

The YEBDC Small Business Information Column

by Sue Gingerich, Business Advisor

"Consider Turnover Rates When Pricing Products"

The first step in pricing products is to determine your strategy; the second part will undoubtedly be to create your pricing formulas. However, matter what your strategy is, no matter what your formula is, there is one other aspect to pricing, and that is 'analysis'. It is important that you take time to review every price of every item, if possible, or at the very least the gross margins of every category of products to help ensure you are indeed charging the right prices. Yet, the right price doesn't always mean the highest profit per item. The right price and the highest profit per category is the price that ensures the products turn over at the most desirable rate.

If your strategy is to price competitively, to determine your prices you need to decide what markup formula to use. The first step might be to try to find out what the competitor's formulas are. Do they take their cost price and add a straight percentage? Or do they take cost, plus shipping and then calculate their price? They may not use the same percentage for all categories of goods. It most likely depends on the type of goods. Often items that are "drawing cards" (bring the traffic into the business) usually have the lowest percentage of markup. Items that are sold less often may have a higher markup. With a competitive pricing strategy, other policies must be put in place, for example, how will you meet or beat the competitor's price. (e.g.. only on advertised or printed proof?) Also, you may want to do weekly price check comparisons of the competition, to ensure you are not over pricing to start with. Your actual margins (what you really make per item) will depend upon whether or not you are able to sell these goods at regular price. (Or how much you are lowering items to meet the competition's prices.) If you have to take heavy markdowns to move your merchandise, then in the end your margins could be significantly reduced.

If your strategy is to price above the competition, you may still need a sense of how they are pricing. One reason you might want to price higher than the competition is that you also include services with your products that the competition doesn't, thus you have other costs to cover. An example of this might be two grocery stores, one that offers bagging and carry out, the other doesn't. Your markup formula might look something like the following: product purchase cost + overhead costs % + profit % = selling price.

For some products there may be one other option for choosing a price. Many manufactures give a suggested retail price for their products. Depending who the manufacturer is will determine just how high or low you can price above or below their suggestion.

When analyzing your pricing consider how many markdowns it took to sell that merchandise over how long a period of time. If a product is kept too long at a high price and it doesn't sell, it will either have to be marked down, or it may become obsolete and actually never sell. Even if it sells at the higher regular price, after a period of say two months, less money may have been made, than if it had been priced at a lower selling price right from the start. How do you ask? Well, because of the costs of "holding" inventory. If the product had sold within 2 weeks instead of two months, something else could have been bought that would have sold equally as fast, that would have been replaced by something else that sold fast, each time realizing a small profit. Each turn may not make as much profit individually as the original product at the higher price, but the three turns of the inventory will actually add up to a greater amount in two months than just selling the one item at the higher price! So be careful, if you think you have to price higher to make more money. Low turn over rates can significantly reduce profits!

So, when pricing products keep in mind there isn't necessarily one set "formula". Yes, it may sound simpler and appear to save time to just add the same percentage (%) markup to everything; however, it won't necessarily result in higher profits. Evaluate your strategy, evaluate your pricing, evaluate your profits, and evaluate the turnover rate of each product, or at the very least each category or department carefully. Sometimes, lower prices can actually improve profits dramatically!

If you have a small business and have a question or problem that you think The YEBDC could help you with please call or write to: The Yellowed East Business Development Corporation, Box 249, Sangudo, Alberta, T0E 2A0
1-800-556-0328 or 1-780-785-2900, e mail: yebdc@yebdc.ab.ca, or access our Website at:
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