Pricing Your Products and Services: A Basic Review

Pricing goods and services is one of the most difficult tasks in the business arena. Many small businesses fail to make a profit simply because they don't consider all the factors necessary to make prices competitive and yield that elusive profit.

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Before setting prices, you must understand your 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 quickly.

This Financial Guide does not attempt to be an in-depth discussion of pricing analysis. Rather, it is intended only to provide a basic review of the several pricing strategies - and perhaps encourage you to take a fresh look at your present strategies. Professional financial guidance will be helpful in working up and evaluating the financial aspects of the analysis for your financial resources.

Retail Cost and Pricing

A common pricing practice among small businesses is to follow the manufacturer's suggested retail price. The suggested retail price is easy to use, but it does have one major shortcoming - it doesn't adequately account for the element of competition.

Competitive Position

An alternative to the manufactures suggested retail price is to base your price on those of your competitors. A small retailer, for example, should compare prices with a store that's comparable in size and customer volume. It's very chancy to compete with a large store's prices, because they can buy in larger volume and their cost per unit may be less.

Instead, price products based on your local small-store analysis, and then highlight other competitive factors, like personalized customer service and convenient location. There are any number of factors that influence a consumer's decision to buy from a certain business, including price, convenience, and courteous and attentive service.

Pricing Below the Competition

Some vendors have been very successful pricing their goods or services below the competition. Since this strategy reduces the profit margin per sale, it requires a company to reduce its costs and:

- Obtain the best prices possible for merchandise
- Locate the business in an inexpensive location or facility
- Closely control inventory
- Limit the line to fast-moving items

- Design advertising to concentrate on price specials
- Limit other services.

One word of caution: Pricing goods below the competition can be difficult to sustain. Why? Because every cost component must be constantly monitored and adjusted, it exposes a business to pricing wars. Competitors can match the lower price, leaving both parties out in the cold.

Pricing Above the Competition

This strategy is possible when price is not the customer's greatest concern. Considerations important enough for customers to justify paying higher prices include:

- Service considerations, including delivery, speed of service, satisfaction in handling customer complaints, knowledge of product or service, and helpful, friendly employees
- A convenient or exclusive location
- Exclusive merchandise.

Multiple Pricing

This approach involves selling a number of units for a single price-for example, two items for $1.95. This is useful for low-cost consumable product, such as shampoo or toothpaste. Many stores find this an attractive pricing strategy for sales and year-end clearances.

Cost Factors and Pricing

Every component of a service or product has a different, specific cost. Many small firms fail to analyze each component of their commodity's total cost, and therefore fail to price profitably. Once this analysis is done, prices can be set to maximize profits and eliminate any unprofitable service.

Cost components include material, labor, and overhead costs:

- **Material costs** are costs of all materials found in the final product. For example, the wood used in the manufacturing of a chair is a direct material.
- **Labor costs** are the costs of the work that goes into the manufacturing of a product. An example would be the wages of all production-line workers producing a certain commodity. The direct labor costs are derived by multiplying the cost of labor per hour by the number of personnel-hours needed to complete the job.
- Remember; do not only use the hourly wage but, also the dollar value of fringe benefits. These include social security, workers' compensation, unemployment compensation, insurance, retirement benefits, etc.

Overhead Costs are any costs not readily identifiable with a particular product. These costs include indirect materials, (e.g. supplies) utilities, depreciation, taxes, rent, advertising, transportation and insurance. Overhead costs also cover indirect labor costs, such as clerical, legal and janitorial services. Be sure to include shipping, handling, and/or storage as well as other cost components. 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. This is a complex task. It is best to consult with an expert in this area. It is important to review your overhead costs periodically. Charges must be revised to reflect inflation and higher benefit rates. It's best to project the costs quarterly, including increased executive salaries and other projected costs.

Figuring Costs and Profits for a Consultant Service

As a consultant, you will most likely price your service by the hour. Remember to charge for an adequate number of hours. Travel time is usually listed as an extra charge.

It's unlikely that all 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.

Summary

Your price 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 that retail pricing. The equation, however, is the same: Cost + Operating Expenses + Desired Profit = Price

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