The $trategy of Pri¢ing

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With the combination of math (anxiety), economic theory (boring) and money (irrational emotionality) involved, it's hardly surprising that most of us hate to think about pricing. Add to that the natural apprehension that comes with the thought of the criticism, disappointment and even students quitting that can accompany a pricing increase, it's no wonder that most club owners cringe at the thought.

But here's the thing: pricing is the heart of what drives the success or failure of our businesses. If there is not enough demand for our product or service at a price which will produce profit, we are out of business.

There are many theories of pricing on which those long, complicated books on economics will happily drone for pages and pages. But in my experience, most gymnastics business owners use one of three methods: cost plus, competition-based pricing or SWAG to set their pricing.

COST-PLUS PRICING

Just like its name, cost-plus pricing involves figuring out what the total costs are to make the product or service with a "reasonable" percentage of profit added to make the final price. The difficulty in cost-plus pricing for a service business is that costs can vary dramatically depending on the season (as enrollment ebbs and flows) so that "reasonable percentage" of profit can vanish in no time. Not to mention, what is the definition of "reasonable"?

COMPETITION-BASED PRICING

Competition-based pricing determines prices based on those of a club's competitors. The club owner must then choose to skim (set prices slightly higher to attract the cream of the crop), be neutral (set them the same as the competition, essentially making both gyms equal commodities) or penetrate (set the price lower in hopes of gaining a larger share of the market). While each of these competition-based methods has their unique drawbacks, the biggest mistake in using competition-based pricing is the faulty assumption that the competition knows how to set a price!

SWAG (Scientific Wild-A__ Guess)

SWAG marries these two other methods, adding or subtracting a few dollars here or there to arrive at the best estimate of what to charge. Of course, there is an inherent danger in basing the success or failure of a company on a hunch.

I've been guilty of all three, and my profit line showed it. While I managed to remain profitable, it wasn't until I learned another method of pricing that my business really started to provide the kind of return-on-investment for which I had hoped.

So, what is the magic formula for setting prices?

Here is the bad news: there isn't one.

Pricing is an art, as much as it is a science. Therefore, it is more useful to think of pricing as a part of the overall strategy to market and brand the gym than a formula.

And the good news is that this method is called value-based pricing.

Value-based pricing is about creating a set of strategies that maximize profits. It is pricing through marketing and branding so that customers understand the perceived value of the product or service and, therefore, are willing to spend more than what they might have initially spent. This method helps craft a story that communicates to customers the value of the gym club.

So, how does one begin value-based pricing?

John Gourville, a Harvard professor who writes about pricing, suggests the first question a business owner should ask when considering pricing is: "How much would a rational customer pay for the product or service, assuming the customer had a perfect understanding of what the product or service was worth?"

The answer to the question depends on how the owner is marketing what the club is doing. A birthday party provides a good illustration of this point.

How much is a parent willing to pay to have his/her child's party at the gym? That will give the X price.

How much is a parent willing to pay to avoid entertaining 25 4-year-olds and their parents in his/her home, plus avoiding scraping purple frosting off the carpet after everyone leaves? That will provide the X plus Y price.

How much is a parent willing to pay to create a precious childhood memory for his/her child and everyone gathered to celebrate the child's

The $trategy of Pri¢ing *(cont.)*

one and only fourth birthday? (Oh, and don't forget that the club will do all the work for the parents so they will get to visit with their guests, take pictures and enjoy the moment. Plus, their house will be spotless when it's over.) That will determine the X times Y price!

Value-based pricing, when done well, will not only make the club more money but also will have the club's customers happier about paying it.

Don't just take my word for it. A survey of more than 200 companies found that companies developing and executing a value-based pricing strategy earned 31 percent higher operating income than competitors who used the cost-plus or competition-based model. That's the "more money" part.

So, what about the happy part? Why in the world would someone be happy to spend more money on a product or a service?

Because people buy things for two reasons: to solve a problem and to create a feeling. In the birthday party scenario, the first two party pitches solved a problem (a place to have the party; not having to do the work of entertaining and cleaning), but the third created a feeling (a lifetime memory for a beloved child and his/her community on his/her one and only fourth birthday). While the first party might be less expensive and the second more expedient, neither one creates the same feeling or tells the same story as the third party option.

The story itself is an illustration and doesn't represent a sound value-based pricing strategy. The value has to be based on real features and ideas that the product delivers. The features of the product or service need to appeal to the people available to purchase it. So, in addition to Gourville's question, some of the considerations of value-based pricing are listed below.

What are your customer segments and what do they value?

Not all customer segments value the same things. For instance, the parent of a high-level competitive gymnast will value an Olympic-caliber coach, foam pits and championship banners. A parent of a 2-year-old sees little value in those characteristics, but places value on a bright clean gym with friendly coaches and lots of toddler-sized equipment. Part of the club owner's job is to decipher the qualities that matter most to his/her various customer segments and market to those desires.

What are your customers' alternatives?

Are there other gymnastics schools in town? Are they similar to the club? If so, the club owner needs to find ways to differentiate his/her club from the competition and communicate those differences to potential customers. Are there other activities that cut into the market share? Remember, the gym down the street isn't the only competition. Soccer, ballet, ice skating and art classes are also competition. Do the marketing materials and information effectively communicate why gymnastics is a terrific sport?

Compare the gym club's characteristics relative to the competition in areas such as brand, convenience, quality, attributes, service and style.

Figuring out where the club lands in these areas versus the competition will give insight into how to position pricing.

What is the gym's "story"?

The gym's mission, vision, philosophy and core objectives form its story. How effectively that story is communicated to existing and potential clients will shape the club's ability to charge higher prices.

Pricing is not as easy as plugging numbers into a formula. A club's ideal price is based on its market, the segment or segments that it attracts, the perceived value of its products and services, the quality it delivers, what its competitors charge, and its tolerance for risk, as well as many other variables.

No matter what the market is, moving the club's pricing strategy toward value-based pricing will strengthen the bottom line while helping design the club's marketing tactics around what "makes" the gym and its offerings unique.