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trafoon

Traditional Food Network to improve the transfer of knowledge for innovation

Costing and Pricing: how much would it cost your innovation?

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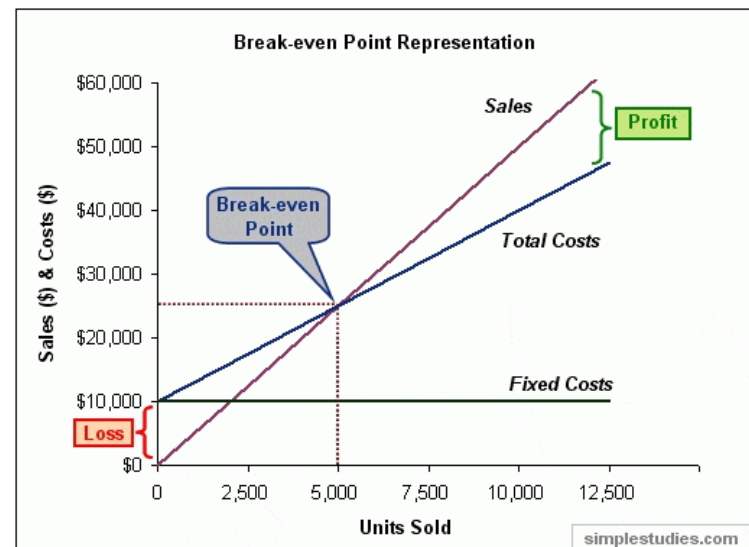
Why is pricing (and costing) important

Two widely used concepts derived from marketing and accounting easily explain the importance of pricing and costing

The concept of Marketing's 4 Ps



The break-even point concept



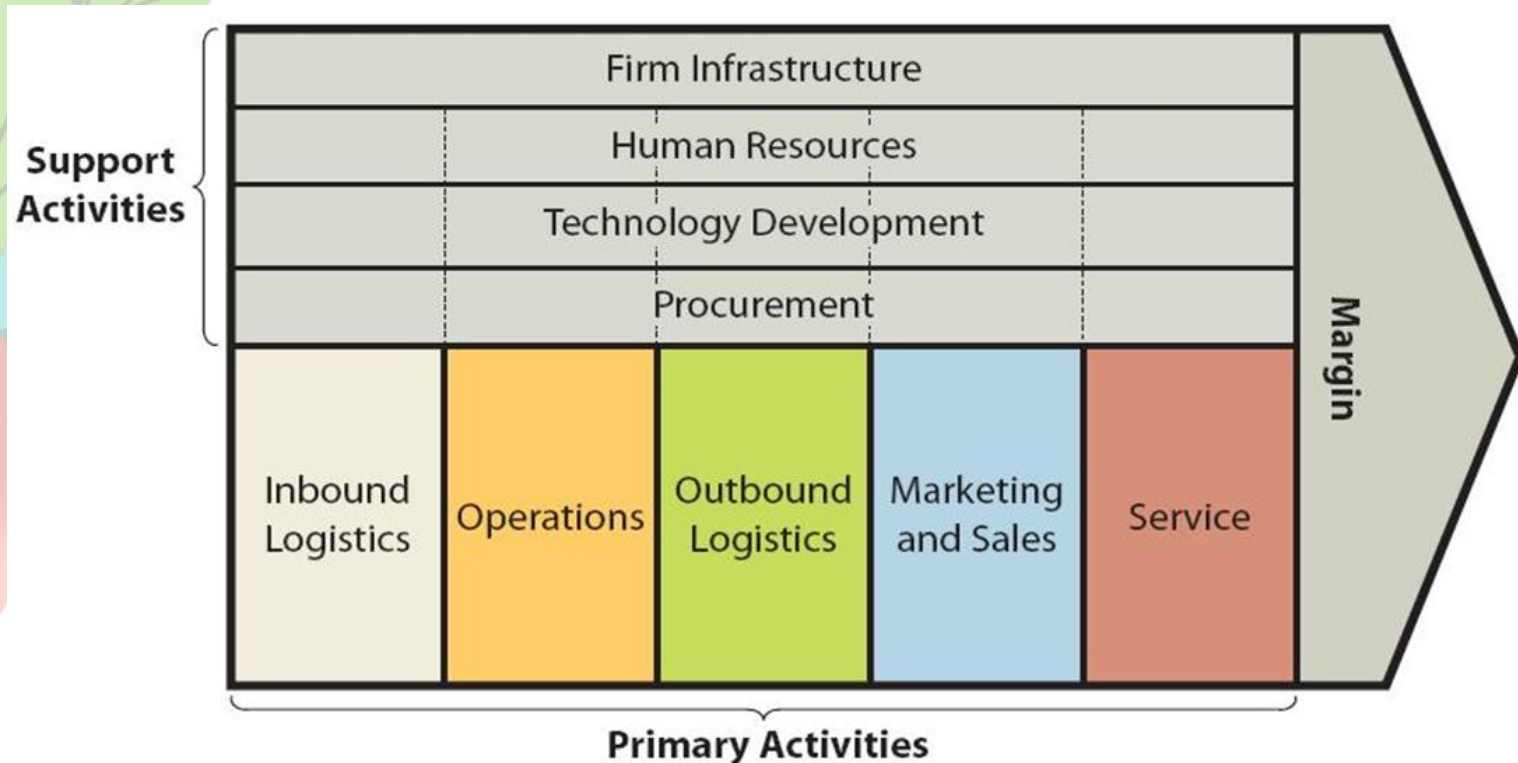
Costing – Business model and value chain

- A business model describes the rationale of how an organization creates, delivers, and captures value

Key partnerships Some activities are outsourced and some resources are acquired outside the enterprise.	Key activities ...by performing a number of Key Activities	Value propositions It seeks to solve customer problems and satisfy customer needs with value propositions	Customer relationships Customer relationships are established and maintained with each Customer Segment	Customer segments An organization serves one or several Customer Segments
	Key resources Key resources are the assets required to offer and deliver the previously described elements...		Channels Value propositions are delivered to customers through communication distribution, and sales Channels	
Cost structure The business model elements result in the cost structure			Revenue streams Revenue streams result from value propositions successfully offered to customers	

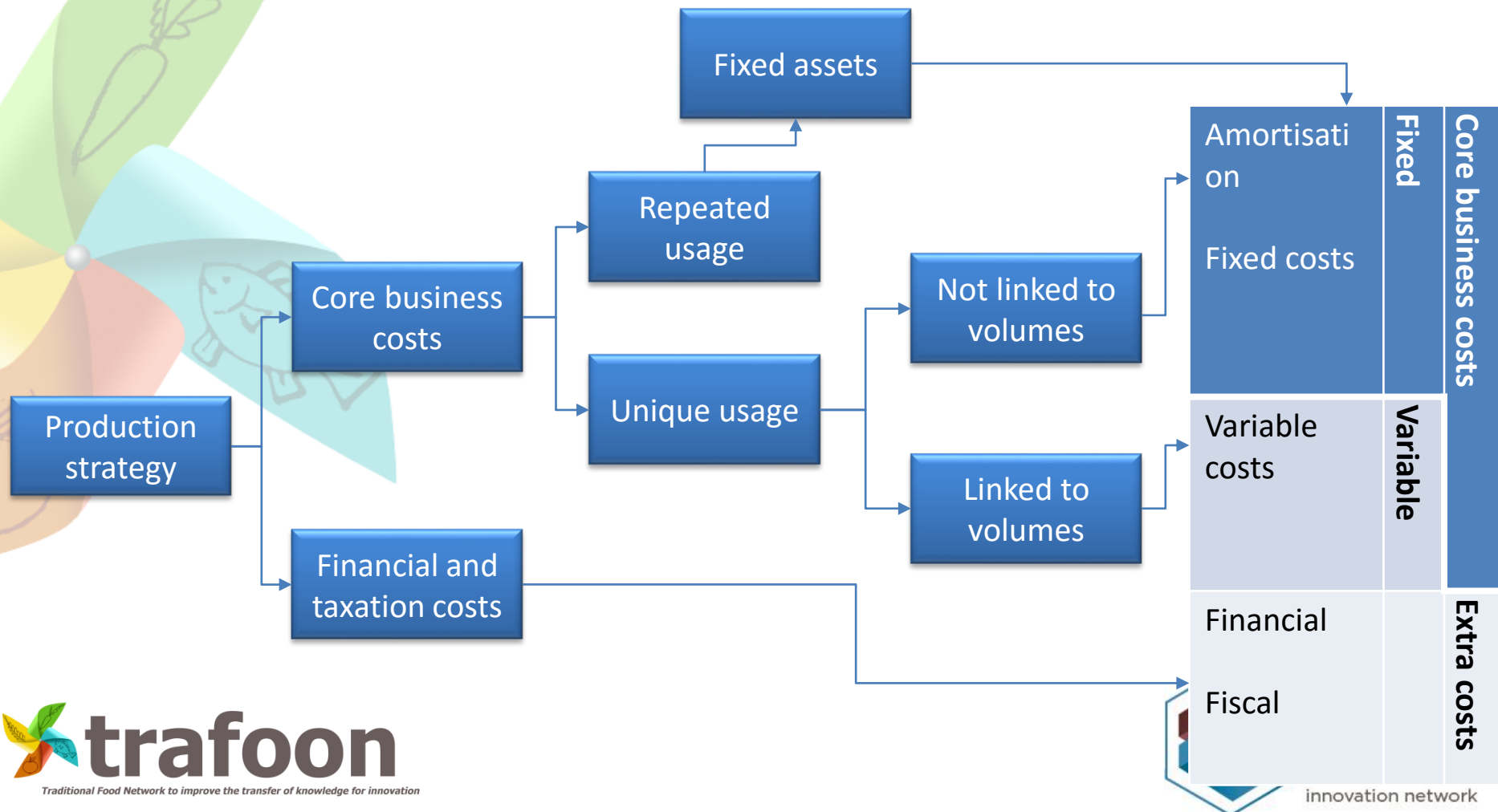
Costing – Business model and value chain

- Have you already thought about the value chain of your start up?



Costing – Have I considered all the possible costs?

- The type of cost (fixed vs variable, direct vs indirect, ...) has potentially a relevant impact on total cost → total cost per Unit and its evolution



Costing – Have I considered all the possible costs?

- As you can see in the table below, economies of scale contribute to the reduction of total costs per unit and if well managed outsourcing can help the economic sustainability of a business by transforming costs from fixed to variable

Volumes produced	Fixed costs per unit	Variable costs per unit	Total costs per unit
600.000	1,9	3,00	4,91
800.000	1,43	3,00	4,43
1.000.000	1,14	3,00	4,14
1.200.000	0,95	3,00	3,95

Pricing – position your product

Porter's competitive strategies, though theoretical, help you reflect on how you want to position your product on the market and what you believe is your competitive advantage and value proposition

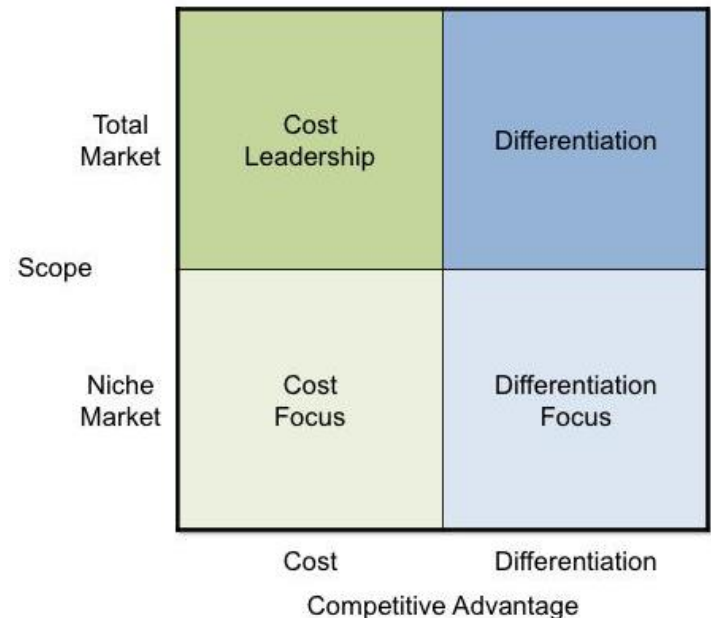
Is your product unique in the context?

Does it satisfy specific needs?

Does it substitute existing products (with better quality or lower price)?

Does it serve a niche or a mass?

Are you able to squeeze costs down to guarantee a profit?



Pricing – position your product

In order to position your product, you need to know the market you plan to compete in:

- **PRODUCT** – Who are your target customer? What needs does your product satisfy? How does your product satisfy such needs and how is it different from competing/substitute products?
- **PLACE** – Where do your customers look for products meeting their needs? How do you plan to sell your product? How do you plan to access your distribution channels? Do you need a sales force?
- **PROMOTION** – how do you plan to reach your customers? Do you foresee to advertise your product? Where and when?
- **PRICE** – is the customer sensitive to price? Is there a market price for your type of product? Do you plan to bundle your product with others? Are you foreseen a discount policy?

Pricing – cost driven or market driven?

Cost driven

Product → Costs → Price → Value → Client

Market driven

Client → Value → Price → Costs → Product

Pricing – cost driven or market driven?

Cost driven

Product → Costs → Price → Value → Client

Once you have calculated your total cost per unit (also meaning you have estimated the expected volumes sold)

- Define the target mark up per unit (or final profit)
- Add the mark up to the cost per unit

Pricing – cost driven or market driven?

Market driven (1/2)

Client → Value → Price → Costs → Product

- When the market is driving the pricing policy, the first step is represented by understanding and evaluating the perceived value to the client → market and statistical analysis (conjoint analysis, cluster analysis, ...)

What are the specific features that the client values most and that would determine his/her willingness to pay more?

What is the average elasticity to price of your cluster of customers?

Is the product perceived as a commodity?

Pricing – cost driven or market driven?

Market driven (2/2)

Client → Value → Price → Costs → Product

Once the relevant features are identified and prioritized (price included), the target price can be defined

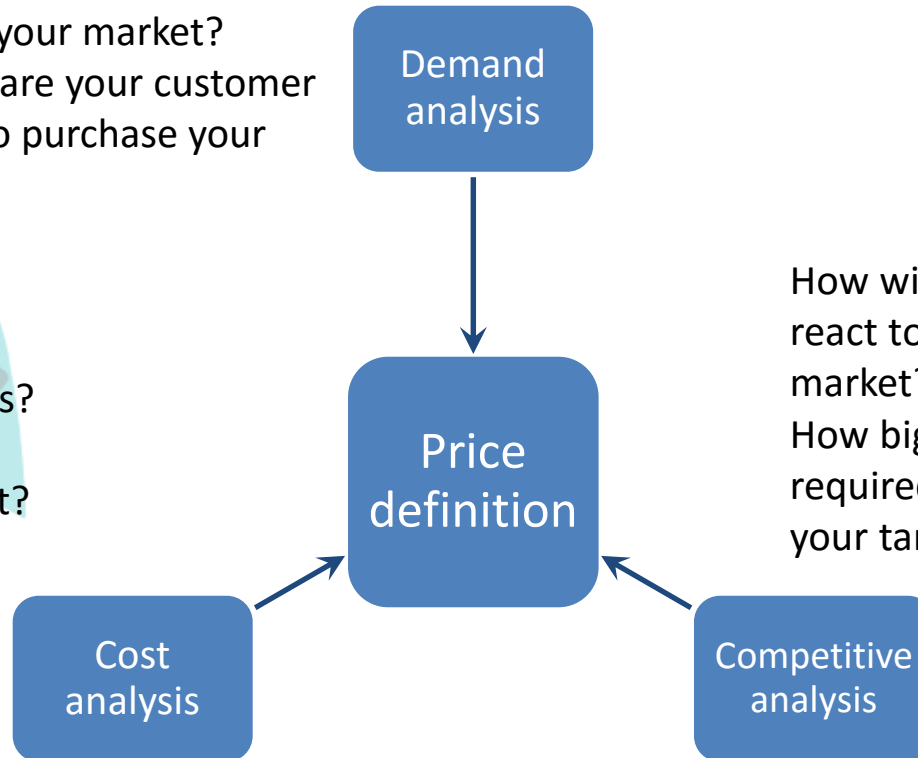
The key challenge is represented by the ability of the company to achieve the target costs that are a consequence of the identified target price in order to guarantee the expected profit

Pricing – cost driven or market driven?

Even if you plan to define your product price as a good balance between costs and market needs, you should consider the following in your price definition process

How big is your market?
How often are your customer expected to purchase your product?

How flexible are your costs?
Is your business capital intensive? Who will fund it?
Are there ways to reduce fixed and variable costs?
Is make or buy an option you can consider?



How will your competitors react to your entrance on the market?
How big of an effort is required to reach and attract your target customers?

Price wars and differentiation strategies

Price war – Commercial competition characterized by the repeated cutting of prices below those of competitors

Price wars are (and have been) a wide spread strategy used in almost every industry to increase market shares

Sometimes price wars are driven by key players who are downstream in the value chain (typically retailers)

To start or participate in a price war you need to make sure that:

- Your cost structure is the most flexible and effective in the whole market and price reduction will not lead you to bankruptcy
- Your competitors don't have such a big margin that will allow them to successfully follow your price reduction
- You are ready to face the consequences of commoditization

Price wars and differentiation strategies

One of the alternatives to price wars is differentiation of the product or segmentation of the market

You avoid competing on price by:

- focusing on one or more key features that the target customers perceives as valuables (brand is a typical feature in food and fashion), differentiating your product from that of competitors
- Segmenting the market in sub-segments (e.g., premium vs mass) offering to the identified segments different products, characterized by different features and price → this strategy is feasible if the company has the possibility to produce at substantially different costs per unit

IF YOU HAVE ANY QUESTION



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