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# Pragmatic Product Leader Course

Become a Product Manager with Superpowers





Lesson 15E

# Pricing Strategies: Cost-Oriented & Value-Oriented Pricing



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# Cost-Oriented Pricing



# Cost-Plus Pricing

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Cost-plus pricing, also called gross margin pricing, is a pricing strategy in which a company determines the cost of the product to the company and then adds a percentage on top of that price to determine the selling price to the customer.

Here, a desirable profit percentage is selected then worked backward to set the price. Thus, the gross margin is the difference between the total cost and the net sales, and the profit % is the gross margin expressed as a percentage of net sales.

## **For example:**

- Let's say your desired profit percentage is 20%; you will price your products at 120% of the cost of making the product. Say the cost of making your product is \$30, then you would price it at \$36, at a 20% profit percentage.
- The main advantage of this pricing strategy is that you do not need to forecast sales. This pricing also ensures the costs are covered.

## **Limitation:**

- Difficulty in meeting competition
- It does not take into account the consumer's perception of a product's value.
- Since the cost of manufacturing is constantly fluctuating, therefore the price of the product may vary. Consequently, it does not prove to be viable or sustainable in the long run.



# Break-Even Analysis

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The break-even price is the price that will produce enough revenue to cover all costs at a given level of production. In this strategy, the pricing is less volatile than cost-plus pricing and works well when the product or service is undifferentiated in the market.

$$\text{Breakeven Price} = \text{Variable Cost} + (\text{Fixed cost} / \text{Production Volume})$$

The components of break-even analysis are:

- **Fixed Cost** - This is a constant over the short run, such as renting a warehouse for a year.
- **Variable cost** - This keeps changing, for example, the cost of raw material. However, this cost can be kept constant for specific volumes.

## For example:

Assume the cost of raw material(variable cost) = \$5/per unit and renting equipment to manufacture the product (Fixed Cost) = \$50,000. Let's say we are producing 10,000 units. Then the breakeven price =  $\$5 + (\$50,000/10,000) = \$10$ .

## Limitation:

- This strategy can separate all costs and expenses; however, it isn't easy to achieve a clear-cut division of the costs into fixed and variable components, for example, advertising expenses.



# Demand-Based Pricing

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Demand-Based pricing is a method that uses the customer's demand and the product's perceived value. In this strategy, the company assumes customers have different responses to the price of the product or service and then sets an acceptable price.

This strategy focuses mainly on the nature of the demand curve for the product. The product in the industry heavily dominates the nature of the demand curve.

If the product is very competitive, the business may use the price or service strategically. For example, the Airline industry is very **competitive**, and the target audience is also very **price sensitive**.

On the other hand, if the business introduces the product into a less competitive industry, the price would not be of strategic advantage; for example, Designer watches.



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# Value-Oriented Pricing



# Value-Based Pricing

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Value-based pricing is a strategy of setting prices primarily but not exclusively based on consumers' perceived value of a product or service. This pricing works well when you are trying to establish a strong customer relationship.

The previous three structures were from the seller's perspective and not the buyer's, and this pricing structure focuses on the customer's perspective.

This pricing strategy revolves around:

- How high can the price of the product go and still be sold?
- Are you comfortable selling at that price?

For this strategy to be successful, it is crucial to understand the following factors:

- Customer-Buying Process
- Cost of switching to your product
- Buyer's price knowledge
- Price expectations
- Competitors in the market of the product.



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# Thank you.

