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“Pricing Strategy”

Pricing is not difficult. Pricing does require the business owner or senior managers to focus carefully on their business. A Strategic Business Plan – not a Business Plan – is quite helpful in preparing Pricing Strategy and tactical implementation. By year, your Strategic Plan outlines business growth, performance and objectives to be funded.

Price increases should be taken for 3 primary business reasons:

- To cover annual cost inflation
- To assist in improving overall business profitability, i.e. PBT (Profit Before Tax)
- To help fund business building programs that are recognized and perceived as valuable by your current user or new trier.

1. To Cover Annual Cost Inflation

The key word here is “annual.” Each year your business incurs increased costs that are not really controllable or negotiable – especially to small and medium size business. Increases in “costs” must be passed on to your user each year. If not, business profitability (performance) will erode.

This is where “value added” marketing, brand positioning and new product/solution introductions help you successfully take and “flow through” the price increase to your users. Good customers, clients and users understand that the costs to produce and market (sell) valuable, quality products must increase, reasonably over time.

Each year business owners and managers must estimate cost inflation for the new year. Our illustration estimates 4% in 2006.

2. To assist in improving business profitability

Income Statement or Profit & Loss management should be your month to month business performance touchstone. You must be familiar with P&L categories and their “chart of accounts” – pigeon holes for current account payables.

Your business owner or management report card is the monthly P&L. Toward the bottom, you will find your Profit Before Tax for the past month and year to date. It is usually compared to the same period one year ago.

You are in business to make a profit. Your “grade” is the profit before tax. One way to increase your profit is to take a price increase. Hopefully this increase flows through and is acceptable to your user as mentioned above.

If PBT is at 1% and you eventually want to be at a 10% PBT, consider taking 2-3% price increases over several years. In our example, we will use 2%.

A current Midwest pizza client has 7 units. In mid-year, they added a 50¢ increase to their delivery charge. The increase “flowed through.” Only two phone calls were received questioning the increase. The client is estimating approximately \$90,000 of increased bottom line profitability.

3. To help fund business building programs that are recognized and perceived as valuable by the marketplace

Introduction of valuable new products, services and solutions provide excellent rationale for price increase. You are bringing something new – something better – to a marketplace that wants it! Increased convenience in product use or purchase also provides “valuable” price increase justification. In our example we will use a 2% estimate for new business building programs in 2006.

4. Real Sales Gains

Each year business must challenge itself to sell more product to more users. Selling is what Sales does. Through the years, your business, its marketing and its performance should be gaining new users and increasing purchase frequency and larger order volumes from current users. In our example we will use a real sales gain of 4%.

5. Pricing Illustration

Estimated Cost Inflation	4%	of Sales
PBT improvement	2%	" "
Business Building Program	<u>2%</u>	" "
	8%	" "
Less: Real Sales Gain	<u>4%</u>	" "
2006 Price Increase	4%	of Sales

6. Implementation – Taking your price increase

- a. If you take a 4% price increase effective January 1 and it flows through you're fine. If you wait until April 1, you will have to take more than 4% as January-March volume was sold at the older price.

Consider taking smaller, multiple price increases throughout the year to earn the 4%.

You would be wise to take price increases just prior to high demand seasonality periods for two important reasons.

- 1) It gives your business the full effect of a price increase.
 - 2) Your price increase is less visible just prior to the high demand season than during it.
- b. Carefully consider what products should be a part of this year's price increase. Taking a price increase on a low demand product won't get you much. Taking too large of a price increase on a high demand product, too often, will put you at risk.

Pricing Summary

Pricing is your profit accelerator. The better you understand your customers, their buying needs, limits and patterns, the faster you make money. That is why Pricing and Product Line Strategies are the two most important parts of marketing and business performance.

I am, for business –

Ken Lerman

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