How to Build The Business of Your Dreams

Secrets for attracting customers who buy at prices high enough to let you live the lifestyle you really want.

The failure rate of businesses is staggering.

According to Michael Gerber, in his book *The E Myth Revisited*, over 1,000,000 businesses are started each year in the United States. By the end of the fifth year, 80% of them have failed. By the end of the tenth year, 80% of those that survived the first five are gone. Out of 1,000,000 new businesses started each year, only 40,000 (4%) still exist ten years later.

Dr. Lawrence Steinmetz, the author of *How To Sell At Prices Higher Than Your Competitors*, says there are 11,000,000 real businesses in the United States and that approximately 800,000 new ones are started each year. He says half of the new businesses will fail in the first year and that half the survivors will fail in the second. Only 25% last beyond two years.

It's interesting to note that the number of real businesses in the United States has hovered around 11,000,000 for at least the past 30 years, meaning that for every new business that's started, an existing one fails.

The bottom line is that 75% to 90% of all businesses fail, most sooner than later. The average life span of a business is 7 ½ years.

Why do businesses fail?

Most business owners are highly skilled at their crafts, but are untrained as business operators. They've never learned how to manage people, service customers, handle finances, and most importantly, profitably market and sell.

The cause of at least 90% of all business failures is a lack of marketing and selling skills. You, as business owner, must be able to get your customers to buy at prices high enough to cover all costs and earn a profit. You may be able to delegate many of the day-to-day tasks to others, but unless you personally know how to market and sell the specific products and services your company offers, your chances of success are very low. Lacking these two skills, you'll default to competing by offering low prices and end-up selling below cost. Instead of earning a profit, you'll lose money and go broke.

Becoming an effective and profitable marketer requires mastering two key skills. The first is knowing how to attract the right customers while ignoring those who are not legitimate prospects. The second is to learn effective pricing skills and strategies.

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As Ted Levitt, the legendary Harvard marketing professor says, "Price is the measure of marketing skill."

Although there are many causes of business failure, everything from natural disasters to the disappearance of a market for the company's products, virtually every failure is caused by its owner's lack of business, and especially, marketing and selling skills.

When does a business fail?

A businesses fails when it runs out of cash and can't pay its bills. No one except its owners, and possibly its lenders, cares whether or not a business is profitable. As long as the creditors get paid, a business can stay open as long as its owners choose to keep it open.

How does a business get the cash it needs?

There are only four ways for a business to get cash, no matter how large or small.

- **Equity investment.** Cash can come from owner/operators or by selling a portion of the company's equity to outside investors. To get outside investment capital, there must be a convincing argument showing how the principal portion of the investment will be recouped at a later date, along with a return in the form of dividends or appreciation. Investors must be convinced that the company will achieve profitability in a reasonable period of time because, in most cases, profit will be the source of their investment return.

- **Loans from banks and trade creditors.** To successfully get funding from lenders, there must be a compelling case that shows how the borrowed funds will be repaid at a specific, future time, along with interest. Sufficient collateral to insure repayment of the loan must also be provided, except possibly in the case of loans from family and friends. To obtain loan funds, the business must already be profitable or, in the case of borrowed start-up capital, must convince the lenders that the company will become profitable in a reasonable period of time.

- **Sale of assets the company already owns.** This is almost always a desperation move made by a failing company. It's a last resort tactic, used when there is no other source of cash. The amount of cash available via this method is very limited because few companies have excess assets to sell. Even if they do, used assets nearly always sell for pennies on the dollar. Selling assets needed in everyday business operations effectively puts the company out of business.

- **Profit from operations.** This is the only viable long-term source of cash. Without profit, a business will not be able to repay its loans and provide a return on invested capital. It will soon run out of operating cash, be unable to pay its bills, and go broke.

Be careful not to chase good money after bad.

Continuing to pour money into an unprofitable business to cover cash shortages is a frequent and tragic mistake made by many owners. Their hope is that by providing additional cash, the business will magically become profitable and able to sustain itself. Lack of profitability is the real cause of the cash shortage and more cash only prolongs the inevitable. Until the business is made profitable, it will continue to waste every dollar put into it.

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An even bigger tragedy is that oftentimes, an owner will continue to pour money into a failing business long after there is no hope of it becoming profitable. A combination of desperation and denial pushes them to borrow money from the equity in their homes, from family, from friends, and from any other source they can find. Only after they've drained every cash source do they discover that, not only has their business failed, but that they've used up all their personal assets, alienated their family and friends, and are destitute.

A competitor's desperation can also harm you.

Businesses that are strapped for cash chase every sale they can find, generally by cutting their prices to the bone. It's common to see desperate business owners sell products below cost, without considering how much they're going to need to pay the company's overhead. If you let yourself get caught up matching their ridiculously low prices, you'll get clobbered. The practice of selling below cost is common across the board, but is especially prevalent in today's slowed economy.

When faced with the choice of matching a competitor's extremely low price or refusing a sale, you're far better off refusing it. Oftentimes you'll get a second chance at the sale, on your terms, once the discounter has failed to perform.

When is a business truly profitable?

Many, if not most, business owners believe that when their company has earned enough to pay its outside creditors, it has broken even and that every additional dollar it earns is profit. The reality is that if a business earns only enough to pay its outside creditors, it hasn't broken even, it's lost money.

Many business owners, who think they own profitable businesses, eventually discover that they've short-changed themselves. They realize they've gone without adequate salaries, payment of health and life insurance premiums, and retirement plan contributions. These costs are not luxuries but legitimate business expenses that should have been paid but weren't, because their companies didn't earn enough.

Even when a business earns enough to cover all its costs, including those due its owners, it still hasn't broken even until it has earned enough profit to provide a reasonable return on the capital invested in it. Absent an adequate return on capital, the company's still lost money.

Owning a business is a risky proposition.

One of the riskiest investments a person can make is putting money into a privately held business. Due to the high risk involved, most knowledgeable business people consider a reasonable return on capital invested in one to be 25% to 30% per year. Generally, private investors and venture capitalists look for even higher returns. They commonly expect a return of ten times their initial investment. Not until a company has earned returns at levels this high, has it broken even.

Even though earnings in excess of costs show up as "profit" on the company's income statement, there is no real profit until earnings exceed the amount needed to compensate investors for the use of their capital.

Why leave your money in an unprofitable business?

It's amazing that so many owners allow their money to be tied-up in businesses that don't earn reasonable returns when they have other alternatives that are much safer and pay more. They can invest in places where their money will grow and/or earn regular dividends. They can earn a salary working for

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someone else and, oftentimes, receive better benefits than they're able to pay themselves. They end up with more personal time, get rid of many of their headaches, and sleep far better at night.

Only when a business earns enough to cover all of its costs, pays a reasonable return on the capital invested in it, and has additional earnings, is it truly profitable. Once profitable, it begins to build value and become a saleable asset. Until then, all its owner has is a job he or she can't afford to abandon.

There are four profit drivers in every business.

All companies have four financial profit drivers; fixed costs, sales volume (units), variable costs, and price. Each one effects profitability, some more than others. Focusing on the right ones makes all the difference in the world when working to build your business.

Fixed cost

A fixed cost remains the same in total, regardless of sales volume, but goes down per unit as sales volume increases. For example, rent is generally a fixed cost. To illustrate the behavior of a fixed cost, let's assume that a company's rent is $5,000 per month. If the company's sales are $50,000 per month, each $1 of sales has to cover 10¢ of rent, ($50,000/$5,000 = $0.10). If the company's sales are $250,000 per month, each $1 of sales has to cover only 2¢, ($250,000/$5,000 = $0.02). Because the rent is $5,000 per month regardless of the sales volume, it drops from 10¢ to 2¢, at the higher volume.

Sales volume

Sales volume expresses the number of units sold. Often times sales volume is also expressed as a dollar amount, which is misleading. The correct term for dollar volume is revenue. For example, assume that a company sells 100 bottles of wine at $18 each. The sales volume in units is 100 and sales revenue is $1,800. If the company reduces the sales price to $12 and sells the same number of bottles, the volume in units will still be 100, but the revenue will drop to $1,200.

Variable cost

A variable costs stay the same per unit, regardless of sales volume, but the total changes incrementally in the same direction as sales volume. Each time an item is sold, revenue increases by an amount equal to the sales price and each variable cost associated with the sale increases by its unit cost. For example, assume that each time a book store sells a book for $10 it has to buy it from a distributor for $6 and pay $1 for freight. If one book is sold, sales revenue is $10 and variable costs are $7 ($6 book cost + $1 freight). If two books are sold, sales revenue is $20 and variable costs are $14.

The most common variable cost is the actual cost of the item being sold, called cost of goods sold. Many business people think that cost of goods is the only variable cost a business has. They incorrectly think that all of a company's other operating costs are fixed and frequently use the term "overhead" when speaking of them. They fail to realize that many operating (overhead) costs are variable and increase as sales volume increases. Because of this misconception, they end-up selling at prices too low to cover them.

Variable costs are also sometimes called direct costs because they are directly tied to sales volume and vary in direct proportion to it.

Price

This is what a company charges a customer for a product or service.

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What does margin mean?

Business people talk about profit margins as though everyone understands exactly what is meant. The truth is that the term is used very imprecisely. There are four different measures that are frequently called margin. They are:

- gross margin
- gross profit
- contribution margin
- net profit

Gross margin

Gross margin is the difference between the sales price of an item and the company's cost to acquire it and make it available for sale. For example, if a store sells a book for $10 and it costs the store $6, most people think the gross margin is $4 or 40%. Often overlooked in the calculation are any other costs incurred to obtain it. If the store pays $1 for freight to get the book, its gross margin is really $3 or 30%. Overlooking the $1 of freight can cause a company that uses cost-based pricing to significantly under-price its products.

Cost based pricing is an ineffective way to price products and services and is not recommended, even though it's probably the most common method used by independent businesses. Companies that set prices based on cost invariably under-price their goods and services.

Gross profit

This term means exactly the same thing as gross margin and the two terms are used interchangeably.

Contribution margin

Contribution margin is the difference between the sales price of an item and all of the variable costs a company incurs when it makes a sale. In addition to amounts included in cost of goods sold, (as in the gross margin calculation above), it also includes any other direct costs incurred. Examples of such costs include the cost of processing the transaction, delivery, sales commissions, and credit card fees.

Using the book store example from above, let's assume that, in addition to the costs already mentioned, a commission of 8% ($0.80) must be paid to the sales clerk that made the sale, a 3% ($0.30) credit card fee must be paid, and that the bag that the book is placed in costs $0.05. If the store sells only one book, its sales revenue will be $10 and its variable costs will be $8.15 ($6 book cost + $1 freight +.80 commission + .30 credit card fee +$.05 bag) leaving a contribution margin of $1.85. For every additional book that is sold, sales revenue will increase by $10 and variable costs will increase by $8.15. Assuming that the store sells ten of these books during a month, sales will be $100, book cost will be $60, freight cost will be $10, selling cost will be $8, credit card fees will be $3 and packaging cost will by $0.50. Its gross profit will be $30 ($100 – $60 – $10 = $30) and its contribution margin will be $18.50 ($100 – $60 – $10 – $8 – $3 – $0.50).

To calculate a company's contribution margin, variable costs must be identified and separated from fixed costs.

Accurately knowing your company's contribution margin when setting prices will have a very positive effect on profitability if you're using cost-based pricing.

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Net income

Net income is the difference between sales and all costs and is sometimes called profit margin, overall margin, or bottom-line profit. Each of these terms mean the same thing.

The reason for defining these terms is that, because of their imprecise usage, people need to be clear on what's being included or excluded in a conversation or in a calculation. Lack of clarity can cause significant mistakes to be made. The most common mistake is understating costs and therefore, charging too little.

What's the difference between gross margin and mark-up?

Mark-up is a percentage of an item's cost that is added to it's cost to set a selling price. For example, if an item costs $10 and a 50% mark-up is desired, $5 will be added to the cost of the item ($10 cost x 50% = $5) and the selling price will be $15.

Gross margin is the difference between the selling price of an item and its acquisition cost divided by the selling price. For example, the illustration above used a mark-up percentage of 50% which resulted in a gross margin, or gross profit, of 33%. Step one is to calculate the item's dollar gross margin ($15 sell price – $10 acquisition cost = $5 gross margin). Step two is to divide the $5 gross margin by the $15 sell price. ($5/$15 = 33%). It's vital that the difference between mark-up and gross margin be understood or pricing errors will be made that can cost a company many thousands of dollars.

How do the four profit drivers effect profitability?

Studies have been conducted to determine the effect each of the 4 profit drivers has on profitability. Two studies, one conducted by Harvard Business School, and another by McKinsey, the highly respected management consulting firm, show the effect that a 1% improvement in each of the 4 profit drivers has on a company's net income.

	Harvard	**McKinsey**
	Net Income Increase	**Net Income Increase**
Fixed costs down 1%	3%	2.3%
Sales volume (units) up 1%	4%	3.3%
Variable costs down 1%	7%	7.8%
Price up 1%	12%	11.0%

These studies show that a 1% increase in price is four times as valuable as a 1% decrease in fixed costs.

Trying to reduce fixed costs has little pay-off.

Many, if not most, business owners spend a lot of time trying to save money by reducing fixed operating costs. They go after things like making sure the lights are off so electricity isn't wasted and cutting down on the number of photo copies being made to save paper and toner costs. Mostly their efforts are futile. Reducing fixed costs has been a focus for so long in most businesses that there are few savings left to be found.

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When owners spend so much of their time trying to cut fixed costs, they've little time left to focus on increasing their margins, a far more productive use of their time. They let massive amounts of money slip through their fingers due to their misplaced focus and the money they lose can never be reclaimed. Tom Peters, the well-known business strategist said it best. "You can't shrink your way to greatness."

Increased sales volume often doesn't increase profit.

A business absolutely can't exist without profitable sales. Unfortunately the PROFITABLE portion of this axiom is frequently forgotten. Far too often, sales are booked at prices that contain no profit. Some of the most common reasons are:

- the mistaken belief that all sales are profitable.
- the company's trying to build market share.
- sales people are paid commissions based on sales, not on margin. They're motivated to sell more volume rather than make sure their sales are profitable.
- all costs of the sale aren't known.
- the fear that they'll lose customers if they don't sell at low prices.

Regardless of the reason, lack of profitable sales is the cause of virtually every business failure.

Programs aimed at increasing sales volume can backfire.

There are three common tactics that companies use to increase sales volume; they offer special promotions, add salespeople, and cut prices. All three are fraught with problems.

Promotional programs cost money and often reduce future sales volume. Offering 2 for 1 deals, vacation trips, and similar incentives to boost sales volume cost money and erode profit. In reality, prices are discounted by the cost of the promotion.

Astute customers often take advantage of these offers, loading up on product, and then not buying again until they run out, months later. Once the promotion period ends, sales fall off until all of the product sold during the promotion has been depleted. The end result is that the company ends up selling items at a discount that, in the absence of the special promotion, would ultimately have been sold for full-price. Only if end-user consumption can be increased, does offering a promotion possibly make sense.

One example of how promotions can backfire in a big way is what's happened in the grocery industry. Studies have proven that they've significantly and permanently harmed themselves through the issuance of discount coupons. Use of them has lowered industry-wide gross margins and profitability. Retailing experts estimate this loss of gross margin to be as high as 3%, which translates into an on-going loss of bottom-line, net income of at least one-third.

Adding a sales person is expensive. A sales person earning a modest $60,000 annual base salary actually costs about $98,000 per year when all out-of-pocket costs are considered. If gross margin is 40%, it will take additional sales of $245,000 just to cover the added cost.

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Annual salary	$60,000
Payroll benefits	15,000
Vehicle	9,000
Phone & Computer	4,000
Entertainment	6,000
Sales collateral	2,500
Miscellaneous	1,500
	$98,000

$98,000 / 40% = $245,000

Discounting is deadly. Don't cut prices. You'll rarely, if ever, recover the lost profit. If your normal gross margin is 40% and you cut prices 10%, you'll lose 50% percent of your net income. To earn back the lost profit, unit sales must increase by 35%. If your normal gross profit's 35% and you cut them by 10%, you'll lose 67% of your net income and have to sell 50% more units to recover the lost profit. These examples assume that your fixed cost percentage is typical of most businesses and that you have no variable operating costs, a highly unrealistic assumption. Including them in the calculation would make the profit losses stated above even higher.

It's also assumed that you can handle the extra sales volume without adding staff, increasing inventories, and increasing your accounts receivable, which is impossible. More inventory and higher accounts receivable totals are by-products of increased sales. The cash you'll need to pay for them is enough to put you out of business without even considering the profitability of the added sales. Allowing full-price, profitable sales to increase too rapidly can cause a company to fail. To drive-up sales volume by cutting prices is a sure-fire way to go broke.

The lower your normal gross margin, the more you'll lose from a price cut and the more you'll have to increase unit sales to recover the lost profit. Enter your own information in the *Effect 0f Profit Driver Changes On Net Income Worksheet* and see for yourself what effect increasing and decreasing prices has on your company's profitability.

Curiously, most failing businesses experience increased sales volume right before going bankrupt. Have you ever seen a failing company hold a going-out-of -business price increase?

Does it ever make sense to discount?

There are four situations where granting a discount may be appropriate.

The first is if you remove a commensurate amount of cost from the transaction so that your margins are maintained. For example, assume your normal price includes delivering your product painted in the customer's colors. If the customer will take them un-painted, it may make sense to offer a discount. Cutting prices without removing customer benefits and costs makes no sense.

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The second time it may be appropriate to discount is if you're in a mature market, are the low-cost provider, and can get a long-term contract that blocks your competitors from selling to that customer during the life of the agreement.

The third, and somewhat unethical time, is when you are able to quote or publish artificially inflated prices and then discount off of those prices. This tactic sometimes creates the illusion of a bargain and is used extensively by retailers and in the home remodeling industry.

It's baffling that customers don't shop and compare net prices instead of believing that a discount always provides them with the best bargain.

Beware of the grapevine.

Never forget, customers and prospects talk among themselves at coffee shops, trade shows, and at business mixers. They love to brag about their excellent business and negotiation skills. If you give one of your customers a discount, you can count on the rest of them knowing about it and expecting one too. If you can't justify why only one of your customers is being given lower prices, you'll be faced with the choice of giving discounts to all of them or losing many of them to your competitors.

The fourth situation where discounting may make sense is if you are able to reduce your cost of goods substantially and then pass on a portion of the savings to your customers. Sometimes it's possible for a company to grow to a size that allows them to buy direct from a manufacturer. Buying direct saves the profit margin a local distributor would have received and results in lower costs which can be passed on. It may also be possible to add machinery or new technology that enables a company to operate with lower costs.

Reducing variable costs can make or break you.

The two profit drivers involved in the calculation of both gross margin and contribution margin are variable costs and price. As was shown above, a 1% reduction in variable costs will cause an increase of at least 7% in net income or bottom-line, pre-tax profit.

Reducing variable costs is an excellent way to increase your company's profitability as long as doing so doesn't jeopardize the quality of your product or service to the point that your customers get upset and leave.

How often have you gone to a new restaurant and enjoyed the quality and quantity of the food you were served? How often have you gone back a second time, only to find that the quality's gone down or the quantity of food's been reduced? How often have you gone back a third time, hoping that your second visit was an aberration, only to find the restaurant out of business?

How often have you gone to your trusty, full-service hardware store to buy some screws and gotten home to find that they twisted off just like the low quality junk you find at the discount hardware chains? It's too bad the full-service store owner chose to cut variable costs by reducing product quality instead of learning how to compete in other ways.

Reducing variable costs almost always means reducing the quality or the quantity of the product or service you're selling. Most business owners, who are deathly afraid of raising prices, work diligently to cut costs. They cut them thinking their customers either won't notice or will prefer a low price rather

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than a product that works. If you're not extremely careful, you'll irritate and lose customers, costing you far more than the incremental savings realized.

THE WORST PART IS THAT THE CUSTOMERS YOU'LL LOSE WILL BE YOUR LEAST PRICE SENSITIVE AND MOST PROFITABLE.

It's ironic that owners who work so hard to cut costs do so because they think they're making their businesses better. In reality, all their cost cutting accomplishes is to remove the uniqueness and dependability their customers appreciated. Their well-intentioned efforts end-up costing them their businesses.

Learning pricing skills pays big dividends.

Price has the greatest impact on profitability of all 4 profit drivers. As the studies cited above show, a 1% increase in price will increase your net income by at least 11%. Many businesses discover even greater profit increases when they raise prices. Improvements of up to 30% are often found. Test your own situation by entering your information in the *Effect Of Profit Driver Change On Net Income Worksheet*.

Chances are 9 out of 10 that your prices are too low.

Studies conducted by Harvard Business School prove conclusively that 92% of businesses under-price their products and services, 4% charge too much, and 4% get their pricing about right. These odds say that there's a very strong likelihood you're charging less than your customers are willing to pay, often far less.

You have a tremendous opportunity to increase your company's profitability right now, simply by learning strategies and techniques that will make you a better pricer. So few business owners know how to price effectively that there's a lot of low-hanging fruit for you to pick. Go after it and you'll immediately start earning more and enjoying better cash flow.

Never take your eyes off of your margins.

Ask any successful business owner what the secret is for building a highly profitable business and they'll tell you; "always maintain full margins." They've learned that business is a game of margins, not sales volume. The truth is that when you sell your products and services at full margin, your revenue always goes up while your costs stay the same, leaving you with more profit.

It's really a shame that many business owners spend so much time working hard to cut costs that they have little time left to work on improving their margins. As the table above shows, you'll get a 3 to 4 times better pay-off from increasing margins than you will from cost cutting. Coupled with the fact that the vast majority of businesses set their prices below what their customers are willing to pay, it only makes sense that the focus should be on building margins, as opposed to cutting costs, especially fixed costs.

Healthy margins are vital to success.

Far and away, a company's greatest source of profit's its ability to sell at prices high enough to produce fat profit margins. A company can have the best products and most efficient manufacturing and operating systems in their industry and still not be profitable. Unless its sales force is able to sell at

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prices high enough to produce profit, it will fail. Healthy margins are absolutely essential to a company's success, yet they're something that most business owners find very hard achieve.

Profitable low-cost sellers also earn high margins.

Most business owners correctly believe that Nordstrom's, Mercedes-Benz and other high-end sellers are profitable because they enjoy high profit margins. They're also sure that low-cost providers such as Southwest Airlines and Wal-Mart are forced to work on razor thin margins. Nothing could be further from the truth. Southwest, Wal-Mart and the rest of the PROFITABLE low-cost providers earn margins that are just as fat as those enjoyed by businesses selling at the high-end. They've built cost structures that enable them to sell at prices lower than their competitors and still maintain fat margins.

It's the companies that believe they have to deeply discount, and in the process destroy their margins, that we hear about when they go bankrupt. They are the 75%, or more, of your competitors who are failing. They are the businesses you can't afford to match prices with.

Discounters are a fact of life.

Many business owners believe that their price-cutting competitors will soon go broke, and that once they're gone, prices will go back up. All they have to do is weather the storm. How wrong they are. There'll never be a time when business owners won't have to deal with discounters.

Competition is extremely stiff today and foreign businesses, who enjoy different cost structures and even government subsidies, make selling at profitable prices even more difficult. Nevertheless, to stay in business, you must learn how to sell without giving away the store. You must learn to out-sell them while maintaining your margins. You will fail if you use price as your primary sales tool.

The bottom line is that foreign competitors with low prices and subsidies are in your marketplace to stay. No matter how low their prices, you can't match them or you're a goner. When competing against them, you are the high-cost provider and must learn to sell using tactics other than price. You simply can't match theirs.

Curiously, many businesses fail to increase their prices during boom times, when there's more than enough work for everyone and price sensitivity is at its lowest. They continue to sell at prices that haven't been increased, sometimes for years, while blaming discounters for their low prices and resultant low margins, instead of taking charge and raising them.

You're probably thinking, "I'd love to charge higher prices and enjoy fatter margins, but how in the world can I hold my prices when all my competitors are cutting theirs? I can't stay in business if I don't match them." And it's true that approximately 80% of businesses use discounting as their primary sales tactic, a hurdle you and your sales people must overcome every day. What's also true is that these price-cutters are committing economic suicide and will fail, only to be replaced by other price-cutters. You can't afford to make the fatal mistake of matching the discounters' prices or you too, will fail.

You can learn how to profitably compete with discounters.

There are many skills and strategies that are effective in counteracting discounters such as targeting the right customers and fully communicating the value of your products and services to prospects. There are many other ways to sell at a profit which will be discussed further on and all of them will help you be a more effective competitor.

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Why do so many business owners set their prices too low?

Far and away, the number one reason for under-pricing is fear. Mis-information is a major cause of the fear of raising prices.

For those owners who attended business school, fear was instilled when they took Economics 1A, the most harmful class they ever could have taken. There they were taught that a good didn't sell until its price was equal to the price consumers were willing to pay .Although this statement was, and still is correct, the emphasis was wrongly placed on low price and on finding one optimum selling price. The assumption was made that transactions take place between average buyers and average sellers. In real life, there are no average buyers and sellers. Buyers and sellers are individuals who have minds of their own and behave differently from each other. To make matters worse, as students, they were led to believe that most products have a highly elastic demand and that demand, and sales, significantly go up as price goes down. This is also not a valid assumption in real life. The truth is that at least 75% of buyers are willing to pay a 10% to 15% premium for value and good service. Demand doesn't really follow the economists' tidy but unrealistic graphs.

Studies have also proven that price buyers comprise less than 25% of all buyers. There have been numerous studies that have conclusively proven that price ranks fourth or fifth in importance among the factors that cause a customer to buy or not buy. An even more startling fact is that 96% of all price complaints aren't really about price, they are really a socially acceptable way for a customer to say no without disclosing their real reason for not buying.

There's rarely only one "right" price.

To complicate the situation even further, there's rarely only one optimal price for a product or service. There are usually several different groups of buyers, each willing to pay a different price for the same product or service, and all of the prices are profitable to the seller. The trick is to profitably sell to as many groups of buyers as possible without alienating those buyers who are willing to pay the higher prices. This goal can be accomplished using price fences, a key pricing skill.

Discounting to build market share is foolish.

The holy grail of business school and Wall Street is market share. Students are taught that gaining a large market share is the over-arching goal. Wall Street analysts focus on the speed at which a company's revenue is growing and what their market share is. This focus causes students, who later become business owners, to believe that owning a large market share is more important than being profitable. They're afraid that they'll lose customers by raising prices, costing them market share. This belief is behind many of the failures of publicly traded companies and is absolutely fatal to the independently owned business. A large market share has never produced a single dollar to cover a company's expenses.

The "I can do it better" syndrome.

Many people decide to become business owners because they think they can do whatever it's they do better than their employers. They expect to gain more freedom and keep all the money earned by the business for themselves. They're unaware of what they don't know. They're mostly excellent at their trades, but know little or nothing about running a business. To make matters far worse, most of them go into business undercapitalized. Without enough cash, the odds are stacked against them from the start.

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As soon as cash becomes tight, they begin to view any sale as a source of cash, and cut prices to make deals, regardless of whether or not they're profitable. As they continue to make sales at prices that are too low, they find themselves in an ever more desperate situation and sales, at any price, become ever more vital.

Pressure to cut prices comes from all directions.

Pressure to offer low prices comes from all sides and contributes to an owner's fear of high prices. Everyday, customers ask for low prices, often just to test you and see what they can get away with.

At the same time, the media continually run ads that claim to be offering low, low prices. Hardly ever do you see or hear an ad that doesn't offer a discount. Whether or not the discounts quoted in the ads really provide buyers with the lowest prices available, other business owners believe them and try to match them. Oftentimes, their every-day prices are actually lower than the discounted prices offered in the ads.

What many business owners fail to realize is that many of the businesses that use discounting as a tactic, artificially increase their prices before discounting them. They also entice prospects to visit their stores by advertising stripped-down, loss-leader products that hardly anyone ever buys. They fail to disclose that the products being advertised require add-ons to work, long-term contracts, or use some other device to add profit to a transaction. These tactics produce the illusion of savings to customers while enabling stores to maintain full margins.

Competitors put pressure on a business to discount because most business owners believe they have to match their competitors' prices to make sales. Virtually all price competitors are going broke and any business that follows their price lead will also fail.

The real task of a business owner is to find out what a significant segment of people in his or her market place really want, provide it to them, fence off various groups of buyers, and set prices that match each groups' willingness to pay.

Successfully selling at higher prices requires two rare skills.

Highly successful business owners have two skills in common. The first is their ability to attract and sell to the right customers and the courage to walk away from bad business. The second is their knowledge of pricing strategies and techniques. They thoroughly understand how much value they give their customers and are unwilling to be short-changed by those who want something for nothing. For some, these skills seem to come naturally, while others have to learn them.

Some customers are more valuable than others.

A common mistake made by many business owners is thinking that everyone is a prospective customer. To achieve real success, it's vital that you target only those people who have both an appreciation for and a willingness to pay full-price for the value your company provides. Once you've found them, it's up to you to find ways to give them precisely what they want. If you're successful in your efforts, you'll be well on your way to dramatically increased profitability.

Gambling casinos and airlines and are examples of industries that have long known that segmenting prospects and customers and catering to their unique needs is crucial to their success. Casinos are very aware of their high rollers and give them all sorts of extras so they keep coming back. Not only do they cater to their high rollers, they also offer bus trips and special packages to the huge group of senior

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citizens who love to spend a day or two playing the slot machines. There are only a relatively few travelers willing to pay first class fares, but targeting them is certainly worth the airlines' efforts.

Targeting the wrong customers can actually drive your best prospects and customers away. The following example is exaggerated, but it emphasizes the point being made.

Imagine a restaurant deciding to offer both high-calorie meat and potatoes entrees and low-calorie, vegetarian faire. They advertise thick, juicy T-Bone steaks in a magazine aimed at big-game hunters and salads and meatless dishes in another aimed at the health conscious, animal rights, and anti-gun communities. What's going to happen when the ads from both magazines work and customers from each group start showing up? Not much that's good, and the restaurant's chances for survival are nil.

Learning how to attract and keep customers that fit your niche will have a dramatically positive effect on your company's profitability and cash flow.

Increase sales and margins by using proven pricing strategies.

There are several tools you can use to increase your company's sales and profitability. Using tiered pricing, fencing, velocity pricing, properly quoting prices, and the correct handling of visible vs. blind items will help you increase your profit margins anywhere from 3 to 10 percent or more and double or even triple, your bottom line, net income.

What if I lose clients?

If you're like many, if not most, business owners, you're probably worried that if you start tightening your focus and increasing your prices, you'll lose customers and your business will suffer. The truth is, you won't.

What business owners who've adopted the strategies taught by Fat Margins have discovered is that they end up selling more to customers who pay higher prices. Their customers' satisfaction and trust have gone way up while price sensitivity has gone way down.

They've also seen a significant increase in referrals to new, profitable customers. The only ones they've lost are those they've chosen to cut loose because they were unwilling to lose any more money on them.

Your financial statements won't help you much.

The financial statements you receive from your accountant don't provide you with much help in managing your business and maintaining your margins. They're not designed to help you monitor day-to-day operations. Financial statements are prepared based on generally accepted accounting principles, (GAAP), and are designed to be used by outsiders, such as bankers, investors and governmental agencies. To make matters worse, they're prepared after the fact, when it's too late for you to take action.

You need much more detailed transaction data than is shown on your financial statements. The data needs to be presented in a way that tells you about the activities that are taking place, as they are taking place, so you can take corrective action quickly, whenever and wherever needed.

Very few business owners insist on accurate financial information and very few know how to read the information they do receive. To add to the problem, it's astonishing how often financial statements are inaccurate and transactions are mis-classified. For example, an extremely common error is for the dollar

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amount of inventory on the balance sheet to remain unchanged for months, and even years, at a time. Another example is when expense items are mis-labeled, such as when yellow page advertising is included in utilities expense.

Check out the *Automotive Center Case Study* to see just how valuable having the right information on hand can be as you manage your business. You'll be amazed.

Your accountants aren't much help either.

An additional problem is that most accountants aren't able to advise you on how to maintain adequate profit margins. Their focus is almost always on cutting costs and reducing taxes. Few are trained in marketing or business management. To expect them to be able to advise you on how to guide your business to profitability is naïve.

A major contributor to the lack of quality financial information is that many business owners fail to see value in it and pay the least amount possible to get their books done. They're typically only concerned with complying with governmental regulations and see no value in having anything more.

Profit and sustained success come from earning fat margins.

Holding on to your margins is the only long-term solution you have for maintaining profitability. Fortunately, there are tools you can use to guide you. If you are already doing well, they'll help you move your business to an even higher, more profitable level. If you are struggling, they'll help you improve your profit margins, insulate your business from discounters, and turn it into a highly profitable and valuable asset.

The strategies, techniques, and tools discussed in this paper and available through Fat Margins are used by savvy, successful business owners in every industry, including the Fortune 500. Not only are their businesses profitable, they generate excellent cash flow, enabling them to grow, expand, and become ever more valuable and marketable.

Here's where you can find help for growing your margins.

Fat Margins provides business owners with the knowledge, tools and guidance they need to turn their companies into high-profit operations. On the web site you'll find educational articles, programs, case studies, strategies, techniques, calculators, templates, worksheets, and links to other sites that will enable you to become a margin master. The site has been designed to be a resource for you. It's a place for you to return to anytime you're working to fatten your own company's margins.

You can also get your questions answered using the Fat Margins Blog and by subscribing to the FREE Margin Builders monthly e-zine.

If you choose to apply the knowledge and use the tools that are here, you'll wring far more profit out of your business, make operating it far easier, and improve your own personal lifestyle.

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