SMALL BUSINESS SOLUTIONS

How to Competitively Price Your Product or Service

>>> Before any enterprise opens for business, it must have a clear understanding of how it is going to make money.

By Steven Bortnick

The price of a product or service is often dictated by competitive market forces or third-party insurance payers, as is the case in healthcare. Given this reality, every company must have a grounded expectation of what it will take to succeed. Product retailers or distributors must know the purchase cost and sales price of their products, the number of units they must sell in order to cover the sales and marketing and administrative costs. This is known as the "break even point"; the point at which the revenue received equals the costs associated with creating the revenue.

A "break even analysis" will give way to a volume vs. profit argument; should you set a higher sales price and aim for a higher gross profit per unit, or could you sell more units at a lower price and achieve the same overall gross profit? Take frozen yogurt stores for example; how many cups (ounces) of yogurt and toppings will the store have to sell in order to cover its payroll and rent?

For a service organization, pricing is based on a combination of factors. It is a calculation usually based on the payroll and benefit costs for those providing the service, plus overhead and administrative expenses vs. the concept of "value added" for the client.

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Most professional services are billed at an agreed upon rate multiplied by the hours spent on a project. You can also set a price in advance regardless of the amount of time it actually takes to complete the project. Or maybe you share in any costs savings achieved. Clients may accept fixed prices if they perceive value in the engagement, regardless of time spent. Each of these methods require the service company to have a good understanding of time and costs.

Knowing the timing of your cash flow is perhaps the most critical concept for any enterprise and especially so for a start up. Even if the selling price and volume are sufficient to cover all costs and generate a profit, if expenses and costs must be paid before the sales are collected, the business could fail. For example, a product distributor needs inventory on hand to make the sale. If the manufacturer requires payment in 60 days and it takes the distributor 30 days to sell the inventory, and another 45 days to collect from the customer, the distributor would have to pay for the goods, on average, 15 days before collecting all the money. Add in the need to pay employees and the landlord and any business could be out of money before it collects enough sales proceeds.

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About the Author:

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