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Pricing of Products

With the improvements in communications, greater ability to travel and freer trade agreements, we are becoming more of a single world marketplace. And, while this presents new opportunities for businesses both new and old, at the same time it is also forcing major changes in the economic environment. And, these changes are continuously developing, with many not yet even with a clear end.

During the past decade, the Internet has developed into a diverse and wide reaching method of communication. While at the same time, there has been a tremendous growth of production ability in lower-wage countries. And, both of these are large factors in the changes now occurring through-out the world marketplace.

Within the environment of trade, the matter of product pricing is critical for the long term well-being of the various participants in trade - From the producer through to the retailer.

The combination of the availability of products from lower wage countries with the better communications, that allow producers to sell more directly down the supply chain, seems beneficial. As it can give the end-consumers lower prices on the products that they buy.

And, as we have all been seeing, many large companies involved in selling products in their own domestic marketplaces have been closing their own domestic plants, and utilizing the new supply chain. Thus, these companies have been greatly influencing the changes that are occurring.

Also, we are now seeing very ambitious efforts of relatively new companies that are looking to expand within this new environment. Many are new businesses that are in the producing countries (either working for the new producers or independently), while there are many trading companies (new and old) growing in the target marketplaces.

And though this new environment is presenting more competitive pricing and opportunities, it has not yet matured. Many businesses, eager to compete with the overall lower prices of goods in the marketplace, do not yet fully understand the responsibilities and risks associated with bringing a product to market, and calculating proper pricing to cover those responsibilities and risks.

A good example of this is the recent ambitious efforts of companies in the new producing countries to offer products more directly to dealers and retailers in the consuming countries. And, those dealers and retailers have been equally ambitious in taking advantage of the lower market prices.

Though, what many of these sellers and buyers have not fully understood are the risks and responsibilities that come with successfully bringing a product into a marketplace. Thus, many of the dealer and retail buyers have been unprepared to deal with the logistical problems of getting the products from the producers to the store, and are realizing the difficulties of selling what consumers will see as just a generic product. And, that is because consumers place value on known name brands - known from extensive marketing efforts.

So, the subject of pricing is not only of interest for new businesses, but also for the established businesses that now find themselves selling more directly into new marketplaces, and those that find themselves sourcing from new marketplaces.

What's involved in pricing?

From the time a product leaves a plant or factory to the time that it becomes part of the consumer marketplace, there are more than several levels of price mark-ups that it can go through. And, it is important that both buyers and sellers understand the methods and reasons for a product market's pricing structures. .

There are really no formulas that can easily be applied in this matter. Some people simply go by rules of marking up a certain percentage (based on their role in the marketplace), whereas others try to gain information about their competitors prices (to match or undercut), and there are others that apply formulas based on their expenses.

In this article, I am not going to give any specific formulas that you would be able to apply to your particular situation. Rather I am going to give you a description of the overall structures of a market - an indication of the costs that you should factor in at any of the various levels in which you would fit, and insight into the costs that your buyers will factor in at their level.

With this information, as well as information that you would be gathering from industry data, publications, your own network of suppliers, buyers and even competitors, you should be able to structure competitive pricing.

The one known rule of pricing

There are certain products and commodities that are traded in product specific or world exchange markets, and have published prices - products such as stocks, bonds, oil, metals, lumber and many others.

While many people in those markets quote their prices based on those published prices, they are not often the prices that they finally settle on in all transactions. And, this is because of the one known rule of pricing - "Everything is negotiable".

This is true for all products and services - from negotiating a \$30 bank charge up to negotiating a \$10 Billion purchase of a corporation, and everything in between. It's all negotiable, no matter how adamant the other party is about it - if they need to close the transaction, they will negotiate.

You should keep this in mind when structuring your own pricing. You will be negotiating.

The one unknown rule of pricing

Simply - "You'll never know all the costs that you can incur - No matter how long you've been in a marketplace"

That is why you should really make it a point to sit down and write up a good business plan, or at least a spreadsheet (list) of all known and potential expenses that you may incur. This is true for any new business entrepreneur or long established business looking to enter a new marketplace.

Obstacles of pricing and selling

There are many obstacles that work against both your pricing and selling efforts. The basic obstacles are:

- Your own pricing structure that may be too high or too low
- Your competitors pricing and/or tactics (Such as stressing their integrity over others, or exploiting personal relationships with the buyers)
- Selling in the wrong marketplace(s)
- Changes in the marketplace
- Unforeseen costs and occurrences

Though these may seem very obvious and too basic to even mention to industry-wise sellers, they are not always so obvious when you are selling into a new marketplace or with new market conditions - and, not always easily resolved.

And, while there are business people and companies that do have much foresight and adapt quickly to change, there are others that cannot easily change - Especially those that have much invested in plants and equipment. And, that is why even a business with a long term presence in a marketplace may also have to develop a (new) business plan.

Low Prices Alone Do Not Assure Market Success

Even those that do adapt to changes in the marketplace do not always succeed in the long term. And, perfect examples of this are some of the companies that fairly recently changed to now primarily selling the lower priced goods from the low-wage countries. Though many companies are doing well with this change, there are also many that are finding that selling low priced goods can not sustain their economic structures - And, they are going out of business.

There can be many reasons for this. Perhaps some of these companies could not properly control quality or delivery issues that exist with sourcing from distant suppliers (Not only from low-wage producers - These problems can arise from any distant supplier). Or, perhaps they were selling products too similar, or the same, as others importing from the same sources - and, the consumers found nothing unique about them, or felt that they were unjustifiably higher priced than others.

So, even though these companies adapted to the changes in the marketplace, and they may even have been competitive with the pricing of their competition, there are obviously some unforeseen costs and occurrences that they were not prepared to handle.

Selling in a Wrong Marketplace Can Work Against You

Obstacles can also arise in your general marketing endeavors, or in a simple, singular endeavor. For instance, not doing a proper exhibition in a proper trade show, or in a proper location within that show.

Trade shows are significant - Many companies book up to 60% of their sales in trade show exhibitions. And, exhibiting in a popular trade show for a particular industry is a good investment for your business - if you fit in with the exhibition.

A seller may have a very good product, or group of products, that they can market at competitive prices. The idea of their exhibiting at the biggest and best trade show in their industry would seem like a very good idea. But, it could instead be a costly mistake.

They may be exhibiting among bigger or more diverse companies. And, with their prices somewhat less than these other exhibitors, they may find that the buyers attending the show will indeed be attracted into their exhibit by the low prices - but, they may not necessarily get any orders from them.

The reason for this is that many of the buyers attending the large shows will often be looking for many products. And, though you may be offering very good products at excellent prices, you may not be offering a sufficient mix of products to make it worth the buyers' time to deal with you.

For instance, buyers from large retail stores - they are looking for known name brands, diverse products, more unique styles or designs (from long established designers). And, quite frankly, they may feel more secure working with their long term, long established, more diverse suppliers - even if their prices are higher. Equally important to these buyers is the fact that a diverse supplier saves them time and effort - they do not have to follow-up on production and delivery issues with numerous suppliers.

You may have more success at a smaller show, directly marketing to the larger buyers (outside of the large shows) - or, simplifying your life, and sub-contracting to the larger companies that would be exhibiting at the large shows (Which would save you much marketing efforts and expenses).

With any of these options, you must think long term about your pricing, and how it would affect your ability to market under these options. Developing demand for your products at the smaller shows and directly marketing to the larger buyers will require much public relations and advertising expenditures - a good reason to be in line with market prices (rather than being the lowest priced).

On the other hand, if you will be negotiating to sub-contract for the larger companies, you do not want to betray their pricing to the buyers (which you would do by improperly exhibiting at their trade shows).

Again, this is why I suggest that you develop a good business plan before you start to market your products. These obstacles, and others that would be unique to your own industry, should be considered and carefully reviewed.

The three (3) unpredictable costs to be concerned about

In your business, you have many expenses to take into account. Some are more predictable than others - for instance, fixed overhead items, salaries and communications (that are more predictable today than in years past, as there are very good plans available). But, no matter what role you play in the commercial sector, you must be concerned with at least one of the more unpredictable costs.

And, even with the best negotiations to minimize your exposure and risks, you will have at least some unforeseen expenses - and they will arise from some unpredictable costs.

These unpredictable costs can come from the following:

- 1) Production or (value added) processes
- 2) Warehousing/Storage of Inventory
- 3) Shipping and handling

If you are already involved with production or processing of products, you are very

familiar with the problems associated with these aspects of your business.

For those that are new to business, or are now planning to work in this part of a market, there are potential problems that you must factor into your costs.

Production or (value added) process problems

Unusable or defective materials - The materials that you receive may arrive damaged, contaminated, or not conforming to needed specifications. And, even though you may have a claim against the supplier, you are going to incur some lost time and costs.

Your production may be interrupted, or far worse - you may not notice a problem (such as with a material being used) until your production or processing has already started. Or, perhaps the problem will not be noticed until after you already shipped your completed product to your clients.

And, of course, there is the possibility that a problem can occur from your own error in production or processing. This can arise from something as simple as a miscalculation, an equipment malfunction, or any other occurrence, such as simple human error.

No matter how experienced you and your workers are in the production process, problems arise - and they can be costly.

Warehousing/Storage of Inventory

Again, even with cautions, there are risks - from both procedural and natural occurrences.

The simple risks can arise from damage from improper stacking or storage (for instance, improper temperature or humidity control); you or your workers may accidentally damage some pieces; there can be pilferage; storm damage to your facility; and, many other problems.

And though you may have insurance coverage, often the coverage does not fully cover the total loss - especially factoring in that time and attention are part of any loss.

Shipping and handling

Experienced business people will tend to negotiate their business with shipping being the responsibility of the other party. It is the safest position to have in a contract. And, if you are new to business, you must learn the aspects of shipping, and you must understand that there are risks

This is one aspect of business that I always stress to people as being the most perilous part of doing business. If something is going to go wrong in a transaction, it will very

likely go wrong in shipping and handling.

And, this is not a criticism of the shipping industry. Considering the volume of traffic that is continuously occurring in our economic community, and the security cautions that attention must be given, the shipping industry, as a whole, is amazingly reliable.

But, from the volume and the complexity of handling, the probability of mishaps is always present. And, the logistical movement of any shipment should always be followed-through with close attention. Often, problems can be prevented with cautious follow-through on the part of the shipper.

Of course much depends on how you are shipping - Bulk shipping or container shipping. And, if you are competing in a product market, you should certainly be familiar with the logistics of shipping that product in the most profitable way. And, there are products that can be shipped both ways, depending on order quantities and best economics.

The first and foremost thing is that you should be working with shipping brokers/agents and customs brokers that are both reliable and knowledgeable (with the shipping of your product).

There are of course problems that can be completely avoided. Among the things that you must be attentive to are measuring dimensions correctly (to get the maximum benefit out of your shipping expenses) and packing or loading properly. And, of course, you must be attentive to the issue of time schedules (for timely delivery).

But, I again stress that problems can be minimized to some extent with careful attention. And, this involves careful tracking of your shipments. With the tracking options now available on the Internet, it is inexcusable not to be doing this.

The structure of a typical product market

The following is a list of participants that can be part of any product market:

- 1) Producer/Manufacturer of either a basic product or a finished product ready for the consumer marketplace/retailer.
- 2) Distributors/traders/brokers/agents that may be used to market the product for the producer, or work as buying agents for the purchasing companies. They may be independent from the producer/manufacturer (principals that buy and sell for their own account) or commissioned agents.
- 3) Processors/Value Added Manufacturers/Assemblers that will enhance or use the product in their own final product, or added to one of their own product lines - Which can be then sold to even another processor/value added manufacturer or ready for the consumer marketplace/retailer.

- 4) Wholesalers or importers that can either be independent or designated distributors.
- 5) Retailer/dealer that will finally sell the finished product to the consumer.

Some products will go through all five of these market participants, whereas others will go through at least several. And, each of these participants has their own costs that are added to the product before it is finally sold to the final consumer.

It is important that wherever your business fits in among this group, you understand the other participants costs as well as your own, as well as their pricing structure. Otherwise, you may be pricing wrong if you simply try to apply some basic formula - such as 40% or 50% less than the final retail price.

Each market participant has plenty of expenses - And, you must be cognizant of them

I've often hosted overseas manufacturers visiting the U.S.A. And, very often they are shocked beyond belief when they see the retail prices for their very own products. They'll almost feel like they've been cheated when they realize that their product is selling at 300%, or even nearly 400%, of the price that the importer's buyer or agent had negotiated with them.

But, what they are failing to take into account, are the costs incurred at each participants level to finally get that product into the hands of the consumer.

Selling to consumers has its costs. And, the closer you are to the consumer, the higher the costs.

The costs of product promotion and advertising are very expensive. Whenever there is a major sporting event - how often do we hear that the costs for television ads are about \$1 million per minute? And, if you have ever priced advertisements in many of the popular newspapers and magazines, you would know that they run into the tens of thousands of dollars.

Retail space in high traffic areas and malls often rents and sells for up to 10 times that of industrial space. Whereas, warehouse space in the more populated and higher income cities rents and sells for 5 times the costs of other areas.

These and other costs are factors in the commerce of the wholesalers and retailers that bring products closer to the consumer market. And, they too have to contend with the unpredictable costs of warehousing, shipping and handling

Marketing departments determine prices

Supply and demand indeed influence prices. But, unless a product or service is absolutely critical, there is a price level at which a consumer will find it not worth buying. And, someone usually “sets the scale”.

It is the marketing departments of the parent companies of the larger retail companies that may often determine the potential selling price of a product. They may be producing the products in their own domestic facilities. Then their production departments will be working to make the products at the targeted costs, that would allow the producing company’s selling price to be in the range of 40% to 50% of the final retail price.

If they are buying from contracting producers (such as overseas sources), their buying departments will seek to buy the products at the costs that allow them to sell at those determined prices. And, they would be buying directly from the producers, perhaps using local buying agents, or they may buy from importers. But, with their large and complex structures, they will have more expenses and look to buy the product at prices sometimes as low as 25% of the estimated retail price. And, with the large quantities that they buy, this is very possible.

At the same time, smaller, independent retailers may also be competing with the same or similar products. And, they would be buying from wholesalers/importers - though not with the influence of the larger buyers.

Let’s take a simple example of a small consumer product that is determined to have a retail value of \$30 (or \$29.99, as it will be marked), and look at the target purchase prices and mark-ups that may apply in these cases:

1) Producer (of a name brand product) making domestically, selling through dealers or retailers:

- Production Cost	\$ 7.50
- Producers Mark-up	7.41
- Shipping	.08
- Dealer and/or Retailer Mark-up	15.00
- Retail Price	\$29.99

This is a simplified breakdown. In reality the productions costs and shipping costs can be more or less than the example. While at the same time, the producers mark-up may be more or less, depending on the production costs they can achieve.

2) In the case of a large (name brand) company, that would be buying product direct from another producer, and selling the product through their dealers/retailers (who may be independent):

- Purchase Price from Producer	\$ 7.50
- Purchasing Agent Commission	.38
- Shipping/Customs Clearance	.15
- Parent Company Mark-up	6.96
- Dealer or Retail Store Mark-up	15.00
- Retail Price	\$29.99

I point out that in each of these situations, the companies may determine their own formula. For instance, rather than allowing their dealers/retail stores 50% of the retail price, perhaps they would allow them 40%. Thus, the parent company would have about a \$10 mark-up and the dealers/retailers a \$13 mark-up.

Also, it is important to point out that unique to some items, and to certain industries, some of the larger companies may be paying 30%, or more, of the final retail price to producers, and the formulas for the mark-ups would be adjusted accordingly, to meet the final retail price. There isn't one formula for all.

And again, one must be cognizant of the expenses of the name brand product companies and their retail stores.

The parent company has the expenses of:

- National advertising
- Promotions and sponsorships
- Numerous exhibitions in trade shows (for the dealers and retailers)
- Product design and development
- Warehousing and distribution
- Overhead costs associated with any business.

At the same time, the dealers/retailers have the expenses of

- Local advertising
- Local promotions and sponsorships
- The (usually very high) costs of retail space
- Warehousing and deliveries
- Product damages and repairs
- Sales commissions as well as salaries
- Overhead expenses.

Very important to remember for both, are the expenses of discounting un-saleable products - products that simply don't sell. And, anyone familiar with marketing is well aware of this situation.

So, even though the mark-ups themselves may seem high - taking all into account, the reality is that the producer/parent companies and their dealers/retailers may only be seeing net profits of less than 10% - sometimes much less.

3) In the case of a wholesaler or importer, the mark-up structure may be entirely different. Much depends on the quantities that they buy. But, often they do not have the same purchasing power as the larger companies. So, they would often be paying more for their products.

And though they may sometimes be able to buy the same products as the larger buyers, many products are exclusive designs of the larger companies, and not available to them. Thus, many wholesalers/importers may buy the line items of the producers, or even have the producers make items exclusively for them.

So, as they would be competing with the \$29.99 product, their mark-up could be less. For instance, the analysis may look like the following:

- Purchase Price from Producer	\$10.00
- Purchasing Agent Commission	.38
- Shipping/Customs Clearance	.15
- Wholesaler/Importer Mark-up	4.46
- Dealer or Retail Store Mark-up	15.00
- Retail Price	\$29.99

Again, this is assuming that they are having a similar product made for themselves - and, they are not benefiting from lower prices from the large quantities-of-scale that the larger companies have.

Though, it can go either way. For instance, they may be able to negotiate a lower purchase price, and benefit from the higher mark-up. Or, on the other hand, they may be buying large quantities to supply a larger company, and considerably reducing their own mark-up.

And, here too, one must be cognizant of the expenses of these wholesalers/importers. They are also incurring the expenses of product promotion/advertising, exhibiting at trade shows, warehousing stock, and the other overhead expenses associated with business.

Basic product/commodity producers

Further back in the market chain are the basic product/commodity producers and the traders of their products. Their economics are greatly influenced by market conditions. And, these market conditions are influenced by the overall supply and demand for their products, as well as natural and political occurrences.

Often their mark-ups are low, unless there is an extraordinary event that may influence the price of their products. And, their benefits from any market fluctuation depend on whether they are “long” or “short” in their position, both contractually and physically (that is, their inventory).

Pricing advice for a new product manufacturer

The first thing that you should do is write up a business plan that will include your financial statements. Within these financial statements will be your P/L statements, that you can start constructing with accurate operating costs - and this would include the recovery of your investment in your machinery and equipment, as well as your production and overhead costs. It should cover a period of at least several years, and project all your costs for your planned business expansion.

You will be faced with the dilemma of having to start selling your new product at a price low enough to introduce it into the marketplace, but not selling it at too low of a price, as that may interfere with your future expansion of your business. And, that is why a business plan can be an important guideline.

You must remember that as your business grows there will be more marketing costs. For instance, exhibiting at trade shows, advertising - and, perhaps eventually distributing through dealers and wholesalers. These add substantial costs to your product's final selling price.

And, though you may enjoy benefits from the lower production costs that usually come with increased volume, it may not be enough to sustain your desired profit level (with these higher marketing costs).

So, if not planned correctly, you may be entering the market with prices that are indeed profitable to you at your beginning operating level. But, you may have to raise them as you expand. And, a number of your original clients will find the increases upsetting and unjust - even though your new (higher) prices may still be very competitive in the marketplace. That's human nature.

If you are entering a market in which you will be selling a product which is similar to or the same as others on the market, then you have a good indication to guide you in your own pricing. Though, it is more difficult when the other products are known name

brands, or from long established suppliers - you would then have to do some market research, to find the price level at which your product would sell. And, depending on your target market, this can be done either by you, or with some professional help.

If you are looking to sell to a limited number of buyers, such as wholesalers ,or you will look to work as a contractor to produce for a larger company, then you could very well make the inquiries into the marketplace yourself.

But, if you are looking to sell into the consumer market, through retailers, then you may want to use the services of a market research company. Even if your initial production capabilities are small, you should at least inquire about their services - you may find it to be a worthwhile investment.

Companies entering distant markets

For those companies that are entering a new and distant marketplace, I would suggest that you work with a knowledgeable agent or distributor in that marketplace. Though your own marketing department may be quite capable and ambitious, there are many benefits of having an experienced representative in your target market. Not only will they be familiar with the structure and protocol of that market, but the fact that they are located in that market allows them to remain in close contact with your new buyers.

The local representative will be able to visit the buyers in their own facilities, and promptly address any issues that the buyers may have. And, this is always looked upon favorably by buyers - an immediate personal response to their needs.

Additionally a representative located in a marketplace will be aware of any changes in the market, and be a good source of information regarding your competitors, product developments and that market's pricing.