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Wood-based Entrepreneurs Toolkit: Pricing Your Products and Services

Julian Geisel and Eric Hansen

Forest Research Laboratory
College of Forestry
Oregon State University
Corvallis, Oregon

Oregon State University

The Authors

Julian Geisel is an MS student in Wood Science and Forest Ecosystems and Society, specializing in the gainful application of forest products marketing and silvicultural alternatives in small forests, and Eric Hansen is Professor of Forest Products Marketing, Department of Wood Science and Engineering, College of Forestry, Oregon State University.

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The Forestry Communications Group
Oregon State University
202 Peavy Hall
Corvallis, Oregon 97331-5704
Phone: (541) 737-4270
Email: ForestryCommunications@oregonstate.edu
Web site: www.forestry.oregonstate.edu/forestry-communications-group

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This is a publication of the Oregon Wood Innovation Center (OWIC), Department of Wood Science and Engineering, College of Forestry, Oregon State University.

Abstract

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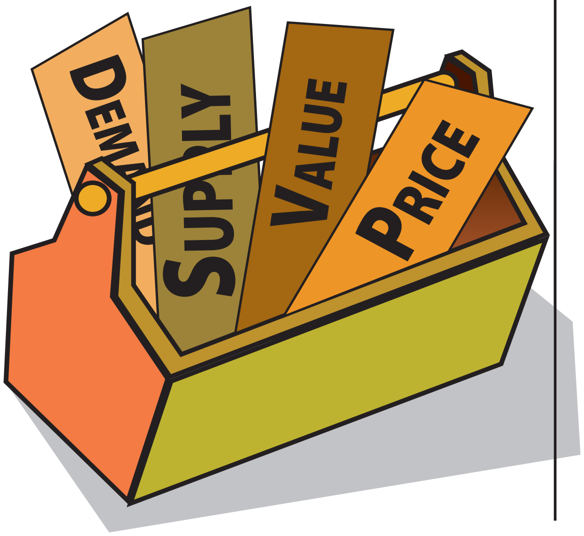
The success of your business will strongly depend on what price tag you attach to your products—and whether your customers are willing to pay this price. Hence your strategic marketing planning should include considerations about how to adequately price your products/services right at the start. After reading this publication, you should know what pricing is and what to consider when pricing your products or services, have encountered several pricing methods, know how to approach pricing when your product or service is unique, and be able to avoid typical pitfalls in pricing. Throughout this publication are examples drawn from the fictitious "Caveman Crates" company that illustrate how this information can be used in practice. Lastly, experience from Oregon entrepreneurs is used to provide practical advice on pricing.

Keywords: Price, value, supply, demand

Contents



Price** is merely the dollar value you assign to your products or services. Hence, you **have a lot of control over price.

***Value** is what **your customer** is willing to pay to own your product or receive your service. Your control over value depends on many things, including the quality of your marketing, yet it remains limited. The value of your product to a customer increases with how special or possibly unique it is. However, different customers may attribute a very different value to the exact same product.*

*Before going into production or offering a certain service, ask yourself this important question: **"Can I offer my product/service at a price the customer is willing to pay?"** If the answer to that question is a clear "Yes!" then you have the potential to run a successful business.*

1 Introduction

The success of your business will strongly depend on what price tag you attach to your products—and whether your customers are willing to pay this price. Hence your strategic marketing planning[1] should include considerations about how to adequately price your products right at the start. Note that there is an important distinction between price and value, however. You must also try to *match* the price of your product as accurately as possible to the value the customer allocates to it.

After reading this publication, you should understand more about pricing, value, and what to consider when pricing your products or services. You will have encountered several pricing methods, and you will know how to approach pricing when your product or service is unique. Finally, you should be able to avoid typical pitfalls in pricing.

In each section, follow the examples in the gold sidebars for a brief look at how a fictitious company, Caveman Crates, puts the information presented here into practice. Through these examples, we will look at the value aspect of a product and address pricing.

Example: Caveman Crates Considers Pricing

On the advice of his cousin Niko, Olle Smith has established a small wood products company in the Pacific Northwest called "Caveman Crates." Modeled after the successful Caveman Pallets in Sacramento, Caveman Crates sells crates, pallets, and boxes to the fruit and vegetable industry in western Oregon. These markets are highly seasonal, with particular crates and pallets required at specific times of the harvest season. Orchards and farms value punctual delivery of the correct amount of the specific product. There are several other pallet and crate companies in the area that compete with Caveman Crates. Olle takes all this into consideration for pricing.

1 See especially the appendix in publication CEO 3a, *Strategic Marketing*, Hansen (2010): http://hdl.handle.net/1957/14641.

2 Value and What It Depends On

Having an idea about the value of your product on the market can make the difference between working overtime to just keep the business going and working reasonable hours and still getting paid well enough. What we call a price-value mismatch occurs when a product is underpriced or overpriced compared to the value.

Taking value into account first means you try to estimate how much your product may be worth to a customer when deciding on a price. Value can be particularly useful when you try to sell a *specialized* or unique product or service to a few select customers (see Figure 1).

In order to accurately estimate your product value, you need to invest time and money into *getting to know your customers* and getting a feel for what they are willing to pay, while keeping your own costs (see section 3.3) in mind.

Also, keep in mind that people tend to think that a more expensive product is also a better quality product. If your customers are looking for better product properties, and you can convince your customers that your product is superior,[2] you may be able to answer "yes" to that very important question: *"Can I offer my product/service at a price the customer is willing to pay?"* If so, this means you can charge higher prices than the competition for what you offer without risking the loss of those customers.

2 See publication CEO 3a, *Strategic Marketing*, Hansen (2010): http://hdl.handle.net/1957/14641.

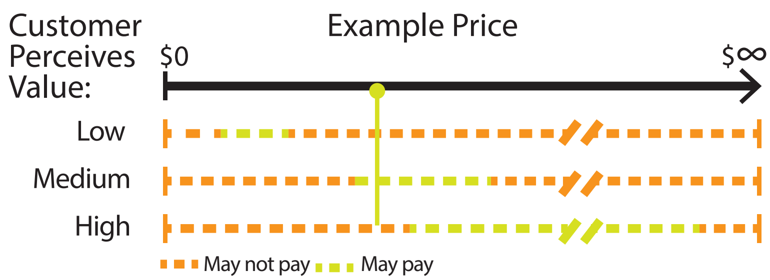
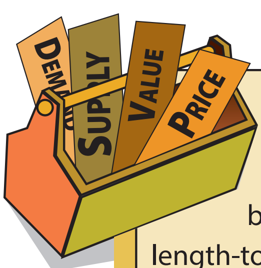
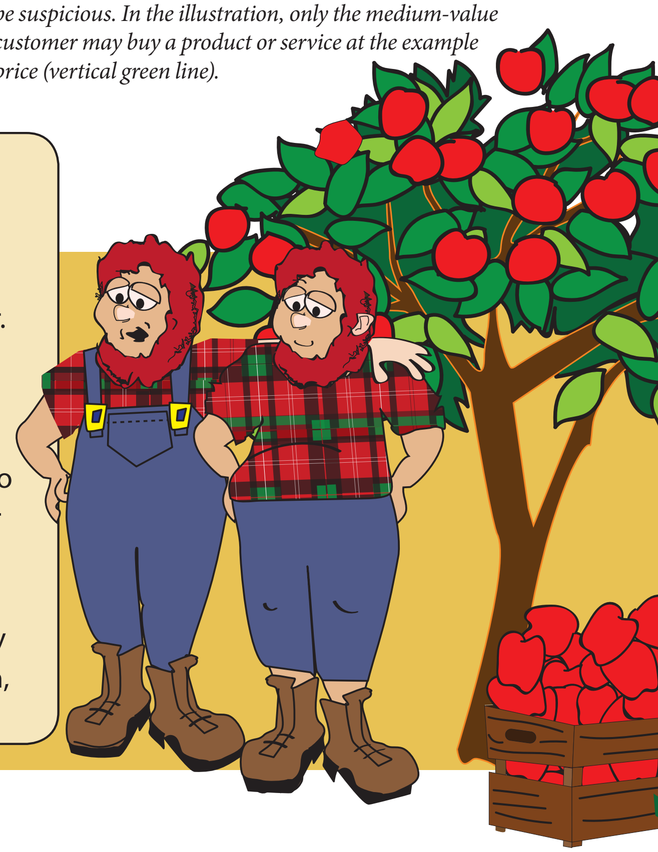


Figure 1. Higher value-higher price: the value of your product or service influences the possible price. The uppermost line represents the price; the three lines below it are the value of a product or service as perceived by the customer, with the price range that he or she may pay highlighted in green. Note that there is also a lower limit, as customers expect to pay a certain minimum price to get what they want. Below that line, they may be suspicious. In the illustration, only the medium-value customer may buy a product or service at the example price (vertical green line).



Price and Value

A local apple orchard, Mack & Tosh Bros., chooses to buy from Caveman Crates because Olle offers a certain length-to-width ratio of crate that none of his competitors offer. Due to the layout of storage space that Mack and Tosh want to use efficiently, boxes from Caveman Crates have a higher **value** compared to others of equal quality and volume! The apple growers would even pay a little extra if Caveman Crates chose to raise the **price**. Olle does not know that his crates have a higher value to Mack & Tosh Bros. This **price-value mismatch** means that Caveman Crates is leaving money on the table with the apple growers as a result. Meanwhile, another customer, Peachy Keen Orchards, is not interested in that specific crate dimension, however, and will thus choose boxes sold at the lowest price.



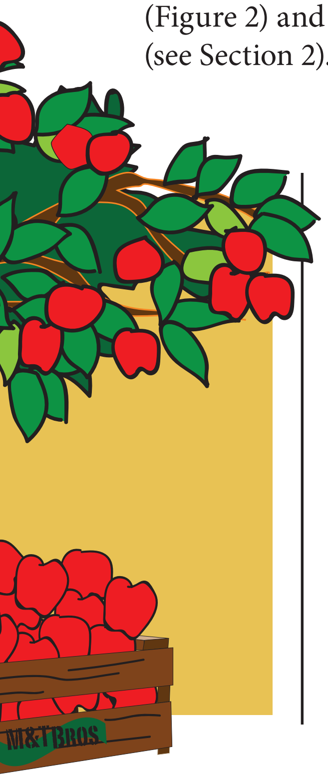
3 Price and What It Depends On

Let us define the process of deciding on and placing a price on a product or a service as *pricing*. Placing a price on a product is not like an employee in a supermarket using a pricing gun. It's mostly about deciding what prices are listed on the clipboard the employee is holding in his other hand. How much money you can (or should) ask for a product in order to run a successful business depends on a couple of things. We'll describe the most important ones in the following sections.

3.1 Price Sensitivity

We define *price sensitivity* as how much the price tag of your product or service influences *the customer* to buy or not buy. A strong price sensitivity means that the price tag matters a lot and that lowering the price is a good way to convince more customers to buy your product.

The opposite is the case if your sales stay the same regardless of a change in price. You are then probably selling a product to customers with a low price sensitivity who really want your product (Figure 2) and are happy to pay a high price for it (see Section 2).



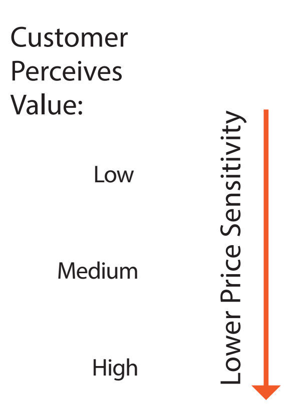


Figure 2. Connection between value and price sensitivity.

Another way of expressing the same thing is that changes in price directly connect to changes in demand (i.e., price goes down, more people buy; price goes up, fewer people buy). This *price elasticity* depends mainly on the *product*.

If your costs do not allow you to decrease your prices further to attract sales, you could try a different approach: *Lower the price sensitivity* of your customers. Listed below are several examples of how you can do this.

- Offer a unique product, such as "noiseless tree removal with hand saw and bike trailer."
- Increase the investment your customer makes in you by offering extra service, for example, by working on his orders first. Your customer may then be able to tolerate a higher price more happily because he or she likes working with you.
- Offer a product that is hard to compare to others in terms of performance. This applies particularly for service packages.
- Offer a product that costs a small part of the final product your customer is going to make, i.e., boxes for expensive cigars
- Sell an amount of product that keeps your customers from being able to stockpile your product. They may not need to buy from you in the near future. Try instead to roughly match supply and demand unless you have a good reason not to.
- Convince your customer that you sell a product or service unrivaled in quality. Customers may be looking for the "best" product and nothing else will do for them. Detailed product descriptions are helpful here.

Note that not all will apply to every product or service. Also note that doing the opposite will, of course, increase price sensitivity.

3.2 Costs and Income, Profit and Loss

We define *costs* as the amount of money you spend to make the product or provide the service and income as the amount of money you receive for it. If your costs add up to be lower than your income, your business is considered *profitable*, and the difference is called *profit* (see Figure 3).

Knowing whether you are operating profitably and whether what you calculated is really true entirely depends on how well you keep track of all your costs and income. Not properly accounting for these may lead you to believe all is well, while in truth, you are generating the opposite of profit, i.e., *loss*.

It is feasible but hard to keep good track of all your costs; this is why many entrepreneurs decide to seek the help of a *bookkeeper*. Bookkeepers have experience in grouping the many different types of costs and can help you *identify* and *categorize* all of your costs. With this information you will be better positioned to control costs. If you decide to be your own bookkeeper, there is no right or wrong way to group your costs. The Caveman Crates example shows four ways of grouping costs: fixed/variable, expense, recurrence, and type.

Fixed versus variable costs

No matter how you decide to group your costs, an important distinction you should be able to make is the one between *fixed costs* and *variable costs*. If costs are not directly related to how much you produce or how many clients you have, they are considered fixed costs. For example, you need a workshop and a telephone, no matter how much of your products or services you are actually selling. Fixed costs recur periodically and within fairly regular time intervals. Variable costs are those related to how much you produce. For example, the variable costs for Caveman Crates will increase if they build more crates (they will use more nails) or visit more customers (they will buy more fuel).

Alternative or further grouping

You can also order your costs by level of expense, recurrence, or type, for example. Depending on what type of business you run, actual dollar values or different intervals/cost types may make more sense.

If your costs are high, which is increasingly likely as the specialization of what you offer increases, you will have to ask a high price for your product or service. This would require you to offer an increasingly unique product in order to be profitable.

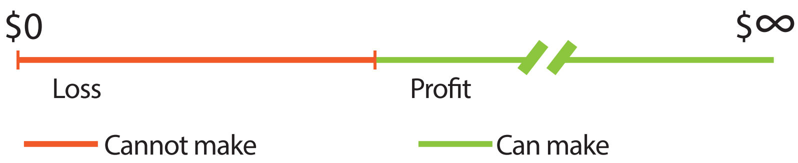
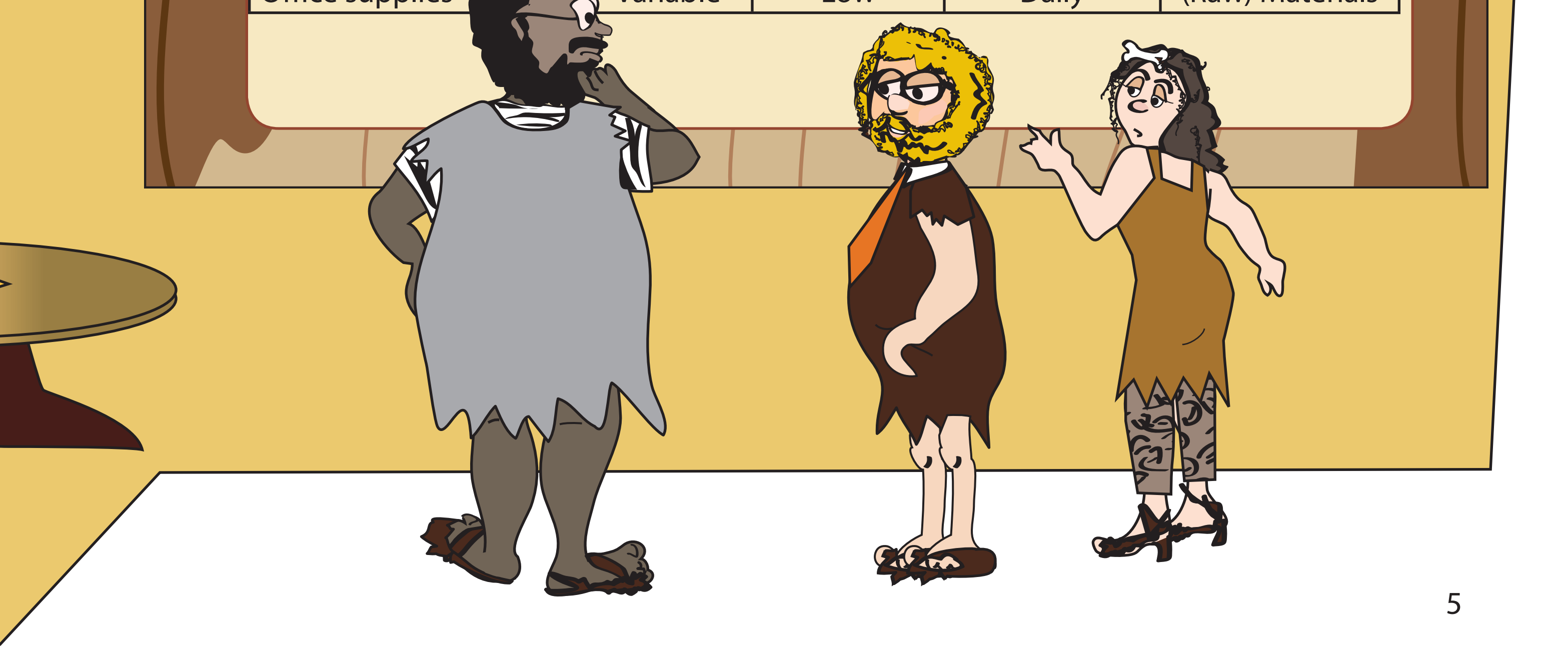


Figure 3. Loss and profit.

Caveman Crates — List of Common Costs

Cost for	Fixed/ variable	Expense amount	Recurrence	Type
Office furniture	Fixed	High	Every 10 years	Infrastructure
Car	Fixed	High	Every 10 years	Transport
Loader	Fixed	High	Every 10 years	Transport
Workshop equipment	Fixed	High	Every 10 years	Infrastructure
Computers	Fixed	High	Every 5 years	Infrastructure
Secretary	Fixed	High	Monthly	Labor
Carpenter	Fixed	High	Monthly	Labor
Vehicle maintenance	Fixed	Medium	Yearly	Transport
Phone and internet bill	Fixed	Medium	Monthly	Infrastructure
Insurance costs (for most of the above)	Fixed	Medium	Monthly	Insurance
Property taxes	Fixed	Medium	Monthly	Infrastructure
Trade association membership fees	Fixed	Low	Yearly	Public Relations
Lumber	Variable	High	Weekly	Raw materials
Hauling	Variable	High	Weekly	Transport
Electricity	Variable	Medium	Monthly	Infrastructure
Advertising	Variable	Medium	Monthly	Marketing
Donation for noble cause	Variable	Medium	Irregular	Public relations
Workshop consumables	Variable	Low	Daily	Raw materials
Fuel	Variable	Low	Weekly	Raw materials
Office supplies	Variable	Low	Daily	(Raw) Materials



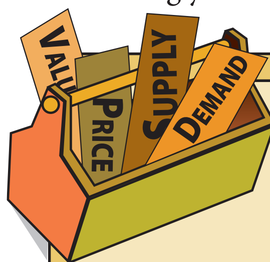
3.3 Markets: Demand, Supply and Size

The market for your product is the environment in which it is traded, very much like a farmers market, just not as visible. A busy market would see many customers shopping for your product, which means a high *demand*. A slow market would mean that few sales of your product are made, either due to a low demand (few customers) or low *supply* (not much product on offer to be sold).

Be aware that by just increasing the supply, you may not necessarily improve the market situation. Pricing is a more effective tool to influence the relationship between supply and demand. Strive for a rough match between the two. However, the bigger the *size* of your market (e.g., number of producers, volumes of a product or an offered service and uniqueness of the product) the smaller the influence you will have on price.

3.4 Competition

Closely related to markets is your competition (i.e., all the other sellers of similar or identical products and services). All of your competitors will make pricing decisions that may influence your pricing and vice versa. Most of them may be familiar with the use of the techniques and approaches presented in this publication. How they use them cannot be predicted, but it is something you should be aware of.



Markets and Competition

Olle buys boards and cants from five local sawmills and sells his products as locally as possible. The lumber market is hard to predict and the crate and pallet market is highly seasonal, with particular boxes and pallets required at specific times of the harvest season.

There are several other pallet and crate companies in the area that compete with Caveman Crates for customers and raw materials. On the raw material side, all of these competitors special-order **pre-dimensioned boards** from only two of the five sawmills. Olle has his own workshop to do the trimming of standard boards before assembly, however. This is why he can buy and then process **standard dimension boards** from all five sawmills into products when the prices are low, reducing his competition for raw materials. On the down side, Olle has to deal with and pay for storage of raw materials, residual disposal, and extra equipment.

Yet Caveman Crates can be more flexible about the dimensions and can process orders quicker because Olle can produce the desired dimensions on site in his workshop. He has successfully eliminated all local competition for urgent, special-dimension offers, giving him a good competitive advantage, despite some added cost.

4 Setting Prices

We have explored what pricing is and what influences it. So how do you now allocate prices to your products? Pricing tools help you apply what we have learned so far about pricing in different ways, which you may find useful for your overall strategic marketing plan.[3]

Over time, your business objectives will change in response to your environment. Remember, however, that initially there must be demand for your product or service, and its value must be high enough for you to run a profitable operation. Once you know this is the case, then ask yourself about your current objective:

- Am I establishing myself or a new product?
- Am I established and expanding, or downsizing, or do I just want to hold my market share?

Changing objectives are reflected in adaptations to your strategic marketing plan and your approach to pricing. Several pricing methods to choose from, as well as typical situations for when to apply them, are presented in the following sections. These sections are designed to help you identify the right pricing method(s) for your purposes.

4.1 Market-based Tools

For mass-produced, low-value goods, prices are mostly determined by supply and demand. In the forest sector, logs and sawn timber are the typical products that follow market-based pricing. The more processed and specialized your products become, the less market-based tools will be useful for you. As an entrepreneur you will most likely not be competing on this scale; yet, as a heads-up on how wood products are commonly priced, we will briefly address these methods here. Market-based methods may be useful to know when you buy your raw materials or intend to offer services trading in them. Large companies do the following to track that "market" price so they can act accordingly.

Follow the price leader

A price leader is the strongest company (in terms of market share and influence) among several companies all making the same product or providing the same service. The price leader observes the market, in terms of supply and demand, and more or less sets the most profitable price that all other companies then adopt. Thus, profitability for all companies is maintained, as price wars are kept at a minimum. Some sectors of the paper industry exhibit this sort of pricing behavior. Unfortunately, the price leader may also use its power to set prices in a way that makes it hard for small companies to enter or stay in the market.

Consult pricing newsletters

In commodity-like product sectors, such as lumber and panels, it is common for a third-party provider to compile price information in a regular newsletter (weekly is common). Examples are Random Lengths for softwoods and The Hardwood Review for hardwoods. Sales departments of individual companies use this information, knowing that nearly every other company does too. However, they reassess their individual situations in terms of cost, inventory, and others factors, and then sell accordingly.

4.2 Cost-based Tools and "Return vs. Profit"

Cost-based methods can be applied to any kind of product or service and are fairly common, but do not take customers' perceptions of value into account. Rarely will they yield the highest profits.

Cost-based methods simply add up all of the costs of a product or service and add a profit to that total. Although this sounds easy, be aware that cost-based strategies require you to have a firm grasp on your bookkeeping and your costs (see Section 3.3). Errors in calculations will seldom be to your advantage.

3 See publication CEO 3a, *Strategic Marketing*, Hansen (2010): http://hdl.handle.net/1957/14641.

Both methods presented here use *return* instead of profit. Return expresses your profit in relative terms, for example, a 140% return on 1 dollar equals a profit of 40 cents:

$$\textit{Return (in \%)} = \frac{\textit{Income}}{\textit{Fixed costs + Variable costs}} * 100$$

Break-even analysis

A useful addition to any of the following approaches is a break-even analysis that will inform you of how many units you must make in order to fully recover your costs. In other words, your break-even point is the amount of product or service you need to sell within a certain amount of time before you begin to make a profit. Time is a factor because you have fixed costs like rent. So, knowing how much of your products you can make or how many services you can provide in that certain time can help you determine your minimum profit margins (see Figure 4).

Activity-based pricing

You should consider looking at the costs for your different products when you are selling more than a couple of items or offering more than one or two services. Activity-based pricing compares costs and profits between your products (or the activities to make and sell them) and gives you information about which products or services are most profitable. Using this strategy may help you decide to make more of a more profitable product, while sacrificing output of one that is less so. Or you may decide to change your prices in order to reflect the extra effort it takes to make the currently less profitable product or provide that service. If you have a hard time deciding on the best combination, let your computer do this work for you (see Reeb and Leavengood 2002).

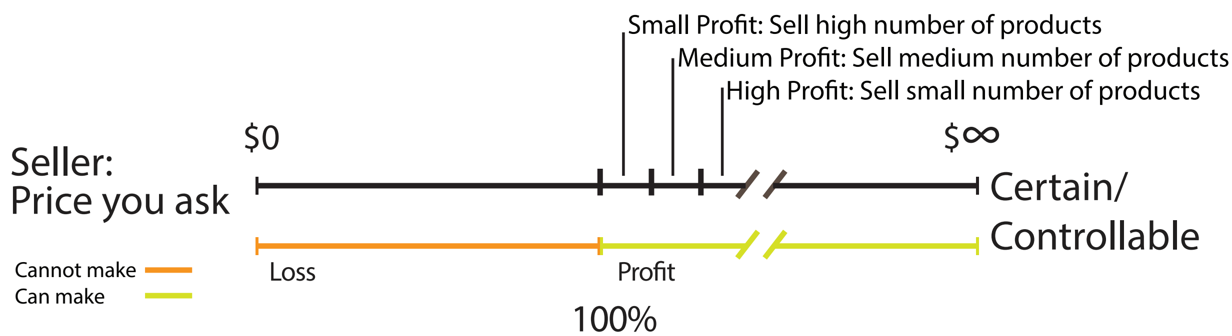


Figure 4. Profit margins and rate of production. Where the lower bar switches color from orange to green at the first crossbar is your break-even point or a return of 100%. Or in other words your minimum number of products or offered services before you start making profit. If you sell products or services that only yield a small profit (i.e., boards, upper black bar, between first and second crossbar) you need to make more of them compared to a product that yields a medium or high profit (crates or an entire harvest plan, further to the right on the black bar) to end up with the same total profit.

You can experiment with your rate of production to see if it influences your break-even point and your costs per unit. The lower the better! The following formula can be used to calculate the break-even point:

$$\textit{Breakeven point} = \frac{\textit{Total fixed costs}}{\textit{Unit selling price - Unit variable cost}}$$

Be aware that the products and services might be connected. Do not make drastic decisions, such as to stop making a certain product, without considering the impact on related products and services. For example, if you stop making chairs, although they are less profitable than tables, your table sales will likely also decline as a consequence. Read the next section on changing prices to learn about ways around this problem.

A New Order, Considering Break-even

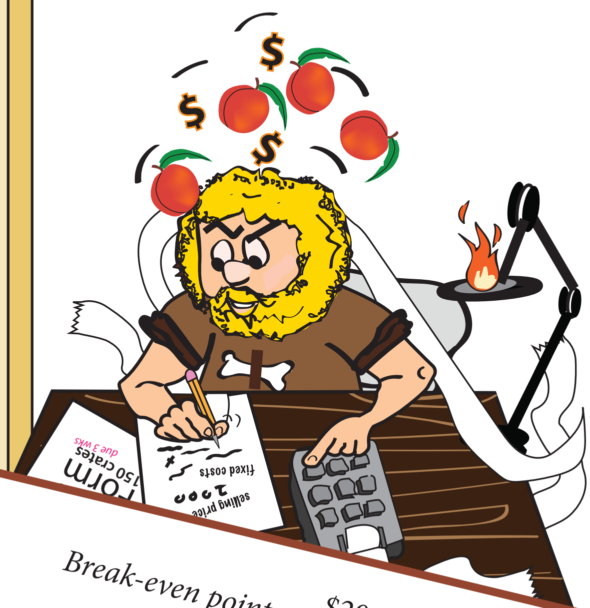
Caveman Crates receives a request to make 150 large crates by next week. The customer, Peachy Keen Orchards, is willing to pay $20 per crate ($3000 total). Assuming Olle has no other customers at this time, and

Total fixed costs for a week (from the table on p. 5) = $2000

Unit selling price = $20

Unit variable cost at production volume 150 pieces = $450 ($3 per crate)

Can he break even on this order? He calculates:



$$\text{Break-even point} = \frac{\$2000}{\$20-\$3}$$

$$\text{Break-even point} = \frac{\$2000}{\$17}$$

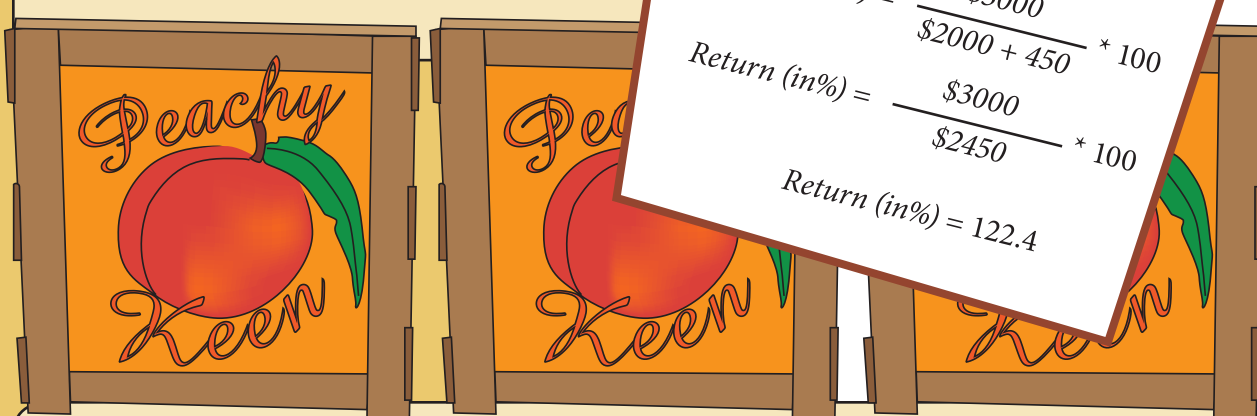
$$\text{Break-even point} = 118 \text{ crates}$$

$$\text{Return (in\%)} = \frac{\$3000}{\$2000 + 450} * 100$$

$$\text{Return (in\%)} = \frac{\$3000}{\$2450} * 100$$

$$\text{Return (in\%)} = 122.4$$

The answer is yes. He would break even after 118 crates and would even generate $544 of profit with the remaining crates (32 crates, each sold at a profit of $17 after the fixed costs are covered). His return would be 122.4%. He accepts.



Activity-based Method

Olle uses the activity-based method, in addition to break-even analysis, for Caveman Crates. His customers' business needs are seasonal and ever changing. So Olle compares the orders for crates and pallets he receives in the springtime with his costs for making the crates and pallets, and he adjusts the price accordingly (break-even). Because different pallets and boxes need different amounts of labor and/or types of wood, he changes the prices according to what the market situation is for his wood supply and how much of which products he will need (activity-based). He gets the numbers for his calculations from a pricing newsletter because market-based strategies are common in the timber industry.

5 Changing Prices

Keeping track of costs, markets and competition will help give you a sense of whether you should raise or lower your prices. Be aware that there are different ways in which you can react. Some are visible, such as *direct pricing* (i.e., changing the price tag of an article), and some are more hidden, such as *indirect pricing*. Several examples of indirect pricing are listed below:

- Offer better service or better quality for the same price
- Distribute coupons to selected customers that allow them to buy your product cheaper (targeting the most price-sensitive customers)
- Offer discounts for certain amounts (quantities) bought at the same time
- Offer discounts during certain times (e.g., seasonal specials)
- Offer package deals, where the additionally purchased products or services (that would otherwise not have been bought) bring in extra money
- Heavily mark down a product to lure people in, and count on them buying additional products at full price that recover your losses
- Sort your products and charge less for the low-grade ones and charge a premium for products that are high grade

Once you are familiar with these indirect-pricing methods, you'll easily recognize them. You will be surprised how many you will identify on your next shopping trip. However, having an array laid out to consider for your own pricing needs may help you to pick the best ones for your products or services.

It is important to be able to make changes to your prices and to react quickly to your ever-changing environment. It is equally important, however, to think about pricing more in line with your strategic marketing planning and to develop a long-term "pricing strategy" to guide your actions. Also keep in mind that it may be off-putting to your customers if you change your prices *too* frequently.

Adjusting Prices

Caveman Crates employs a mix of direct and indirect pricing tools. Olle does not mind buying cheaper low-grade material in order to be able to sell a little cheaper than his competitors (direct pricing). Caveman Crates offers custom sizes of pallets and crates, however, because every farm or orchard has different requirements.

During harvest season, Olle reserves some capacity for last-minute orders, and then he charges an express fee (direct pricing) on regular boxes or sells "b"-grade boxes at regular price (indirect pricing). He can do this because if boxes are in short supply, the growers become less price sensitive.

To keep his workers employed year-round, Olle offers special prices for orders placed throughout the winter months (direct pricing). He never distributes coupons or announces clearance sales for his products. Instead, he stores products for later in the year.

6 Pricing a Totally New Product

You may find yourself in the situation where you offer a unique product or service and have no guidance on how to price it. How much would you charge for a picnic on top of a tree, for instance? Again, it all comes down to your customers and what they are willing to pay, enabling you to make a well- or not-so-well-informed guess.

Publication number CEO3e, *Finding Market Information*, in the *Wood-based Entrepreneurs Toolkit*[4] elaborates how to find market information in more detail. Because you will probably not be able to get the price exactly right initially, consider these two approaches to pricing at the launch of your product or service.

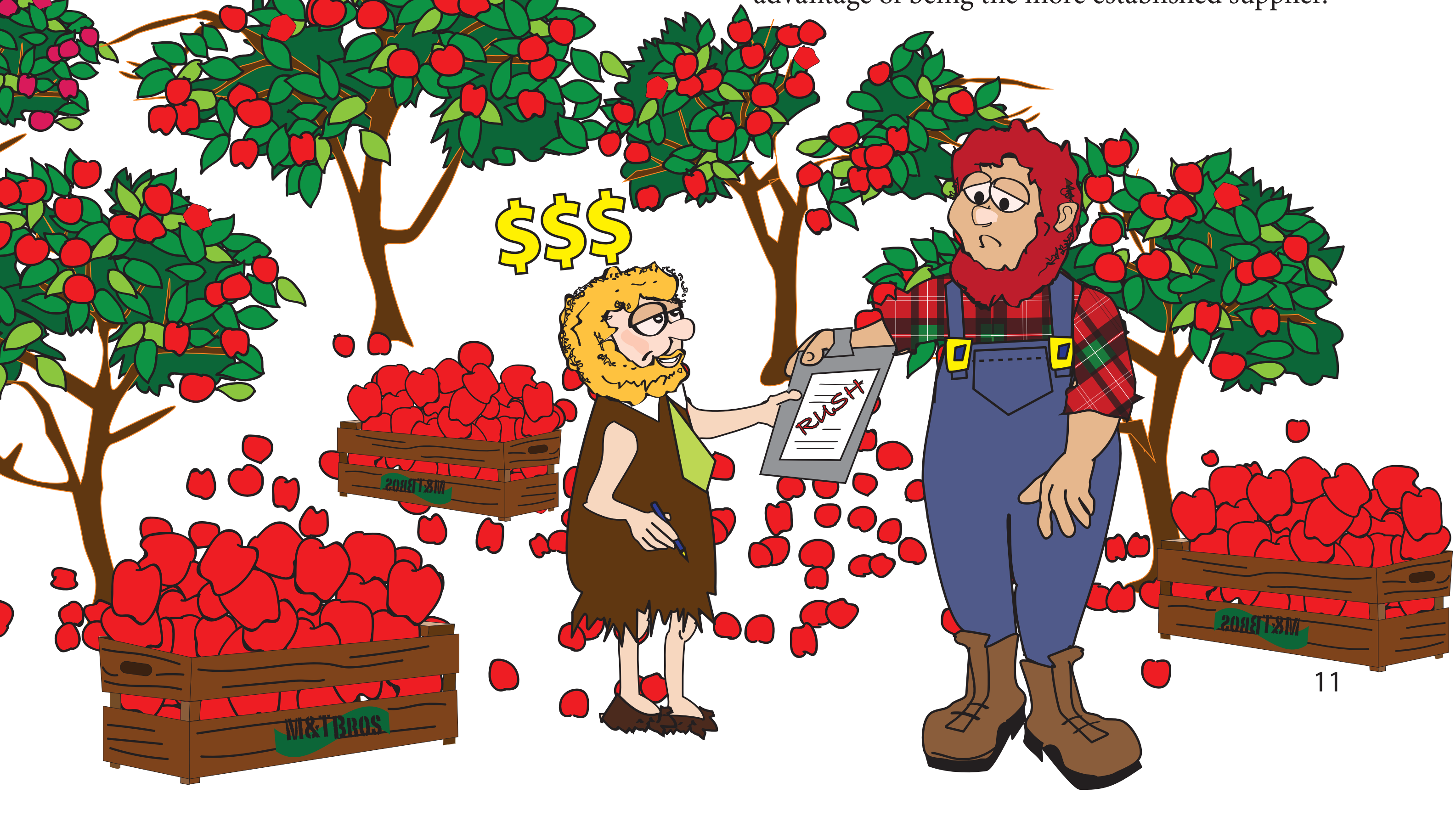
4 Hansen and Salim (2014): http://hdl.handle.net/1957/52235.

6.1 Penetration

This approach has you pricing very low in the beginning, with the intention being to lure customers and make many sales so that your product becomes widely known. The more you sell, the more you will learn about what customers value and about the production process itself, which will allow for more accurate pricing and more efficient production. Pricing low initially will also discourage people from copying your product, as the chances of a profit are already low.

6.2 Skimming

The idea behind this approach is to price your product or service high in the beginning. You may want to do this if you know there is a market already waiting for your product, you want to cash in on the relationship between quality and price, or if you want to recover initial investments quickly. This approach has the disadvantage of attracting competitors who may wait to see how your product is received to later launch a similar product at a lower price. So if you use this approach, make sure to keep an eye on the competition and match their price when they enter the market—you will still have the advantage of being the more established supplier.



7 Pricing in Practice

In this section we take stock and provide a small reality check for the theories and the science of pricing we have made available to you so far. Conversations with local entrepreneurs allow us to revisit the previous sections and lead you towards what you will be facing with your business—the real world. We also combine all the illustrations of pricing aspect as a graphical summary of the content (see Figure 5).

7.1 Pitfalls in Pricing

Quite a few things can go wrong when you decide on a price.

Are you being (1) *greedy*? Pricing with a hefty profit margin may sound like a good idea, but it may scare customers away or attract competition that offers what you make cheaper.

Are you being (2) *too kind*? Supplying your whole neighborhood with your products or services for cheap is nice of you, for sure—but are your neighbors paying for your gas and groceries in return?

Both examples, as shown in Figure 5, moving your prices out of the *possible price range*, either (1) above it or (2) below it, will lead straight to business failure.

Try fixing (1) by *obtaining a good estimate* of the value of your product or service that is the upper limit of your possible price range. Is it high or low value for the people you intend to sell it to? Would you pay that much yourself? How price sensitive are your customers? If you are in doubt, *ask customers* how much they'd be willing to pay for your product or service *before putting a price tag on it.*

Prevent (2) by having excellent *knowledge of your costs,* which represent the lower limit of your possible price range. What is more, you can only

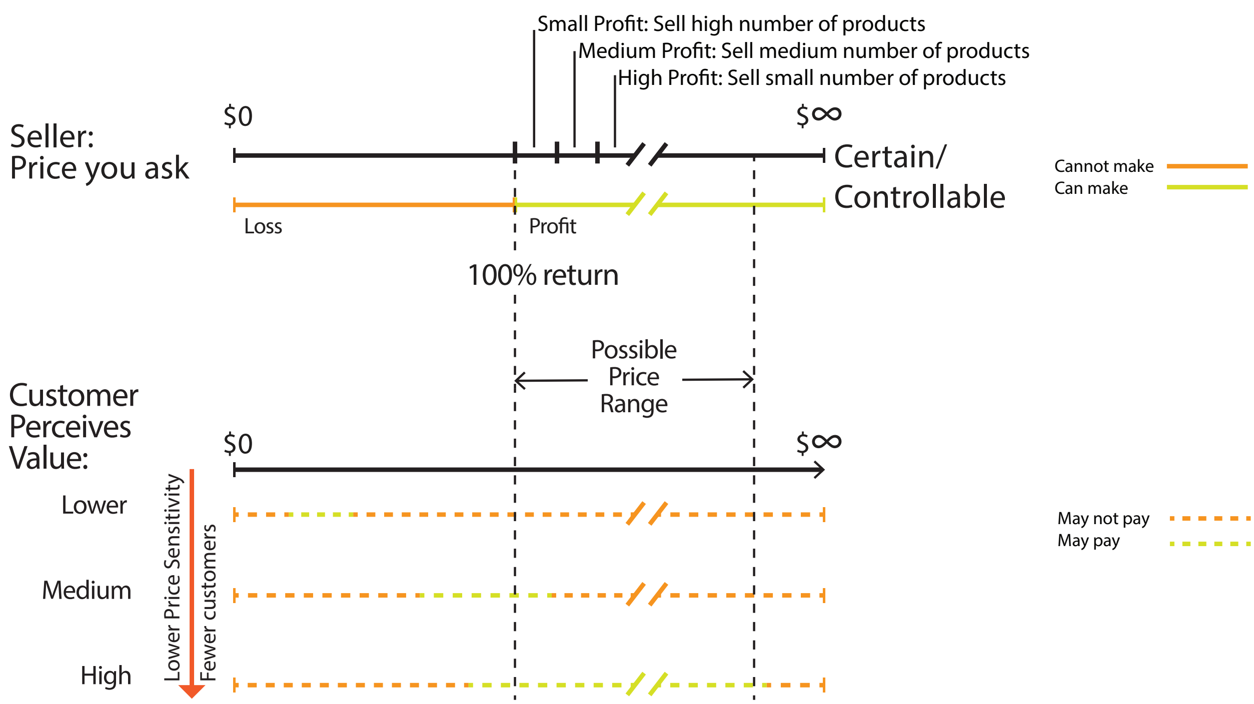


Figure 5. Setting a price with production volume, profit margins, product value, and price sensitivity in mind. Take special note that when you look at price and value at the same time, you get valuable information. Two examples are as follows: (1) Which products or services can you offer without losing money? Look at the bar indicating "Customer perceives low value" at the bottom of the graphic and compare to the "Loss/Profit" bar up top. You see now that you cannot make this product/service or offer that service at the price the customer is willing to pay. (2) What is your price range? Look at the black vertical lines marking break-even as the lower and the maximum customer value as the upper limit. Your price should be somewhere in between.

reduce what you know. This is also the time you do a *break-even analysis* and find out how your rate of production affects *your costs per unit*. Once you know this you can charge accordingly!

Finally, when you are experimenting with a *new product*, consider the scale of your experiment. You are taking a *risk* here! Putting all eggs in one basket may be your early retirement or your ruin. When developing, launching, and finally pricing a new product, make the experiment big enough to catch a good glimpse of how it is received, but not so large that if it goes wrong it has a large negative impact on the rest of your operation. What is the *worst case scenario*? How can you make sure it does not happen?

7.2 What Price and Value May Depend on in Real Life

Our insights from interactions with entrepreneurs provide the opportunity to revisit the first three sections, where we laid the basis of pricing and introduced important concepts, such as the difference between price and value. Value, we claimed, was hard to influence.

As a small entrepreneur, however, you *are* in a position to *influence your value*. One way to do this is to share your story. Make it short, in words or writing, about yourself and your business ethics. If it is convincing and touches your customers, they may identify with you, value your product higher, pride themselves in their purchase with you, and be tied to you a little tighter in their next purchase decision and in their informed recommendations to friends.[5]

Another important aspect of value comes into play where you are not buying or selling the final product: you are merely doing something to it and selling it on. In this case: be fair to the other members up and down the *supply chain*. You all depend on each other as customers and suppliers, and price negotiations should revolve around the question "How can we make this work?" rather than "How can I maximize my own profit?"

A common way to be able to offer competitive prices is by keeping your *fixed costs* at a minimum. Be thrifty and use what is available fully and to your advantage. Buy used or at reduced prices, upcycle your scraps to new products, give equipment multiple purposes, and negotiate special deals with your suppliers.

7.3 The Use of Pricing Tools

Perhaps most important, given that we stress the importance of value, is that there is a general tendency to *focus on costs*, *while neglecting value*. From our experience with local entrepreneurs, pricing is based on a few facts, a rule of thumb or two, and a splash of personal ethics. Business owners typically try to quantify the true cost of their operations and then carefully follow what the competition is doing. These are the facts they rely on.

For operations that rely heavily on farmers markets or similar fairs, a common practice is to offer products that are cheap enough (often $10-20) to capitalize on impulse buying. In impulse buying, one aspect of indirect pricing is vital in the selling equation: convenience. Successful sellers of products in the $10-20 range are always ready for a sale! They can retrieve the product in question quickly, can deal with all sorts of payments (i.e., cash, check, and credit cards, and perhaps even barter), and they can *make the sale while the impulse lasts*.

This works best when operating locally. Passing time and long distances are the enemy of impulsive buying decisions. Finally, with respect to business ethics (defined here as the way people do business because they think it is the right thing to do), fairness and dedication to happy (and returning) customers can be a key component of price setting.

5 For more in-depth info, see also publication CEO 3c, *Public Relations*, McIsaac and Hansen (2012). http://hdl.handle.net/1957/29245.

In cases where there are *many competitors*, entrepreneurs have the tendency to aim for "the best" or "the cheapest": some try to be cheaper than anybody else, mostly using competitor information from the internet or prices directly observed from competitors. On the other hand, if there is a truly distinguishing attribute, such as a label or certification that increases costs, the tendency is to price higher than anybody else.

With regard to *changing prices*, entrepreneurs use indirect methods, especially. Direct pricing is negotiated face-to-face with the customer (haggling) or depends on the type of customer (e.g., working for a good cause). Clearance sales of older items are also practiced.

To attract customers while keeping prices stable, entrepreneurs *constantly reinvent* themselves. They try to continuously anticipate what customers may be looking for and add new temporary items to the classic inventory, or they change the presentation space periodically so that customers perceive it as new and are motivated to come again.

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