

Pricing YOUR PRODUCT OR SERVICE Right

Run the Numbers to Maximize Profitability
Before You Launch

By Andrew J. Birol, President,
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Pricing your products and services correctly is proof that your company understands its marketplace.

Twenty-five years ago, my finance professor gave our class a test called "How Much?" and asked us to compute the cost of an item one factory produced for another. I attacked my blue book ferociously, explaining my logic for costing and writing on for extra credit by giving alternatives. Sadly, I got a "C" because I did not give the one thing he asked, an actual cost for the item.

300 months and clients later, I will ask the same question of all of us. As business owners, do we get an "A," a "B," or a "C" when it comes to knowing how much our product or service costs?

TAKE THIS TEST

See how well you do. On a scale of 1–10, with 10 being the highest, circle your answers to the following questions.

I know my:

- Total direct labor and material costs.*
1 2 3 4 5 6 7 8 9 10
- Average or standard direct labor and materials by market segment; product family or major services.*
1 2 3 4 5 6 7 8 9 10
- Actual direct labor and material costs by individual customers, orders, services, or items.*
1 2 3 4 5 6 7 8 9 10
- Monthly fixed costs and break-even production level of goods or services.*
1 2 3 4 5 6 7 8 9 10
- Overhead expenses are fairly allocated to every sales order and proposal to maximize profitable sales.*
1 2 3 4 5 6 7 8 9 10
- Cost of finding, keeping, and growing a customer.*
1 2 3 4 5 6 7 8 9 10

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7. *Pricing, purchasing, staffing, and servicing decisions are based on real facts and current information instead of emotion and old data.*

1 2 3 4 5 6 7 8 9 10

Add up your answer to the seven questions and grade yourself.

60–70 SCORE

If you scored 60–70, give yourself an "A!" Congratulations, you have true costs, know how to apply them on an individual customer basis, and do so in growing your business. Now you can go on and really exploit your knowledge by:

- Reducing or increasing prices to increase your business with individual customers.
- Determining the product lines or services that have to be profitable on their own and the ones that can be loss leaders or impulse items.
- Focusing your staffing, materials, inventory, and purchasing departments on saving and making you more money where it matters most.

50–60 SCORE

If you scored 50–60, give yourself a "B." Yes, you have a costing system, and while it may not be correct on an individual basis, you do have some structure and discipline in your pricing and investment decisions. Now it is time to bring on a financial/marketing analyst to dig into the average numbers and start rooting out hidden opportunities in your business like:

- Creating a structure of product parents, grandparents, and children to bring order to what you make and sell.
- Assuring your break-even numbers are being used in establishing your monthly pricing.
- Driving your financial, materials, purchasing, and staffing functions to manage their costs for profits.

BELOW 50 SCORE

If you scored below 50, you get a "C" and need a wake up call. Your costs and your subsequent decision-making are flawed. Where you think you are making money, you may not and vice versa. Get started by:

- Making your business run by the numbers. Hire a plant accountant or business manager as soon as possible, and uncover your direct materials and labor costs to forecast your overhead.
- Developing a manual costing system before you invest in a CRM or ERP system. What doesn't work manually will not work when it is automated!
- Changing your peoples' thinking on this, or changing people. Regardless of whether your margins and prices are high or low, you cannot manage your business if your people are not managing its costs.

Imagine the day where you can confidently answer all your customers', sales reps', and inside staff's questions to maximize your business' profits. You will, only when you do know... How Much?

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Pricing Right

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FIVE RULES FOR PRICING

To ensure your business prices its products or services correctly, here are five rules to follow:

1. Never base prices on costs. Too often, business owners link their prices to their costs. What something costs a small business is rarely related to what the market will pay. Lawyers learned this lesson long ago. They pay less costly staff to complete routine work but still bill the client at the firm's standard prices.

2. Price products and services by their value to a customer. Remember that customers buy holes, not shovels. Restaurants do not price their meals by adding up the cost of food and service. Instead, they create an experience customers will pay more for. The better the experience, the more costly the restaurant. Therefore, price your product or service by what value your customer derives from their consumption.

3. Price your product to fully cover the cost of selling and servicing the customer. Too often, smaller business owners forget to include all the hours involved in developing proposals, creating trial orders or samples during the sale, as well as after-the-sale-service.

Your product's or services's price must reflect the total value of selling and servicing it. Manufacturers are most susceptible to providing product consultation and not charging for it. If your customers want commodity pricing, find better customers or make your consultative services an invaluable necessity.

4. Only compete on price when the customer and the opportunity are right. If a special opportunity offers your business a chance to pick up new skills, publicity, or economies, you can price more aggressively. But many customers are never worth the price they cost, particularly those that require (and don't value) additional services or extraordinary responses from your company.

5. Price your products and services differently to prospects, reordering customers and multi-buyers. When attracting new customers, create trial-size or simple, low-risk products and services designed to attract a skeptical buyer. Price these aggressively to close new business fast. Price re-orderable products and services for maximum profitability, as these are the backbone of your company's earnings. If you add customer value through more information, service, and simple reordering processes, customers will be

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Steps to Pricing on Value

By Andrew J. Birol, President, Birol Growth Consulting, Inc.

Proper pricing shows you are confident in what you do and what your product or service is worth. Do you want your pricing to stress your firm's conviction as much as your quality standards or guarantees? Since price and cost are not connected, and since growing margins are the best indicator of business health, here are three steps to help you price on value:

- 1. Quantify the value your customer derives from what you sell.** Have your customers define the contribution your product or service plays in their profits and growth. If you can't show any greater value between your offer and your competitors' offers, change what you sell or change your business. Price to the total value that your product or service provides.
- 2. Know your total cost of production, delivery, sales, and service.** If your cost is not well below No. 1, change what you sell or change the products or services you sell.
- 3. Consider any additional but real value you derive from special customers.** Consider tangible new skills, referrals, or access to more business you can develop through a target customer. If you can quantify actual savings or incremental revenue, you can factor this into your final price. **HBM**

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pleased and so will your accountant. New products and services sold to existing customers provide additional sales to your customer base and can be priced at levels in between those new sales to prospects and reorders to customers. Customers will pay more for your innovation and value than prospects, but your new offers won't be as profitable as your reorders until your experience in selling the new items grows.

Pricing your products and services correctly is proof that your company understands its marketplace. If your pricing doesn't lose you business or if your pricing leaves money on the table, you are winning the fight. **HBM**

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