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California Community Colleges

## **Unit 6 – Pricing Contracts**

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- Implementing pricing best practices

### **The Importance of Pricing**

Understanding Contract Education finances is important, but even more important is being able to use what you comprehend about finances to price. Knowing how to price ensures you get the operating margin you want on the contracts you are selling.

### **Understanding Contract Costs**

When pricing, the most important costs to know are your production costs – the costs to deliver the contract. Examples of production costs are instructor fees, materials, food, product development, thus any cost required to deliver the contract.

Costs such as staff costs, phone costs or any correspondence such as overnight packages, and any other indirect costs or overhead are not included in production costs, thus are not critical to know when pricing. As the person pricing, the costs you should know are production costs, the costs you need to know to come up with the right pricing.

### **Market Pricing**

Only using a formula to price does not work. You need to understand what your competitors are charging and also what your clients have historically paid, thus are willing to pay. Using all three – formula, competition, and client knowledge, you can do market pricing.

Using these three factors, you can arrive at a price that will be fair and profitable. Your three steps are:

- #1. First, determine the cost of producing/delivering the contract.
- #2. Second, see what other competitors are charging by asking your present clients who the competition has sold to before, checking out the competition's website, and talking to other Contract Education programs who have sold against the same competition.
- #3. Third, try to determine what the client is willing to pay.

Then come up with a price that is fair for your Contract Education program and your client.

### **Pricing Contracts**

Keeping your pricing as simple as possible is most important. Follow these steps:

Step 1: Use a formula to determine the minimum you should be charging. So:

- If production costs are \$4,000 and
- You want production costs to be 40 percent of the contract's income then
- You divide \$4,000 by 40 percent to get \$10,000

You now know how much income the contract has to generate to keep your production costs at 40 percent.

Step 2: You check what the competition is charging and what your client or similar clients have paid in the past. If those prices are lower, then you have three choices

- Choice 1: Cut your production costs, thus cutting your formula price.
- Choice 2: Plan to charge more because the value is there.
- Choice 3: Walk away and do not submit a price.

Step 3: If your formula price is in range, you now think in terms of price breaks – the point at which most clients would say the price is too high. The following are Contract Education price breaks:

\$250	\$2,500	\$15,000
\$500	\$3,000	\$20,000
\$750	\$5,000	\$25,000
\$1,000	\$7,500	\$30,000
\$1,500	\$10,000	\$40,000
\$2,000	\$12,500	\$50,000

Normally you do not want to land on a price break unless it has a 5 in it, like \$250, \$750, \$1,500 and \$2,500. So with price breaks you are normally going to be under or above the price break. In this example instead of \$10,000 you would price at \$9,500 or \$12,500. If you price at \$11,500 for example, you are leaving money on the table, as the client will not be concerned until you go over \$12,500.

It should be noted that if you can make big money on a contract, you should. So if in this example the competition is charging \$20,000 and clients have paid that before, then you should charge \$19,500 and make a great operating margin. No all contracts generate an appropriate operating margin, so support the underperformers by letting the winners win.

### *Materials*

Some contracts have a higher materials cost and marking materials up the same as other costs may be challenging. With materials, they should be marked up at least 20 percent. If you have \$3,000 in materials costs, you may charge \$3,600 for materials (materials pricing is not sensitive to price breaks). So your final price might be \$12,500 plus \$3,600 for materials or \$16,100 in total.

### **Pricing Best Practices**

When pricing contracts keep the following in mind:

- Use market pricing and where you can charge more do so, and if you cannot compete, walk away.
- On an average your income for a contract should be at least two times the cost to deliver the contract.
- Add worth to your contracts by adding value, such as including a nationally known presenter possibly by webinar.

- Understand price breaks. Stay off of double (that do not include a five) or more zeros numbers and use the number five. It should be noted, the higher the price, the less sensitive to price breaks, so pricing a contract at \$2,950 instead of \$3,000 is more important than not landing on \$30,000.
- Don't sell just one price range of contracts. Diversify your contracts, thus prices. It allows you to appeal to audiences who want contracts at different levels of prices.
- Give your clients, especially new clients, more than one price. Each price would be a different level of product and/or service. It is easier to say no to one price, thus multiple prices keeps the conversation active. Most times your client will pick the middle price.
- A salesperson should be able to charge what they can get, as long as they are getting the required operating margin. If the operating margin is below the requirement, they would need to get a supervisor's approval. A salesperson can sell lots of contracts and generate lots of money, but if they are not getting the operating margin, then the contracts may not be to your benefit.

## **Product Development Costs**

It costs money to develop new products and services. Very often the operating margin generated by a contract can be reduced by the addition of the cost of product development.

If you are going to incur product development costs, such as new curriculum development, you need to decide how the cost is going to be covered. The following are your options:

Option 1: You charge the client separately for the product development. At the least you should be charging double the cost. This strategy is normally selected if the client is the only one who is going to take advantage of this new product and/or the new product or service requires significant customization specific to the client's situation.

Option 2: You split the cost of the product development out over multiple contracts. This would be true with a new product or service you are confident you can sell to multiple clients. So if the product development costs are \$5,000 and you project you will be able to sell the contract to at least five clients, you would add \$1,000 to your production costs when you are pricing.

Option 3. Not charge for product development costs, but they still remain a cost. Not the best strategy, so you need to make sure by incurring the product development cost your operating margin does not drop below an accepted minimum level.

### **Summary**

Bottom-line, keep your pricing simple. Make sure to get your operating margin and make money where you can. Normally, two contracts are winners, two contracts are losers, and the other six are okay.