing sizes dramatically and charging proportionately less. For example, if you own a restaurant, reduce your 500 AFN one kilogram kabob entrée down to a half kilogram for 350 AFN.

4. Play the numbers game. The same pricing principle as # 3 can work for non-food items. For instance, if you normally sell a 10-pack carton of tissue paper for 300 AFN but you need to raise the price to 350 AFN, create some additional, different-sized packages, such as a six-pack for 250 AFN and a three-pack for 150 AFN. This makes the 10-pack seem like a deal, even at the new, higher price.

5. Add or raise fees. You can avoid raising prices on your actual product or service by adding fees. Electricity providers do this all the time, and many small businesses used the tactic when gas and electricity prices soared a few years ago. They simply added a "utility increase fee." This is a good strategy if you think your price increase will be temporary; you can easily remove the fee when the need for it is over.

6. Add improvements. Customers are more willing to accept a price increase if it's accompanied by improvements to your product or service. If you are a dress maker, you can use a higher quality fabric in the clothing that you manufacture to help justify a price increase.

7. Offer discounts to cancel out the price increase. When you raise prices, you may lose very price-conscious customers. To keep some of them, raise your prices, but offer occasional discounts and deals that bring prices down to their original levels. While frugal customers will use these discounts, less frugal customers probably won't bother, so you'll still get plenty of people paying full price, while keeping your bargain shoppers happy.

8. Bundle products or services. Soften the pain of price increases by offering new bundles of products or services. For instance, if you own a nail salon and need to raise the price of your manicures, pedicures, and foot massages, add a bundled manicure/pedicure/foot massage service in which the three services are offered together at a discount compared to the price if the three services were sold separately.

9. Target a different customer base. If you need to raise prices drastically, you may need to go after a new, more affluent customer base. Even if your price increase is modest, expanding your target market a bit to more upscale customers or businesses with bigger budgets can be a smart way to offset the customers you may lose.

10. Raise your rates at regular intervals. If your business is service-based, such as a yard-care business or house cleaning service, your customers will expect price increases from time to time. If it's justified, raise prices at the beginning of every year or after a customer has been with you for a year. If your services are provided on a month-to-month basis, offering a six-month or year-long contract at a lower cost than the month-to-month rate is a good way to lock in customers who want to avoid the price increase.

11. Plan ahead.  Before raising your prices, make sure you've considered not only your current costs but also any cost increases that are likely to happen in the next year or two. You don't want to go through a huge struggle to raise prices, only to find four months later that you need to do it all over again.

Be ready for a negative reaction to your price increase. You can't keep all your customers happy, and when you raise prices, you're bound to upset some of them. Be prepared to explain why you're increasing prices (higher costs and/or better products and services are typically the only reasons customers want to hear), both in person and on social media if customers complain there. Raising prices may not be easy, but these tactics can make it as painless as possible for you and your customers.

## Glossary

**Target Market** - A specific set of potential customers that a company focuses its marketing and sales efforts. Often the most likely customers to buy from a company.

## For More Information Related to this Topic See


- What are the 3 main components of the pricing process that I need to understand? *9. Pricing*
- What are some of the ways that people use to establish their prices? *9. Pricing*

- Is there one way that is the best way to set prices for my business? *9. Pricing*
- How do people think about prices and how does this impact my pricing decisions? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*

## Additional Tools Available

Price Setting Worksheet

Price Comparison Worksheet

# 16.
# How can I sell different versions of my product to different customers with different prices?

## The Basics

This pricing approach means that you develop different versions of your product/service to meet the needs of various customers at various price points. You do this to have more options in your pricing and, importantly, to set apart the products/services you offer by their prices. By offering different versions of your product, you can attract many different customers to your company, without angering your current customers.

One example of this approach is a restaurant that offers both a private section (at a high price) and a general public section (at a low price). Both customers will eat at the same place at the same time, but they will pay very different prices for the different experience (privacy, personal seating, more attention from the staff). Understanding the opportunity that different versions offer your business should help you improve your profits.

## Tell Me More

Here are some of the many techniques that companies use to give them pricing flexibility.

**A la carte –** Offer customers a menu of options. Think of going to a restaurant and having many choices to eat and drink versus a place where there is only one food item and one drink item on the menu. Customers prefer having a choice, so you should give them a list of your services for them to pick and choose from, so they buy only the ones they want. For example, a fitness center for women may offer different packages at different prices, allowing customers to choose additional benefits such as a personal trainer, training plan, access to more advanced equipment, etc.

**More is better –** Offer products/services with more benefits – more service, higher quality, or a greater experience. The newer smart phones offer more features and are priced higher than older style phones. A hotel may offer a room with a view of the mountains – rather than a view of the wall of the adjacent building – and charge more for this added benefit.

**Offer Less –** This is the opposite of 'more is better'. Here you offer less service or a lower quality product to attract the value-conscious consumer. Many cell phone companies have a basic cell phone plan to address the needs of people with less income.

**Avoid the wait –** Offer options so that the customer goes to the "head of the line". For example, a visa service providers have an express line for VIPs, but charge higher if an applicant wishes to avoid the wait and process an application faster.

**Reduce uncertainty –** Offer ways for customers to reduce their risk when making a purchase from you. Many electronics shops offer free repair for a period of one year (warranty) to make sure customers feel more certain about the purchase of electronic products. Others offer a power stabilizer along with the electronic item to protect the electronic item from breaking down due to power cuts. If you own an auto repair store, you could **also offer a money**-back guarantee with the purchase of new brakes, so that your customer understands that, if they are unhappy with their new brakes, they can come back and you will fix it at no additional cost to them.

**Expedited service –** Provide faster service than average. For example, some postal package couriers, like DHL, promise to deliver the package by next day before 9 AM, instead of before noon, and they charge more for this. If you owned a tailoring shop, you could offer to repair the customer's torn pants the same day instead of within your standard week, and charge more for this accelerated service.

**Add or subtract features –** Change the product/service's features to attract new customers. In the technology industry, there can be many versions of a product, each priced at different levels to reflect the additional capabilities of the product. BlueSonic at Kabul offers many level of its computer chips for when you are looking to buy a computer – with each one having different features and costs. For example, if you owned a gadget store, you could offer, in addition to the cellphone, to install software on the phone and give them a screen glass or a cover– all at an additional cost.

**Bundling –** Grow your business by providing convenience or having the customer buy products they otherwise would not buy. Mr. Cod's Family Meal packages are an example of this. In this case, they combine zinger burgers, fries, chicken legs and sodas for less money than buying each item separately.

**Prepaid –** This strategy provides payment flexibility as well as serving people who do not have the ability to buy on credit to draw in new customers. Prepaid cell phone plans and prepaid long distance calling cards are good examples of this.

**Rental –**. Car sellers, for example, rent fancy cars to brides and grooms for their wedding day as a rental service through wedding halls that host the reception for a party. While the cars are not for sale, the car sellers can offer many other options to new couples after a connection is made.

**Two-part pricing –** This is one price for a service plus additional fees for additional services. The airline industry turned a profit by using this technique – they earned billions of dollars with their many added fees – such as a fee for baggage or a fee to board the plane earlier - to the basic fare of getting from one place to another. For example, if you own a gym, you could charge a monthly fee plus offer other services - such as access to a personal trainer - which would be made available at an additional cost.

**Hurdles –** Use time as a way to isolate different customers. Many restaurants offer specials to bring in customers later in the evening during Ramadan, after the iftar rush has subsided. Slice Bakery lowers their prices after 7 PM in order to attract the value-conscious café goer.

**Payment plans –** Using this strategy, you match when you request payment from the customer, with when the customer is able to make payments. Many companies offer a payment plan where you don't have to spend the total amount of the purchase upfront, but can pay the bill over time. Consumer technology distributer, AQSAAT offers "Only 4000 AFN a month" as a way to attract customers that don't have 30,000 AFN for a new mobile device or computer.

**All-in-one pricing –** Offer a price that includes everything you provide convenience and peace-of-mind to attract new customers. There are many tourist companies that take you to Mecca, Saudi Arabia to perform Umrah or Hajj and offer a complete vacation with all costs included (room, food, and activities). Cell phone providers offer plans with unlimited calls, data, and text all included in one monthly price.

**Instant discounts –** Offer an immediate discount, you encourage greater purchases by offering an incentive to spend more right now. For example, "Get 1000 AFN off your purchase of 8000 AFN or more".

**Free delivery both ways –**Companies could offer free delivery and free returns to encourage people to purchase things they may not end up keeping – but, for the customer, there is very little risk in buying because they can return the product for free.

**Gift with purchase –** Reward your customer by giving them a gift. "Buy 6000 AFN worth of cosmetic goods and get a free makeup kit." For brands that are worried about decreasing their prices, free gifts with purchase are another way to motivate customers to spend more. Experts agree that a gift with purchase is a great way to steer away from offering discounts. For some shoppers, the offer of a free gift is also an unexpected, yet pleasant surprise.

**Post-purchase discounts** – Reward the current customer's purchase in some way. "As a special thank you for placing your last order, here's 20% off your next purchase." You should use post-purchase discounts to re-engage your customer and encourage repeat purchases.

These are just some of the many ways to offer different versions of your product and price to maximize your profitability. However, you must be careful not to practice price discrimination. This is when a company is selling the same product at different prices to different groups of consumers. In some cases, this behavior is unethical or even illegal.

## Glossary

**Price Point** - A suggested retail price of a product, determined to compete with prices of other products.

**Price Discrimination** - The situation where a company is selling the same product at different prices to different groups of consumers.

## For More Information Related to this Topic See

- How can I find out what my customers are willing to pay? *9. Pricing*
- What are some of the ways that people use to establish their prices? *9. Pricing*
- Is there one way that is the best way to set prices for my business? *9. Pricing*
- How do people think about prices and how does this impact my pricing decisions? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*

## Additional Tools Available

Price List Worksheet

# 17.
# When should I run a sale or promotional price?

## The Basics

A sale is a way of saying that a price has been reduced and consumers need to act quickly to take advantage of this opportunity. It is important to let customers know that the sale is a one-time event. Sales should be short-lived so people don't think they can wait and come back again next week and find the same prices. There are many different types of sales.  Here are some of sale options:

- Loss Leader: You can dramatically reduce the price of one item to attract customers - with the hope that they buy other products with higher profit margins. The product you sell at the low price is called a "loss leader."
- End of the Season: This is a way to free up space for new merchandise that will soon arrive. We often see this type of sale at the end of the winter or right after the two Eids.
- Pre-season: this takes advantage of the coming season. For example, if you own a clothing store you could offer a pre-season sale on all new jackets in the Fall, before it is cold and snowy in the winter.
- Get it before it's gone: This sale encourages customers to come quickly, because the merchandise won't be around very long and they may miss out. Perhaps you have some excess merchandise in your store that you would like to get rid of. In this case, try having a sale for any designs you're considering removing from your shop so that people know they must act fast to get the merchandise at this price.
- New Arrival: You can discount new items to get attention for any newly stocked items in your shop. A new arrival sale also shows people that you are staying on top of market trends and are regularly updating the goods in your shop.
- Reduce the price of everything: You may hold a shop-wide sale by bringing down the price of everything in your store. This rarely used tactic should be used only when you are going out of business, as it sends a negative message to your customers who may then think your everyday prices are too high making it hard to return your prices to normal levels after the sale.

If you're going to offer a sale, offer it for a short period of time – don't reduce prices over a long period of time. Gradual discounting gives customers the impression that, if they wait, they will save more money, so they are less likely to make a purchase now.

## Tell Me More

If you decide to run a sale here are some tips to making it more successful.

**Tip # 1 –** Schedule your offers. Scheduling out when you'll have sales/promotions is a great way to prepare yourself for what you need to do before each event. You will plan out when you're going to focus on selling certain products and when you're going to need advertising for your sale. Having a schedule is a proven way not only of organizing sales or promotions you know you want to have, but it's also a good way of looking toward the future and getting inspiration for scheduling sales/promos that line up with public holidays, cultural events, your business's birthday, etc.

**Tip # 2 –** Follow the trends. You can plan your sales to coordinate with other things happening in your area. For instance, maybe there is an Ariana Sayeed concert taking place in the summer and you can offer tickets to the concert if your customer buys a certain amount from you. Or maybe you know that there is going to be a special event in your area and you can offer a "20% Roz-e-Deqaan Discount" to celebrate National Agriculture Day to anyone with a ticket stub from the Agricultural Day Fair. Or maybe you own a restaurant and you can offer a free appetizer to anyone with a ticket to from a recent football or cricket match.

**Tip # 3 –** Track your efforts. The key to getting better at doing sales and promotions is looking back at ones that didn't work out well and learning from what failed versus a time when you did well. You need to understand what worked and what didn't work to get better results the next time.

**Tip # 4 –** Set a clear goal for every sale/promotion. Knowing what your goal is for each sale will help you figure out how to price the items that you are discounting. Are you doing a big sale just to get more traffic into your shop? Therefore making money isn't the goal, and making a little bit less for giving a higher discount on some items is the way to get more people to try your store. But if it's a sale where the goal is to make money, you want to make sure that you're careful with how much you are discounting your items and which items you are discounting.

**Tip # 5 –** Let people know about your sale. You should let customers know you're having the sale. In-store banners, e-mails to your best customers and fliers are just some of the marketing tools you can use. Make customers notice that something's different by changing the look of the store and throwing them off their normal traffic patterns. Think about how to interrupt customers so they see the sale.

## Glossary

**Loss Leader -** A product or service that is intentionally priced low in order to draw people in with the hopes that they will also buy other, higher priced items at the same time.

## For More Information Related to this Topic See

- What are the 3 main components of the pricing process that I need to understand? *9. Pricing*
- How do people think about prices and how does this impact my pricing decisions? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*
- What are some of the options I have when setting my prices? *9. Pricing*

# 18.

## What are some of the options I have when setting my prices?

## The Basics

When it comes to setting your prices, there are a number of options for you to think about. Each option described below focuses on a pricing tactic to enable you to better tailor your price towards a specific target market. Not every one of these tactics will work for you, but, by becoming aware of them, you can see where opportunities exist for you to price intelligently. Some options are:

- Price by buyer type. Charging different prices to different buyers based on some of their observable characteristics, such as their age.
- Price by time of purchase. Charging different prices at different times of the day/week/month/year.
- Price by purchase location. Charging different prices based on the location of the purchase.
- Price by purchase quantity. Charging different prices for purchasing different quantities.
- Price by product bundling. Selling different products only as a group together or selling each individual item at higher prices if the bundled items are separated.
- Price by metering. Charging based on a variable fee measured by a metered usage rate. Customers pay what they use, such as mobile phone minutes or a taxi ride.

## Tell Me More

**Here are six possible pricing options to explore:**

**Option 1 -** Price by buyer type. In this option you will charge different prices to different buyers based on some of their observable characteristics, such as their age. This process relies on segmentation, which is dividing up the market into smaller pieces, each with their own clearly differentiating factor, such as selling lower priced bus tickets to people above 65 years old. Segmentation recognizes that buyers have different characteristics that are obvious. An example might be a gym r that offers lower prices from morning to 4 PM. This may work to bring in people who are not at work or are retired. A restaurant could give an early dining discount to people who dine from 3 to 5 PM when the dining room is likely to be less busy.

**Option 2 -** Price by time of purchase. For this option, you would charge different prices at different times of the day/week/month/year. There must be a natural difference in time of purchase patterns for you to price to these different segments of buyers. Some examples are:

- Utilities may charge a business more for their electricity use during the week and less on the weekend.
- Airlines charge you less to fly on their overnight flights.
- CKabul zoo offers lower prices during school holidays or national holidays such as Nawroz.
- Hotels may offer international travelers lower room prices for an extra weeks stay versus their first week's price to get them to stay an additional week.
- Some mobile phone companies offer different prices for peak and off-peak minutes. They may also offer free calls during late night and weekends.

**Option 3 -** Price by purchase location. This means charging different prices based on the location of the purchase. Some supermarkets charge higher prices in their stores that are in more affluent areas. Often, convenience stores charge more for beverages or snacks as the buyer is willing to pay more for the convenience of the later hours or closer locations. You may find that a hotel will charge more because it is located right in the heart of downtown, while another hotel, just a few miles away, charges less because its location is less convenient for travelers.

**Option 4** - Price by purchase quantity. This occurs when companies charge different prices for purchasing different quantities. For example, a supermarket may offer a lower price if you buy 2 cases of soda versus the price when you buy just one. Many food companies offer more than one size of an item. For example, Coca-Cola offers its larger can of soda at a reduced price per ounce over the smaller size cans that are sold in stores.

**Option 5** - Price by product bundling. This is where you are selling different products only as a group together or selling each individual item at higher prices if the bundled items are separated. Offering different products in a bundle can be effective if the bundled products have a particular relationship to the different buyers. In many countries, cable TV companies bundle their TV service with a phone service and internet access.

**Option 6** - Price by metering. This is where payment arrangements have a variable fee that is dependent upon a metered usage rate. The price being charged reflects the metered usage of the asset, such as a taxi fare, electricity/water usage or mobile phone minutes.

## Glossary Terms from this Section

**Segmentation** – Dividing up the market into smaller pieces, each with their own clearly distinguishing factor, such as selling a lower priced train ticket to people above 65 years old.

**Bundle** - The tactic of combining two or more products into a package deal, usually offered at a lower price than if the items were purchased separately.

## For More Information Related to this Topic See

- Is there one way that is the best way to set prices for my business? *9. Pricing*
- How do people think about prices and how does this impact my pricing decisions? *9. Pricing*
- Why do some prices appear more attractive to customers than other prices? *9. Pricing*
- How can I sell different versions of my product to different customers at different prices? *9. Pricing*

## Additional Tools Available

Price Setting Worksheet

Price Comparison Worksheet

Product Cost Template

Value Based Pricing Worksheet

Break-Even Template

# 19.
# Is charging high prices unethical?

## The Basics

Some ethical issues are extremely easy to understand: don't steal and be sure to treat others with respect. However, when it comes to pricing, the concept of what is right and wrong is not as clear. Is it a business's right to price however they want? After all, if the price is too high, then consumers won't buy it.
The biggest issue regarding ethical pricing is between what is legal versus what is ethical. All marketing activities should be honest and transparent. That means "don't break the law" by committing unethical practices, such as using cheap or harmful ingredients or lying about the performance of your product.
In pricing, the line between what is legal and what is ethical is less clear. For example, suppose there is law in your country that you cannot sell a product below its cost. But, you own a dairy and want to be sure that the poorer people in your area can have milk on their table, so you sell them the milk below your cost. This creates a good feeling with the local people towards you, and, because of your low milk pricing, they buy other products from you, like your highly profitable cheese. In this case, selling milk below cost seems like the ethical thing to do, but it is illegal.

On the other side, suppose your company sold a life-saving medicine for 1,500 AFN per dose. If you decided to increase the price to ten times that amount and charge 15,000 AFN per dose, that may be legal but it may not be an ethical decision because many poorer people would not be able to afford the medicine.
Because of many situations like these, pricing ethics and pricing legality can be difficult. In many cases, there are no 100% clear answers. However, in almost every situation, it is best to price within the rules of law and to think about the ethics behind your pricing decisions.

## Tell Me More

To better protect you and your business, here are some of the most common pricing practices that highlight this difficult situation between ethics and legality.

**Price fixing** - This involves an agreement between competitors who buy or sell the same good or service to only offer their good or service at the same fixed price. Typically, competition between these companies drives down prices for goods. But if the competitors coordinate to keep all their prices high, normal competition doesn't work. For example, imagine a world where every ice cream shop in the country sells a one scoop cone for 1000 AFN. Consumers would lose out, because either they would find an alternative to ice cream or they will be forced to pay much too high a price for ice cream. In many countries, including Afghanistan, price fixing is illegal. What should you do? Look at what your competitors are doing to understand the market, but don't get in a room with them to fix prices and try to take advantage of consumers.

**Bid rigging** - This involves a company or organization promising a commercial contract to one group, even though you make it look like multiple parties had the opportunity to submit a bid. Not only is this morally wrong, but it's also one of the few pricing areas that most governments regard as illegal and actively fight. Bid rigging hurts consumers considerably, because the best producer doesn't always receive the work. There are many variations of this offense, and all include some pre-determined agreements between corporations involved in securing a contract. What should you do? Even if you are tempted to ask for help from someone who can influence a bid from the inside, don't do it. Keep the bidding process honest and transparent on both sides. Everyone will end up better off. As a practical example, many roads and streets which were initially rebuilt in Afghanistan after 2001, were quickly unusable and in terrible condition, because the right companies with experience and ethics were not selected to complete the work and thus the entire country suffered.

**Price discrimination** - This is situation where a company is selling the same product at different prices to different groups of consumers, usually based on the maximum they are willing to pay. The practice also surfaces in hiding lower priced items from customers who have a higher willingness to pay. This one is a little tricky, because it is socially accepted in some cases, yet rejected in others. For example, very few people would complain that it is okay that a 6-year-old girl pays 300 AFN less to enter the carnival than an adult, but that it is not ok to charge someone a higher price because they are a different race or religion. What should you do? It is ok to charge different types of customers differently for different versions of your product through legitimate pricing practices such as product differentiation or bundling. Remember to be exceptionally careful about communicating differences in price.

**Time discrimination** - This involves price skimming, when a product is first sold at a very high price and then gradually lowered over time. The goal here is to maximize profit - producers want to capture as much money as possible as they recognize that there are consumers who are willing to pay more to buy the product first. Like price discrimination, this practice isn't illegal, but, if it is too obvious and not tested enough, it can cause an unfortunate negative public reaction. What should you do? Find ways to lower prices to new groups of customers discreetly. Coupons, promotions, and lightweight versions of a product are all effective pricing techniques to use while keeping the same price. Most people would agree that setting super high prices for basics like water or power generators following a hurricane is unethical (and some countries have laws against it). However, some people feel like this sort of behavior is just the result of a free market and is allowable. What should you do? Use common sense. Ask yourself if the pricing change will hurt some by denying them basic necessities. If the answer is yes, you shouldn't do it. To sum up, don't do anything illegal when setting or changing your prices, but even with the questionable practices, always step back and think about what the price looks like from a customer's perspective. You're not building a quick sale business. You are building something sustainable, so make sure to avoid any and all pricing disasters.

## Glossary Terms from this Section

**Unethical Practices** - Any negative activity that a business conducts that is against the moral nature of the majority of the population.

**Price Fixing** - Agreement between a group of people on the same side of a market to buy or sell a good or service at a fixed price.

**Bid Rigging** - Occurs when a company or organization promises a commercial contract to one group, even though they make it look like multiple parties had the opportunity to submit a bid.

**Price Discrimination** - The situation where a company is selling the same product at different prices to different groups of consumers.

**Time Discrimination** - The situation when the price for a product is first sold at a very high price and then gradually lowered over time.

**Price Skimming** - When a product is first sold at a very high price and then gradually lowered over time.

## For More Information Related to this Topic See


- How can I find out what my customers are willing to pay? *9. Pricing*
- What are some of the ways that people use to establish their prices? *9. Pricing*
- How do people think about prices and how does this impact my pricing decisions? *9. Pricing*
- How can I sell different versions of my product to different customers at different prices? *9. Pricing*

# 20.
# Is “free” ever a good idea?

## The Basics

Free is the most powerful marketing tool we have. Giving away something for free is used to enable people to try your product or service with no risk. The hope is that, after trying the product, they will like it and become a loyal paying customer. In marketing, free is a word with an extraordinary ability to change people's mindset, create new markets, break old habits, and make almost any product or service more attractive. Free overcomes almost every objection that people have when they think about trying something new.

## Tell Me More

How do you get people to buy what you are selling? One option is to give something away for free. You do this because your generosity will catch people's attention. People love to get something for nothing. It makes us happy that we have gotten something that we did not pay for – and this reflects positively on the brand. There's so much advertising noise in the world that it's difficult to know what's worth buying. Most people buy things that they have a personal connection with or that is recommended by a trusted friend. Giving away your product/service (for example, a 30-day free trial offer) will allow future customers the opportunity to hear about you, see the value in what you are selling, and then reward you for it by becoming customers.

Does a "free" price tag devalue your product/service? No. It just raises the visibility of it. It's a way to get in front of people that would otherwise ignore you. It's a very successful (if expensive) tool in marketing.

After all, it's your job to get people talking about the product or service that you have to offer. The best way to do that is to give it away for free. Will this possibly attract the wrong type of customer – the one who only wants something for free and will never buy the product when they have to pay for it? Yes, it might. But, if you do your job right, your free offer will also attract everyone else. Plus, it helps you build a reputation as a generous, creative person who shares their product with the world.

**Here are 5 reasons why free can work for your business:**

**Reason # 1 -** Free stuff creates a buzz.
Today it doesn't take long for news to travel. People like free stuff, plain and simple, and the power of social media means the ability to get the word out is much easier than ever before. Plus, people are willing to pay more attention to buzz if they hear something from a friend on social media or in person.

**Reason # 2 –** It encourages people to try your products/service/experience risk free.
This is a huge benefit if you want to prove that you have something different or better to offer. People are more likely to try something they normally wouldn't if it is free and there is no commitment. That's why a gym may offer a complimentary one-day pass to people considering membership. The same is true for free perfume samples that shops hand out in Share Naw. The idea is that if customers try something and like it, or have a positive experience, they'll come back for more.

**Reason # 3 –** It can be a hook that gets customers into your business so they'll stay longer and spend more.
There will always be a few people who will order the bare minimum and leave, but most will stay for a while and order more. That is why many restaurants offer "Kids Eat Free" because they know that kids don't dine alone. Their parents have to bring them and eat, too. The cost of a child's plate is minimal in comparison and it gets the entire family in the door, so they spend money at your place instead of a competitor down the street.

**Reason # 4 -** Customers are more forgiving when something is free.
People are more forgiving if they feel like they're getting a bargain. That's not to say you should use it as an excuse to give poor service, but it can be an advantage for a new business just starting up. Let's say you are opening a new restaurant. While you and your employees struggle to learn the order-taking process and figure out how you want each meal served, customers may be willing to give you a break if they get something for free, such as a free soda with the meal. Just don't take advantage of them. If they leave with a negative perception, they may never come back.

**Reason # 5 –** Free creates a buying habit.
By offering something free, people are more likely to give your business a try. And once they've been to your business – assuming the experience was positive – they're more likely to come back. It's harder to gain a new customer than keep a current one, and buyers have habits, so they go with what they know and feel comfortable with. Part of the challenge of a new business – or even an established business – is creating customer traffic (foot traffic to a retail location or traffic to your website). So now that your location is included in the list of locations they will consider, you're much more likely to gain their repeat business in the future.
In summary, free can be the most effective kind of pricing decision you will make. You need to weigh the pluses and minuses, as offering something for free can be very expensive. However, if you want to get your product into as many hands as possible, free can be a good option.

## For More Information Related to this Topic See

- What are some of the ways that people use to establish their prices? *9. Pricing*
- Is there one way that is the best way to set prices for my business? *9. Pricing*
- Is there a framework I can use to help me to understand how to do value-based pricing? *9. Pricing*
- How ca I sell different versions of my product to different customers at different prices? *9. Pricing*

# Tools