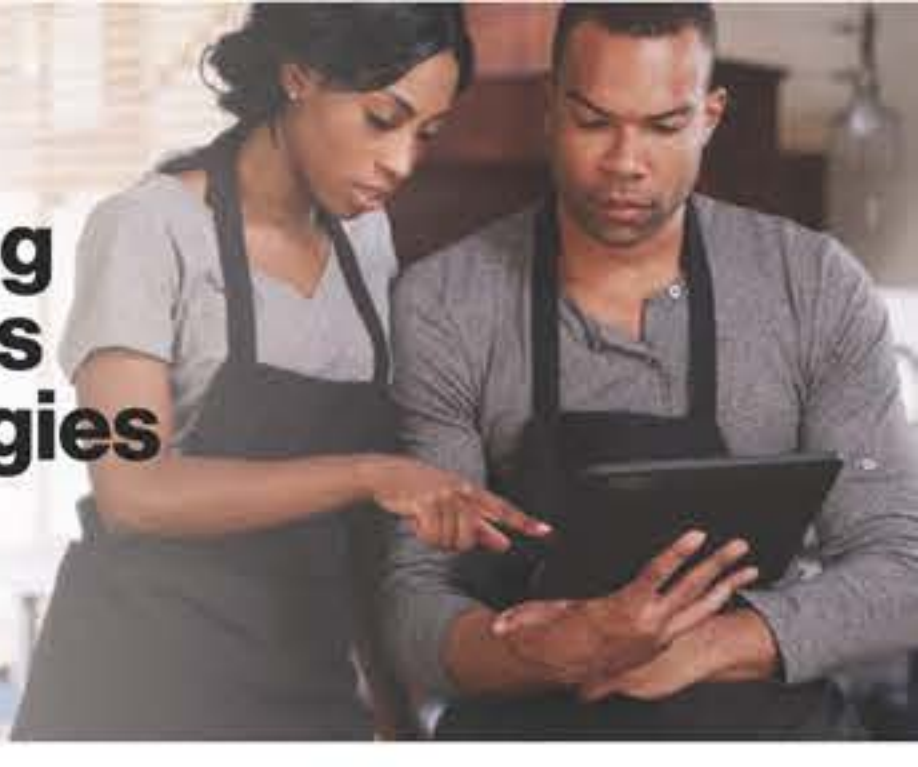


# Understanding small business pricing strategies



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As a small business owner, pricing is more than just a number affixed to your products or services; it helps determine your business's profitability, competitiveness and longevity. Selecting your small business pricing strategies can be intimidating, but with the right approach, you can develop a pricing model that covers your costs and maximizes your profits.

So, let's dive into the different pricing models available and consider some practical advice for choosing [the best pricing strategy](#) for your business.

## Understanding small business pricing strategies

A pricing strategy is simply a plan for setting the best price for your products or services. Ideally, your price can encourage consumers to buy while still generating profit. You can take a trial-and-error approach to setting prices until you find the sweet spot, but a tried-and-true pricing strategy can help you narrow in on an appropriate price more efficiently.

Here are five small business pricing strategies to consider:

### 1. Cost-based pricing

Cost-based pricing is one of the most straightforward and intuitive forms of pricing. It involves calculating the total cost of producing your product or service and adding a markup percentage to ensure profitability. For example, say you own a pie shop, and each pie costs approximately \$15 to make, including supplies, labor and overhead. If your target profit margin is 25%, you need to price the pies at \$18.75 (\$15 x 1.25%).

Cost-based pricing is popular for new small business owners because it is a clear, straightforward calculation.

- **Advantages:** Cost-based pricing's clarity and simplicity make it easy to communicate to stakeholders and adjust based on changes in cost structures. It ensures you cover all of your costs and maintain a profit.
- **Challenges:** While this method covers costs, it may not always reflect customers' perceived value of your product or service. It can lead to underpricing or overpricing, especially if market conditions or the competitive environment change.

### 2. Hourly pricing

With hourly pricing, you bill for your services based on the time you spend on a specific task or project. This model is common in professional services like consulting, legal services, accounting and freelancing because there is a clear link between time spent and revenue received.

- **Advantages:** Hourly pricing is easy to understand and communicate to clients, making it transparent. Clients pay only for the time spent on their project, which can be easier to justify and feels fairer to many customers.
- **Challenges:** Clients may be wary of hourly pricing due to the uncertainty of the final bill. Projects can extend beyond initial estimates, leading to potential disputes over costs and perceived value.

### 3. Value-based pricing

Value-based pricing is based on the perceived or estimated value of a product or service from the customer's perspective rather than the cost to produce it.

Say you own a plumbing company and typically charge \$100 per hour for your service. However, if you provide emergency repair services on evenings and weekends, value pricing can make your business more profitable. For example, clearing a clogged kitchen drain might only take 15 minutes, but a customer might be willing to pay \$150 for your services if they're preparing to host a family gathering or holiday party.

- **Advantages:** Value-based pricing can significantly increase profitability by capturing the value customers place on a product or service. It often leads to higher customer satisfaction, as the pricing aligns with their perceived value.
- **Challenges:** This approach requires a deep understanding of your customers' needs, preferences and how much they are willing to pay for the benefits they receive. Setting your prices too high can lead to lost revenue and market share while setting your prices too low can also lead to lost revenue.

### 4. Competitive pricing

Competitive pricing involves setting prices based on what competitors charge for similar products or services. This strategy is often used in highly competitive markets, where price is a major factor in customer decision-making.

For example, say you own a gift shop in a shopping mall that caters to tourists visiting the area. Several other gift shops in the vicinity sell similar products. If you price your t-shirts and other souvenirs too high, customers can simply buy from the shop next door. Unless you can offer something your competitors don't, you need to set prices competitively.

- **Advantages:** Aligning your prices with the market average can prevent price wars and build stability in your market presence. This strategy can be beneficial in markets with little differentiation between products.
- **Challenges:** Relying solely on competitive pricing can squeeze profit margins and stifle your business's unique value proposition if not combined with other strategies

### 5. Penetration pricing

Penetration pricing is a strategy businesses sometimes use to enter a competitive market. It involves initially setting a lower price than the current market leaders to attract customers, boost market share and establish a strong presence. Once you gain a foothold, you raise prices to a more sustainable level.

Firms often use penetration pricing to attract new customers when they enter a new market. For example, a bank might offer a cash bonus when a new customer opens a savings account. These offers can be very appealing, encouraging people to switch financial institutions.

- **Advantages:** Penetration pricing can be effective for quickly building a customer base, which is crucial for new businesses that need to establish themselves.
- **Challenges:** Initially, profit margins might be very thin or even negative. This might be unsustainable for businesses lacking adequate capital to cover short-term losses.

## Choosing the right pricing strategy for your business

Each strategy outlined above offers pros and cons, so how can you select the right one for your business? Here's a step-by-step guide for evaluating small business pricing strategies.

### 1. Understand your costs

Regardless of the pricing strategy you choose, know your numbers. Understand all costs involved in your business, from labor and materials required to produce products and services to marketing and overhead. This helps ensure your pricing covers your expenses and desired profit margins.

### 2. Analyze your market

Conduct thorough market research to understand your customer's willingness to pay, their needs and how they perceive your competitors. The Library of Congress [Small Business Hub](#) offers free resources to research trends in your industry. Tools like online surveys and focus groups, used to test different messages, can provide valuable insights.

### 3. Evaluate competitors

Keep a close eye on your competitors' pricing strategies. Are they using discounts, premium pricing or a penetration pricing strategy? Understanding this can help you position your pricing competitively.

### 4. Consider your brand positioning

Your price sends a strong message about your brand's position in the market. Decide what you want that message to be and ensure your pricing strategy aligns with your overall brand strategy. For example, do you want to be seen as a value provider or a premium service?

### 5. Experiment and adjust

Your prices aren't set in stone. Experiment with different small business pricing strategies and adapt based on market response, cost changes and competitive dynamics. Whenever you adjust your prices, communicate clearly with your customers to maintain trust and explain the reasons behind your decisions. For example, the Verizon Business' 4th Annual State of Small Business Survey\* found that [nearly 3 in 5](#) small or midsize U.S. business owners raised prices or have plans to raise prices to offset inflation.

*\*Morning Consult on behalf of Verizon Business, August 2023, surveying national sample of 681 small to midsize business owners and decision makers.*

## Get started on your small business pricing strategy

The hardest part of pricing your products and services is often getting started, so select and implement a pricing strategy, and then monitor market conditions and customer feedback. These insights can help you refine your pricing approach and achieve sustainable growth.

Find more resources to help you grow your small business [here](#).

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