d—src

The Profitability Testing Guide

The Founders Guide to Authentically Cultivating a New Business or Idea

Contents

Profitability:

noun

the degree to which a business or activity yields financial gain

The Profitability Testing Guide

Welcome to The Profitability Testing Guide. This tool was built to help you build the perfect pricing model based on your industry and location. This guidebook will help you learn how to use current market and industry data to appropriately price your offerings.

Your pricing model lays the foundation of your company's profitability - ultimately defining the trajectory of your earnings. Getting your pricing right before you begin pushing your product in the market is important to ensure that you're covering your expenses, providing your customers with the best price point, and yielding a profit that makes the investment worthwhile. A company's balance sheets will usually illuminate the profit margin(s) of its offering(s). But, if you're a startup with limited or no financials, a profit test is the best choice for gaining a practical understanding of what it looks like to turn a profit in your industry.

This guidebook covers two critical components of conducting a profit test :

- Developing a Pricing Model
  - The 1st step toward building any financials for your business - including a profit test.
- Executing a Profit Test
  - Combine your pricing model with projected sales figures and data-based expense estimates to assess the extent to which your business model yields a financial gain.

To complete a D-SOURCE profitability test, download the following templates in your account:

For companies with a basic pricing model

The Basic Pricing Model

The Basic Profit Test

For companies with a commission-based pricing model

The Commission Pricing Model

The Commission Profit Test

I. Building a Pricing Model

Your pricing model lays the foundation of your company's profitability - ultimately defining the trajectory of your earnings. When properly set, your pricing model will maximize every dollar spent and earned in your business. A high-quality pricing model ensures three things:

1. The company's operating revenues and overhead expenses are completely covered by it's revenues;
2. The business and its owners are fairly compensated for the investment(s) of time and energy required to create the product
3. The company's rates are aligned with market standards for offerings of similar style, size, location, etc.

Finding that "sweet spot" in your pricing model is critical to maximizing the number of customers at your (physical or digital) doorstep.

Developing a reliable pricing model involves three critical steps:

- Market Research
- Profitability Testing and
- Reconciliation

Step 1: Market Research

Patronize similar businesses in your industry, conduct a web search, beta test your offering, and ask around to decide on the best starting point for your prices. If this is your first time building a pricing model, try not to overly focus on finding the perfect price right away. The profitability test will ultimately illuminate whether your pricing is adequate, for now, you just need a starting point.

Step 2: The Profitability Test

Input your price points and projected sales figures (from market research) into the profitability test. Use the outputs from this workbook to determine whether your prices make a profit.

Step 3: Reconciliation

Use the outputs from the Profitability Test to adjust - or "reconcile" - your price point(s) until you reach a model that best serves your business goals .

Download the D-SOURCE "Basic Pricing Model" or "Commission Pricing Model" to get started. If you need help building your pricing model using D-SOURCE template(s), take the supplemental course(s) on building these Pricing Model templates in your D-SOURCE account.

II: Conducting a Profit Test

Profit margin is one of the most important numbers you should know about your business. Your profit margin can illuminate the answers to critical questions you might have about your pricing strategy such as:

- Am I charging too much or too little for my offering(s)?
- Am I making enough sales to sustain my operations?
- Are my operating expenses too high?

Knowing the ins and outs of your profit margin gives you a leg up in your industry as you minimize risk from making misinformed financial decisions and avoid selling in a vacuum, with little to no context of where you need to cut back or expand to maximize your operations.

Net Profit Margin

Net profit margin is the measure of your company's revenue after covering all business expenses. This number communicates to potential partners and funders the answer to a very important question. What proportion of the revenue from your company's earnings does the company keep at the end of the fiscal year?

A healthy net profit margin is a sign of your financial health and indicates a "low-risk" involved with investing in your company. Founders can use past, current, and projected financials to assess their company's profit margin. What does your current and/or projected profit margin say about the health of your company's financials?

NET PROFIT MARGIN		
LOW	AVERAGE	HIGH
A profit margin under 5% is considered low;	average profit margin is generally 7-10%	a 20% profit margin is high

Profit margins highlight your company's inefficiencies, serving as a reminder of where you need to improve. The better your understanding of your company's profit margins, the greater your capacity is to improve your product or service and serve more people.

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Additional Downloads

1. Pricing Model Samples
   a. Basic Pricing Model Sample - "Bonnie's Body Butters"
   b. Commission Pricing Model Sample - "Property Managers Inc."
2. Profit Testing Samples
   a. Basic Profit Test Sample - "Bonnie's Body Butters"
   b. Commission Profit Test Sample - "Property Managers Inc."