

Do The Math!



Price Elasticity

By Jay Goltz

Proper pricing is critical to making a profit in business. If you price too low, you will get jobs but you won't make any money. As a matter of fact, you could lose money. If you price too high, you will lose jobs to hungry competitors. The eternal question is, what is the right price?

The answer to that question cannot be answered for a particular job, since you can't know what is too much or what is too little. It has to be answered in the bigger picture, when considering multiple bids. Let's do the math!

Let's say that you bid 100 jobs a year. The average job is \$10,000. Last year you got the job 80 times. Your business grossed \$800,000. You bid all of the jobs at a 50 percent margin, giving you a gross profit of \$400,000. Your fixed expenses are \$300,000 a year. That includes everything from rent to labor. You made \$100,000.

You want to make more money next year, and you feel that you are going to get the same amount of bids. You talked to two different contract framers in different cities to get advice. One told you were not pricing right. One told you that you should work on a 45 percent margin and you will get all of the bids and will dominate the market. The other guy said you should be working on a 55 percent. If you did, he said, you will lose a few more bids but you will still make more money, and do it with less work.

Here is the key—no one can predict how much more or less business you will get by lowering or raising prices. It is called price elasticity, and it is not an exact science. You can, however, do a breakeven analysis and see if one option makes more sense than the other. Here is the math.

To break even, you have to have a gross profit of \$400,000.

The new bids are \$11,110 if you work on a 55 per-

cent margin, leaving you with a gross profit of \$6,110 on every job. It's \$9,090 if you work on a 45 percent margin, leaving you with \$4,090 gross profit on every job.

To make the same \$400,000, you will need $\$400,000/6,110=65.5$ jobs or $\$400,000/4,090=98$ jobs. That becomes your choice. Is it more likely that you will get 98 of the jobs instead of 80 at the lower bid? I don't think so. Someone is going to bid it lower because they are either desperate, have lower costs than you, or have mis-priced the job.

What about raising your margin? Will you only lose 15 of the jobs? That one is tougher to guess. Maybe, maybe not. Maybe you will lose seven more of the jobs and get 73 of the bids. That makes it $73 \times \$6,110=$

Pricing and Profit Margin Scenarios

Gross Profit Margin	50%	45%	55%	55%	55%
Average Job Bid	\$10,000	\$9,090	\$11,110	\$11,100	\$11,100
Number of Jobs	80	98	65.5	73	60
Gross Profit Per Job	\$5,000	\$4,090	\$6,110	\$6,110	\$6,110
Total Gross Profit	\$400,000	\$400,000	\$400,000	\$446,030	\$366,600
Less Overhead	\$300,000	\$300,000	\$300,000	\$300,000	\$300,000
Net Profit	\$100,000	\$100,000	\$100,000	\$146,030	\$66,600

\$446,030, netting you \$46,030 more. That would raise your income to \$146,030, or a 46 percent increase by doing less work!

On the other hand, you might lose 20 more of the jobs, so it becomes $60 \times 6,110=\$366,600$. Now your income has dropped to \$66,600, a 33 percent decrease. Ouch. I don't have the answer, only the questions. Pricing is a moving target based upon competition, how busy you are, and perhaps on your staffing level. Good luck. ■

Jay Goltz owns Artists' Frame Service in Chicago, IL, which employs over 50 people at its main framing operation. He has received many business honors and is known for his straight talk on succeeding in business.