Establishing Prices

There are three basic approaches to pricing your product:

Pricing to the Market

Almost every new entrepreneur starts with selling their product at the same price as their competitors. What competitors are able to charge would indicate market value or for new products, you could survey potential customers to see how much they would be willing to pay for your product. This would also indicate fair market value for your product. If you choose to price according to competitors, try to set yourself apart by quality and service to the customer.

Break-even with a Gross Profit Margin

The BREAK-EVEN point in your business is the point at which your sales revenue is equal to your total expenses. At that point you neither make money, nor do you loose any. The break-even lets you know what it is going to take in sales to survive. It provides a good indication of the viability of a business project. The break-even can also be used to evaluate a business expansion or any other business expenditure. You are simply asking how much additional revenue will be required to cover the additional cost. There are some key definitions necessary to determine the break-even for the business.

SALES (Revenue) are what have been "estimated" to be the selling value of the product or providing the service to your customers. Is the "estimate" at break-even? See below.

VARIABLE COSTS (Costs of Goods Sold) or (COGS) are the actual costs of making the product or providing the service. They can include materials, shipping, and contract labor.

FIXED COSTS (Overhead) are costs that do not vary directly with sales. Utilities, rent, salaries, advertising, office supplies and telephone are just a few examples. They do not have to be the same every month. What is important is that you pay them regardless of sales made.

To calculate the break-even in revenue, use the following formulas:

(Sales – COGS) / Sales = Gross Margin (X 100 to express as a %) ie: ($1,000 - $500) / $1,000 = .50 (Gross Margin of 50%)
Fixed Costs / Gross Margin = Break-even Revenue ie: $400 / .50 = $800 of Sales needed to "break-even"

$800 needed to pay for COGS ($800/50% Margin = $400) <u>AND</u> pay Fixed Costs of $400 leaving the business with $0.00, not a profit, nor a loss – BREAK-EVEN.

In the above example, the Sales "estimate" of $1,000 is above the break-even of $800, indicating the business would generate a "profit" of $200 on these sales.

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Cost Approach

This is the most desirable approach that an entrepreneur would take to ensure that their opportunity is a moneymaking opportunity. It requires calculating all costs associated with producing your product or service and determining a suitable profit to keep you in business for many years. First calculate the Cost of Goods Sold (COGS) for one item:

Cost of Materials for one item $________________	$100
+ Cost of Labour for producing one item $________________	$ 10
+ Direct Operating Costs $________________	$ 20
= Total Costs of Goods Sold (COGS) $________________	$130

Then:

Cost of Goods Sold (COGS) $________________	$130
+ Profit Rate per item (i.e. (30%) .30xCOGS) $________________	$ 39
= Selling Price $________________	$169

Selling price for this product needs to be $169 to cover all costs to produce it; $130, AND generate a Profit at a rate of 30%, $39.

The Six Secrets of Costing

1. Find out what you need to produce your product, where you can get the supplies and what they will cost.
2. Decide how many products you can create and sell to satisfy your customers' needs.
3. Calculate the total costs that went into creating your product and mold it into your selling price, making sure your customers are willing and able to pay that price.
4. Look at your business location and the monthly maintenance cost to maintain a good venue for your product.
5. Make sure to pay yourself for the work that you put into your business.
6. Figure out how many customers would have to buy your product to keep the business open.