

# How To Price Your Products and Services

Successful small business expansions and new formations lead the way in creating new markets, innovations and jobs that fuel economic growth and prosperity.

In recognition of the importance of small business to a strong economy, the U.S. Small Business Administration (SBA) wants to meet the information needs of existing business owners and aspiring entrepreneurs.

We hope "Focus On The Facts" meets your needs and we invite your comments and questions. Your success in business depends on what you know and how well you apply what you have learned.

## Pricing

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. 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.

## 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 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.

## Pricing Above The Competition

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

- Service considerations: delivery, speed of service, satisfaction in handling customer complaints, knowledge of product or service, helpful and friendly employees,
- A convenient or exclusive location,
- 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;
- Ease of selection for customers;
- Reduced inventory;
- Reduced storage costs, due to smaller inventory.

### Multiple 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.

### Service Cost Components

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

### 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.

### 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.

### 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.

A cost lid must always be used 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 listed as an extra charge.

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.

### 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)  
Small Business Institutes (SBIs)

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. In Washington D.C. call 653-7561. Also, you may request a free Directory of Business Development Publications from your local SBA office or the Answer Desk.

Other Sources:

State Economic Development Agencies  
Chambers of Commerce  
Local Colleges  
The Library