Don't believe your price is too high without proof

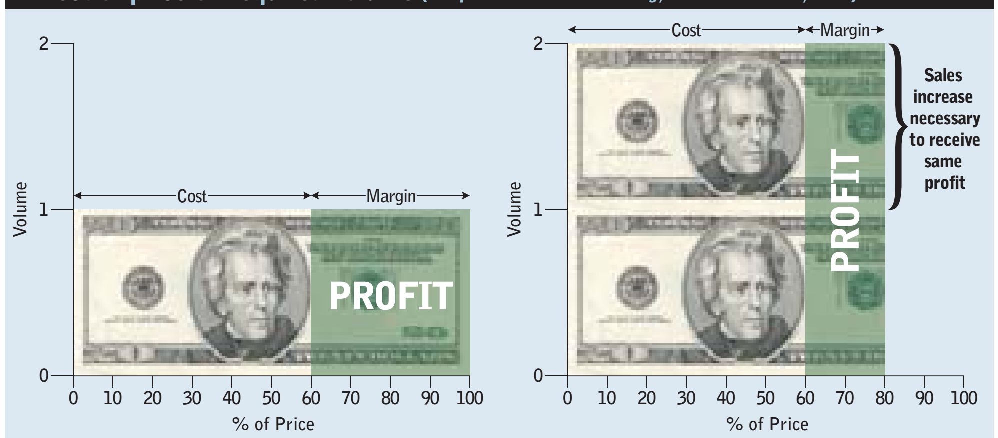
Marketing Insights
from 5MetaCom

For any product or service, pricing helps determine success in the marketplace. Correct pricing maximizes profits and supports the brand. The wrong price diminishes potential profits.[1] Although lowering price is a common tactic to increase sales volume, pricing experts find 80 to 90 percent of poorly chosen prices are too low.[2]

Does a lower price really lead to higher profits?

Reducing price sometimes increases sales volume, but it always reduces margin (if costs stay the same). At a lower price, volume must increase enough to offset lost margin before profit will increase.[3]

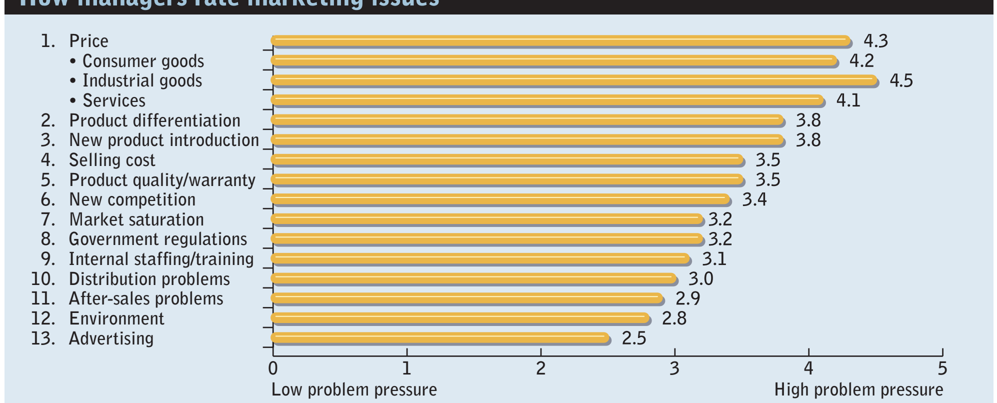
Effect of price on required volume (Adapted from *Power Pricing*, Dolan and Simon, 1996)



For a product with a 60% cost and 40% margin, a 20% price reduction cuts margin in half. For a product selling one million units, sales must double to make up for the lost margin and maintain profit.[3]

Charging too little not only reduces revenue, it fixes the perceived product value at a low level. With so much at stake, it's no wonder managers rate price as the biggest marketing problem they face.[3]

How managers rate marketing issues



In a survey of 186 managers, pricing tops the list of marketing pressures.[3]

Executive Summary

- Managers rate price as the highest marketing pressure they face.[3]
- Reducing price cuts margin, so volume must increase enough to offset lost margin before profit will increase.[3]
- 80 to 90 percent of poorly chosen prices are too low.[2]
- Both low *and* high prices have advantages and potential risks (see table on back for comparisons).

Fighting price competition without eroding the brand

3M uses distinct brands to appeal to premium and low-price markets.

In situations where a brand must compete on price, marketers might have to fight a price war. This was the case for category leader Post-it® brand notes. How did 3M compete? By marketing a second "price fighting" brand, Highland,™ from Minnesota Mining and Manufacturing (also known as 3M)!

A pack of three Post-it notes costs $1.40 and projects quality with rich yellow paper and four-color, easy-open packaging. At 63¢, everything about Highland suggests low price, from faded yellow paper to generic one-color packaging. Each brand targets a different audience segment and offers different features and benefits based on how much customers are willing to pay. Post-it retains its premier position, and with Highland, 3M can still play the price game.

Choosing the right price

How can marketers determine whether to price their brand low or high? Let's look at the advantages and potential risks of both.

Low versus high brand price

Low Price	High Price
Advantages • Easy to communicate • Drives a focused brand position • Will always appeal to a segment of the market (segment size can be small or large depending on category)	**Advantages** • In most cases, suggests high value • May increase perceived brand value over the competition • Drives entire organization to sell on and deliver value • Drives company profits • Allows for investments in quality, R&D, etc. to promote product pipeline and future innovations • Enables high levels of marketing and advertising to improve frequency and continuity of brand messages • Attracts the right audience: buyers who seek value, rather than those who shop based only on price • Often attracts a more brand-loyal audience
Potential Risks • Connotes high risk, low quality, because people expect to get what they pay for • Hard to credibly own marketing "power positions" of reliability, quality, innovation, etc. • Creates a low cost mentality internally and externally • Won't eliminate price objections; some customers will always want a cheaper option • Focuses on low cost instead of best results or highest value • Only one company can be the low-price winner	**Potential Risks** • Eliminates potential audience segment who buys based on price • Adds pressure on marketing to demonstrate value that justifies price

Consider brand value before lowering your price

Naturally, pricing has a very strong impact on profit.[3] So before lowering your price, evaluate and understand the value of a high price in your market. Include market research to determine customer perception of your product's value—and how much they're willing to pay for it. Instead of considering a price cut, first consider increasing brand value.

Effective communication can add value to nearly all services and products, including commodities. An attractive 20 oz. bottle of "filtered" water sells for $1.09 at convenience stores—a price 4,027 times higher than tap water (which is also filtered, but less attractive and convenient). People perceive the product as valuable, so they're willing to pay a high price.

Increasing the perceived value of your product can be a profitable option. And remember—a high price is easily lowered, but once a low price hits the market it might be impossible to raise.

[1] Michael Marn and Robert Rosiello. "Managing price, gaining profit," *Harvard Business Review*, September-October 1992.
[2] Craig Zawada, McKinsey and Company. "Pricing new products," *The Pricing Advisor*, July 2004.
[3] Robert Dolan and Hermann Simon. *Power Pricing*, New York: 1996.

Post-it® is a registered trademark of 3M.
Highland™ is a trademark of Minnesota Mining and Manufacturing.