

## PRICING PROCEDURES FOR RETAIL

When your company purchases and sells a product, the revenues derived from sales of the product will directly affect the success of your business. Though pricing strategy and computations can be complex, the basic rules of pricing are straightforward.

1. Prices must cover all costs. **See SCORE Brief 4.05, Profit and Loss (P&L) Statement.**
2. The most effective way to retain or improve the profit margin is to reduce fixed and variable costs, and adjust price as necessary.
3. Prices may need to be increased or decreased to assure that they reflect changes of costs, market demand, and competition.
4. Competitive prices must be established to assure sales. Benchmark pricing against your competitors, but price to sell. Pricing of some products may be lower than cost (known as a loss leader) to create demand for products that can be priced at the desired profit margin.
5. Product utility, longevity, maintenance, and end use must be judged continually, and target prices adjusted accordingly.
6. Prices must be set to preserve order in the marketplace. If you raise your prices because you want a higher profit or a bigger marketing budget, but the competition doesn't follow suit, your price will not be consistent with the market.

### THE RELATIONSHIP BETWEEN PRICES AND COST

Before you can set a price for your product you have to determine the costs of running your business. Revenue from the sale of your products and services must cover all of your expenses, no matter how or why they are incurred. If the prices you set for your products and services do not cover all your costs, you will have a negative cash flow and have to infuse cash into the business until your resources are depleted and your business fails. **See SCORE Brief 4.09, Cash Flow Projections.**

How much does it cost to run your business? You must add fixed costs (such as property/equipment leases, loan repayments, management cost, and depreciation) to the variable costs of raw material, inventory, utilities, and labor. **See Score Brief 4.07, Balance Sheet.**

You must also take into account other costs such as damaged goods and handling of returns, and desired profits to arrive at an initial price for your products and services. However, the most important aspect of cost versus price is that ultimately the market determines the price you may charge. Bottom line, successful pricing must be between your cost/breakeven point and the maximum price the market will allow. **See SCORE Brief 4.13, Breakeven Sales.**

### PRICING METHODS:

**COST PLUS PRICING:** The key to cost-plus pricing is to ensure that the "plus" figure not only covers all overhead, but generates the percentage of profit required. It is usually used by manufacturers.

DEMAND PRICING: Where there is little or no competition and you price what the market will bear.

COMPETITIVE PRICING: Where there is substantial competition and you must meet the competitive price, unless you can provide added value (location, delivery, features, warranty, service, etc.).

MARK-UP PRICING: (See below). Many retailers and wholesalers use mark-up pricing. It consists of adding a certain amount to the costs of the product, which becomes the selling price to the consumer. This markup amount must cover all other expenses plus the desired profit. For example, if your price tag says \$5000 and the cost of your product is \$3000, your markup is \$2000.

Markup represents a percentage of the seller's product cost. It is expressed as follows:

$$\begin{aligned} &(\text{Total sales} - \text{Cost of sales}) / \text{Cost of sales} = \% \text{ Markup} \\ &\frac{\$5,000 - \$3,000}{\$3,000} = \frac{\$2,000}{\$3,000} = .66 = 66 \text{ percent markup.} \end{aligned}$$

### Pricing a product

To price products, you need to be familiar with pricing structures, especially the difference between margin, markup and break-even. As mentioned already, every product should be priced to cover its purchase costs, labor costs, packaging costs, freight charges (variable costs), and a proportionate share of overhead (fixed operating expenses), and a reasonable profit. Such factors as unpredictable insurance expense, theft, shifts in wholesale material costs, freight expenses, and sales or discounts will all affect final pricing.

### Margin

Margin, also referred to as gross margin, is the difference between your total sales and the cost of sales (variable costs); it equals the fixed costs plus profit. It can be expressed as a percentage or a dollar amount. As a percentage, the GP margin is always stated as a percentage of net sales. It represents a percentage of the seller's price.

$$\begin{aligned} &(\text{Total sales} - \text{Cost of sales}) / \text{Net sales} = \text{Gross profit margin.} \\ &\frac{\$5,000 - \$3,000}{\$5,000} = \frac{\$2,000}{\$5,000} = .4 = 40 \text{ percent} \end{aligned}$$

### Break-even (Refer to SCORE Brief 4.13)

Break even analysis is a method that indicates when revenues equal total cost. Your break-even point represents the point at which you neither make nor lose money in producing your product. It is expressed as follows:

$$\text{Breakeven sales} = \frac{(\text{Fixed cost} \times \text{Unit selling price})}{(\text{Unit selling price} - \text{Unit variable cost})}$$

It is highly recommended that you get advice from your SCORE counselor or go to the library, or search the Internet (Google "Pricing") to get as much information as possible on pricing. Pricing is not easy and can be very confusing if you are not familiar with pricing concepts and structure.

Just remember, with any business that you start, the key to pricing is to find the price that (1) Customers are willing to pay, (2) is competitive in the marketplace, and (3) will produce the desired profit for your business.

Do not forget a very important rule: "Cash is King".

*If you would like to request a Cincinnati SCORE counselor please [click here](#).*

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