Small Business Success Podcast:
PRICING FOR PROFIT

The **SCORE Small Business Success Podcast** features interviews with the best and brightest in the world of small business, covering topics such as business plans, financing, marketing, human resources, SEO, social media and more. In this podcast, SCORE mentors chat with Jack Grise and Mike Lewis.

*Jack Grise is a SCORE certified mentor, a Navy veteran, and entrepreneur. In his initial entrepreneurial venture, he developed one of the first automated pharmacy prescription systems in the country. Having spent over ten years in corporate America as Senior Vice President of Sales and Marketing, he then returned to entrepreneurship. He founded a medical dealership and distributorship specializing in MRI related equipment and patient immobilization devices for radiation therapy. He founded the SCORE Pinellas Veteran's Initiative specifically to help aspiring veteran entrepreneurs start, grow, or buy a business.

Mike Lewis is the Chapter Chair, a certified mentor of SCORE in Pasco and Hernando Counties, Florida. He was an entrepreneur in the medical distribution business, and the principal of a sales motivation and training company.

Dennis Zink: Jack, what do you mean by pricing for profit?

Jack Grise: That's an interesting question. Many small businesses we encounter as we go forth with our SCORE efforts are starting a business without much thought about pricing. When you ask them, "How do you price your product or service?" They seem to pull it out of the air. They really don't know what pricing for profit really means.

What it comes down to is that they have to know their costs, both variable and fixed, and can apportion a part of the fixed costs to their overall structure, and then figure out what their pricing needs to be. Then there's a whole host of things that they need to do to make sure that that pricing makes sense. We can talk about all these different issues related to that as we go forward, but pricing for profit, if you just arbitrarily put a price on your product or service and don't know what your costs are, you're really having a hard go at it because you don't know how much money you're making.

Dennis Zink: Jack, can you go into a little more detail as to what you mean by what is a variable versus a fixed cost?

Jack Grise: The easiest way to say that is a fixed cost is typically related to overhead, things like your executive salaries, your rent, your insurance, bank loans that you pay statically every month. Variable costs are those related to whether you're making a product or service, the things that vary on a basis every month. Your number of pieces that you might get, the various things that change. I can't be specific because if you're looking at a service oriented business versus a product oriented manufacturing business, the variations will be quite different. Quite different.

Dennis Zink: Doesn't the market, and or the competition, actually determine what your pricing should be?

Jack Grise: Interesting question. There are many pricing strategies. When we started talking about pricing, I said people typically arbitrarily pick a price that they think the market will bear. One of the ways of calculating what price you should have is called competitive pricing. You get to know your competitor's, and you see what they're pricing their product or service at and you match that in hopes that you'll be able to gain some business. Matching that doesn't mean you can make a profit with that price because the competition may have something on you that you don't know about in the sense that their costs may be significantly lower and hence they have a price. Your costs are higher and you price to match the competition, you end up losing money and you don't know why. It is a form of a pricing strategy, but you need to be careful as to how you arrive at that.

Mike Lewis: Jack, how does a company take into account what's going on with online pricing today versus somebody who may be in a retail situation?

Jack Grise: If you're looking at online pricing, you have to do your research like you would if you were researching a competitive retailer. You have to look at who's offering what. What is the product? Is it similar? Do they charge for shipping? What are the advantages that they have that you might not have? How do you adjust yours to compete with that?

Online, you're talking globally because you could be dealing with someone from France, Sweden, or some place like that, not only in the USA. If you're a retailer, you're typically looking at more of a geographically local type of environment. It really depends on what you're doing, but you need to do your research to find out how are they arrive at that pricing, what are they offering for that price, and how can you meet that or beat that.

Dennis Zink: Jack, what's the difference between markup and margin? The people often confuse those two.

Jack Grise: That's an interesting question, too. As you market your product, there are things that you need to look at. Like we just talked about all of the costs. You need to know what your costs are. Your markup percentage is gross profit dollars divided by your cost of your goods sold. The difference in that, that's how much you mark up your product in order to hopefully gain a profit margin.

A profit margin is different than what your markup is. Your profit margin is arrived at by taking gross profit of all dollars divided by sales dollars. If you have a 20% markup, that doesn't mean you have a 20% margin. You may mark it up 20% and only have a 4% margin, so you need to understand the difference of the two.

The markup is not something that you should really look at to try and arrive at margin. You should back it up and say, "How much margin do we need to make? What, then, price do we need to have in order to reach that margin and how competitive is it? What are my differentiators that will allow me to have that price?"

Fred Dunayer: I believe in the restaurant industry, they have a number that's a standard that the food cost can only be about 30% of the sales price of an item on the menu. Would that be a margin?

Jack Grise: No, the food cost at 30%, they know what they allocate for that cost. Then they take a look at what services are they offering. If it's an upscale restaurant, they can command a higher price, therefore a higher margin than can a family restaurant that doesn't have the niceties or the quality of service that you would get in a more upscale place.

So, as a rule of thumb, if you would just take 30% of your cost across the board, you still have to look at what are you offering, what are your differentiators, and what kind of facility do you have versus the competition?

If I was running a family restaurant that typically has breakfast and lunch and not dinner and I'm trying to price my lunches at what dinner rates are in a more upscale restaurant, would you come to my restaurant? The answer is no.

Dennis Zink: What profit margin should a business try to achieve and does it depend on the kind of business?

Jack Grise: It does depend on the kind of business and it depends on your competition. A very important aspect of any business is what is your differentiator or differentiators. How do you set yourself aside? Why would a person want to buy from you versus buy from your competitor? There's no set way to arrive at a profit margin.

Like we just said, restaurants typically have a 30% cost factor. Well, they typically don't have a 40% margin factor. No one has a set 40% margin factor because I'm in the industry. They take a look at all the things that you need to know. Not only competition, but what will the market bare? How much is the average person willing to pay for your product or service? How does that measure up competitively? Are you able to compete and make money at that price?

If you do that, if you look at what that comes out to be for a price and you understand what your costs are, now you know what your margin percentage is and can it be profitable because now you know what your costs are. You look at it and say, "Okay, if we sell N number of these services or products, we can make enough money."

Fred Dunayer: It seems like that's a calculation that ought to be done before you even start the business.

Jack Grise: Absolutely, it's called a business plan.

Mike Lewis: Speaking about calculations, what about people who go into business that have the cliché, "I'll make it up in volume." What do you think about that?

Jack Grise: Excuse me for laughing. You can't lose five cents on everything that you sell and make it up in volume because you're still making losses.

Fred Dunayer: Unless you're Amazon, in which case you take big losses on the expectation that you're building a market and that people will become married to you at some point. Then you can start making some money with it.

Jack Grise: You must have very deep pockets to begin with.

Fred Dunayer: Indeed.

Dennis Zink: There were certain industry publications that probably have articles from time to time about what the range of profits are in those industries. Would you suggest that is a good source for different kinds of businesses, if there are such publications, trade shows, or trade magazines?

Jack Grise: Absolutely. Industry dynamics and industry publications, there's a lot of data available if one were to do the research. That's what we talk about in your business plan. If you were to write a business plan for your business, whether before you've started it or after you've started it, you need to have that business plan that forces you to do the research.

To do the research, you're going to come across an industry standard somewhere, if you look at the industry standards that are available, and you find out your industry average and what it is. If your pricing, and your margin are not comparable to that, you need to question yourself as to why and go back to your business plan and see where your costs and margins are.

Fred Dunayer: By the way, we had a presentation here from a local librarian at our SCORE chapter here not long ago. They talked about the resources that are there in the library for helping you to do that research. There's a lot of market analysis. You'd be surprised at the different resources that are available at the library to help you do this research.

Jack Grise: That's very accurate because most of the larger branch libraries have a research department. You just go to them and they're more than willing to help you.

Dennis Zink: Can you comment on the psychology of pricing?

Jack Grise: The psychology of pricing we've all experienced. When you look at things that are priced at $12.95 versus $13.00 dollars or $13.25 where the margin would be a little better for the company, they're trying to get you psychologically to think it's a lower price.

You did ask previously about value. People like to buy value for what they're paying for. If they perceive that they're getting good value for their dollar, they'll buy it. I'll give you a good example of something. There was a perfume company, they had a $10 dollar bottle of perfume that they were offering in places like discount stores and so forth. The executive management said, "We think we can get a better price if we package this differently."

They took the same perfume, put it in a different bottle, put it in a really ritzy type of package and put it on the market for $100 bucks a bottle. They put it into the upscale stores and took it out of the discount stores and they found that people were buying it because it's a perceived value at $100 versus $150 that the other ones were getting. As such, people will pay for something they perceive as a good value to them.

Dennis Zink: As a wine drinker, it's interesting if you compare sometimes a more expensive bottle of wine, say $60, $70 dollars versus maybe a $15 dollar bottle of wine. A friend of mine had a really interesting comment. He says, "I want to drink a wine, buy a wine, that tastes better than it costs." I always liked that phrase.

Let me ask you this. We have, it used to be called Robert Morris Associates, it's now called RMA, they kept the same three letters. RMA is a source that bankers use to see what profit margins exist in different industry classifications. Do you recommend that someone know that NAICS code, N-A-I-C-S code, and look up and see what kind of margins are typical of the industry?

Jack Grise: Absolutely right. I think they should. In doing the research to create your plan and get your business started, you need to know what the industry commands, what your able to get. If the industry says, for example, that the typical gross margin is 20% and you're marking your stuff up so that you're going to be getting a 40% margin, you're not going to be competitive unless you've got really a significant differentiator. We talked about value, the perception that if I'm getting value for my dollar, then you have a chance, but your marketing dollars are going to go up because you have to educate the public as to what value you're offering for that price.

Fred Dunayer: By the way, I think the RMA now stands for Risk Management Association. I just wanted to clarify that because if people want to look it up online, they probably ought to know Risk Management Association.

Dennis Zink: Thank you for adding that.

That helps to figure out how much to charge, and that's a great thing. How can I know what the industry metrics are, and dynamics in terms of any other things. You had FINTEL, BizMiner, etc. I'm not really familiar with that, can you explain what that is?

Jack Grise: Those are websites that you can do some business intelligence research on like we talked about, industry associations, and so forth. These are subscription sites, I believe you have to pay for the data, but they have a lot of data based on NAICS codes and the type of industry that you're in so that you can get a better feel for where you fit within that organization or within that industry. When you set your price, and you know your cost, then you see if you're going to be competitive. You may come in at a lower price and may be able to command more market share. It really depends. If you don't do your homework, you don't know where you're going to go.

Dennis Zink: What would those sites be? Is it dot com? Can you spell those for our listeners.

Jack Grise: Fintel.com and bizminer.com

Dennis Zink: And that's F-I-N-T-E-L and B-I-Z-M-I-N-E-R?

Jack Grise: Correct.

Dennis Zink: Okay.

Jack Grise: There are others as well you can search around and find. A matter of fact, if you ask your librarian in the research department, they'll probably give you a few more to look at.

Dennis Zink: What's your opinion on having a loss leader? Does that help to bring people in the store? Is that worth doing or is that a zero deal?

Jack Grise: I think loss leaders need to be carefully examined by the particular organization that's using it. If you've got deep enough pockets, people will often times, depending on the product or service, take advantage of a loss leader and buy nothing else. The intent of a loss leader is to get you into the facility or get you into the site to buy, not only that, but to see other things that you'll buy on an ad hoc, impulsive basis.

If people are buying a loss leader and nothing else, you've got to be able to absorb those. You typically shouldn't sell a loss leader even though it's named as a loss. You're taking a loss on it? I think you should sell it at your raw costs.

Fred Dunayer: We all have seen situations where a company will do a loss leader and only have one of the item and, in effect, create a stampede. We've seen those kind of things happen around Black Friday. Obviously, that's a very dangerous strategy. I would think that it's not good for the business's reputation to have a loss leader and only have one of those items in stock.

Jack Grise: It's not a loss leader in that particular scenario. It's a strategy that's based on discrimination, I'll call it. Discrimination pricing can be based on store hours. If you're in the store between 9:00am and 10:30pm, you can get these products at these prices. Or, if you're a senior citizen over the age of 65 and show your ID, you can get these products at these prices, etc, etc. It's not necessarily a loss leader, it's discriminating pricing. I'm sorry.

Mike Lewis: Jack, do you think that the use of loss leaders are good or bad for your business based on the fact that if you only have one item, that will kill your reputation. It would make people angry?

Jack Grise: I think if you're using a loss leader and you only have one item, that could hurt your business, but rather than do that as a loss leader, do that as discrimination pricing where you're saying, "If you're in the store, it's very quick. It's going to be a half hour only at this price and only while supplies last." No one knows you only have one, and when it goes out the door, you say, "Sorry, the supplies or gone," and or the one didn't go in that half hour, you've tried it and you didn't hurt your business.

Fred Dunayer: The old Blue Light Special.

Jack Grise: Correct.

Dennis Zink: I thought of that too.

Mike Lewis: Continuing this discussion, the use of a loss leader should really go into your marketing plan as a part of your business plan, and not so much your financial plan.

Jack Grise: As your marketing plan, if you're planning a year ahead with loss leaders, God bless you. Most loss leader things that I know about are things that are not moving within a particular store and you're looking for a way to garner revenue from people buying other things, and using that particular product or service as a loss leader to get people to look at other things. If you're planning a year ahead to take a loss on something, I want to talk to you as a SCORE mentor because you're doing something wrong.

Dennis Zink: Let's talk about Internet pricing for a moment. I think, to some extent, you're going to see the death of brick and mortar in the next five to ten years. Businesses that have a place to go, to shop at, if you can get those same products, if they're commodity products, you get them online, typically I would think you can get better pricing. Would you agree with that? Do you think that'll have repercussions in terms of business failure as it relates to brick and mortar stores?

Jack Grise: I think in today's market, buying online is not a panacea, unless you can get free shipping, because if you look at shipping costs, typically they're exorbitant. FedEx and UPS, if you look at buying a product online, they charge you more than if you were just using a standard UPS or FedEx shipper. I did that in my own business, so I know what the prices are and the discounts that they get. They're making money on the shipping.

The latest trend is to say free shipping. If you can get free shipping buying online and the price is worth it, and you know what you’re buying because of color, size, and things like that with clothing, it's a little bit iffy unless you really know what you're looking at. Then returns come into being. If you have to return it, they don't pay for shipping on the return. You pay for shipping on the return. Take something to the post office in a box and see how much it costs you to ship it. What you make up for in price, buying it without good knowledge of what you're doing, you're probably going to end up spending more because it's going to cost you more and you're going to be without the product or service.

Dennis Zink: There's one very successful group called Zappos, which probably most people are familiar with, Z-A-P-P-O-S. They do pay for returns. They'll send you six pair of sneakers in different colors that you ask for, and you can keep whatever you want or not and they pay for the round trip.

Jack Grise: It's an interesting concept. I don't know how long that will last or how many retailers would be able to afford to do that. Think about it. If Zappos sends you six pair of shoes, those are five pair of shoes that may come back, that are out of circulation for that period of time. They're stocking a lot more inventory than they need.

Dennis Zink: They're doing something right.

Fred Dunayer: I think Dennis has an interesting point though. He actually referred to it, when he talked about commodity items. It's one thing if you're buying a book or something that maybe you can tell just from the cover what it is and buy that versus something where you're going to have to judge quality or something like that. I think brick and mortar is in trouble when it comes to commodity items, but for specialty items where you actually need to touch the product to know what you want to buy, that's going to work.

I bought a device called the Amazon Echo. I don't know if you guys are familiar with that. It's basically a little cylinder that's got some microphones in it. It links to Amazon over the Internet. I've in the past purchased dog food and now I can walk up to this device, sitting from my couch, and I won't use the word because if somebody has one of these at home, it's going to turn theirs on, but I'd say, in effect, "Amazon, order me a bag of dog food." It will tell me what I ordered last time and ask me what I want. I say yes and it places the order. With Amazon Prime, it shows up two days later at my door.

That shopping experience, especially where you've got two day delivery, it's going to be hard for brick and mortar to keep up with.

Dennis Zink: That's impressive. Amazon is now ... I don't know if you heard though the holidays, where they had two hour delivery. They're looking at drone delivery, which could be in minutes. I'm not sure I'd want my sushi delivered that way, but then again, if it was done in minutes, maybe I would have it with a little wasabi and ginger.

Jack Grise: There's no argument that brick and mortar are going to change, for sure. There's going to be that element of people that still want to go in some place, that leave their house to go out and shop, and to touch and feel things and look at it. Look at women going into a retail place. I happened to do this with an old place in Boston, Massachusetts called Filene's Basement, if you've ever heard that?

Fred Dunayer: Oh yeah, sure.

Jack Grise: I used to stand there. My wife would go around. I'd stand there with my arms folded and just watch people. They would go touch and feel and hold it up and see. They looked at it, looked at the mirror. You can't do that online. You have to know what you're doing. If Zappos is willing to just send you a whole bunch of stuff, you can probably look at that.

Dennis Zink: You know, it's interesting. I see people shopping and they do that. They touch and feel the products, but they also pull out their iPhone, or their smart phone, and they start looking up prices and brands and trying to see what it costs. It's kind of interesting. The buying experience is totally different than it used to be.

Jack Grise: Exactly right.

Mike Lewis: Jack, a lot of businesses today are doing dual business where they're doing retail and they may be doing Internet. They all have websites. Do you think people are really taking into consideration the different psychologies of marking up a product or having margin and is that important?

Jack Grise: I don't know how important it is. I've never taken a look at that from a research perspective to see what value it might bring, but most retailers already offer an online service with their products. How they're priced, I've honestly not looked at either, but my guess would be they'd be very similar.

Mike Lewis: My point is that, perhaps businesses should take a look at their margins given the different cost factors of doing business on the internet, shipping out, versus somebody just walking in the store.

Jack Grise: Absolutely.

Dennis Zink: One of the things, getting back to, while we're looking at pricing strategies in the marketplace, if you could maybe go over some of those, maybe the key ones and talk about those.

Jack Grise: The most commonly used pricing strategy is called cost plus. That's what we talked about knowing your cost. Most businesses don't really know their costs because they haven't really written a business plan and they haven't put down their fixed and variable costs that we discussed earlier. They don't know what the competition is doing. The other part is that they don't know what the market will bear.

There's market pricing as well as cost plus that has to be considered because market pricing means that you go out and pre-test what the people are willing to pay for your product or service. If it fits within the price structure that you think and you come back and measure it against your cost to find out you can make money at doing it, then you can go forward.

If the people say no, and I call these focus groups and I recommend to many of my SCORE clients that they set up a focus group, not made up of friends or family but of people that they've either met somewhere or that they go out and solicit and ask to participate as part of a focus group. Be prepared by asking a whole series of question to learn about what these people are willing to pay for your product or service. They need to understand what that is. You come away from that with a whole host of information that you can know how you want to proceed and even if you should proceed.

Pricing strategies are numerous. There's skimming, and we all know what the skimming thing is. You see that we talked about earlier, I called it discriminatory pricing. Something is available for a brief period of time with a price. Something new, Apple is great at this, something is coming out and they price it and they get the earliest adopters that stand in line for hours waiting to get this product. What happens after that? That goes. The production happens, the prices fall. It becomes more of a, not a commodity item, but more acceptable to the general public. That's skimming. There's all kinds of different strategies that you can use but the common ones are cost plus, and the most important one, in my opinion, is using the cost and finding out what the market will bear along with your competition.

Dennis Zink: Restaurants will often have three different prices, let's say on a bottle of wine or a type of wine. Is there a reason they do that? In other words, are they expecting to sell maybe the middle one or the cheapest one? Why would they do that?

Jack Grise: I don't know their expectations, but I think it relates to their cost and or what they feel they can make as a margin. If, for example, you show three different bottles of wine and I'll pick Chardonnay because I like Chardonnay when I typically have dinner because I have fish. You look at the wine list and you see something that's $15 dollars, $28 dollars, $35 dollars, something of that nature, and they're all Chardonnays, but they're all different labels. Not being a connoisseur, I don't know what that means, which label might be better in terms of aging or quality. For me, after I have a glass of wine, the second glass of wine doesn't really make a difference whether it's good, bad, or none of that.

Dennis Zink: Now we're back to buying a wine that tastes better than it costs.

Jack Grise: My point is that, how do they tell that? If the buyer in that store is clever enough to be able to get those bottles within a very small markup percentage or dollar rate, if he pays $10 dollars for one bottle, and $10.50, $11.00 dollars that they're charging $7.00 dollars more for, God bless them, they're making the money. That's where they make their money.

Fred Dunayer: It's interesting that we talk about that perceived price versus the actual price, for example. If I go out to a website and I'm looking at a product and that product has all five star reviews versus one that's mediocre, three, three and a half stars. The price could almost be double, but I'll still go for that five start product, unless it's ridiculously expensive, simply because I now have the feedback as to the quality of that product. How much more it costs to manufacture to make that better product? I don't know. I know that I want the product that's rated well, that's more likely to last longer, and all those other factors.

Jack Grise: See, that helps on your perceived value. Remember we talked about the bottle of perfume? The perceived value to you is because other people have tasted it. Well, your taste buds could be totally different. What might taste good to someone might not be so good for the other one. A restaurant is a prime example. I've been going into a restaurant with people coming out and say, "How was it?" They say, "It was fantastic." I go in and I have something and I'm like, "My God, it was terrible."

Mike Lewis: One thing we discussed during this entire conversation is the usefulness and the critical use of a business plan. We at SCORE emphasis that over and over and over again. The pricing strategies, the markup-margin strategies should be a part of the financial plan within your overall business plan. SCORE emphasizes that and that's a very, very important factor.

Jack Grise: It is, absolutely. Any clients that I have, we make sure that we cover all of that stuff.

Fred Dunayer: So, Jack, is there anything we didn't cover in this discussion that you would want to either cover or reemphasize?

Jack Grise: It's important that you pay attention to what your gross profit margins are, and you control those. It's not something that you price and stay static. You have to look at how you adjust your prices. Is your product in a particular lifecycle? Is it in the beginning stage? Is it in the decline stage? Is it in the intermediate stage? You have to understand what each of those product lifecycle stages are and price your product accordingly, so you can maintain your margins and not just be sitting like a lump.

Dennis Zink: Jack, thank you for enlightening us today. Michael, thank you as well (regarding our discussion) on Pricing For Profit.

Jack Grise: Thank you, I appreciate being here.

Mike Lewis: Thank you.

Fred Dunayer: Thank you.

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