

# Getting pricing right

Ron Wood, Pricing Insight

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Chartered Accountants Business in Focus  
Monthly audio program

May, 2011

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What's the role of the accountant in the family office? It's important but not without challenges and Michael Heine of Netwealth Investments offers perspectives and some great advice on this month's CD. There's great advice also for accountants on assessing the risks of investing in expansion projects or acquisitions. That's where hurdle rates can assist, and Hamish Blair of Leadenhall Corporate Finance will show us how. And share investing gets the preferential thumbs up from John King of AJK Consulting. The proviso is: you've got to do it right. John King has some clear views which he outlines carefully for us. Also this month, we cover the critical area of pricing, where fine-tuning can make the difference between a client's ledger being in the black, or red. And the dangers of over-confidence when it blinds business operators to reality. It's instinctive but we need to beware, as we'll hear from behavioural expert, Andrew O'Keefe.

We'd like to take the opportunity this month to tell you about some exciting developments here at Business Essentials. We're delighted to announce that we've merged our operations with those of business education provider Multiple Coaching Services, whose founder Geoff McDonnell joins us as General Manager. Building on Business Essentials' well-respected brand and the many CDs we produce each month, we're now able to offer wide-ranging support to business owners right across Australia. As a business strategy partner, Business Essentials will help other businesses grow – just as we're growing ourselves. We'll assist in getting business models right, we'll help businesses find and reach the right markets, understand social media, improve internal and external communications, manage HR requirements and train key staff. There's more detail on our website, [www.be.com.au](http://www.be.com.au).

Enjoy this month's CD.

**Nick Schildberger**  
Managing Director



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For more information about the topics discussed on this May 2011 program, please contact the relevant organisations listed below.

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Andrew's new book is titled  
"Hardwired Humans – Successful Leadership  
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The book is published by O'Keefe.



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# THE ESSENTIALS

May 2011

## Track 2

### The Accountant's Role In The Family Office

Michael Heine, NetWealth Investments

- There's a growing acceptance by many high networth individuals and families of the need to establish a Family Office
- The structure can vary widely, from a dedicated office with staff servicing the full needs of a family, to a group of professionals, to an office servicing many families, to a part time service
- The services of a Family Office could include: accounting, investment, philanthropy, property, tax planning, secretarial, estate planning, even concierge services
- Clients establish Family Offices for the expertise, to spread the load, or control and to assist with generational issues and challenges
- The accountant can play different roles: He or she could be the central professional figure, a team leader or team player, he or she may provide all the services needed or outsource areas of non-specialisation
- The Family Office will help maintain client relationships as the client's company passes through generational change

## Track 3

### Economic Update

Professor Neville Norman, Melbourne University

- I've called this "Budget Blues", to reflect the difficulties the Government has been facing, and the problems that have bedevilled business
- Two years ago, in 2009, Prime Minister Rudd and Treasurer Swan were talking doom and gloom about the budget deficit and the long road back to surplus
- A year later, with an election coming, things had suddenly got a lot better - with promises of a return to surplus 2 or 3 years earlier than in 2009
- Now, in May 2011, after all the natural disasters, the expectation is that the gloomy view will return, with a \$60 to \$70 million deficit
- The old political economy paradigm was for a tough budget in the first year of a new government, with tax increases and government spending cuts
- The government's popularity then nosedives, but picks up again as some of the measures prove economically sensible, and sweeteners can be offered before the next election
- The Hawke, Howard and Rudd governments took a different path, but maybe we'll go back to that scenario this time
- Treasury is urging some corrections to the tax system, and other lobbies want another look at Henry Review proposals. Two types of excise - on tobacco and petrol - may be considered for increases



- The implications for business will be shock and horror in the short term, but a good outcome in the longer term if corrections are made
- Watch for the major announcements in the Budget and the detail that affects you. We'll review it all next month
- The Australian economy is not heading towards recession but it's not experiencing the boom that was predicted
- The problem is the process: a fog of policy uncertainty and a second-rate debate, which is causing business to stop investing
- On interest rates, no-one's talking about cuts, but I am. I think there's a good chance the next change will be a reduction

#### **Track 4**

### **Hurdle Rates For Expansion Projects And Acquisitions**

**Hamish Blair, Leadenhall Corporate Finance**

- Investors want a return ON investment and a return OF investment. A hurdle rate shows the rate of return needed to deliver value to the shareholder.
- It's calculated using CAPM.
- A typical hurdle rate looks at 15% return on funds before tax for an existing business, higher for brownfields and higher again for greenfield investments
- Hurdles rates are a useful tool for expansion and acquisition, upfront and on-going.

- Don't underestimate the hurdle rate, this can lead to impairment and the destruction of shareholder value
- Hurdle rates can be used by most accountants but complex investments may need specialist advice

## **Track 5**

### **Share Investing: Low Risk If You Do It Right**

**John King, AJK Consulting**

- Investing is for the long term, 5 years or more, and the biggest risk long term is inflation
- Investing is to achieve a lifestyle and intelligent share investing is the only way to do this, but you must do it right
- Focus on risk first, not return. Don't trade or speculate, but rather, invest in a diversified portfolio of low-risk, dividend-paying shares
- In the past 40 years, only shares have kept ahead of tax and inflation for every period of 10 or more years
- Shares fluctuate but rise in the long-term - the market always recovers to exceed previous highs within a few years
- If you've retired, own your own home to protect against rent inflation, have cash in the bank worth 12 months of living costs and invest the rest in low-risk, dividend-paying shares
- If you're saving for retirement, pay off your own home, have 3-6 months of living costs in the bank. Invest the rest in low-risk, dividend-paying shares. Reinvest the dividends and the imputation credits

- Only shares will build up sufficient assets to allow for a comfortable retirement after allowing for inflation, with low risk of failure

## **Track 6**

### **Getting Pricing Right**

#### **Ron Wood, Pricing Insight**

- Buyers are more sophisticated these days as pricing transparency increases, with customer segments fragmenting into small groups who require individual attention
- Your sales force needs to be aligned to a consistent pricing strategy but able to be flexible to meet the requirements of each customer group
- If you can get a 2 percent increase in prices, that can flow straight through to the bottom line if volumes remain constant
- Perceived discounts can work very effectively in a retail environment, but it's not a sustainable way to grow your business
- A 10 percent discount may mean you have to double your sales just to break even
- The commonest mistake people make in pricing is to use "cost plus" mark-up. It's easy, but you're likely either to underprice and lose margin or set an unsustainably high price and lose the sale
- Avoid it by segmenting your customer base and then developing price lists, and discounts, that are realistic for each segment
- Don't overreact to demands from customers to cut prices. Sales people must be able to

understand and articulate the value they're offering to customers

- And don't allow the sales force too much discretionary pricing power. Make sure they have clear guidelines they can work to, but don't bog them down in red tape
- Train your sales team to sell consultatively through understanding the customers's needs and the value your product is providing, before quoting prices
- Look out for warning signs like "the jaws of death", where revenues are rising but gross margins are falling
- Customers may leave you for a cheaper competitor, then return because the service or product is not up to scratch. Don't let them back in at a cheaper price than they were paying before
- Understand your capacity to service the customer. Don't promise more than you can deliver, or enter a market when you're not ready
- Know where you are in the business cycle, so that you're not increasing prices in a falling market
- Never use cost to determine your sell price, but use it to determine your margins and whether you'll play in a market
- And understand your competitors' value proposition and why they're in a particular market segment, and try to avoid head-to-head competition

## Track 7

# Beware Spurious Offers Of Government Grants

Dr Michael Schaper, ACCC

- The ACCC has become increasingly worried about a number of websites purporting to offer special access to or exclusive information about government grants to small business
- People, believing the websites are official, are handing over hundreds of dollars for information packs which contain nothing which isn't freely available through government sources
- One such site is called [australiangovernmentgrants.org](http://australiangovernmentgrants.org). They often have 1-800 phone numbers and make frequent references to government
- It's often only in the fine print disclaimers that you discover that the site has no official standing
- Any genuine government website will have a ".gov.au" suffix. There's a dedicated site at [www.grantslink.gov.au](http://www.grantslink.gov.au), which has all the information you'll need about applying for grants
- Make sure you read the fine print if you suspect a website, and be wary of requests for money. Government information about grants is free
- Don't be put off applying for grants because of the dodgy operators
- If you've been tricked into paying for their services, you have some redress if you've paid

by credit card - contact your provider or the ACCC

- You can also expose the scammers by contacting the government's scamwatch.gov.au website. But often the websites will be based overseas, and securing any redress will be expensive and complicated
- There are legitimate websites offering help to potential applicants. They're often industry-based and can be found through industry associations or by referral from the government websites

## **Track 8**

### **Tax Watchouts On Selling Your Business**

**Michael Jones, Cummings Flavel McCormack**

- If you're selling your business, remember that assets are taxed at a lower rate than income, and small business CGT concessions can reduce tax even further, down to zero in many cases
- If your business is a company - or a unit trust - you can either sell the business assets or your shares in the company. In most cases, you'll be better off selling the shares
- The concessions are easier to apply in that situation, and cash from the sale will end up in the right place
- If you're selling intellectual property in a business, like software, make sure it's owned by a separate company and sell the shares in that company. The CGT concessions are then available

- Be wary about the tax implications of earn-outs. If your assets were acquired before the introduction of CGT, the tax won't be payable when the assets are sold, but the earn-out amount - paid after the sale - would attract CGT
- There are other factors arising from the introduction of CGT in 1985: the goodwill in a business started before that date may not be taxable, but if the business has changed since its inception - e.g. by the later issuing of shares - that could make a difference

## **Track 9**

### **Sharemarket Update**

**Elio D'Amato, Lincoln Stock Doctor**

- Despite the sharp dip caused by the recent natural disasters, the sharemarket has had a flat month, finishing where it started
- Commodity prices have experienced a strong rally, but oil has been the big story, pushed by the political upheavals in the Middle East to beyond \$US100 a barrel. With strong demand, it will be an important gauge of economic activity
- As we've said so often, volatility provides opportunity, and the important thing is to hold your nerve and be prepared to buy quality stocks when the market's dipping
- As always, diversification in your portfolio is the way to allow for the ups and downs that will hit different sectors of the market in times of uncertainty
- We've been trying to identify value in the market and have highlighted four stocks which

all have good prospects: gas and oil explorer Horizon Oil; M2 Telecommunications; engineering firm Bradken Limited; and Cedarwood Properties, based in Western Australia, which is also on takeover watch.

## **Track 10**

### **Don't Let Confidence Obscure Reality**

**Andrew O'Keeffe, Hardwired Humans**

- We all possess an instinct to opt for what's possible rather than what's achievable. If we don't recognise it, we can run into serious trouble
- The pilot of the aircraft which ditched safely into New York's Hudson River in 2009 could have tried to reach an airport when geese knocked out both engines. It was possible, but he understood the risks and opted for the river.
- Good decision, and a strong contrast to the Garuda pilot who ignored cockpit warnings and his co-pilot's pleadings because he believed he could land safely in bad conditions at Jogjakarta. He couldn't and many died
- In a business setting, we're often overly optimistic, opting for the big, sexy decisions and ignoring reality when it doesn't suit us
- The instinct comes from a primeval mating strategy, when choices of a partner were limited and self-confidence was a powerful influence
- Only days before the disastrous Gulf of Mexico oil spill, a BP engineer said repairs had been completed and "it will probably be all right".
- In the HR context, bosses will often not want to hear about a staff problem because they don't



want to believe it and because they might have to take unpalatable action if they face reality

- The ideal is a blend of optimism, to dream of what's possible, and realism, to make sure it happens properly
- That means ensuring we have the systems and resources in place to carry our plans through in a practical and realistic way