# Art or Science?

## A deeper look at pricing strategies

*By Richard Gottlieb*

I was on my way to the gym when I remembered that I needed a new workout shirt. I ran into a store, grabbed one off the counter and took it to the register. As I pulled out my credit card, I suddenly noticed the price—$40.50. "Whoa," I blurted out. "I'm not going to pay that much for a workout shirt." I put it back and took my business elsewhere.

Later, I laughed at myself as I considered that if the shirt had been priced 51 cents lower (at $39.99), I probably would have purchased it. Then I laughed even harder at the person who came up with that price, because who in the world prices something at $40.50? Well, the answer is simple: someone who pays $20.25 wholesale and then doubles the price.

As in this example, sometimes pricing—probably the most important element in the success or failure of products and the companies that set them—is treated either as a perfunctory science or as voodoo. Maybe, however, it's neither. Maybe it's an art.

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That's why I decided to give Rafi Mohammed, the author of the Crown Business Press book *The Art of Pricing*, a call. I wanted to know how his method might be applied to an industry that has to somehow balance its pricing between mass merchandisers like Wal-Mart and the large number of specialty retailers.

Mohammed says that, typically, there are two methods used in developing price. Both seek a one-size-fits-all solution. One method is to work up from your cost, and whatever that calculates out to be is the selling price. In other words, start with what it will cost you to actually make the product, add in additional costs such as freight and duty, allow for profit and whatever that adds up to is what you sell it for.

The other method is to arbitrarily choose a selling price that feels 'right' and work backwards. In other words, you decide that it should sell for, say, $10.00, and you try to make sure that your costs allow that to happen. In either case, sales or profits are going to be lost because the final price isn't actually connected to the reality of the marketplace or to the various levels of prices that different consumers are willing to pay.

Mohammed's method takes a far more nuanced approach to pricing. It involves pricing that ekes out the maximum profit the market will bear by considering multiple price points and product variations.

### Pricing for the toy market

When I asked Mohammed how a toy manufacturer might want to approach pricing in this industry, one of his suggestions was to consider *versioning*. Versioning means that you create variations of your product and pricing for different kinds of retailers. In other words, you don't attempt to sell all formats to all customers. Rather, you look at your customer base as a portfolio of retailers. Each retailer carries a different version of the product that best fits its clientele, and thereby plays a unique role in pleasing the entire consumer market and maximizing your profit.

For example, a Wal-Mart shopper is typically driven by finding products at the lowest price, so sell Wal-Mart a basic, stripped-down version of your product. A Target shopper, however, is looking for more quality and is willing to pay more for an enhanced version of your product. So, sell Target a better—but not your best—version. Continuing with this logic, a specialty store may attract a shopper who seeks the best quality, uniqueness or even luxury. Sell the specialty retailer a best quality version of your product with all of the bells and whistles. In this way, you maximize your profit at every level, as do your retail customers, because they are really not competing with each other. They are each just taking care of their own particular niche.

### The Value Decoder

An aspect of *The Art of Pricing* that I find to be particularly beneficial is the Value Decoder, which you can find at www.pricingforprofit.com/pricing-tool. This system asks you to find a competitive item that is as close as possible to being a substitute for your product. Then, by adding and subtracting value based upon variables like quality, brand identity and the market environment, you are able to develop the right price for your product. When used in conjunction with the working-up-from-cost method, it is an excellent way to calculate a price that maximizes profit and sales.

It is extremely important to get all aspects of the company involved in using this system, particularly salespeople, because it's salespeople who understand a company's customers better than anyone else. Tools like the Value Decoder can educate and empower the sales team by treating them as the experts they are. Most importantly, this puts the salesperson in the position to turn what is typically a one-sided conversation with retail buyers into a dialog. Salespeople who don't know how to value their own product are in a weak position to deal with buyers. By increasing their knowledge and confidence, salespeople can take a more powerful seat at the negotiating table.

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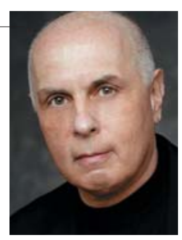

THE LEGAL DEPARTMENT

## Licensing Landmines

HAVING JUST RETURNED from a licensing tradeshow, you walk into your attorney's office armed with a competitor's board game. You are certain it infringes on your recently issued patent. A lawsuit is not on your mind, though— after all, you just spent three days talking and thinking about nothing but licensing. Instead, you ask your attorney to write a letter to your competitor inviting them to license the patent. You explain that the letter should not be threatening. It should simply point out the obvious—that they may need a license to continue selling their game, and you are more than willing to offer a license on reasonable terms. Worst case scenario: They tell you to take a hike. Right?

### Invitation to the Courthouse?

Not now. Several court decisions earlier this year gave potential patent licensees increased control over license negotiations and over going to court.

Previously, a patent owner could discuss licensing of its patent with a potential licensee with little worry of a retaliatory lawsuit. Offering a license was not seen as creating enough of a "controversy" to give the potential licensee the right to ask a court to determine whether a license was needed. So long as the patent holder did not make an explicit accusation of infringement, or threat of filing a patent infringement lawsuit, the patent holder generally remained in a safe zone, free from being sued itself. The line would be crossed, however, if, as discussions continued, the potential licensee grew to have a "reasonable apprehension" that, unless it accepted the license, it would be sued. At that point, the law gave the licensee the right to sue for a declaration that it did not infringe.

Earlier this year, the law moved in the licensee's favor. No longer is a "reasonable apprehension" required for a potential licensee to clear up uncertainty about whether it infringes by going to court. Instead, by simply offering a patent license based on specific products sold (or planned to be sold) by the licensee, the patent owner has handed over some control of the next step to the potential licensee. If it wishes, the potential licensee can, of course, accept the invitation and/or negotiate the license terms. Alternatively, if the licensee believes it is not infringing the patent, it can use the patent owner's license offer as an invitation to file a lawsuit.

The line between a license and a lawsuit just became blurrier. Make sure you know where the line is, and exactly when you want to cross it, when going after the bad guys.

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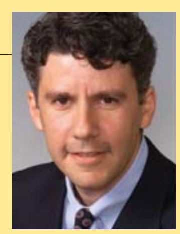

*Helped by an earlier Easter holiday and unseasonably warm weather, U.S. retail industry sales in March 2007 rose 3.7 percent over last year and increased 0.8 percent from February.* **—The National Retail Federation**