How to Improve Profitability Through Pricing Strategy

by Dave Clark, Karmak, Inc.
If you want to maximize parts profitability, having an effective parts pricing strategy can help. Maximizing profitability isn’t simply selling more parts at a higher profit. High profitability is attained by pricing items competitively where necessary and by maximizing your profitability on items where your market allows. Implementing and maintaining an effective pricing strategy will make your selling and pricing processes more efficient and improve your bottom line.

**What is pricing strategy?**

Pricing strategy is the method you use to determine the price of parts. Using a strategy creates consistency in how parts are priced, ensuring you can better manage your parts sales and profits. Determining the best strategy to use for your business is dependent on your business’s individual needs, and your market. Here are two common strategies, typically used together, that can help strengthen your profitability.

**Cost Matrix Pricing**

With Cost Matrix Pricing, the selling price of the part is inflated, based on its cost. The lower the cost, the greater the mark-up. More expensive items have little or no additional mark-up. This allows you to make increased profit margin on inexpensive items, and recover some of the high transactional costs associated with these items.

This strategy relies on the idea that inexpensive items are generally parts used in the installation of a more expensive item. The focus of the transaction is on the more expensive item, which tends to be more market sensitive, and not the supporting components.

<table>
<thead>
<tr>
<th>Your Cost</th>
<th>Original Selling Price</th>
<th>Original GPM%*</th>
<th>Additional Mark-up</th>
<th>New Selling Price</th>
<th>New GPM%</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.05</td>
<td>$0.10</td>
<td>50%</td>
<td>2.0</td>
<td>$.20</td>
<td>75%</td>
</tr>
<tr>
<td>$0.50</td>
<td>$0.75</td>
<td>33%</td>
<td>1.5</td>
<td>$1.12</td>
<td>55%</td>
</tr>
<tr>
<td>$1.00</td>
<td>$1.50</td>
<td>33%</td>
<td>1.25</td>
<td>$1.87</td>
<td>46%</td>
</tr>
<tr>
<td>$2.00</td>
<td>$2.85</td>
<td>30%</td>
<td>1.2</td>
<td>$3.42</td>
<td>42%</td>
</tr>
<tr>
<td>$5.00</td>
<td>$7.50</td>
<td>33%</td>
<td>1.1</td>
<td>$8.25</td>
<td>39%</td>
</tr>
<tr>
<td>$7.00</td>
<td>$10.50</td>
<td>33%</td>
<td>1.05</td>
<td>$11.02</td>
<td>36%</td>
</tr>
<tr>
<td>&gt;$7.00</td>
<td>none</td>
<td>none</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* GPM – Gross Profit Margin
Velocity Matrix Pricing

Velocity Pricing is the concept of selling slower moving parts at an increased profit margin. Slower moving parts have additional carrying costs associated with stocking the part and should have higher mark-ups to account for these additional costs.

Your fast moving parts are the same as the fast moving parts of your customers and competitors. Your customers will shop around for a good price on those parts, since they tend to be more of a commodity. Your customers will buy lower demand parts, out of convenience, with less concern for the price.

<table>
<thead>
<tr>
<th>Part</th>
<th>Frequency of Sales</th>
<th>Cost</th>
<th>Selling Price</th>
<th>Profit Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part A</td>
<td>Daily</td>
<td>$200.00</td>
<td>$275.00</td>
<td>27%</td>
</tr>
<tr>
<td>Part B</td>
<td>Weekly</td>
<td>$200.00</td>
<td>$285.00</td>
<td>30%</td>
</tr>
<tr>
<td>Part C</td>
<td>Bi-weekly</td>
<td>$200.00</td>
<td>$300.00</td>
<td>33%</td>
</tr>
<tr>
<td>Part D</td>
<td>Monthly</td>
<td>$200.00</td>
<td>$325.00</td>
<td>38%</td>
</tr>
<tr>
<td>Part E</td>
<td>Bi-monthly</td>
<td>$200.00</td>
<td>$350.00</td>
<td>42%</td>
</tr>
</tbody>
</table>

Do I have to change my pricing?

Pricing strategy is an integral part of business strategy. As your business evolves to meet the demands of your customers, your pricing strategies need to be re-evaluated to make sure they are up-to-date and still working for your business.

After evaluation, you may find that your pricing strategy is working well for your business goals. In that case, you should keep doing what you’re doing, but evaluate your strategy regularly to make sure it continues that way. However, if you find some of the following red flags you may need to revisit your strategies and supporting business system configurations.

Low or declining margins on parts sales

If your pricing strategy isn’t where it needs to be, you might start to see a decline in profit margins in your parts sales. By adjusting your pricing, you can get your profits back to where they need to be to achieve your business goals.

New product lines have been introduced

Introducing a new product line that differs from your existing business is a good time to evaluate your pricing strategy. You will need to apply the current pricing strategy to the new product line or alter the current strategy to accommodate it.
Employees are performing too many overrides

Your employees should be able to sell parts with the prices in your business system rather than make changes every time they help a customer. Excessive overrides at point-of-sale usually mean that your pricing strategy is out-of-date for your current needs.

For more indicators that it’s time to restructure your pricing, download Karmak’s tip sheet, 10 Signs It’s Time to Restructure Your Pricing.

What can I do?

Developing a pricing strategy is not just a matter of adjusting your prices on parts. As the name implies, there is a strategy involved that takes your whole business into consideration, as well as your competition and your customers’ needs. As you evaluate your pricing strategy, or start to implement one, there are a few things you can do to make it easier.

Know your numbers

One of the most important aspects of improving profitability in parts sales is knowing exactly where your business is now. Understanding your current pricing and profitability creates a baseline to measure changes against as you work toward your profit goals. If you don’t have a strong understanding of your business numbers, it’s nearly impossible to set and achieve your profitability goals.

Know your customers

The cost of your parts and how much you want to earn are not the only factors in determining your parts prices. You have to take your customers’ perception of value into consideration, as well. You may know what your part is worth, but if your customers have a different idea of the part’s value, there will be a gap in your pricing strategy.

Restructure your pricing

It may be necessary to restructure your pricing to increase your profitability. After gaining an understanding of your pricing and learning the value your customers put on your parts, you may decide that your current pricing doesn’t maximize your parts profitability. Defining your pricing strategy and getting your business system configured to support your strategy will help you maximize your parts profitability.
Conclusion

Pricing strategy is one important component of your overall business strategy. Finding the best strategy and pricing for your individual business will help you achieve the financial goals you want, as well as continue to move your business toward operational excellence.

Watch for Karmak’s upcoming article, *How to Restructure my Pricing?*, to evaluate your business and determine the best path for your pricing strategy.

About Dave Clark

Dave Clark joined Karmak in 2008. While at Karmak he has always worked in business consulting, and has worked with Karmak’s Product Owners in Fusion development. Prior to joining the team at Karmak, he was a Vice President at Uptime Parts, a division of Navistar, and was Vice President of Operations at Power Brake & Equipment. He has experience as a Karmak customer, giving him unique insight into how to best help customers realize their operational goals.

About Karmak

Karmak, Inc. is a leading provider of business management solutions for the commercial transportation industry. With more than 30 years of heavy-duty experience, we offer a unique approach combining innovative technology, strategic advice and best practices. Our success programs produce measurable results by improving ROI, mitigating risks and achieving operational excellence.

Serving more than 1,800 locations across North America, Karmak is an employee-owned company with headquarters in Carlinville, Illinois.