

# Raise Your Prices – Now!

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If you raise your prices, you might lose some clients. If you don't raise your prices, you might lose your business.

When was the last time you increased your consulting rates? If you're a contractor, have you recently increased your mobilization fee or your footage charge for drilling? If you have not raised your prices, your profit margin is undoubtedly falling as external costs continue to rise. If your rates are static, every added dollar of cost takes a dollar of profit off your bottom line. Allow that profit erosion to continue too long, and soon there will be no profit remaining and your business will fold.

Of the many pricing models in use throughout the business world, most consulting and contracting firms use some amalgam of markup pricing and going-rate pricing. In markup pricing, you add a standard markup to your fixed and variable costs. For a consultant, the markup will typically be some percentage of the total costs, including salary, benefits, personnel taxes, and some allowance for overhead. The going-rate approach is purely market-based, reflecting the realities of competition; if all other things are equal, your pricing must be in line with the competition. So most firms start from a markup basis and then adjust up or down based on what the competition is doing. But very rarely are "all other things equal".

## What Type of Company Are You?

Are you a Wal-Mart or a Saks Fifth Avenue? Are you catering to clients with a low-bid mentality or those who appreciate quality work and good customer service? Chances are you're somewhere in between, feeling the squeeze of demanding clients who expect great service and low prices. If you're an upstart, perhaps you aspire to be a Saks, but must be more of a Wal-Mart as you build your business and reputation. Either way, you must

find a way to effectively recover all of your costs and make a profit.

If you go the Wal-Mart route, you have to steadfastly minimize or eliminate every cost that you can. You'll make a thinner profit margin, but make up for it in volume. If you go the Saks route, you'll have much higher costs of goods and services, higher prices, and fatter profit margins, but probably fewer clients. In both cases, however, if you fail to pass along the increases in the external costs that you cannot eliminate or minimize, your profit margin will erode and put your business at risk.

## Small, Regular Price Increases

My wife and I recently received a mass email from one of the babysitters that we occasionally use. She was notifying all of her clients of a rate increase. For several years, she had charged \$10/hr and suddenly realized that she should be charging much more and was raising her rate to \$12/hr. I'm sure that a contributing factor was her 20-mile commute and the mounting gasoline bills that come with it. What would happen to your business if you suddenly told all your clients that their costs were going up 20%? It's safe to say you would be looking for lot of new clients. But for our babysitter, it was not a risky move: she is a very responsible college student who is in tremendous demand, and for most people, her price increase amounts to an extra \$8 on a Friday night. It's not that big of a deal – especially when you're talking about the caretaker of your children.

If you're a consulting geologist who suddenly raises rates by 20%, however, that might mean thousands of dollars in additional expenses to your clients, creating a significant marketing opportunity for your competitors. So it makes sense to enact regular, small price increases that are grounded in reality and easier for your clients to absorb. Even if you



don't want to increase the bottom-line price to your client, I suggest that you at least increase your billing rates periodically – you can always charge fewer hours to keep the price static.

## Communicate

As with most things in business, good communication is an absolute necessity. Most clients are just like you – they're real people and they're mostly reasonable. If you explain to them the reason for the increase, what you're doing to alleviate the increase and minimize future price changes, they will understand and stick with you as long as you continue to focus on good service and not take them for granted.

A recent example of the importance of communicating the reasons for price increases affected the oldest gas utility in the country. At the risk of getting on a bit of a soapbox, let me give you the details from my home state. Baltimore Gas & Electric (BGE) was "deregulated" in 1999 to allow competitors to enter the Maryland market and drive down energy costs. However, deregulation is a misnomer, because the state imposed a rate cap that held electric rates artificially low at 1993 levels (price controls are hardly a hallmark of deregulation). Not surprisingly, competitors failed to enter the market, because no reasonable company would want to compete for the opportunity to charge customers less than the market price for something!

Effective July 2006, the rate caps expired and rate payers were hit with tremendous increases on the order of 72%. BGE took an absolute beating in the press. In my opinion, that beating was completely unjustified. The price increases, as most geologists can understand, are the result of market

forces and the demand pressures on world energy supplies. China and India are consuming energy at exponentially-increasing rates, and supply is further limited by geopolitical disruptions in the Middle East, environmental restrictions, damaged production and refining capacity in the United States following the hurricanes of 2005, among others. For years, the utility was mandated by law to absorb these costs. Regardless of the price of energy on the open market, BGE was forced to sell electricity at the 1993 levels.

BGE's problem was exacerbated by a heated political season and a state legislature nationally regarded as unfriendly to business; indeed, in the last couple of months, the utility's bond rating has been lowered twice because of the political uncertainty in Maryland. The utility shouldered much of the blame for the price increases and was widely skewered in the press as greedy – even though they do not profit on price increases! BGE makes its money on the delivery of the commodity, *not* the supply. The costs of purchase are simply passed along to the consumer when the utility buys energy

from the lowest bidder at a state-regulated auction. In fact, one could argue that the higher prices will actually *hurt* BGE's profitability, because it's reasonable to assume that customers will cut back on consumption to reduce their overall bill (i.e., BGE will be delivering less energy on which it can profit).

The moral of this story is that the 72% increase was so large and shocking, that consumers were not willing to listen to the very reasonable explanations, and the politicians seized an opportunity to exploit the issue rather than help the populace understand the facts. Imagine that the state had not muddied the waters in 1999 by trying to control the market. If this large increase were annualized over the 13 years of frozen prices, the annual increases would be just 3.5%. Most people would hardly notice such an increase and this 200-year old company would not suddenly have experienced two drops in its bond rating.

If you continue to "eat" the costs when your expenses rise, you run the risk of hitting your clients with a whopping increase just like BGE. At that point, they might not be willing to listen to

your explanations. At best, they might think you were a bad business owner for letting things get so far out of control. At worst, they might penalize you in the most extreme way by ceasing the business relationship. But if you take baby steps and enact reasonable price increases at reasonable times, such as when gasoline prices are skyrocketing, your clients will understand.

Now it's time to call that babysitter and have a little chat about price increases....

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