

Profit Pricing for a Manufacturer

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Pricing of your product is an integral part of your marketing program, whether you are a manufacturer, a broker, a wholesaler, a retailer.

There are 4 keys to proper pricing:

- know your market;
- know your competition;
- establish company profit goals; and
- know your costs.

When determining costs, it is obvious to retailers, wholesalers, and brokers, but not quite so evident to manufacturers.

In order to tabulate an accurate cost of finished product, the manufacturer needs to establish a costing system to account for material costs, direct labour costs, and factory overhead expenses.

Once costing is complete, the manufacturer then must determine a reasonable list price that will achieve the company's desired volume and profit goals. This price needs to also consider the competition and the market.

Other considerations which come into play when determining price include:

- previous/current/projected profits;
- new market penetration;
- increasing market share;
- meeting or excluding competition;
- stage product is in, in its product life cycle; and
- external economic trends.

Each of the above can play a major role in your pricing decisions.

You may wish to price on the low side in order to penetrate new markets, or increase market share, or your intent may be to meet the competition, or keep it out.

Manufacturer and the end customer, there may be as 3 intermediaries - a broker or manufacturer's representative, a wholesaler, and a retailer, each of whom requires a gross profit percentage.

A. Manufacturer > Consumer

B. Manufacturer > Retailer > Consumer

C. Manufacturer > Wholesaler > Retailer > Consumer

D. Manufacturer > Broker > Wholesaler > Retailer > Consumer

Let us assume a product that costs \$100 to manufacture (includes all costs such as labour, materials and overhead) is distributed through a broker/manufacture's representative a wholesaler and a retailer. If we assume a gross profit requirement by the manufacturer of 30%, 10% for the broker, 30% for the wholesaler, and 50% for the retailer, the end price of a product costing \$100 to manufacture would be \$454.

Manufactured cost - \$100

	Assumed gross profit %	Resulting mark-up %	Selling price \$
Manufacturer	30	43	143
Broker/Representative	10	11	159
Wholesaler	30	43	227
Retailer	50	100	454

Remember that "gross profit percentage" is the ratio of profit to sales, whereas "mark-up percentage" is the ratio of profit to cost of sales.

e.g.

Gross sales	-	\$454
Cost of sales	-	\$227
Gross profit	-	\$227

Gross Profit Percentage (%) is:

$$\text{Gross profit \$ / Gross sales \$} = \$227.00 / \$454.00 \times 100 = 50\%$$

Mark-up Percentage (%) is:

$$\text{Gross profit \$ / Cost of sales \$} = \$227 / \$227 \times 100 = 100\%$$

Your market research will determine the best types of distribution to use for your product to generate the desired profit margins.

You must remember that profits margins for the different channels of distribution are negotiable, and may be driven by product demand, etc.

Your price must fall somewhere between a "price ceiling" and a "price floor", that is within the "relevant price range."

The price floor is determined by costs and desired profits, while your price ceiling is established by the market and the market research you have done.

Only if you can produce and distribute at a cost which will permit recovery of costs and the desired margin at the price the market determines can you expect to conduct business profitably.

There are two basic rules to remember in setting prices:

- First, you must recognize that it is the market, not your costs, that determine the price at which your product will sell.
- Secondly, you must be aware that your costs and desired profits only establish the price floor (that price below which you cannot sell and make a profit).

Pricing practices in small manufacturing businesses sometimes become outdated. Market conditions change, and pricing practices which were successful a year or so ago may no longer be appropriate.

Therefore pricing practices should be reviewed regularly for possible impacts of rising costs, material shortages, swings in the economy, and tougher competition.

Good pricing practices require an understanding of the influence of market factors, the economy, technology, competition, and resources. The manufacturer must regularly consider each of these factors in addition to cost-related factors internal to the company.

Source: Bank of Montreal—Independent Business Review - Volume 4., S.B.A. Management Aid No. 226 - Pricing for Small Manufacturers.

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