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Pricing a Product Takes Research, Objectivity

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Pricing a product really isn't that complicated, even for high-tech products; it's just a matter of using educated judgment. Before settling on a price, the entrepreneur must assemble facts about the competition and customer base and know what the product cost to produce, among other things.

Value proposition: An entrepreneur needs to be objective about how his product is meaningfully superior to competing products and how it provides more or better benefits.

Competitive products and prices: Trade journals don't always provide industrial product pricing, so the most reliable way to find these details is to talk with potential customers, sales people or industry suppliers — at a trade show, for instance. Competitors may issue press releases with contract details when they make a big sale. The entrepreneur should watch what happens to pricing and products when new products enter the market, as she needs to build a cushion into her pricing to accommodate industry behavior.

Cost basis: A manufacturer should know how much it costs to produce a product before assigning a price. Costs include materials, manufacturing, marketing and administration. Creating a margin or pricing above cost gives the innovator wiggle room.

Customer concerns: Purchasers are often constrained by capital budgets, fiscal calendars and return-on-investment requirements when deciding what products to buy. They might not be able to afford to buy a product but can afford a lease. This information helps a manufacturer figure out where his product fits in the marketplace before pricing it.

Once the seller has gathered and absorbed these facts, she can decide whether to price above, below or at parity with the competition.

If the product provides more benefits than the competitors' products, it should cost more. For example, if the product is a new technological alternative to existing products — such as computer spreadsheets in a market filled with calculators and accounting paper — customers probably will pay more for it. But the entrepreneur needs built-in room to react to what competitors will do when the new product arrives: If competitors lower their prices or enhance their products, the entrepreneur needs room to maneuver within a healthy margin of profitability.

If the product is essentially providing the same benefits as a competitor's products, the innovator can price a new product at parity, especially if she's testing the market while tweaking the product. This approach is good for companies that are new or are entering a new market.

Technical entrepreneurs often set prices lower than competitors because it feels safe. The risk of this course is that it's hard to correct. A lower price can expand a market, or an innovator can release a version of the product with fewer features for a lower cost and later release an upgraded version of the product that costs more. Entrepreneurs who price lower than other products on the market need to be sure to cover their costs and prevent the perception that their product is cheap because its quality is low.

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