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SMME Clinic
Masterclass

How to PRICE for PROFIT

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Clinic with Purpose
Putting you in control of your development

SMME CLINIC
Practical Business Remedies

OBJECTIVE

LEARN HOW TO PRICE FOR PROFIT THROUGH UNDERSTANDING THE IMPACT OF:

* PROFITABILITY
* DIRECT, VARIABLE COSTS
* MARGINS, MARKUPS & DISCOUNTS
* FINANCIAL FORECASTING
* BREAKEVEN SALES & VOLUMES
* REVENUE MODELS
* PRICING MODELS
* PRICE-POINT DETERMINATION
* VALUE PERCEPTION & APPLICATION
* PRICING SERVICE VALUE

Expert opinions……

“If price is all that your customers care about, it’s because you haven't given them anything else to care about.” — *Seth Godin*

“The single most important decision in evaluating a business is pricing power... If you’ve got the power to raise prices without losing business to a competitor, you’ve got a very good business. And if you have to have a prayer session before raising the price by 10 percent, then you’ve got a terrible business.”– *Warren Buffett*

PROFITABILITY & PRICING
The PROFIT & LOSS Statement

SALES
Cost of Sales
GROSS PROFIT
Overhead Expenses
OPERATING PROFIT
Interest
PROFIT BEFORE TAX
Tax
PROFIT AFTER TAX
Dividends
RETAINED PROFIT

Direct Costs
Indirect Costs

Variable Costs
Fixed Costs

MARK-UP
Gross Profit / Cost of Sales
x100%

GROSS MARGIN
Gross Profit / Sales
x100%

COST OF SALES
THE COSTS OF GENERATING SALES

OPENING STOCK + PURCHASES – CLOSING STOCK

Breakeven
Gross Profit = Overheads

MARGINS & DISCOUNTS

	Month	
REVENUE	170	Direct Costs Marked Up by 100%
DIRECT COSTS	100	Direct Variable Costs of Products/Services
GROSS PROFIT	70	Gross Margin 50%
INDIRECT COSTS	80	Fixed Expenses Overheads
PBT	(10)	Operating Profit

What is the effect of a 15% discount?

Answer
200 – 15% = 30
GP 100 – 30 = 70
GP has decreased by 30/100 = 30%
Result is an Operating LOSS (10)

DISCOUNTS SIGNAL INABILITY TO PROVIDE VALUE DIFFERENTIATION

BUSINESS TYPES & AVERAGE MARGINS

BUSINESS	GROSS MARGIN	MARK-UP	NET MARGIN
Manufacturing	40%+	66%	10%+
Reselling	25-40%+	33-66%	10%+
Retail Goods	50-80%+	100-400%	10%+
Retail Foods	30%+	43%	5%+
Wholesale FMCG	8-20%+	9-25%	<5%
Prof Services	40-90%+	66-900%	20%+
Building	20-30%	25-40%	5-10%
Transport	30%+	43%	10%+

FINANCIAL MODEL

SALES	
Segment 1	200
Segment 2	150
Segment 3	175
TOTAL SALES	**525**
COST of SALES	
Segment 1	100
Segment 2	100
Segment 3	100
TOTAL COS	**300**
GROSS PROFIT	**225**
EXPENSES	
Salaries	100
Rent	50
Other Fixed Costs	50
TOTAL EXPENSES	**200**
OPERATING PROFIT	**25**

MARK-UP MARGINS
S1 100 + 100% = 200
S2 100 + 50% = 150
S3 100 + 75% = 175

GROSS MARGINS
S1 200-100=100 / 200 = 50%
S2 150-100=50 / 150 = 33.3%
S3 175-100=75 / 175 = 43%
TOTAL 525-300=225 / 525 = 43%

OPERATING MARGIN
25 / 525 x 100 = 4.7%

PROCESS STEPS

1. CALCULATE OVERHEAD
2. ESTIMATE SALES REVENUE
3. CALCULATE MARK UP & GROSS MARGINS
4. ESTIMATE OPERATING PROFIT

INCOME STATEMENT	E.G.	
SALES	200	Direct Costs Marked Up by ?% (in this case 100%+)
COST OF SALES	100	Direct Variable Costs of Products
GROSS PROFIT	100	Gross Margin (GP/SALESX100%)
EXPENSES	80	Indirect Fixed & Variable Costs
OPERATING PROFIT	20	Profit before Tax

1. TRADING BREAKEVEN
GROSS PROFIT = OVERHEADS
E.G. GP 80 = EXPENSES 80
2. SALES BREAKEVEN
GROSS MARGIN = EXPENSES/ 'x'
E.G. 100/200 = 80/ 'x'
'x' = 160

BREAKEVEN

3. VOLUME BREAKEVEN

$$\frac{\text{FIXED COSTS}}{\text{SELLING PRICE/Unit} - \text{VARIABLE COST/Unit}}$$

EXAMPLE:
Selling Price: R15.00 per unit
Variable Cost: R10.00 per unit
Fixed Costs*: R2000
*Fixed Costs relates to Overhead Contribution

Breakeven: $\frac{R2000}{R15-R10}$

Breakeven VOLUME = 400 units

Breakeven VALUE = 400 x R15 = R6000

REVENUE MODELS

RETAIL
The process of selling goods and services directly to consumers for their personal use, typically in small quantities.

WHOLESALING
The sale of goods to business or institutional customers, typically in large quantities

BUSINESS to BUSINESS SERVICES
The sale of services to business or institutional customers, typically with terms and conditions

SUBSCRIPTION
Repeated transactions that are scheduled on a regular basis.

COMMISSION
A form of compensation where employees earn a percentage of the sales or transactions they generate.

PURPOSE:
Maximise Profit & Protect Cash Flow

RELEVANCE:
Cost of Sales: Opening Stock + Purchases – Closing Stock
Markup % Gross Margin %
Price Point Determination

Procurement Terms & Conditions

Licensing Agreements for Annuity Income

Remuneration structures & Incentives

PRICING MODELS

	When to use…
COST +	To achieve targeted GP% (products & services)
COMPETITIVE	Meeting Competitive Prices (mostly commodities)
SKIMMING	High initial price for early adopters who will pay a premium
PENETRATION	Low initial price to buy market share
VALUE BASED	Where value can be sold & perceived (always services)

“Pricing is the only element in the marketing mix that produces Revenue; all the other elements produce only costs” ***Phillip Kotler***

PRICE POINT DETERMINATION
Wholesale & Retail

A strategic price set for a product, reflecting its market position and targeted customer segment.

WHO PAYS?

If it's a Housewife – she's on a budget and likely to be very price conscious and aware of specials
***Feminine purchasing is driven by gathering, nurturing, total price discounts* & what products do**
***Masculine purchasing is driven by hunting, protecting, winning with specials* & how products work**

WHAT'S PAID?

Children & Pensioners pay from Allowances or Savings / Housewives pay from Budgets / Females pay from Cash reserves / Males pay on credit / Business pays on terms

HOW MUCH PAID?

Personal spending for large amounts benefit from choice / Personal spending small amounts benefit from .99cents psychological price marking (left-digit effect) / Discounts are used for special offers to clear stock / Premiums are paid for innovations that attract early adopters

HOW PAID?

Credit /Debit cards / EFT requires clearance / Debit Orders (Subs) / Scams prevalent in personal exchanges & some websites / Terms applicable for many businesses / Professional services in advance

WHAT IS PAID FOR?

Commodities on receipt and exchangeable / Services against Invoices / License fees for utility services / Annual v Monthly v other period related transactions

PRICE POINT DETERMINATION AIMS TO STIMULATE DEMAND & INFLUENCE BUYING DECISIONS

VALUE MUST BE **SOLD** TO BE PERCEIVED

PRICING STRATEGY

- Value-based
- Competitive
- Skimming
- Cost-plus
- Penetration

Products/Services B2C

Products/Services B2B

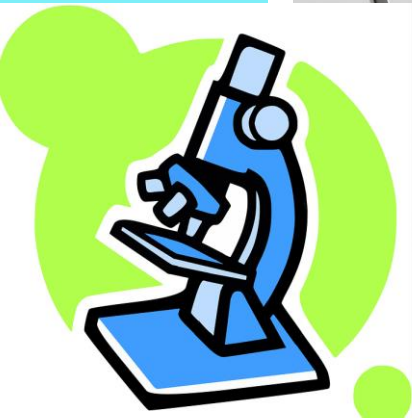
"Price is what you pay. Value is what you get." — ***Warren Buffett***

IS IN THE EYE OF THE BEHOLDER – NOT THE PRODUCER OR SELLER

HOW IS PRICING VALUE PERCEIVED?

ATTRIBUTE

Symbolism
Fitness
Risk
Quality
Profit
Differentiation
Simplicity
Brand



VALUE-BASED PRICING

Commodities

1. Calculate the direct variable costs of product/service inputs
2. CHECK COMPETITIVE PRICES
3. Mark-up for profit & breakeven volumes & *Ensure the value* (*comparative differentiation of* feature-benefits *dissection*) assures demand

Services

1. Check comparative competitive prices
2. Price for value that you can prove through USP

*"Nowadays people know the price of everything and the value of nothing." — **Oscar Wilde***

PRICING SERVICES

SERVICE QUALITY

1. **RELIABILITY** (USA 70% / RSA 40%)
2. **RESPONSIVENESS** (USA 20% RSA 40%)
3. **EMPATHY** (USA 2-5% RSA 10%)
4. **CREDIBILITY** (USA 2-5% RSA 5%)
5. **ATTRACTIVENESS** (USA 2-5% RSA 5%)

SERVICE QUALITY VALUE:

"I KNOW IT WHEN I FEEL IT"

REVIEW

PROFITABILITY
COST OF SALES
MARGINS, MARKUPS & DISCOUNTS
FINANCIAL FORECASTING
BREAKEVEN SALES & VOLUMES
REVENUE MODELS
PRICING MODELS
PRICE-POINT DETERMINATION
VALUE BASED PRICING
SERVICE QUALITY

"Cutting prices or putting things on sale is not sustainable business strategy. The other side of it is that you can't cut enough costs to save your way to prosperity."
Howard Schultz

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Thank **You!**

QUESTIONS?

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