

# FACTS SHEET – September 1996

## The Pricing & Volume Decision

### The Effect of Price Cutting

It is tempting indeed to boost your sales by cutting your price. Your argument is that by doing so you will in fact increase your volume sales to compensate for the loss of your profit margin, and also, that you will increase your share of the market.

Some may simply cut their price 'because everyone else is doing it'.

But do you know how much volume additionally you have to sell to justify your price cut?

Let's assume that your product sells for \$6.00 each but costs you only \$4.50 and typically you sell 100 everyday. Your profit would be \$150.00. However, if you reduce your price by 10%, your new price is \$5.40 each. If you still need to make your \$150.00 then you will need to sell 166 everyday - an increase in volume of 67%!! The chart below details the increase in volume that justifies a price cut just to break even.

Price Cut	Volume Increase Required
2%	9%
5%	25%
10%	67%
15%	150%
20%	400%

### The Effect of a Price Increase

If you provide a better service or a better product, should you be trying to compete on price alone?  
**Quality is not cheap.**

It is logical to assume, that if you cut your price, you raise your volume sales. Conversely then, if you raise price, then you may lose sales volume.

Losing sales volume, or losing some customers, can sometimes be a good thing. Think about it. You will probably be losing the customers who don't respect your service or product, and who probably don't pay on time, and, it gives you more time to concentrate on those customers you want to sell to.

How many sales can you afford to lose but still receive the same profit?

Assuming the same example used, if you increased your selling price 10% to \$6.60, then you **only** have to sell 71 a day to make your \$150 - a reduction in sales volume of 29%, as noted below:

Price Increase	Affordable Lost Sales
2%	7%
5%	17%
10%	29%
15%	38%
20%	44%

Be careful though, research your market, survey your customers, and obtain professional advice before acting. You may be surprised with the results.

**Important:** *The information contained in this Facts Sheet is not advice. Many of the comments in this Facts Sheet are general in nature and anyone intending to apply the information to practical circumstances should seek professional advice to independently verify their interpretation and the information's applicability to their particular circumstances. Also please note that changes to legislation may occur quickly.*

**For more information**, or if you would like assistance, please contact Farmilo & Co.

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