THE PSYCHOLOGY OF PRODUCT PRICING

In this second and final article on product pricing, the focus will continue to be on the Psychology of Product Pricing. The WHAT, WHEN, WHY and HOW to change pricing which for some can be a daunting task and decision. Even though some Operators just randomly change prices, it is best to have a pricing strategy in place that will provide improved product performance as it relates to popularity (quantity sold) and contribution margin (product profit).

Starting with the WHAT of pricing, this is directed toward the individual products you sell in any type of operation. Periodically you are going to ask yourself, WHAT product prices should I change? Please keep in mind that when you are going through this review process, again, you should definitely be looking at products that are slow movers (not very popular) and/ or are not generating a reasonable contribution margin.

As you identify the WHAT factor, then the WHY factor comes into play. The WHY can be for several key reasons: 1) the cost of the product and/or packaging have increased and you want to recover this cost in your selling price; 2) there is a price reduction of the product tied into a promotion so that you can reduce this price during the length of the promotion; 3) your pricing strategy is to gently raise all product pricing regularly (this is usually done once to twice per year; 4) the product is not very popular (slow mover) and/or 5) the product has the lowest contribution margin in its category.

The WHEN should product prices change is driven to a large part based on the WHY. If you get a product price increase, the first thought is how soon and how much can I raise the price on this product. Most Operators have a theoretical product cost goal that is the target for all pricing. Usually these goals are established by product category and are not the same across all product categories-at least this is how it should be done. In this case, the selling price is raised to the level that will yield the Operator with at least the theoretical product cost goal.

An example of this approach would be as follows:

If the theoretical product cost goal is 45% and the current selling price is $2.50 (the cost is $1.12) and the product cost goes up by .20 cents, the cost would then be 1.32 so the selling price would then become $2.93 which you would hopefully round up to $2.95 or better, $2.99.

If a product's cost increases, the WHEN to raise the price usually follows soon after. Most Operators have a variance factor that helps make the WHEN a price should increase decision. For example, if a product cost increases by 5% or less, no price increase would take place until the regular scheduled pricing adjustments are made. Any increase over 5% may require an immediate review of the product in terms of re-negotiating the cost with the manufacturer/distributor, changing the size of the product (smaller product to keep the same price or larger product and increase the price), raising the price now to recover the cost increase or replace the product with a similar item at the current cost and keeping the price the same. Fortunately with the advancement of technology, particularly with Micro Markets, you can change prices (the HOW) via the internet from your office (as long as there are no price tags on the items).

Another key HOW factor has to do with bundling of products so that you take an item that has a higher costs and promote it with one or more items with lower costs. This can be very effective when you have an item that is popular but yields a contribution margin below the category goal. Obviously, bundling generates higher dollars for a sale which is a good thing.

Beyond the product cost increase that may result in the increase of product pricing, I have some clients that automatically raise prices twice a year-the first of July and the first of December. Why these months? The clients feel that the July and December price increases generate less resistance than other months when they raised prices. By the way, they do not do wholesale (all products) price increases, but methodically identify those items that are STARS (high contribution margin and high popularity) that can with stand a gentle price increase without damaging popularity. And of course they "tweak" the pricing of those products that are below the contribution goal. One additional step that is taken has to do with dropping and replacing ALL items that are low in popularity and yield contribution margins less than the category goal. You should never have a product in a category that sells less than 10 units per month.

In many cases, Operators at least review product performance on a quarterly basis to monitor the popularity and contribution of each product within each category so that the bad performers can be deleted and/or replaced.

Often the Operators directly justify the price increases to the belief that they are selling convenience: time vs money. This concept also supports the strategy of reducing the SKU's in any category to focus on the most popular items with higher contribution margins. You do not need to be a "Mega" operation with 30 SKU's in each category.

When pricing products that are a dollar or more, keep in mind that the customer reads these numbers from left to right, so an item priced at $2.99 is perceived as a better deal than one priced at $3.00. This is called the "left digit effect." Interestingly, over 60% of most pricing ends in a "9!" My thought on this is that there can be too many 9's and where do you go from there? However, I have one client that prices all products ending in 9, whether it be .99, 1.99 and so on. This strategy works for this client, so the 9's are part of the pricing strategy.

Recently there also seems to be a trend to NOT use the dollar sign as part of the pricing. So on a product label it would show PRICE: 1.99, rather than PRICE: $1.99. Personally, I am not sure this has any value to whether a customer buys an item or not. But this is another example where Operators are trying different pricing strategies in an effort to sell more product.

Another key factor to take into consideration when establishing product pricing within a category is directly related to merchandising. .Where you place a product within the category will impact how many are sold. So location-location-location is very applicable in product placement. Hence place you "STAR" performing products in the very best location within a category display that will draw immediate attention to the product.

Also when setting up your plan-o-gram by category, keep the lower priced categories away from the higher priced category. So do not have gum and mints near the refrigerated FRESH FOOD-sounds strange, but a consumer may decide on buying a pack of gum at the lower price versus a salad that is more expensive. GUM and MINTS are really impulse items and should be near the Point of Sale.

And finally, as you plan your pricing strategy and have identified the “right” products to sell in each category based on the contribution margin-keep in mind that the other key factor (popularity) can only come from how many of a product within a category your customers will buy. So part of your Pricing Strategy must be to know who your customers are at each location and their likes and dislikes-their needs versus their wants.

The Psychology of Pricing can be tricky and for some complicated, but spending a little time analyzing what products perform best in each category and what products need price tweaking or replacement can make a positive impact on your profits and customer satisfaction. An important element of any Pricing Strategy has to do with Product Intelligence-product profit and popularity. These two factors should always play a major part in the WHAT, WHEN, WHY and HOW of your pricing strategy.

Why not take a few minutes and examine your current Pricing Strategy to determine if a) you even have one; b) what are the mechanics-how does it work and 3) how well is it working for you.

This article is part of a series that Mr. McVety has presented to many hospitality organizations throughout the years and is based on his own personal experience and success when he was an executive with several major retail companies.

Jerry McVety, President of McVety & Associates, a food service and hospitality consulting firm

www.mcvetyassociates.com