



A GUIDE HOW TO

PRICE YOUR
PRODUCTS
AND
SERVICES

VOLUME

2

HAFFHUR

HANDBOOK

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Welcome!

It is always tough to decide what price you should charge for your product or service; but it is also one of the most important decisions you'll make as an entrepreneur.

For some reason, we always seem to undervalue our own products and service – it is just human nature. We always think that people won't pay what we need to charge - when there is absolutely no logic to the statement.

In the next 29 minutes, we will give you what we think are the most important factors that will ensure that you charge what you should.

Let's get going.

As always, we will present this Handbook in steps and ask that you finish one before moving to the next. We will not use a specific business type as an example; rather will deal with business in general.

It may be that you are selling a product, or it may be that you are selling a service. Whatever the case, you should understand both to allow you to price properly.

Let's get started.

Step #1. What is the problem?

It is a question of confidence. As entrepreneurs we always are nervous that people will wake up one day and hate what we do or what we sell. We worry that if we charge what we need to charge, that it will be too much and that everyone will abandon our business for the competition. That is ridiculous; but I understand it.

What you have to do is build your confidence and that can only happen if you do your homework. You have to find out:

- Who is your competition?
- What is their pricing?
- How are they perceived in the marketplace?
- Is price an issue at all?

It is your ability to answer those questions that will allow you to move forward with quiet confidence. There should be no problem if you know what you are doing. So to avoid being haunted by the age-old question about price, do your homework and move on.

If you have a handle on your concept and your potential customers – and especially your “ideal” customer – you’ll know whether price is even an issue. It would be great if it wasn’t; nevertheless, it is unlikely that that will be the case, so let’s see what we have to do now.

Step #2. The Concept

Before you go any further, you have to have an understanding of what you are doing and how you are trying to do it. A concept is not an idea. It is a fully developed business vision that can be explained in detail. Many business owners forget who they are and what makes them different.

Are you going to try and grab a share of the market by targeting price – having the lowest price, or are you going to grab a share by offering outstanding service and having a higher price.

This concept development process is so important because it drives all your decision-making going forward.

Do you have to have an elaborate store or a space that is “out of the way” and sparsely decorated? That is concept. Do you need lots of staff to deliver your services or a few who can ‘do it all’? That is concept.

Do you have an aggressive marketing and advertising program or are you going to rely on ‘word of mouth’ to drive sales. That is concept.

As you can tell, once you are clear in your concept you can look at how you are going to price. A high-end business can charge more for its products and services than a low-end business can. But, the expenses for the high-end business are going to be substantially more than for the low-end. Confused yet? Hope not.

If you are a high-end landscaper, for example, you are going to have to have state-of-the-art equipment; however if you are operating ‘Bob’s Lawn Care’ from your garage, an old lawnmower is going to more than do the trick. Bob will not be able to charge what the landscaper can charge, but his expenses are going to be substantially lower as well.

Concept impacts pricing for sure; so ensure that you have fully developed your concept before moving forward.

Step #3. The marketplace

Before you look at pricing your product you have to look at the competition, and not by taking a glance, but by taking a really hard look. Having a really good handle on your competition is paramount to pricing properly. If you are in business, you should always have a handle on your competition - not just when it comes to pricing but when it comes to merchandising and marketing as well.

The market sets the price. What does that mean? What are customers willing to pay for the product or service? I love when people talk about markets. In reality, **markets don't buy anything, people do**; so if you want to know what people are willing to pay, go and ask them.

You can find out all kinds of good information by talking to people. Ask the right question and you'll get the answers you need to have. Large corporations are constantly asking their customers what they think and why can't you? It's only time and you should take that time to get to the bottom of your pricing issue. Develop a questionnaire and then go out and survey people who you see as being your target market or 'ideal' customer.

The marketplace is an interesting place. There are trends and fads and all other great things. Having an understanding of what is happening within the marketplace will allow you to know how to position your business and therefore how to look at your pricing.

Markets (people) don't lie, they buy. Listen to them!

Step #4. Ideal Customer

Your ideal customer is the person who will help you settle on your pricing strategy. He – we'll use the masculine, no we won't – she, once identified will allow you to make all the most important pricing decisions. How do you identify her? You close your eyes and envision where she lives, what she does, with whom she does it and such. If you can pin her down, you will be miles ahead when it comes to figuring out what it is she likes and what she is willing to pay.

Specific questions you should be asking include:

1. How old is she?
2. Where does she live?
3. Does she work? If so, where?

4. How much does she make?
5. What is her job?
6. Is she married? If so to whom?
7. What does she buy?
8. Where does she buy it?
9. How much does she pay?
10. How can I reach her?
11. What are her priorities?

Does everyone do this? Heck no. That is why a lot of businesses fail. If you can pin her down, you will be miles ahead of your competition. Believe me. Can you see her? Great. She is the one you market to. She is the one who will determine the price you can charge.

Now look at what product or service you are thinking of offering and see if she will like what it is. And then, what does she pay for a similar product or service now and does that fit into what you were thinking? **Doing this exercise will help you strategize not only your pricing but also your marketing and merchandising.** They all go together.

Now let's start getting to the root of the matter – understanding pricing.

Step #5. Cost and Margin

I can say with almost complete certainty that the vast majority of business owners out there today could not explain what I am going to explain right now. And again that is why a vast majority of them fail. Hang in there and make sure you understand it.

If you buy something for \$5 and sell it for \$10 you have a cost of 50% and a margin of \$5. Why, you ask?

The cost is 50 %. Cost: purchase price divided by sales price and stated as a percent

$$(\$5 / \$10) \times 100\% = 50\%$$

The margin is \$5.00. Margin: Sale price minus purchase price stated as a dollar figure

$$\$10 - \$5 = \$5$$

And all those math classes suddenly make sense don't they?

Now that you understand costs and margins let's see how this applies to business.

Cost is the first idea you have to understand. Let's look at a landscaping service as an example. The first item you have to have is a specification for the service that details exactly what you are giving the customer when he orders the service. This specification will be used by the worker and then by you when you figure out how much to charge for the service.

Watch this closely.

Elements include:

- Grass cutting
- Fertilizing/weed control
- Edging
- Clean-Up
- Disposal of clippings and waste

If you have detailed specifications, then you have to ensure that the workers follow them exactly. (If they 'over-service' then all your hard work will be for naught because the profit will be gone.) That is why you hire and pay supervisors and managers. It is their job to watch that the workers follow the specifications to the letter.

You now have to cost each and every item included in the service.

1. Grass cutting	\$15.00
2. Fertilizing/weed control	\$ 5.00
3. Edging	\$10.00
4. Clean-Up	\$ 5.00
5. Disposal of clippings and waste	<u>\$ 3.00</u>
 Total Cost	 \$38.00

That exercise has detailed exactly what it costs to deliver a basic landscaping service to a typical household on a 50 x 100 lot. (Obviously prices will vary depending upon the size of the property and the corresponding amount of service time required to complete the service.)

Now you have to decide what we are going to charge for that service.

If you charge \$76.00 your cost will be 50%

$$\$38 / \$76 \times 100 = 50\%$$

If you charge \$100 your cost will be 38%

$$\$38 / \$100 \times 100 = 38\%$$

The more you charge, the lower your cost. The less you charge, the higher the cost. Got it? If you don't, go grab a piece of paper and work it out until you do get it. This is so important that you cannot move forward until you understand it.

Every service you perform must have a specification as to what is involved in its delivery and a corresponding cost sheet so you know what to charge. If you don't do this exercise, when your costs are, say 50%, you don't know if it is a problem or not. If you have costed every service at 50% and your costs are 50% then you can relax. If you have

costed every service at 38% and your costs are 50% then you can panic big time because there is an obvious problem.

Margin is the next thing you have to understand. The difference between the selling price and the cost price of each service you offer. In the case of the landscaping service, if the selling price is \$76 and the cost is \$38 the margin is \$38.

$$\$76 - \$38 = \$38.$$

That means that when you sell a service you have \$38 left over to help cover, rent, maintenance, utilities, office supplies-up etc.

If a service costs you \$30 to deliver and you sell it for \$80, your margin is \$50.

$$\$80 - \$30 = \$50$$

Putting this all together and testing your knowledge and understanding:

If a service #1 has a cost of 33% and a margin of \$50.00 and another service #2 has a cost of 50% and a margin of \$70 which do you want sell more of?

Show of hands for service #2 please. Thank you. You are right. You want to sell more Service #2. Although your cost of delivering the service is higher (50% for the #2 vs. 33% for #1) the margin is greater for #2 than the #1 (\$70 vs. \$50). And it's money that you want.

If that doesn't make sense to you, then take the time to read this section again. Why? If you don't understand costs and margins then you will fail. **Costs and margins drive business and your profits.** (By the way, they don't teach stuff like this in school because it has relevance and you might

actually use it one day. Instead they teach stuff you'll never ever use in real life. I digress, sorry.)

Back to business. The more Service #2s you sell, the more money you'll have to cover your other costs. Don't get fooled into believing that cost is everything. You are in the business of making money so go out and make it.

If you could get your cost delivering service #2 down to 33% you'd be rolling in cash, but that is unrealistic as the selling price would have to be out of this world and in most cases, people just won't pay it. Maybe in Beverly Hills, but then your rent for that garage wouldn't be \$1500 per month either.

Whew! That's a lot to take in but absolutely necessary. If you can confidently say that you have a handle on your costs and margins, then I can confidently say that you have a better chance of business success.

Step #6. Mark-Up

People talk stuff like this all the time. "What is your mark-up?" If you were in the clothing business and you bought a shirt for \$20, then what are you going to sell it for? That is usually a pre-determined figure such as say 3x your purchase price. So the shirt that you bought for \$20, you put on the rack for \$60. You could go 3.5x or 4X depending upon what your customers will tolerate.

You know their level of tolerance by doing your customer research and depending on where you were located. On Rodeo Drive I am sure the mark-ups are significant but in Somewhere, New Jersey, the owner has to be more price-sensitive.

Note: There are retailers who will only carry products that allow them to mark-up like crazy and still stay within their customers' comfort 'pay zone'. That's how big box stores make profits. Being a small business, you can take the same approach by only bringing in items that allow you

to get your mark-up and still not scare off your customers. For example, you can buy a less expensive item and still charge a good price for it. If you are a good buyer, then you will have no problems.

Remember, it is your goal to make a profit so don't be shy, instead, be creative!

Step #7. Sales and Promotions

Now everyone wishes that the buyer will always be willing to pay full price; but that is not always the case. You are going to have sales and promotions. If something isn't moving, you may want to encourage sales by discounting the price. To kick start sales, you may want to offer a lost leader – essentially offering a product or service at an introductory price to encourage full price sales on complementary items.

We have all fallen for the “*Buy one at full price and the second at a discount*” promotion and they work. You know it! The reason we are talking about this is that these specials are going to adversely affect your costs by reducing revenues.

If you normally are running costs of 33% and then you have some promotions that feature items at a cost to you of 50%, there is going to be less money at the end of the month to cover ‘other’ expenses. You have to make allowances for sales and promotions because not everything you ‘think’ is great is going to excite the buying public in the same way.

The lesson here is that you are going to have a *fluctuating cost % on items* so make sure you allow for the high-cost sale items by carrying some low-cost % items. The best way to explain how this works is thus. Go into a menswear store and ask for a special on a three-piece suit and you'll be shown one for \$199. Then try and buy a complementary tie for less than \$40. They lose a little on the suit then kill you on the socks and belt and tie and shirt.

You have to have costing breakdowns on all your various items; then you have to track your sales mix, so you can anticipate your theoretical costs. That is a big whammy; however, if you check out the accompanying spreadsheet, you will get a better grasp on things. Do that now.

We have handbooks dealing with cost of goods sold and management information systems so please check these out as well.

Step #8. Be Strong on Price

You have a good business. You have poured your dollars into setting it up properly; and your heart and soul into making it great. Do not and I repeat, do not short change yourself by asking the wrong price. Be strong on price. Add value to the product or service by following up after purchase and asking for honest feedback. Then act on the feedback!

Sometimes business people have a fear of success. And I mean success. Get over it and enjoy being a good business person and an outstanding entrepreneur. Price your products where you can make the profit you deserve. Look at Apple. Are they embarrassed about making a profit? Heck no and they charge the earth for most of their products.

Take a page from the best and be confident that you will make your customers happy and that has to be worth something. And remember that you now know how to price your product or service courtesy of taking the time to follow the steps in:

The Haffhour Handbook
On
How to Price your Products and Services

By Paul Morgan
[Plan2Profit](#)

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