Pricing decisions are among the most difficult marketing-related decisions for a greenhouse company. The greenhouse manager must determine and set prices that not only cover their total costs and make a profit, but are also set at a level that will stimulate demand/sales and capture the full willingness-to-pay attitude on the part of customers.

In addition, price is also correlated to the firm’s positioning within the marketplace. For example, a high-priced product relative to the competition has a connotation of higher quality and is consistent with products that have special value-adding benefits and/or services.

In this article, traditional issues affecting pricing are discussed, followed by a discussion of how perceived value plays into the purchasing behavior of potential customers. It is targeted mainly toward growers that both grow and retail plants, but the principles apply to growers that have wholesale-only operations as well.

### Issues Affecting Price

#### Costs
The fixed and variable costs of producing greenhouse crops are usually considered as the major factors affecting their selling price. These costs for growers are often made up of the following:

- Raw materials needed to produce the crops (plugs, liners, or cuttings; media; containers; fertilizers; etc.)
- Production requirements (labor for cultural practices and operating costs of equipment)
- Distribution costs (pulling orders, loading trucks, and distributing the crops)
- Marketing to and servicing customers

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• Overhead items that cannot be attributed to any one particular crop (depreciation, interest, repairs and maintenance, taxes, and insurance)

The total of these costs acts as a price floor for the grower in terms of negotiating final price. That is, a grower should be pricing in such a way as to cover all (fixed and variable) costs per plant. One very short-term strategy that some growers implement is referred to as a marginal pricing strategy: a price is charged that is high enough to cover variable costs and makes some contribution to overhead (but does not cover all of it). In the long run, however, the grower must cover ALL costs to maintain profitability. Unfortunately, too many growers do not have a full and accurate accounting of true overhead costs, so they end up “living off of depreciation,” which is a recipe for disaster in times like these!

Competition

Changes in the competition’s price structure often promulgate reactive pricing strategies on the part of growers. However, growers should be cautioned to never overreact to changes in competitors’ pricing. To some degree, competitive price information enables growers to roughly gauge overall market supply and demand conditions and provides a yardstick with which to measure their own pricing decisions. But growers should actively study their business position in the marketplace to determine the price of their product relative to that of their competitors’ at various times of the year. It is not necessarily a bad thing to be the highest priced competitor in a region – it is a function of the real/perceived value that customers derive from doing business with you (your unique selling proposition).

Product Type

In general, products fall into two broad product classifications: differentiated and standardized (commodity). Floriculture crops are no exception. Many times when a product is first introduced, it is new, exciting, and differentiated. But once competitors start selling that product in volume, it becomes standardized— a commodity item—with no real, meaningful differences. The following demonstrates how product classification affects pricing strategies:

• Differentiated/unique products. Price is not as important in determining purchase behavior. Customer demand is driven by the perceived value of the product’s attributes (features and benefits).

• Standardized products. With standardized commodity products, the customer has many choices among competing products so much of the competitive dynamics tend to focus in on other attributes such as price.

The importance of customer service (versus price) will be a function of the product. If purchase does not require a great deal of knowledge or education, price will be far more important than customer service. However, if the product is new, requires a great deal of education, represents an important purchase decision on the part of the customer, involves the ego or status of the customer, or if the customer is aware of the magnitude of making a wrong purchase, then service will most likely play a more important role in the customer’s decision.

Product Category Life Cycle

Most products go through a product life cycle, so understanding where your product is in its life cycle will help predict the competitive pricing environment.

Introductory stage. Typically, during the introduction of a new plant or product category, a firm has few competitors and enjoys the freedom to set prices based primarily on estimated supply and demand for the product. There are multiple pricing strategies available during this period. The two major ones are at opposite ends of the decision-making spectrum.

• Premium Pricing (Skimming) Policy. If the product is unique and has little competition initially, the pricing choice can be one of maximizing profit per unit sold. The strategy involves selling to a narrow group of customers who are willing to pay more because of unique product attributes. Premium pricing also allows for maximizing short-run profit margins and a potentially quicker payback on the research and development of the new product.

• Expanded Market (Penetration) Pricing. If one of the firm’s marketing strategies is to build market share, then setting a slightly lower price will potentially achieve this more quickly than higher prices. But bear in mind that price-sensitive customers seldom make loyal customers; they are quick to jump ship when the next lower price comes their way.

Growth stage. In this stage, the market is still growing with new users purchasing the product for the first time and the product becoming universally accepted by the public. While competition is focused primarily on product attributes, pricing variations are introduced during this phase, along with diversification of the product. Discounters try to steal market share and obtain an even broader customer base by making the product or service more affordable. Higher priced, higher quality-positioned products are still viable but must emphasize their unique selling proposition (how they are differentiated from other products) in this stage.

Maturity stage. In this stage, price becomes more important for products that have become standardized (commodities) with fewer product innovations and discernible differences. If at all possible, you should attempt to continually improve your product portfolio and service offerings for the customer, providing benefits (new levels of quality, value, service, convenience, or selection) that differentiate your product from the competition.

Price Elasticity

Economists characterize demand with a concept called price elasticity – a measure of how sensitive consumption (demand) is to price levels. A product with a price that is considered inelastic is one for which the demand will remain relatively stable when the price is raised or lowered. Usually this is because there are no or few substitute products, the product is a luxury good, it has a loyal following, or it possesses superior product attributes.

Of course, the opposite is true for products with an elastic demand – by lowering the price, gross margin (selling price minus cost of goods sold) is less, but volume increases. As
long as price is not lowered below break-even levels, the increase in volume will offset the reduced gross margin and profitability will be enhanced. This is, of course, the “Wal-Mart” model and works for commodity-type products only. There are FEW growers in the green industry that have the economies of scale necessary to exercise this pricing strategy. Most who attempt it do so unsuccessfully because they usually either unknowingly lower the price below their break-even (because they do not know their true cost structure) or they find themselves caught in a situation of having made idiosyncratic investments to service large (e.g., box store) customers and must continue their course to pay the interest on that investment.

Price elasticity is also correlated with the total revenue for the business. For example, raising the price of a product will usually have two effects: (1) more revenue is generated per unit sold and (2) fewer units are sold. To increase total revenue for the firm, we must decide which of the two effects is greater. When demand is inelastic, total revenue is more influenced by the higher price and increases as price increases. When demand is elastic, total revenue is more influenced by the lower quantity and decreases as price increases.

What this effectively means is that when demand is inelastic, green industry firms can actually raise their prices, and though they might sell fewer units of the product or service they are offering, total revenue for the firm still goes up. So, the obvious question is this: How does one go about making their local demand more inelastic? The answer...by making the firm unique and different somehow in terms of quality, value, service, convenience, and/or selection! That’s why your marketing efforts are so important. They are the key to successful differentiation.

Let me repeat this important concept – if your company is successful in differentiating itself from competitors, you are essentially making your firm-level demand more inelastic within your respective trade area, and you can subsequently raise your prices and (even though you may sell fewer units) total firm revenue will still increase. Obviously, this is useful information in developing your pricing objectives and strategies.

Behavioral Aspects of Pricing

Another less researched (and less discussed) aspect of pricing includes the behavioral dimensions of why customers buy the products they do and from whom they buy them. In other words, what drives their underlying purchasing behavior? The traditional economic approach to product pricing is driven by a small handful of factors, as shown in Figure 1. One of these factors is the “objective value” the product delivers to the customer, which is a measure of the sum of all benefits that the product delivers to the customer, regardless of whether the customer actually recognizes those benefits (most don’t, by the way).

A second factor in the economic approach to pricing is the “perceived value” of the product to a customer. Perceived value is the value the customer understands the product to deliver. Sometimes, a product’s benefits are readily apparent to the customer and “perceived value” approaches “objective value” with little effort by the firm. Other times, a product’s benefits are less obvious and need to be communicated (or signaled) by the firm to the customer (via advertising and promotional efforts). In such cases, the “perceived value” of a product typically falls below its “objective value.” The perceived value of a product also can be influenced by the price of competing products or “substitutes.”

The last major component to the economic approach to pricing involves the firm’s cost of goods sold (COGS), as discussed earlier. Just as the customer requires an incentive to purchase a product, the firm requires an incentive to sell the product. To stay in business and make a positive return, a firm must charge a price that covers its total costs of production. All of these economic factors come together to form the “value pricing” approach to pricing.

In optimally pricing a product, a firm is bound at the upper end by the customer’s “perceived value” for the product. As implied earlier, this “perceived value” is influenced by the “objective value” of the product to the customer, by the firm’s marketing effort to communicate that objective value, and by the price of substitute products.

At the same time, the firm is bound on the lower end by its COGS. By pricing above COGS and below perceived value, the firm has an incentive to sell the product, measured as [price minus COGS], and the customer has an incentive to purchase the product, measured as [perceived value minus price]. In value pricing terminology, the firm has “created” value by offering a product that the customer values at a price greater than the firm’s COGS. In turn, by pricing between perceived value and COGS, the firm has “captured” some of that value for itself and has allowed customers to capture the remainder.

This “value pricing” framework provides a basic model of how an economically rational customer should respond to a firm’s pricing of a product. A rational customer should purchase a product as long as the “perceived value” of that product is greater than the actual price being charged. In addition, the more one’s perceived value exceeds actual price, the greater should be a customer’s incentive to buy.

The great difficulty is that the drivers of customer value are inherently multidimensional and becoming more

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complex all the time (Figure 2), particularly in the face of an economic downturn. Traditional classifications of value (largely based on demographics) are increasingly inadequate to accurately predict whether and to what degree new initiatives in marketing, merchandising, and services will succeed in generating the desired customer response (purchase).

Negotiating Consumer Values

It used to be that “value” was mostly a function of quality, service, convenience, and selection as compared to price. Now other dimensions play an important role in purchasing behavior (and therefore pricing strategies), such as the customer buying experience, how “green” or socially responsible the company is, how ethical the business practices of the firm are, and perhaps even the political posturing of the firm.

Another dimension of value-driven behavior pricing involves how important the product is in affecting the esteem or status of the customer (does it help fulfill higher-order human needs such as self actualization?). Much attention has been placed on recent research that points to the long-term health and emotional benefits of floriculture products, which means we should have a competitive advantage in terms of premium pricing strategies!

Lastly, the nature of the customer’s shopping occasion also influences purchasing behavior. In other words, it matters whether the customer is merely looking for the closest place to buy (convenience), whether they are simply replacing/refilling items they have purchased before (replenishment), or whether they are in the discovery phase of their buying decision. It also matters whether they view the products they are buying as a means of self-expression and/or providing a solution to a particular need they have. Again, floriculture products fit the bill here as well.

At this point, you may be asking yourself “Why do I need to know so much about what customer’s value? Can’t I simply grow a high quality product that is what the customer really wants?” My answer to that is simple: “If you always do what you’ve always done, you’ll always get what you’ve always gotten!” And from what I have witnessed in the last year of economic downturn, that’s not a viable alternative for many. It’s no longer a matter of just providing quality. Quality gets your “foot in the door” and the other aforementioned aspects “seal the deal.”

In my mind, growers/retailers need to do two things: (1) develop better customer insights by exploring the depth of appreciation that customers have of their current value proposition, and (2) work toward enhancing their perceived value proposition based on gaps or deficiencies that are found. In other words, what is it that your (current and potential) customers really value? And if you’re not providing it, what do you need to do to deliver the value they are seeking? Answer those questions and you’ll more than likely be in the 70 percent of those left in the industry at the end of this economic shakeout period.

Dr. Hall will be discussing these behavior pricing concepts in more detail at the upcoming Southeast Greenhouse Growers Conference, June 18-20, 2009, at the Carolina First Center in Greenville, South Carolina.

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