

## **HOW TO PRICE YOUR PRODUCTS AND SERVICES**

The primary goal of business is to make a profit. Many small businesses fail to do so because they do not know how to price their products or services. Pricing is the critical element in achieving a profit and is a factor that all firms can control.

Before setting your prices, you must understand your product's market, distribution costs, and competition. Remember, the marketplace responds rapidly to technological advances and international competition. You must keep abreast of the factors that affect pricing, and be ready to adjust.

### **Retail Cost and Pricing**

A common pricing practice among small businesses is to follow the manufacturer's suggested retail prices. The suggested retail price is easy to use, but it can cause problems. It may create an undesirable price image, and it doesn't consider the competition.

### **Competitive Position**

Another approach is a strategy in which a firm bases its price on those of its competitor. A small retailer should compare prices with a similar store, but do not try to compete with a large store's prices, because they can buy in larger volumes and their cost per unit will be less. Instead, highlight other factors, like customer service. Customers will often pay more for merchandise if they get courteous service. Or specialize in certain product lines and have the knowledge to back it up, giving customers more choices than at the larger retail store. For instance, generally you can pay less for home improvement by shopping at WalMart, instead of Ace Hardware. However, if you need expert advice on a repair project, you would be much better off going to Ace. That's their competitive advantage and people WILL pay more for the expertise.

### **Pricing Below Competition**

Many vendors have been very successful using this pricing strategy. Since this strategy reduces the profit margin per sale, a firm needs to reduce its costs and:

- Obtain the best prices possible for the merchandise;
- Locate the business in an inexpensive location or facility;
- Closely control inventory;
- Limit the product lines to fast-moving items;
- Design advertising to concentrate on "price specials";
- Offer no or limited services.

Pricing goods below the competition can be difficult to maintain. Why? Because every cost component must be constantly monitored and adjusted. It also exposes a business to pricing

wars. Competitors can match the lower price, leaving both parties out in the cold. The most disloyal type of customer is one who buys only because you offer the lowest price. As soon as a competitor's price is lower – they're gone!

### **Pricing Above The Competition**

This strategy is possible when price is not the customer's greatest concern. This pricing method works well in situations where it is difficult to directly compare similar products to competitors and where the product/service is customized. Other considerations important enough for customers to justify paying higher prices include:

delivery, speed of service, satisfaction in handling customer complaints, knowledge of product or service, helpful and friendly employees, a convenient or exclusive location, and exclusive merchandise.

### **Price Lining**

This strategy targets a specific segment of the buying public by carrying products only in a specific price range. For example, a store may wish to attract customers willing to pay over \$50 for a purse. Price lining has many advantages:

Reduced errors by sales personnel in pricing;  
Ease of selection for customers;  
Reduced inventory;  
Reduced storage costs, due to smaller inventory.

### **Multiple Unit Pricing**

This involves selling a number of units for a single price for example, two items for \$1.98. This is useful for low-cost, consumable products like shampoo or toothpaste. Many stores find this a desirable pricing strategy for sales and year-end clearances.

### **Service Costs And Pricing**

Every service has different costs. Many small service firms fail to analyze their services' total cost, and therefore, fail to price them profitably. By analyzing the cost of each service, prices can be set to maximize profits and eliminate unprofitable services. For a service firm to know whether or not their prices are adequate, they MUST have a system to keep track of time spent on each individual job/contract. Then a comparison can be made between estimated time to complete a task and the actual time taken. This system also provides you with a way to measure the efficiency of service related employees.

### **Service Cost Components**

Material, labor and overhead make up the total cost of any product or service.

### **A) Material Costs**

This is the cost of materials found in the final product. For example, the wood and other materials used in the manufacturing of a chair are direct material. You must be able to compute the exact cost of materials used per unit of production.

### **B) Labor Costs**

This is the cost of the work that goes into the manufacturing of a product. An example is the wages of all production line workers. The direct labor costs are derived by multiplying the cost of labor per hour by the number of man-hours needed to complete the job. Remember to use not only the hourly wage, but also include fringe benefits. These include: social security, workers' compensation, unemployment compensation, insurance, and retirement benefits.

### **C) Overhead Costs**

Any cost not readily identifiable with a particular product is overhead. These include indirect materials and indirect labor, such as maintenance, supplies, repairs, heat and light, depreciation and insurance. These are not charged to direct labor, but must be included as a cost. Examples are clerical, legal and janitorial services and supplies. Insurance, taxes, rent, advertising and transportation are also overhead costs.

Part of the overhead costs must be allocated to each service performed or product produced. The overhead rate can be expressed as a percentage or an hourly rate.

Adjust your overhead costs annually. Charges must be revised to reflect inflation and higher benefit rates. It is best to project the costs semiannually, including increased executive salaries and other projected costs.

You must know ALL of your costs in preparing a bid or quoting a job. Include shipping, handling or storage in the total material cost.

### **Figuring Costs And Profits For A Consultant Service**

Pricing services, where your own labor or expertise is used, is different from pricing services that use materials and other labor. For instance, most consultants price their services by the hour. Senior consultants charge more for their time than do their less experienced counterparts.

Remember to charge for an adequate number of hours. Travel time is usually charged to the customer, but generally at a lower hourly rate..



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It is unlikely that all of your time will be billed to clients. Therefore, hourly or contract fees must be set high enough to cover expenses during slow periods. That is why one-half of the total normal working hours for a given year are used in figuring overhead rates. Try to obtain long-term, monthly, or contract assignments when possible. This decreases the unbillable time when you are between jobs.

### **Summary**

Your pricing structure and policy are major components of your public image and are crucial to securing and keeping your clientele.

Pricing for service businesses may be more complex than retail pricing. However, the result is the same: cost, and operating expenses, and desired profit, equals the service's price.

The key to success is to have a well-planned strategy. Establish your policies, constantly monitor prices and operating costs to insure profit. Accuracy increases profits!

### **How To Get More Information:**

Information is power! Make it your business to know what business information is available, where to get it and most importantly, how to use it. Sources of information include:

- Small Business Administration District Offices
- Small Business Development Centers (SBDCs)
- Service Corps of Retired Executives (SCORE)

Consult your telephone directory under U.S. Government for your local SBA office or call the Small Business Answer Desk at 1-800-U-ASK-SBA (1-800-827-5722) for information on any of the above resources. Also, you may request a free Directory of Business Development Publications from your local SBA office or the Answer Desk.

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