

THE PRICE IS RIGHT OR IS IT?

Learning to price your products and services properly is the difference between profit and peril.

STORY BY TIFFANY HUTTON

Working out the best price to charge for your products or services can be one of the biggest challenges you face, particularly when starting out. Price too low, and you'll be out of business before you know it; price too high, and you're out of the market. Get your pricing just right, however, and you'll maximise your profits.

There's no magic formula that can help you to price perfectly, but there are several basic principles, and if you take the time to apply them, you can hit the sweet spot.

Selling yourself short

Underpricing is rife in small businesses, particularly service businesses with low overheads. The logic goes that if you can afford to charge less, you should.

Stephen Craft, who runs a specialist financial copywriting business, learnt this the hard way. Despite writing about finance for a living, he made the same pricing mistake as many other small businesses:

"When I first ran my own business, I set my rates by looking at similar small businesses," he says. "I had lower overheads, so I figured that I could undercut them and still come out ahead. Later, I went to work in-house for one of my largest clients. Then I discovered what they were really willing to pay for what I did — and it was a lot more than I'd been charging.

"It turned out that my competitors were not who I thought they were [other small businesses]. My client had been comparing me to big companies with high overheads and heavy workloads. For my client, the big attraction of my business was speed and responsiveness. Not price."

Apples vs oranges

The key point here is to know what you're really selling. Is it your product or service? Or is it something else, like convenience, speed or reliability? In other

words, what is your unique selling proposition (USP)?

Quite simply, price is not always the most important factor for a customer. Once you understand your USP and your customer, you can charge accordingly. Value might mean improving your service, rather than charging lower prices.

You need to know how sensitive your market is generally to changes in price. Can you increase prices without losing business? Or can you drive extra sales with a small reduction in prices? Are you in a niche market where your customers are not particularly price-sensitive?

You also need to determine whether you're running a low-margin, high-turnover business or a high-margin, lower-turnover business. The former will be priced for sales, the latter for profit.

The numbers game

Once you've got a handle on your USP, and your market, it's time to look at the numbers.

First you need to know your costs. Your pricing may ultimately be determined by other factors discussed above, but your costs are a crucial benchmark. Your variable costs are the cost price of a product (or an hour's wages, for a service business). Your fixed costs include things like rent, wages, interest payments and all the other bills you have to pay. Don't forget to include the real costs of labour, such as leave, Super, and so on. And don't discount your own time.

Your break-even point is when revenues (the income from your sales) exactly cover your expenses (You can find details and equations in the November 2010 issue of *My Business* and more on page 63 of this issue). Everything over that is profit.

Profit margins

In the end, what you're after is profit. Depending on the type of business you're in, you should know

what's a realistic profit margin. So when you price your products or services, you add margin to your total cost (that's both fixed and variable costs) to give you the profit margin that you want. (Note that the margin is what you add to the cost; margin is a percentage of the selling price).

Table 1 (below) shows the mark-up you need to apply (as a percentage of cost price) to achieve your desired margin.

Of course, you can't just decide to aim for a 50 percent profit margin. Whatever profit margin you're aiming for, you need to know what it will take it.

Margin % of selling price	Mark-up % of cost price
5	5.26
10	11.11
15	17.65
20	25.00
25	33.33
30	42.86
35	53.85
40	66.67
45	81.82
50	100.00

Table 1: The mark-up you need to apply (as a percentage of cost price) to achieve your desired margin.

Discounting: yay or nay?

In most cases, you can't just increase your prices on a whim. Likewise, you should think hard before discounting. There are going to be times for many businesses when discounting is appropriate — you may be happy to charge a lower hourly rate for a client who is going to pay a retainer or bring a lot of business, or you may discount to clear end-of-season stock. But be clear-headed — if you have to cut prices to win a customer, is this a customer you want?

If you're discounting to drive sales, you need to know how much your sales have to increase after a price cut for you to break even. Table 2 (right) can help with this.

A final word

In the end, your pricing decisions have to be your own. Don't be tempted to follow the pricing strategy of a competitor — no matter how similar they may appear, your business is unique, with its own cost structures and customer base, so it deserves its own pricing strategy. ■

Current gross profit margin								
Price cut (%)	10	20	30	40	50	60	70	80
5	100.0	33.3	20.0	14.3	11.1	9.1	7.7	6.7
10		100.0	100.0	33.3	25.0	20.0	16.7	14.3
15		300.0	100.0	60.0	42.9	33.3	27.3	23.3
20			200.0	100.0	66.7	50.0	40.0	33.3
25			500.0	166.7	100.0	71.4	55.6	45.0
30				300.0	150.0	100.0	75.0	60.0
35				700.0	233.3	140.0	100.0	77.0
40					400.0	200.0	133.3	100.0
45					900.0	300.0	180.0	120.0
50						500.0	250.0	166.7

Table 2: Price discounts: Percent increase in sales to break even after a price cut

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