

## Why are over 80% of new products priced too low?

### Avoid this by creating a strategic price plan to harvest your profit potential

By some industry estimates, over 80% of new products are priced too low. The main reason is that companies generally don't understand the true value of their products to customers.

For example, when bar codes readers for inventory control were first introduced, the product was priced too low relative to the cost savings customers achieved. Nothing else provided these same benefits. As a result, billions of dollars in profits for the industry were lost.

Setting new product pricing can be a complex task, with many opportunities to get it wrong.

In this article, I provide 3 practical steps that will allow you to price 99% of the new products your company plans to launch and avoid the most common pricing strategy mistakes. For the other 1%, you will need to look at a few additional steps - more about that at another time.

Remember, pricing should be an integral part of a company's overall corporate strategy, not merely an afterthought. The only real goal of any pricing strategy is to maximize the company's profits generated over the entire product life cycle.

In other words, you need to determine how you can extract the most dollars from your target markets now and in the future. Everything else is only a side issue.

In step 1 of the pricing process, there are three decisions you need to make.

First, you need to decide how unique or innovative the product features and benefits are to your target market. As well, you need to determine into which classification your new product

fits. Is it a revolutionary, evolutionary or me-too product?

Be careful, this is the first and most important step in the pricing process. Unfortunately, many companies tend to overestimate the uniqueness and overall value proposition of their new products. Be honest. Most importantly, research your market and ask your customers what they think.

A revolutionary product brings something completely new to the market and does not have a direct competitor. An example of this type of product is the introduction of penicillin or the first audio tape recorder.

An evolutionary product brings a meaningful, customer-relevant product enhancement to an existing product category. An example of this is a new cell phone with a colour screen or a 5.8 MHz cordless phone.

A me-too product looks and smells almost exactly like an existing product in the market. An example of this type of product is another 100% all-beef hamburger or another cola.

Pricing for me-too products is easy. It's called reference pricing. Look at what your competitors are doing and determine if you can add a little more or less than they do. Set your price accordingly.

Your main goal with me-too products is to maximize your margin by minimizing your product costs.

For revolutionary and evolutionary products, you need to do a little more homework. Decide how unique and differentiated your product is compared to existing offerings in the market, and then classify where they fit. Now proceed to the next step.

Your objective in step 2 is to establish pricing boundaries. To do this, you need to set three different prices: the lowest, the highest and the target price.

This approach will help simplify your decision making so that you can easily visualize how much room you can move prices up or down.

The lowest price to ever consider charging customers is a price that will allow for a decent return on investment, factors in overall project risk and missed opportunity costs. Your CFO can help you here.

Be sure to include all the costs needed to produce, market and deliver the product to your customers (don't forget about R&D and overhead costs). Again, most companies underestimate the true cost of launching and supporting new products.

Once your true product costs are determined, now you can include an appropriate margin to arrive at the lowest price.

Many companies use a similar process as above to determine the lowest price, such as cost-plus pricing, but unfortunately never progress beyond this point.

An important part of step 2 is to project the number of product units you can sell at this particular price over the next 3-5 years. With this information, you can now calculate the gross and contribution margins generated by this product at this price over time.

Remember that in many industries, even a 5% reduction in price can reduce gross margin by 20% or more - net margin will be reduced significantly even further.

Now ask yourself, if your lowest price is below an acceptable return. Should we still proceed?

Now that you have set the lowest price boundary, you can follow this same process for the highest price, except at this point try to estimate the maximum value your potential customers could obtain if they were to purchase your product.

Some form of market research at this point is usually required. Remember, don't just focus on just rational product features and benefits, also include the value of emotional and brand benefits.

Again, this is another trap many companies fall into and which usually results in lower than necessary prices.

Many companies avoid conducting end-user research. This is probably the major reason why many companies opt for the lowest price; because

they think they don't have the time to research the market or, even worse, they think they already know what their customers will say. Just by default, the lowest price usually becomes the final price for many companies.

Once you know the true value of your product to your customer, you are ready for the final stage.

In Step 3, your goal is to set the actual, final price. In some cases the difference between the lowest and highest prices can be very small, but from a profit standpoint, significant. Your research and market understanding should help guide you to know if you should be at the higher or lower end of the pricing boundary.

Now before you finalize the product launch pricing, you need to determine what reaction your competitors will likely take and how well you can defend your

market position if competitive prices drop significantly. Do your volume estimates still hold?

Keep in mind that strategic pricing often requires more than just a change in attitude in the marketing department, but a new relationship with finance, sales and your customers. Don't undersell your products!

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