Title:
Pricing High Tech Products

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Summary:
Pricing is always an interesting topic, but even more so in the High Tech and Software worlds. In the consumer products business, if there is a package of frozen peas from Green Giant that’s priced at $3.99, you’re not likely to see someone else’s same-size package of peas priced at $14.99. But in High Tech, things are different.

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Article Body:

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The pace of innovation in the High Tech world leads to pricing that’s all over the map. It’s not unusual for a brand new competitor to come out at a higher price than the current established market leader—if their product is based on market-changing advances in product functionality due to a new technology. This is unheard of in most markets. Then you have the PC business, where rapid technological advancement over a long period of time has led to continuously lower prices—with great benefit to consumers but squeezing margin (and indeed many competitors) out of the market. Things move fast in High Tech. Sometimes it’s a high initial price to harvest profits while you have a feature advantage, other times aggressive discounting based upon your lower cost structure due to less expensive technology. Whatever the case, you can often count on pricing moves to be dramatic, and to have a profound effect on High Tech market segment in the long-term.

So what’s the best way to price High Tech products? Is it best to add up your fixed costs and, allocate them to a forecasted number of units to ensure you are recovering your investment? Or is it better to take your variable product costs and use a standard multiplier derived from history? Maybe you just set your pricing based on the prices of your competitors. Or let your customers tell you what they're willing to pay. While all of these approaches have merit and a place in pricing policy, none of them should be the over-riding factor in your pricing strategy.

So what is the most important factor to consider in Pricing? The most important thing to focus on in setting prices is VALUE. What is the value of your product to your customer as an economic, functional or emotional return? And how does the customer value the benefits of your product relative to your competitors?

So let's talk about the nature of Value. Value is the underlying need or want that drives a customer to purchase a High Tech product. If the benefit that the product provides closely fulfills that want or need at an acceptable price, you have a sale! The most important consideration in value-based pricing is to SEGMENT your market properly prior to the pricing decision. Segmentation, by definition, is the process of separating the total addressable market into "buckets" or segments of potential customers who have similar values, and therefore will react similarly to a specific offer. What this means is that once you have divided your marketplace into appropriate market segments, you will be able to charge individual segments different prices that are based upon the perceived value the product provides them. Let's look at an example of this segmentation approach, marketing a security software product to Corporate IT departments. Through your market research you have concluded that the potential customers with the highest pain threshold for the particular security problem you are solving are banks. By adding only a few banking-specific features to build a "fence" around this market segment, you may be able to charge a price for a banking-specific version of your product that far exceeds what other segments might pay. If you extend this model to multiple segments and do it properly, this approach will lead to far higher total revenue than if you set just one price for the entire market. The process of establishing value for each market segment, pricing to full value and communicating that value to the marketplace is the essence of Value-based pricing.

Finally it's important also to remember that pricing actions should not be done in a vacuum. Pricing is one of the 4Ps of marketing, and all four are inter-related. You cannot properly price a product without at the same time considering the features and benefits of the product, as well as how it will be promoted and distributed. The price for an Internet-distributed software product will almost certainly need to be in a lower range than one distributed via a sophisticated direct sales force or VAR channel. And if you aren't going to have much of a promotional budget, you most likely will need to be a price leader to have any chance of being successful. If your product is at a perceived value deficit, your price relative to the market leader will probably need to be aggressive. I’m sure you get the picture.

Pricing is a complex topic that many books have been written about. This post is meant to be an introduction to pricing in the High Tech world, and to get you thinking. I hope it’s been helpful. So when your next new product comes out, you’ll look a little harder before just pulling a price out of the air.