

Good Business Run Wisely

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A newsletter to help you Maximize Value Creation in your business

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The McKinney Group, LLC

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Quote of the Month

We will make sure that if there is a price war we will win it.

—**Richard Brasher** of Tesco supermarkets explaining how he was going to help his industry slash their profitability

Developing the Marketing Mix: *Price*

If your business is like most, you are losing 10-50% of your profits due to your pricing alone. That means a business with \$10MM in yearly sales is losing somewhere between \$50k and \$500k in profit each year! After all, small changes in price are large changes in profit.

Costs	\$100	Costs	\$100
Price	\$120	Price	\$108 ← 10% price cut
Profit	\$20	Profit	\$8 ← 60% profit cut!

Pricing is complex. It affects gross profit per sale, total market share, competitive positioning, and customers' perception of your offerings. In the heat of business, decision makers respond to competitive threats with intuition, which usually means a price cut. In return, a price cut often sets off a chain reaction in the market where all companies "race to the bottom" as they compete on price. Such price wars have killed the airline industry in the 1980s, and it is amazing to currently watch the [cellular telephone industry](#) race downwards as well.

Moreover, magazines, business gurus, and the Internet are full of bad pricing advice, much of it followed by the business community. The most common today is the "Value-Added" argument. The argument is that if you are under price pressure, instead of lowering your price to compete you must add additional value to your offerings.

While it may be true that this strategy is not a price cut, it is a profit cut! After all, this added value, whether additional features or increased customer support, is not free. Companies that enact these "Value-Added" strategies inevitably celebrate their success at maintaining or increasing their gross margins but then find profits shrinking due to increased costs in Sales, Operations, Customer Support, or whatever department the added value comes from. *This case study shows the folly of the value-added strategy (Link to EMR case).*

Contact Us

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Instead of reacting to the market or following faddish business trends, you will be far more profitable if you return to the basics. Do a Situation Analysis to understand your Customers, Competitors, Collaborators, and Company. Then strategize. Finally, develop the Marketing Mix that with the right Product, in the right Place, Promoted properly, and Priced to maximize total profits. This is Good Business Run Wisely. Δ

Tighter Economies Call for Intellectual Capital

Everyone makes money when the economy is growing, but when the economy begins to tighten, it becomes survival of the fittest.

- **Profits are shrinking across the board.** The [economic data shows that producer costs have risen 17% in the last year, but consumer prices have not](#). Therefore, efficiency and a well-managed product portfolio will be key to survival.

- **Credit markets are shrinking.** This means lenders are not going to loan money to your business unless they are certain they will get it back. Many small businesses have recently even had their credit lines reduced as banks try to shore up their own balance sheets.

For you to have access to the capital you need, you must be able to show bankers that you know what you're doing, you have a definite business plan, and you speak their language. If you don't and you still manage to get financing, you will pay higher interest rates, which [will severely affect your profitability](#).

- **Competitors will start price wars.** As consumers spend less, companies will start to fight for these dollars. Matching their price cuts will only cause them to cut their own prices yet again until some companies are forced to close their doors. Regardless, the companies that remain will be less profitable. To avoid this, you need to enact Differentiated-Value Pricing.

It is times like these that make it essential to have a strong, well-defined business strategy. If you are serious about keeping your business profitable, contact us before your competitor does. I am creating a toolkit to help you define your strategy. And I am looking to invest intellectual capital in businesses that want to compete in financially attractive industries. After all, business is about to get tough and management by gut and intuition will not be sustainable.

The article *Pricing To Maximize Total Profits* has become a classic. Originally written for an executive of a Fortune 500 company, it has been downloaded thousands of times each month since its debut online.

I invite you to reread this article, which has been recently updated. I have re-titled it *Pricing to Maximize Total Profits: Gross Profit Margin vs. Net Profit* to better match its objective—to explain how the relationship between price and sales volumes affects profit. It also has been reformatted to better match the branding of my strategic management consulting company, The McKinney Group, LLC.