Pricing and markup

Pricing products

The price you set for a product directly affects your business profitability and customer demand. Prices need to be low enough to appeal to customers but high enough for you to cover your overhead expenses and make a profit.

When pricing a product, consider these questions:

- What are the customers willing to pay?
- What is the break-even point? Are all of your costs covered?
- Do you want to price the same or below your competitors?
- What's the supplier's suggested retail price?

The cost of a product can be figured in one of two ways:

- The total dollar amount you spent on the product.
- The total dollar amount you spent on the materials and labor to make the product.

Operating expenses and the cost of products can cut into your profits. Keep a bigger piece of the pie by controlling them.

Premade to-go salad:
Price $5.00
Cost of product $2.00

Pricing is the most important factor affecting profits

Profits = Sales − Costs

Sales = Items sold × Price

Customer-focused strategies

Opportunistic pricing — Setting a premium price on an item in short supply.

Psychological pricing — Making a price sound right to customers.

Price skimming — Setting a high price on a high-demand product.

Loss leader pricing — Selling a few products at a loss in order to bring customers into your store.

Competition-focused strategies

Defensive pricing — Temporarily lowering prices to discourage new competitors.

Responsive pricing — Monitoring competitors’ prices and adjusting yours to be competitive but still make a profit.
**Markup**

One way to set the sales price of an item is to use a markup percentage. To determine the markup percentage, you need to know the wholesale cost of an item and the amount above that cost that you want to charge for the item.

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\text{Markup} = \text{Selling price} - \text{Wholesale cost}
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\text{Markup percentage} = \frac{\text{Markup}}{\text{Wholesale cost}}
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For example, if you buy four-packs of apples for $2 each wholesale and want to sell them for $3 each:

- Your markup would be $3 - $2 = $1.
- Your markup percentage would be $1 ÷ $2 = 0.50, or 50%.

Most suppliers provide a suggested retail price (SRP) on their invoices. The markup percentage of those suggested prices can be between 20 and 50 percent depending on the product. The SRP may be the typical retail sales price, but you should calculate your own price using the SRP as a point of reference.

If after a time you realize you are not generating enough profit, you can slightly raise the markup percentage to try to increase revenue. Then you would calculate the new selling price based on the markup percentage.

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\text{Wholesale cost} \times (1 + \text{Markup}) = \text{Selling price}
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In the apple example, say you decide you want your markup percentage to be 60% (or 0.60):

- Your new selling price would be $2 × 1.60 = $3.20.

Your overall markup should be enough to cover your operations and carrying costs. Be sure to consider how you will factor in the cost of freight, whether as part of your overhead or included in the wholesale cost.

If you would prefer not to increase your selling price, you can try to find a cheaper wholesale supplier to lower your cost.

**Discounts**

In general, business owners tend to mark down prices to reduce inventory. Reasons for wanting to reduce inventory can include the cost to store items, spoilage, space is needed for new merchandise, and items aren’t selling as anticipated.