



How Value-Based Pricing Can Boost Revenue & Profitability

John W. Braine, Partner, CFO Edge, LLC

Pricing is one of the most critical tasks that any successful business has to get right. Price your products and services too low and you won't earn a high enough margin to meet your expenses and earn a profit. Price them too high and you might not sell enough products and services to stay in business.

There are many different ways to price your products and services, but all of the different pricing strategies you'll read about fall into one of two main categories: cost-plus pricing and value-based pricing. Most companies (especially manufacturers) use cost-plus pricing because it's simpler and it ensures that you cover your costs and earn some kind of profit. However, value-based pricing is more strategic and offers the opportunity for higher long-term revenue growth and profitability.

What's the Difference?

Here is one definition that clarifies the differences between value-based pricing and cost-plus pricing:

Value-based pricing is the setting of a product's or service's price based on the benefits it provides to consumers. By contrast, cost-plus pricing is based on the amount of money it takes to produce the product.¹

One reason why value-based pricing is attractive is the fact that improving margins and profitability in the digital age goes beyond just managing costs. Value-based pricing is customer-centric, requiring discipline and skill in a price-sensitive competitive environment.

In general and again drawing from the Investopedia definition, companies whose products or services are unique or offer a high degree of added value are usually better able to benefit from value-based pricing "...*than companies whose products or services are relatively indistinguishable from those of their competitors.*"¹ Or in other words, whose products or services are primarily commodities.

One of the central tenants of value-based pricing is the fact that not all customers are created equal. Different customers have different needs and expectations, so value-based pricing is based on being able to meet these varying needs and expectations. For example, customers who require the highest quality products or the highest level of service are usually willing to pay for this. Is your company equipped to provide these levels of quality and service and charge appropriately for them?

Change Your Mindset

To truly grasp the concept of value-based pricing, you need to change your mindset from what does it *cost* you to manufacture a product or provide a service to what is the product or service *worth* to your customer? These are two very different things. Understanding the difference and incorporating this into your pricing strategies can result in significantly higher revenue and profits when value-based pricing is implemented successfully.

For example, suppose it costs you \$5.00 to manufacture a widget. If you want to earn a 50% gross profit, you would sell the widget for \$10.0. Simple enough, right? However, what if the value of the widget to your customer is \$12.00? If you sell it for \$10.00, you're leaving \$2.00 in revenue on the table with every widget sale.

Successfully implementing a value-based pricing strategy requires that the finance department work closely with all operating departments (especially sales) to provide them with an understanding of data and communicate drivers of profitability. Here are a few more suggestions to help you implement a value-based pricing model:

- Create teams of support services with information about the unique attributes of your products and services and then follow up with customers to ask them about the quality of and their satisfaction with your products and services.
- Continually gather and analyze customer preferences and opinions that you can use in your pricing decisions.
- Collect data to help you identify customer buying patterns that can lead to the creation of pricing tiers based on customer preferences.
- Differentiate your company's products and services from those of your competitors by focusing on your unique selling proposition, or USP.

An outsourced CFO services provider can help you implement value-based pricing. This provider will start by analyzing the effectiveness of your current pricing strategy. He or she will also help you identify your USP and distinguish your products and services in the marketplace. Based on these analyses, the provider will show you how value-based pricing could increase your revenue and profits.

Concluding Thoughts

All pricing strategies fall into one of two main categories: cost-plus pricing and value-based pricing. Most companies use cost-plus pricing because it's simpler and it ensures that you cover your costs. However, value-based pricing is more strategic and offers the opportunity for higher long-term revenue growth and profitability. Successfully implementing a value-based pricing strategy requires that the finance department work closely with all operating departments to provide them with an understanding of data and communicate drivers of profitability. An outsourced CFO services provider can help you implement value-based pricing.

¹ www.investopedia.com/terms/v/valuebasedpricing.asp

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