***What’s our pricing strategy?***

Here’s one to ask the sales team and the directors.

It’s important, because our strategy affects our prices, which affects our profit.

In essence, there are three different sales strategies: corner the market; maximise sales revenue; or maximise profit.

Cornering the market means dropping our prices as far as we possibly can: the lower the price, the more we’ll sell. Ultimately, if we give everything away, we’ll have a monopoly. No income to cover our costs, but a monopoly! This loss leader approach might work, so long as it leads to an income ultimately. Facebook is a good example of this. It’s free, and it’s the social media platform. But it generates good advertising income. LinkedIn is another example. Not only does it generate advertising income, it’s also starting to sell its service: LinkedIn Premium.

Maximising sales revenue means dropping prices to the point that the money we receive from sales is maximised. Suppose we sell 100 units a week at £100: that’s £10,000 sales revenue every week. If we drop the price by £10, we should be able to sell 150 a week (at £90). That’s £13,500 sales revenue every week. Dropping the price to £80 will lead to sales of 200: £16,000. £70 will give sales of 250: £17,500 in total. A price of £60 should lead to sales of 300: £18,000 in total. Dropping the price to £50, with sales of 350 a week is a step to far: total sales fall back to £17,500.

So if we’re trying to maximise sales revenue, the £60 price seems most attractive: certainly a lot more attractive than £100 per unit.

But we’re in business to make a profit, not simply make sales. If we buy these goods in for £80 and sell them for £100, we’re making £20 profit on every sale. On sales of 100 per week, that’s £2,000 profit every week. Drop the price to £90, and the profit per unit falls to £10. Even though we’re selling more (150 a week), profit falls to £1,500. At £60 an item we’re losing money on each sale: the more we sell (and we’re selling lots!), the more we lose.

So if the sales people think their aim is to maximise their sales revenue, and they give discounts to achieve this, they could be actively damaging profitability.

Something else to watch for with this question is whether the answers given by the directors and by the sales teams agree. If they don’t, you have an interesting communications issue on your hands as well as a financial understanding issue!