

Two Basic Approaches to Pricing Strategy By Michael Uhrich

One of the most important decisions for the long-run viability of your cider company, or any company for that matter, is your pricing strategy. Many companies treat pricing as an afterthought, defaulting to whatever the rest of the market is doing. Don't make this mistake. Your price affects your revenue and profit, and it's an easy, objective point of comparison between your brand and others, so getting your pricing strategy right is a top priority.

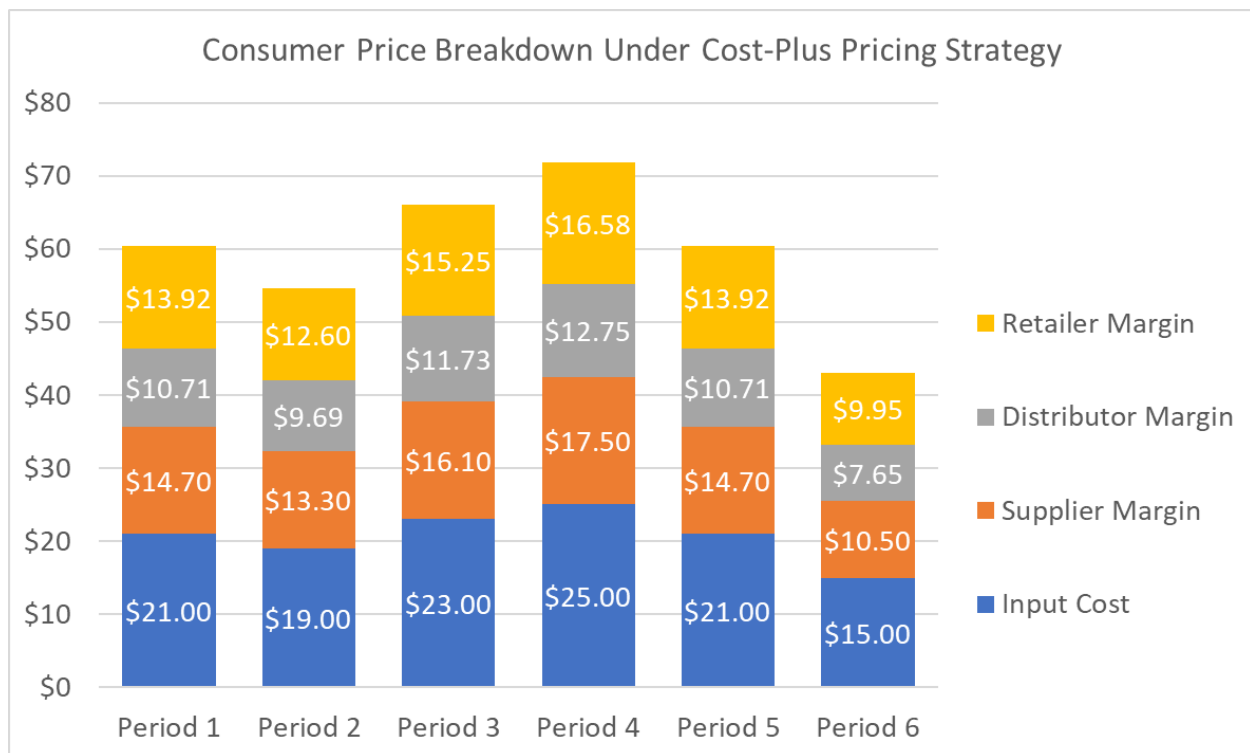
There are many different types of pricing strategy, but most of them boil down to two basic approaches: Cost-Plus and Value-Based.

Cost-Plus Pricing Strategy

A cost-plus strategy is just what it sounds like - you start with your cost to produce a product, including both variable and fixed costs or overhead, and you charge a little bit more than that. The extra bit becomes your profit or margin.

$$\text{Price} = \text{Average Fixed Cost} + \text{Average Variable Cost} + \text{Margin}$$

The margin component is sometimes set either arbitrarily at some percentage or by the market (i.e., the market price per case is X, my total cost per case Y, so profit is X minus Y), but it can be set at a particular level for any reason. Under the cost-plus pricing strategy, you can increase your short-run average margin per case by producing and selling more cases. This reduces your short-run average fixed cost per case, but growth opportunity is limited by your physical capacity and market demand at your current prices.



A cost-plus strategy is relatively easy to apply, and it will always lead to setting a price that allows for profitable sales, assuming that any sales can be made at the price that you set. Unfortunately, that assumption isn't always correct. If a new cider costs twice as much to produce, then you can't necessarily expect to pass all that extra cost straight on to the drinker. Just because it costs more to make doesn't necessarily mean that the finished product is worth that much more to the people you want to sell it to. Also, raising your price to consumer could result in lower sales volume.

If, for example, you grow and press your own apples and produce only a few brands of cider whose input costs are largely similar, then a cost-plus pricing strategy may work very well for you. However, if your input costs are highly variable over time and/or across products, then you might want to consider using a value-based pricing strategy.

Value-Based Pricing Strategy

A value-based strategy is one that largely ignores input costs and instead determines pricing based on a product's value to the buyer. It essentially assumes you should price your cider at the amount your drinkers are willing to pay, and you should charge that price consistently over time, regardless of fluctuations in your input costs, assuming your cider is generally profitable on average over the long-term (or that it accomplishes your other goals - more on that below).

Price = Product Value + Service Value + Intangible Value

The product value component is the value drinkers receive from the product itself. Is the cider good, or is it great? Does it satisfy the drinker's desire for a delicious and unique drinking experience? All cider is good cider, but there's no shame in admitting that ciders are not all created equal and that some consumers may be willing to pay more or less for the experience of drinking one vs. another.

The service value component is the value derived from services that come along with the cider. That may include the responsible service and helpful recommendations made by your bartenders and waitstaff. It may include the clean and comfortable atmosphere at your local grocery store. It may include delivery service. These aspects of a cider's value are often ignored in setting its price. They shouldn't be ignored, however, because there are often things you can do to enhance your cider's service value, thus increasing the price your drinkers will be willing to pay. For example, you may consider whether you can increase the service value of your cider by targeting only upscale accounts where you know your drinkers will have the best experience.

The intangible component isn't about the product itself or the services around it – it's about how the customer feels. Is this a brand that resonates with me? Is it local? Do they share my values? Is the business minority owned? It's important to remember that when a customer buys your cider they aren't buying *only* your cider – they're buying you. They're buying an idea. An image. A feeling. And all of these things have value that's worth money.

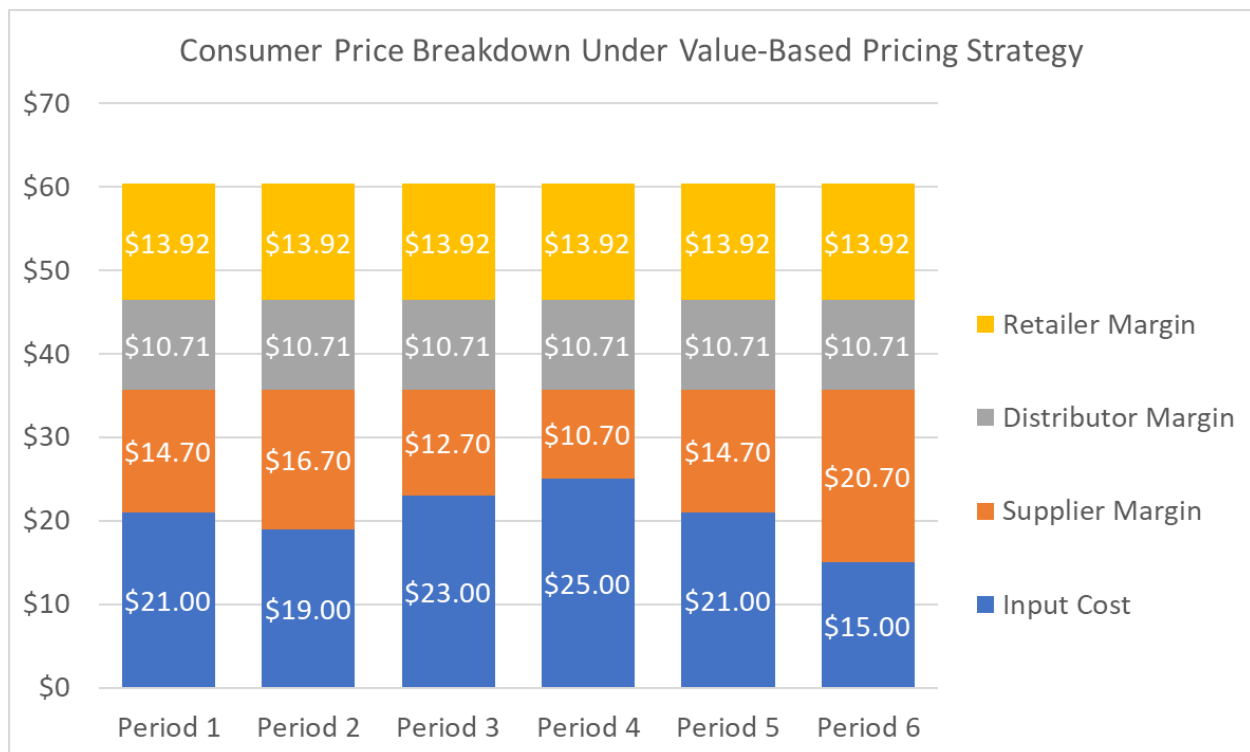
The three components of a value-based cider price will be different for different cider makers, reflecting differences among business models. Your unique business model can help you understand how to increase your profits. For example, if you increase your cider's intangible

value by highlighting your local appeal, you may be able to charge a premium over other ciders that are either less local or that don't play it up as much. Another cider maker may choose instead to focus on either the service value or the product value. Knowing your drinkers' and business partners' preferences should guide these choices, which will allow you to stand out from the crowd.

Another great thing about the value-based pricing strategy is that, if it's executed correctly, then your drinkers should be fairly well insulated against shifts in your pricing caused by input cost fluctuations. Drinkers develop expectations for the value that they will receive from a particular cider and how much they can expect to pay for it. If your cider's price fluctuates, as it might under a cost-plus strategy, it might confuse your drinkers or give them an impression that your cider may not hold the value it once did.

Another useful outcome of consistent consumer pricing is steady, predictable margins for your distributor and retailer partners. Distributors and retailers carry many brands, most of whose prices fluctuate constantly. Offering a consistent price allows your partners to more reliably predict their costs and revenues, thus making you a better supplier partner to work with.

Value-based pricing strategies are generally a little more complicated to execute than cost-plus strategies. You should be able to estimate your average cost in producing your cider based on the input prices offered by your suppliers, but those prices may fluctuate. Under value-based pricing you bear the risk of those changes - not your partners and not your drinkers. Also, you may need to do some research to determine what your cider itself, its surrounding services, and its intangible benefits are all worth to the drinkers to whom you want to sell. Further, any required research to estimate the total consumer value of your product must come before it launches. Otherwise how would you know what to charge?



Now an important note about ignoring your input costs - in general, you should look to launch only products for which the total consumer value exceeds your long-run average cost, allowing for some fluctuation - the more value per cost the better. If your market research shows that drinkers aren't willing to pay at least as much as you would need to charge to make a product profitable on average, then in most cases you probably shouldn't even try to sell it. That said, many suppliers intentionally choose to produce a less profitable or even unprofitable line of higher-end products as a means of increasing the intangible value of their umbrella brand, which often includes more mainstream offerings. This type of "halo effect" can be difficult to pull off, however, so proceed with caution.

No one pricing strategy is right for every cidery. What's most important is to do the work, select the pricing strategy that you think will be best for your business, and try it out. If it doesn't work, then change it, but whatever you do, don't leave it up to others to determine what your hard work is worth.

Incidentally, two important factors in determining whether a cost-plus or value-based pricing strategy is right for your cidery are price elasticity and input cost variation. But I'll save that for my next post ;)

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