What Do Products/Services Cost? How Do We Know?

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ABSTRACT

OF THE FOUR ELEMENTS IN THE "marketing mix," price (cost) analysis provides the library manager with valuable data for decision-making and a practical approach to developing marketing strategies. This article examines the concept of the program budget, cost-finding methodologies, the influence of demand, the impact of technology, and budget presentation. Emphasis is given to looking beyond simple numbers and considering pricing within the broader definition of what products "cost"—and to whom.

INTRODUCTION

Of the elements in Kotler's (1982) "marketing mix" (p. 8), pricing is probably the most confusing. Certainly, library administrators have a strong interest in the issue of pricing and the questions that surround it. Taken at face value, it appears that this discussion will be about user fees—but that is definitely not the case. In the nonprofit sector, price or pricing must be defined as *"cost"—the cost to produce a product.* As one of the key elements in the marketing plan, price needs to identify all present and potential cost factors, including direct costs, personnel costs, indirect costs, profit (if applicable), and intangibles. Careful analysis of these factors yields a realistic appraisal of what a product actually costs to produce (Weingand, 1987, p. 74). Yet, how many library managers truly know exactly what each product/service costs?

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THE FOUNDATION: A PROGRAM BUDGET

There is a direct relationship between cost factors and the budgeting process—and specifically, the structure of that process. While there are many types of budget formats—and many municipalities and institutions have requirements as to what format must be submitted—it is the program budget that yields the most information for planning and decision-making. It is certainly understandable that a funding authority would want all submitted budgets to conform to a single type and style in order to be able to make comparisons among units, and the library must comply with these instructions. Yet, it is a straightforward and relatively painless exercise to take the sums from a program budget and insert them into more condensed formats such as the line item budget.

Why bother? There is simply no profit-oriented business that does not know exactly what costs are involved in producing a product; such information is critical in order to establish the price tag for each item. In the nonprofit sector—where libraries are located—the need for such information has not been recognized. It is true that only rarely must a price tag be established in connection with libraries; however, even though the fiscal pie is fixed, decisions must be made as to how to allocate those resources. If cost factors are not known, simple demand or customer interest will yield only one-half of the equation.

In program budgeting, each product essentially carries its own budget for direct and indirect costs. These separate budgets can be merged in order to create a condensed format budget; for example, all of the "personnel" entries can be taken from the spectrum of program budgets and added together to produce a line item total for personnel. Yet, the library manager will know that the personnel costs are for each product and, since personnel costs in the library's overall budget hover around the 70 percent mark, being knowledgeable about how those staff hours are being spent is necessary information.

Although a budget may, on the surface, appear to be a description of anticipated costs, it is actually a statement of the policy being adopted by the operating organization. The operational and fiscal aspects of budget creation are generally presented separately, although in reality they usually evolve simultaneously (Hamon et al., 1992, p. 12). Data from past and present budgets are examined in order to inform projections for the future. If the only such data available come from a condensed budget format, such as the line item budget, this comparison will need to wait until tentative program budgets have been created and the line item sums calculated.

Cost Finding

In order to produce the components of a program budget, cost-finding methodology of some type must be used. Each product of the library (e.g., reference service, circulation, the collection, network access, and so on) is broken down systematically so that each cost can be associated with an output. This is the opposite of the planning process for a new program, where the desired output would be stated and the resources necessary for that output would be estimated to arrive at a budget. It is a useful exercise to examine a known service in order to learn to recognize those factors that must be considered when planning a new program (Hamon et al., 1992, p. 12).

When doing cost finding, the product (program) being examined must be clearly identified and defined, with a designated output that reflects the mission, goal, and objectives to which that product relates. Each objective in the library's plan requires the implementation of one or more products in order to realize that objective. The relationship between cost and benefit can be ascertained once all cost factors are known.

For each product, both direct and indirect costs must be identified; some of these are fixed (known and stable) and some are flexible (adjustable or negotiable). *Direct costs* include personnel hired expressly for the designated product(s) and new supplies/equipment and so on purchased specifically for the product(s). *Indirect costs* can sometimes be difficult to apportion and reflect what might otherwise be viewed as operational expenses. Examples of indirect costs include the expenses incurred in: the operation of buildings and equipment, supplies from existing stores normally kept in stock, the time of permanent staff, and supplemental services (e.g., municipal or organizational purchasing, billing, printing, and so on). Detailed worksheets for determining costs can be found in Rosenberg (1985). A "quick and dirty" formula for allocating indirect costs based on staff time can be found in Weingand (1987, pp. 77-79).

Pricing and Demand

Whether to offer a low-cost product with a low level of demand is a difficult decision. A low-cost product with high demand is an ideal situation. A high cost product with low demand is probably scheduled for phase out or elimination. A high cost product with high demand is another difficult decision. How is demand determined? One of the outcomes of the marketing audit is an indication of anticipated demand for each present and potential product. This projected demand must then be weighed against the identified cost factors. A series of questions can be useful in this analysis (Weingand, 1987):

- *What is the competition?*
  Is there duplication of this product by some other agency or group? If so, can my library do it better or for less cost?
  Is there potential for growth in the target market so that more than one provider of this product is reasonable?
  Should we provide this product?
- *What is the involvement of the target market?*
  How important is this product to the target market right now?
  Is there a preexisting relationship between the target market and the product?
- *How complex are the information-gathering and decision-making processes?*
  Are library resources available to undertake this analysis of market relationship to product (assuming that this analysis is beyond the capability of the marketing audit)? (pp. 81-82)

If representatives of the various target markets have been included in the planning process—ideally serving on the planning team—and effective communication patterns have been established, then needs can be continually monitored. Such nonformal data collection can provide valuable insights into the assessment of the ratio between cost and demand.

A Three-Dimensional Look at Pricing

Kotler (1982) quotes Adam Smith in stating that: "The real price of everything, what everything really costs to the [person] who wants to acquire it," is the toil and trouble of acquiring it (p. 305). He expands upon that statement by suggesting that there are three costs to be added to actual production cost: effort costs, psychic costs, and waiting costs. To illustrate, if a customer is seeking a specific title, the following cost factors are put into play:

- the cost to the library to purchase the material;
- the staff cost required to acquire and process the material;
- the indirect costs associated with the operation of the library;
- the customer's time, cost, and trouble to physically go to the library (if required);
- or...the library's cost in getting the material to the customer;
- the customer's anxiety over when—or if—the material can be secured;
- the customer's wait until the material is available and/or arrives; and
- the "intangibles" that accompany the transaction, such as speed, convenience, timeliness, accuracy, staff attitude, and so forth.

In addition, Kotler (1987) contends that "consumers balance the expected benefits from an action against the expected costs" (p. 450). He further maintains that "the nominal money price tag on the exchange may be the least important of the perceived costs the consumer is concerned about" (p. 451). Such perceived costs may well involve:

- the *time involved to make a request* (including getting to the library, waiting in line and/or on the telephone, returning once again if the item is not available during the original visit);
- the *potential embarrassment* if the requested information or item deals with a sensitive topic or does not support the self-image the customer wants projected (e.g., checking out a trashy novel);
- the *aggravation* of enduring heavy traffic or busy reference and/or circulation desks;
- *awkwardness* of having to ask for assistance.

Such perceived costs are rarely considered by library staff members—either in terms of the concept of pricing or with regard to customer relations. Yet all of these factors can be described as part of the "cost" or the "price" of linking the customer and the product. Obviously, cost overlaps into the "product" and "place/distribution" categories of the marketing mix and, if the customer heard about the product through the library's promotional efforts, then that aspect of marketing is also involved in the total pricing picture.

And Then There is Technology...

If pricing were not already complex in the traditional library environment, information technology—and particularly networking—is changing the ways costs and benefits are generated, recovered, and diffused across the entire chain of activities and relationships that link producers and consumers (Peters, 1994, p. 8). Peters further states that: "In the business world, corporate executives have found that the benefits of using information technology must be measured differently from the benefits resulting from, say, adding a new manufacturing plant. In the service sector, information technology has greatly enhanced the industry's performance, but the traditional economic measures of productivity do not indicate a corresponding improvement. Researchers have noted that productivity in many cases is measured inadequately: For the most part, those productivity measures reflect neither the aspects of service quality—such as speed or convenience—that are affected by technology nor the alternative cost of what would have happened without technology" (Peters, 1994, pp. 8-9).

Individual libraries develop in-house networks for access and delivery. Networks have inherent cost factors and these also affect the costs in other library operations. In addition, mention must be also made of cooperative arrangements, both regionally and nationally. Cooperative interinstitutional strategies will play a major role in realizing the cost savings hoped for in terms of networked resources and services (Peters, 1994, p. 9). Costing out an individual library's share of cooperative ventures may be both simple and enigmatic. Costs must be identified before contracts are signed; actual operational costs may be more difficult to pin down, but all factors must be considered.

Technology, therefore, will have a significant impact upon both product development and the cost involved in accessing and delivering the information product. As technology changes, and with the passing of time, cost factors will also rise and fall. It is a volatile cost center and one that must be continually monitored.

BUDGET PRESENTATION

Once the budget is constructed in draft form, it should be presented to whatever advisory groups and/or governing boards that are within the library's organizational structure. Boards tend to be policy oriented, and clear explanations of how the desired budget fits with the library's goals and objectives need to be articulated. Advisory groups not only must understand the overall concepts illustrated by the budget, but also should be made aware of the practical ramifications. In other words, an appropriate mix of technical and theoretical should be presented, depending upon the audience (Hamon et al., 1992, p. 14).

Some common pitfalls to be avoided include:

- Assuming a common understanding and/or acceptance of the mission statement.
- Leaving out key personnel in the budget development process, thereby depriving them of a sense of "ownership."
- Having key budget proponents who do not understand what the numbers mean.
- Concealing unfavorable data.
- Missing established deadlines.
- Failing to develop persuasive arguments. (Hamon et al., 1992, p. 14)

Lack of adequate and appropriate communication with other key players, both internally and externally, can result in generation of the wrong data in the wrong format, missed key elements, and conflicting testimony (Hamon et al., 1992, p. 14). A successful budget presentation will always be made within the political context, and requires that the presenter be completely knowledgeable about what the numbers signify and how they mesh with the library's overall planned response to identified customer needs. Since politics involves the art of negotiation, contingency plans and proposals should have been developed—with clearly understood fallback positions and elements that can be surrendered in the spirit of compromise.

The final step in budget preparation is the actual presentation to the funding authority—those individual(s) who have the actual power to either approve or deny budgetary requests. Some libraries, particularly in the public sector, simply send in their budget; this can be a costly mistake. Every library director has a right to a personal presentation of the budget so that explanation of requests can be made, questions can be answered, and a shared understanding of library needs (based on customer needs)—and "what is possible" given additional funds—can be developed. This budget presentation should take cognizance of all aspects of pricing—beyond the actual numbers of the budget—in order to present a complete picture.

Much of any success will be rooted in the credibility of the library staff and particularly of the library director. If budgets are routinely "padded" and this fact is known, budget requests will always be seen by funders in that light. If complete documentation, sound fiscal management practices, and good rationale are normally delivered as part of the presentation, this will add to the library's credibility. The development of a healthy working relationship between the library manager and the funding authority cannot happen overnight; it must be nurtured over time. The seeds must be planted during nonbudget times when there will be no perceived vested interest. If carefully tended, the relationship may flower during the stress of budget hearings and add a very real intangible to the library's argument.

Conclusion

Price can be a difficult element in the marketing mix, but its importance must be acknowledged. Careful analysis of the transactions between customers and products through the lens of pricing results in a realistic assessment of what a product actually costs to produce and gives input into the decision of whether or not to continue to produce it. Knowing the projected cost figures provides a direction for establishing priorities of service as each present and potential product/service is evaluated using the same set of criteria. This pragmatic examination, when measured against the library's goals and objectives, helps to determine service priorities that are realistic as well as being in tune with the mission (Weingand, 1987, p. 74).

While some of the concepts may be unfamiliar and thereby cause some apprehension, there is no substitute for a clear grasp of cost factors, demand, and perception. Without attention to pricing, no library can operate both efficiently and effectively. In a time of increased attention to accountability, the full range of marketing elements—including pricing—must be incorporated into managerial practice.

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