Methods to Price Your Products

Choosing an effective pricing strategy for your business's product or service can mean the difference between a profitable, successful business and one that fails to thrive.

There are many ways to set your product's price. This factsheet will outline the three most common ways of setting the price of your product as well as the advantages and disadvantages for each method:

- Cost-based pricing
- Competition-based pricing
- Customer-based pricing

As you review each pricing method, think about your business, the industry you operate in and your target customer. Although the pricing methods listed are detailed separately, it is acceptable to blend several pricing methods to suit your business and the type of products you sell.

The way you set prices can change over time and for many reasons. As you learn more about your customers and your competition or if new opportunities arise in the marketplace, you might decide to change your pricing method.

Your pricing method can change with time and circumstances

Cost-based pricing

Cost-based pricing involves figuring out what it costs you to make your product, then adding a percentage mark-up (profit element) to determine the final price.

With cost-based pricing, it is important to include all the costs of producing your product (such as, but not limited to):

- Raw materials
- Transportation
- Advertising
- Wages
- Rent
- Operating costs
- Value of management expertise or labour
- Cost for the use of your land or capital equipment
- Cost of depreciation on your machinery and buildings

Refer to the checklist found at the end of this factsheet for items to include when determining cost of production for an agriculture-based business selling direct to consumers.

Including all costs in your calculations will ensure your cost-based pricing will be more accurate. Once costs are calculated, use one of these three cost-based pricing methods.

Mark-up pricing: This approach favoured by businesses with several products is simple to calculate. The profit level expressed as a percentage and is added to the production cost to set the product price.

Example: Wild Blue Preserves makes 15 different jams and jellies and sells at a local farmers' market. A jar of wild blueberry jelly costs $4 per 250 ml jar to produce. The mark-up profit percentage Wild Blue Preserves wants to use is 40 per cent. The jar of jam will have a retail price of $5.60.

Cost-plus pricing. This method is similar to mark-up pricing, but the profit added is a set dollar amount rather than a percentage. This method is used when buyers and sellers agree on a price, while the cost of production is unknown or may fluctuate. Even if production prices go up or down, you still have a consistent profit.

Example: You are a co-packer packaging and distributing low fat energy bars for a start-up snack food business. As a co-packer, you purchase ingredients through your suppliers, but do not know your exact input costs. You sign a contract with the snack food business to pay for your input/material costs, plus a guaranteed processing cost of $40 per case.

Planned-profit pricing: This approach ensures you earn a total profit for the business. Planned-profit pricing combines per-unit costs with output projections to calculate the product price. A break-even analysis is used to calculate planned-profit pricing. Planned-profit pricing allows a manufacturer to consider how increasing levels of output affect the product price.

Example: A special order cake business sets prices by considering the size of the orders they receive from various customers. A price break is given to customers who order 10 or more cakes at one time.

Advantages of cost-based pricing
Cost-based pricing ensures you cover all your costs, and the method is a relatively simple way of figuring out your profits.

Disadvantages of cost-based pricing
Cost-based pricing does not take into consideration the customer demand, the perceived value of your product, or how your product compares to the competition. A cost-based system may lock you into a more moderate profit and may leave potential revenue on the table.

Competition-based pricing

Competition-based pricing involves using the price of competing products as a benchmark to set your product's price. This method is used when producing a product that is similar to your competitors' products. When using competition-based pricing, you still need to cover the costs of producing your product.

Ask yourself these questions to help you assess your competition.

- Which companies would you consider your direct competition?
- What are the types of substitutions – or indirect competition – for your product?
- How many competing companies operate in your market?
- Are your competitors larger or smaller than you?
- Are your competitors close by or far away?
- Is it difficult for new competitors to enter the industry?
- What types and number of products do your competitors sell?
- What pricing method(s) do your competitors use?
- What are you selling and how does it compare to your competitors' products?

To understand more about your competition, you may need to conduct research. Information about market research is found in the factsheet Market Research. Once you know more, decide whether you will set your pricing to be the same as your competition or whether you will price your product lower than the competition to potentially increase your sales.

Example 1: You make a sugar-based pancake syrup and price your product the same as your competition, thinking that a new product in the marketplace will inspire customers to try your brand. As you gain more customers and sell more product, some of your costs will decrease because of economies of scale, thus increasing your profit over time.

Example 2: An established producer of beef jerky decides to introduce a new flavour of beef jerky. They decided to price lower than other jerky companies as a way of encouraging customers to try their new flavour. The competitors' jerky is priced at $6.50 - $10.00 per 75-gram package of jerky, so the seller of the new flavour decides to set the introductory price at $5.95 per 75-gram package to sell a larger volume of product.

Advantages of competition-based pricing
Pricing the same as your competition makes calculating your price easier. Charging a lower price than your competition may allow you to lure customers away from your competitors and differentiate yourself based on price.

Disadvantages of competition-based pricing
Pricing that matches your competition may not be based on your ideal target profit and may not allow you to cover your costs. Other competitors can also easily mimic the price you set or even set a lower one, so this approach can have a negative effect on the industry by lowering prices over time. When you price the same as your competitor, price is no longer a factor in the customer's decision-making process, so increased marketing efforts (and increased costs) may be needed to attract sales for your product.

Customer-based pricing

Customer-based pricing (also known as value-based pricing) involves setting the price based on customer "demand" and considering customers' perceived value of the product. Customer-based pricing requires businesses to have an in-depth knowledge of their customers' needs.

To use customer-based pricing, you will need to take a market focus with your business and find out more about customer buying habits, purchasing decisions and attitudes towards various prices. Think about your target customer when you answer the following questions.

- Does your customer assume that price reflects product quality?
- Do customers think they are getting their money's worth from your product?
- Do your customers care more about product prestige than product price?
- Do your customers buy solely based on price?
- At what price do your customers think your product offers good value?
- What are target customers prepared to pay for your product?

If you are just starting out in business or expanding into a new market, you may find it hard to answer these questions yourself. Talk to potential customers or develop a formal interview questionnaire. For advice on the best way to conduct market research, read the Market Research factsheet.

Here are five commonly used customer-based pricing methods:

- Set the price according to your customers' view of your product
- Give customers a promotional price to increase product sales
- Design a price range to appeal to a variety of consumer groups
- Give customers a volume discount for multiple purchases
- Bundle products to move inventory or motivate buyers

Set the price according to your customers' view of your product: Prestige-oriented consumers believe a higher price means higher quality while bargain seekers are happier with lower prices. Does your price reflect your product image?

Example: Go Green Organic Vegetables targets a health-oriented customer who shops at specialty organic shops. The price for a bag of mesclun mix salad greens is $7. This is $1 above the competition that markets its salad greens through a large retail grocery chain.

Give customers a promotional price to increase product sales: Promotional pricing uses lower prices to catch the attention of consumers and includes coupon books, holiday discounts, buy-one-get-one-free promotions and more.

Example: Terrific Tea Company circulates a flyer at the local farmers' market for a buy-one-get-one-free promotion when customers purchase tea blends priced at $10 or more.

Design a price range to appeal to a variety of consumer groups: Grouping potential buyers into differing definable groups is called segmentation. Rather than pricing for one group, you design a range of prices that would appeal to different groups. For example, market segments could group customers by income level, age, geography, amount of product consumed, etc.

Example: A processor of pie fillings has segmented its customer groups by the amount of volume consumed. The low-volume user buys 3 - 6 jars per year, mid-level users buy 6 - 10 jars per year while the large user buys 10 - 20 jars per year.

Give customers a volume discount for multiple purchases: Volume pricing gives a discount to customers buying a larger volume of product. This is done to sell more product or reward established customers who buy more often. If you sell perishable goods, like produce or flowers, volume pricing during peak times may help you sell your perishable product at a lower cost rather than lose profits through spoilage.

Example: During peak harvest season, a Saskatoon berry grower sells a u-pick ice cream pail of berries for $10 each or two pails for $16.

Bundle products to move inventory or motivate buyers: Slow-moving inventory can get a boost when packaged with a group of popular items. Customers seeking a bargain will be drawn to product bundles that offer good value. Product bundling can also be designed for the convenience market: for example, salads bundled with croutons and a single portion of dressing offer added value for the consumer.

Example: A Saskatoon berry grower bundles Saskatoon preserves, syrup and chutney in a gift set. Normally, half as much Saskatoon chutney is sold compared to preserves and syrup. When packaged gift sets are offered for sale, chutney sales increase by 30 per cent.

Advantages of customer-based pricing
You may be able to charge a higher price than your competition if you can show how your product has a unique or innovative quality that is worth more to the customer. When a product is unique, a value-based price may be a more profitable option for you. Often, value-priced items are more resilient in economic downturns.

Disadvantages of customer-based pricing
Being too focused on the customer can sometimes take your eye off other important aspects of your business, such as your production costs and what your competition is doing.

Tips for successful pricing

Product prices are important to any successful business. Effective pricing requires creativity, research, good recordkeeping and flexibility. Follow these tips to ensure greater pricing success.

- **Be creative** by thinking of new ways to sell more to existing customers or to attract new customer groups.
- **Listen to your customer** and keep track of their comments, then review them periodically to glean new ideas.
- **Keep good records** of how you arrived at a price and track the performance of your pricing, so you can adjust your prices (if required) in the future.

- **Be flexible** by regularly reviewing internal and external factors and understanding how price changes would affect your business.

Resources

These resources, tools and business templates may be of value when starting and growing your business.

- The Essentials of Pricing
- Pricing Processed Food Products
- Pricing Horticulture Products
- Pricing Meat Products: An Introduction
- Identify your Market – Right Buyer, Right Price (Step Three)
- Market Research
- Business Basics for Alberta Food Processors

For more information, contact
Alberta Ag-Info Centre
Call toll-free: 310-FARM (3276)

Website: www.alberta.ca/agriculture-and-forestry.aspx

Cost of Production

Checklist: What to Include in the Cost of Production

There are many different costs involved in an agriculture-related business selling a product direct to consumers. When determining your cost of production (COP), make sure you include all costs to create your product – from those involved in making the product to business-related expenses.

Variable Costs

Variable costs increase proportionally to the amount produced. Variable costs can include direct labour, ingredient/seed/feed costs, equipment repairs, fuel costs for distribution, marketing expenses and other costs.

Fixed Costs

Fixed costs are consistent costs (overhead) that do not change from month to month. These costs occur no matter how much is produced. Often they are related to time; such as monthly rent, yearly real estate taxes, annual machinery costs and depreciation.

Note: When determining Cost of Production for your total operation, only include an expense once. You will notice that some of the expenses categories are the same in the fixed expense sections. You may wish to split costs between operations (raising animal and processing) by estimating how much each operation uses i.e., utilities – raising animal 75% and processing 25% of the total cost. This will give you a better idea as to the actual costs for each operation.

Horticulture	
Variable Expenses	**Fixed Expenses**
Production Expenses ☐ Seed ☐ Chemical ☐ Fertilizer ☐ Packaging ☐ Irrigation ☐ Custom work ☐ Other Operating Expenses ☐ Trucking ☐ Repair and Maintenance (buildings) ☐ Repair and Maintenance (machinery) ☐ Fuel, oil and lube ☐ Advertising and marketing ☐ Travel ☐ Farmers Market booth fees Labour Expenses ☐ Paid Labour ☐ Unpaid Labour ☐ Other **Total Variable Costs = $____________**	☐ Operating interest ☐ Depreciation (building) ☐ Depreciation (machinery) ☐ Small tools ☐ Land taxes ☐ Insurance (building, vehicle, liability) ☐ Utilities (heat, electricity, telephone) ☐ Office supplies ☐ Professional fees (i.e. accounting, legal) ☐ Other **Total Fixed Costs = $____________**
Cost of Production = variable costs + fixed costs	

Processed Food	
Variable Expenses	**Fixed Expenses**
☐ Ingredients – for food product ☐ Processing expenses (commercial kitchen rent, co-packer, etc.) ☐ Labour (including paying yourself) ☐ Packaging costs (jars, labels, boxes, etc.) ☐ Transportation (shipping, travel to farmers' markets, etc.) ☐ Marketing costs (advertising, samples, etc.) ☐ Farmers' Markets booth fees, etc. ☐ Other **Total Variable Costs = $____________**	☐ Insurance (liability, vehicle) ☐ Utility costs (heat, electricity, telephone) ☐ Equipment ☐ Office supplies ☐ Operating interest ☐ Professional fees (accounting, legal) ☐ Management salaries ☐ Other **Total Fixed Costs = $____________**
Cost of Production = variable costs + fixed costs	

Meat Raising animals	
Variable Expenses	**Fixed Expenses**
☐ Feed (pasture costs, grain etc.) ☐ Bedding ☐ Veterinary costs ☐ Breeding costs ☐ Trucking ☐ Equipment maintenance and repair ☐ Building maintenance and repair ☐ Fuel, oil and lube ☐ Labour (including paying yourself) ☐ Other **Total Variable Costs = $____________**	☐ Insurance (liability, vehicle) ☐ Utility costs (heat, electricity, telephone) ☐ Equipment ☐ Office supplies ☐ Operating interest ☐ Professional fees (accounting, legal) ☐ Management salaries ☐ Other **Total Fixed Costs = $____________**
Processing Costs	
Variable Expenses	**Fixed Expenses**
☐ Kill costs ☐ Inspection ☐ Environmental fee ☐ Health fee ☐ Brand inspection ☐ Cutting and wrapping ☐ Transportation ☐ Packaging (wrapping paper, boxes) ☐ Marketing ☐ Labour ☐ Other **Total Variable Costs = $____________**	☐ Operating interest ☐ Insurance (liability) ☐ Equipment (freezers) ☐ Office supplies ☐ Utilities (heat, electricity, telephone) ☐ Management salaries ☐ Professional fees (accounting, legal) ☐ Other **Total Fixed Costs = $____________**
Cost of Production = variable costs + fixed costs	