

Beat: Business

Why undercutting doesn't work for most entrepreneurs- Don't be afraid to pri

Entrepreneurs undercutting

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USPA NEWS - Special editorial piece for entrepreneurs- Why undercutting is not a viable business strategy in most cases.

I've been an entrepreneur for a long time, and I've played around with a lot of different business models. I've tried different pricing strategies and have seen a wide breadth of what's out there in terms of pricing models.

So say you've got a new product or service and you're about to soft launch and test the market. Now one of the main things you're testing, other than product market fit, is pricing. Because if the price isn't right, then the customers is not going to buy even if they like your product. So you need to competitively price your product or service and there's a huge urge to simply undercut everybody in the market. Why is there this temptation?

Well basically you've got a lot of competitors who are pricing within a specific range, say you've got 10 competitors and the range of prices is \$5 to \$10 for the product and they're making money with a healthy positive profit margin per sale. So now you come in and you decide to undercut everybody in order to capture the entire market, or maybe not capture the entire market but cut out a market share for yourself as a new market entrant by pricing at say \$3.

Assume that you're still maintaining a profit margin that's positive and not break even, say 50 cents per product. You're hoping that every 50 cent sale will eventually make up for itself through sheer quantity by outselling your competitors who are making larger margins and theoretically, in your estimations, fewer sales.

But what's the problem here? Well there are many problems, but I'll spend this time pointing out of the main ones.

What you've done is that you actually haven't undercut anybody. You've actually just put yourself into a lower bracket of quality. What does mean? It means that you have products in the \$5 to \$10 range, and consumers there expect a certain level of quality from these products for that price. Now there's another bracket of products below that, one that you didn't anticipate, that sells products for \$1 to \$4.99.

Now you've just entered a new territory. You see, consumer behavior is interesting because it's oftentimes unpredictable (ask any economist). Now even though you personally know that your product is of higher quality deserving to be in the higher bracket your customers don't. It's difficult to convince to a customer that you're selling at a lower profit margin in order to compete with your customers.

It's a hard sell. Customers don't buy into these pricing models and strategies. They buy into simple price and quality correlations. They buy into what they can see with their own eyes.

So now you're "playing in the mud" with other undercutters that you've just taken yourself out of the higher quality bracket. You're playing with companies that are taking even smaller profit margins than you are and some are even selling at break even pricing in the hopes of an upsell. You might also encounter a startup or two that's selling at a subsidized price of negative profit per sale.

What's worse is that the clients and customers that you get as an undercutter are just horrendous. They complain a lot, they ask for more while giving less, and they're always late with payments. In fact many are still asking for even more discounts. Well hey, it's comes with the territory.

So don't be afraid to price higher.

While it's not always true in all cases, it is true in many cases that it can actually just put you in a higher bracket of quality.

For example, lets say you wanted to buy someone a novelty gift. Most novelty gifts are priced at around \$10 to \$20, approximately

because that's about the amount of pocket change you have when you're looking to get someone something of that nature. Novelty gifts are things such as a talking clock, a lava lamp, a cigarette lighter that shocks you, or a Chinese finger trap.

You see here, in this category of items, you get undercutters galore. For novelty gifts, how many do you see priced well below \$10? These are all companies that are fighting down to the last dollar for that customer that's extremely price sensitive.

At the same time, how many novelty gifts do you see above the \$20 mark? Not very many.

That's why I found the Beef Jerky Roses from The Manly Man Company to be a shocker. It's a novelty gift, a bouquet for roses that's made out of beef jerky and contains an entire pound of meat.

What surprised me about the Beef Jerky Roses is that it costs a whopping \$69 USD. This is considered expensive to the point where I'd call it a premium novelty gift. Now of course there are gifts out there that can cost a whole lot more in the hundreds or thousands, but this falls into the range of middle class consumer gifts.

The surprise here is that it sells. And it's selling like hotcakes.

Now the company isn't shy about the price. In fact, the price tag is prominently displayed next to the product name. What they're doing here is portraying this as a high quality product. So now they're fighting against other products in that higher quality product bracket.

And the undercutters are left fighting the other undercutters.

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Editorial program service of General News Agency:

United Press Association, Inc.
3651 Lindell Road, Suite D168
Las Vegas, NV 89103, USA
(702) 943.0321 Local
(702) 943.0233 Facsimile
info@unitedpressassociation.org
info@gna24.com
www.gna24.com