How to Choose the Proper Pricing Strategy

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Choosing the right discounting strategies is one of the biggest ongoing challenges for Los Angeles and Southern California business owners and entrepreneurs. This is true for both manufacturers of products and providers of professional services.

Many CEOs, CFOs and controllers find themselves constantly evaluating and re-evaluating different discounting models and alternatives, never quite sure if they are using the right model that's resulting in the biggest financial benefit of the company. For example, they often wonder things like:

- Should we be matching our competitors' prices?
- When should we discount, and by how much?
- What products or services should be discounted and for how long?
- If we discount, how much will this cut into our bottom line profits?

No Magic Discounting Formula

To be sure, there are many different variables that go into discounting. So solving the discounting puzzle isn't as easy as plugging a few numbers into a generic formula and — presto! — out pops your ideal discount. However, choosing the right discounting model is critical to finding the right balance between unloading slow-moving inventory or filling idle employee time and maintaining the highest level of profitability.

Here are 5 guidelines to keep in mind when trying to decide whether or not to discount your products or services:

1. **Make sure you understand the economics of your business.** For example, what is your ideal profit margin? What is the lowest profit margin you're willing to accept? Work backward from here to determine the proper discount amount.

2. **Identify what sets your company apart from your competitors.** This is especially important if you are a service provider. Many products are often seen by customers as commodities, in which case they will look for the lowest price. However, it's often easier for service providers to set themselves apart from the crowd by stressing their unique selling point (or USP).

3. **Factor in your discount-motivated customers.** Some customers will only buy from companies that offer discounts. If this describes many or most of your customers, increase your desired price by the discount amount to arrive at a sticker price and then discount this so you still sell it for your desired price.

4. **Decide upon the proper discount duration.** Discount programs are marketing tools that should have a start date and an end date — they shouldn't go on indefinitely. At the end of the discount term, analyze the results and decide if the marketing investment was worthwhile or not.

5. Determine the cost of the discount ahead of time. Find out what the discounting program will cost in terms of lost revenue and profits before implementing it. Don't just discount blindly with no regard for the financial impact.

Popular Discounting Programs

Now you are ready to implement your discounting program. Three of the most popular kinds of discount programs are:

1. **New customer discounts** — These can be especially beneficial for service providers. The client will enjoy a lower price while you're getting to know each other, while you are able to lay the groundwork for a long-term working relationship together.

2. **Volume discounts —** This strategy can help boost top-line sales and revenue, but it sacrifices bottom-line profits. Careful analysis is required to ensure that the revenue-profit tradeoff is worthwhile.

3. **Prompt-payment discounts —** These can help boost cash flow by giving customers a financial incentive to pay their invoices early. Most common is a "2/10, net 30" discount in which the customer receives a 2 percent discount if the invoice is paid in 10 days instead of 30 days. If you offer prompt-payment discounts, make sure you only apply the discount if customers actually pay their invoices early.

Care should also be taken when it comes to price-matching. Since you probably don't know what your competitors' costs are, price-matching can put you at a serious disadvantage in terms of profitability. If your competitor has lower costs, it can probably afford to sell for a lower price than you. If you try to match this competitor's price, you could give away your entire margin — or worse, end up selling at a loss — while your competitor is still making a profit selling the same product or service.

Concluding Thoughts

Discounting is a challenge for almost all businesses, including both manufacturers and service providers. There are many different variables that go into discounting, so solving the discounting puzzle isn't as easy as plugging a few numbers into a generic formula. However, it's critical that you choose the appropriate discounting model if you want to find the right balance between unloading slow-moving inventory or filling idle employee time and maintaining the highest level of profitability for your company.

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