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presents:

your guide to... pricing



your guide to pricing

why is correct pricing so important?

Getting your pricing right is the key to building a profitable business. Charge too little and you will go out of business because you cannot pay the bills. Charge too much and you will go out of business because you won't sell anything.

The price you can command for your product or service is governed by factors both inside and outside your control, so you need to really understand the value of what you supply to your customers.

How you choose to price your product/service will tell customers more about what to expect than just what they are being asked to pay - so pricing can be a mine field from more than one stand point.

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the pricing problem!

confidence

Confidence affects everything about your business not least your ability to price your product/service effectively.

It is important to get to grips with:

What value you are giving your customers

Too few business owners understand the real value their customers get from using their product/service. If you can't define your value you will not be able to price effectively.

What your product or service is

Many businesses, particularly in the service sector, are not clear on exactly what their customers are paying for. This leads to discrepancies in service delivery and real problems with billing.

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the market

You do not run your business insulated from market conditions - you are surrounded by other companies vying to attract the attention of your customers, and potential customers.

So, make sure you are you clear on:

Who your competitors are

Customers will compare the value of your product/service against that of your competitors. If you don't know enough about your competitors' products/services you will have a problem demonstrating how your value offering differs from theirs.

What other products/services you are competing against

Even if your product/service is unique you will still be competing with other companies for customers' spending power, or with different solutions which solve the same customer problem. Unless you understand your position in the market, you won't be able to demonstrate why spending with your businesses is the most effective use of the customers hard earned pennies.

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financial knowledge

Unfortunately far too few small business owners are on top of their business finances. If you wait for your annual accounts to help you make financial decisions your information will be way out of date. It is vital you use up-to-date financial information when putting your pricing together.

Particularly you need to know:

What the full costs are in your business

For any business to flourish it must take more money in than it pays out. It is as simple as that. However, if you don't know your business expenditure clearly enough you will not know the minimum you need to earn to make a profit. This means you will have no minimum price point.

What your pricing strategy is

Because reviewing prices is a difficult job many business owners avoid doing it on a regular basis. This means when they do put up their prices they have to make large increases which customers find hard to take.

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What equipment you need to buy in the coming year and how much it will cost

As well as understanding your daily running costs it is also important you know what you are likely to need in the form of largish investment. Will you need new computers, machinery, a car...? If so, you need to ensure your business brings in enough money to pay for these too.

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factors to think about

value

The most effective way to price is to establish what the value of your product/service is to your customers. This value is defined by the following:

- ➔ Your exact product or service - clearly defined
- ➔ The 'perceived' value of that product/service to the customer, which will be a function of:
 - How much the customer needs or wants it
 - What else is in the market place to fulfil that need or want
- ➔ The customers' perception of your business and the quality of your offer
- ➔ The customers' perception of your competition
- ➔ What else the customer could spend their money on

The only way you can really understand your customers' needs and wants is to do your research.

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Look at the elements of what you do that differentiate you from your competitors. Talk to your customers and find out why they buy from you - this will give you the confidence to recognise your own value. Make it very clear to customers the full value they get from your product/service - based on what they need and the problems you solve - and demonstrate what good value they are getting. That way it is more difficult for customers to make a direct comparison with competitors and makes them less likely to buy purely based on price. Even if you run a shop you can differentiate yourself based on the level of service you give your customers.

If you are struggling to put a price on what you do, look at what the 'market value' of your product/service is. A way of finding this out is to look at what your direct competitors are charging for the same element of value. It is very important that you compare like with like. So for example a handmade kitchen does not have the same value as a B&Q kitchen even if the basic elements are the same.

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more about perception

As indicated above one of the most important lessons you can learn is that creating value in your business is all about your clients' perception.

You can change the perceived value of your product/service by changing the way your business is presented. A brand new porcelain dish sold at a car boot sale will command a far lower price than the exact same dish sold at Harrods. This is not because the dish sold at Harrods is any better but because the customers' *perception* of the value of the dish is altered due to the way it has been presented for sale.

Another interesting thing to note is that price can influence the customers' perception of quality. When presented with a price which they believe is too low, customers may suspect the product/service is of poor quality. Alternatively, some companies publicise their product as being 'reassuringly expensive' thus emphasising that quality generally comes at a cost.

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costing

So, you know how much your customers are prepared to pay for what you provide, but is it enough to make you money?

To answer this question you need to be able to have enough financial information about your business to fill in the following formula using annual figures:

$$\text{PROFIT} = \text{TOTAL REVENUE} - \text{TOTAL COSTS}$$

Where:

TOTAL REVENUE = price x quantity sold (or total net invoiced amount)

TOTAL COSTS = costs directly involved in providing goods and services + monthly overheads + your salary

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If the revenue you will earn by charging the market price is less than your total costs, you will not make money!

Your options then are to increase the volume of what you are selling, or to reduce costs.

If you don't know what the costs of running your business are **FIND OUT!**

Although it is difficult to estimate the volume of products/services you may sell in the coming year, it is important to estimate what you are likely to achieve. No one has a crystal ball and initially your forecasted activity may be wrong. However, if you build a clear picture of what you are achieving, your ability to forecast will become more accurate.

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hourly rates

If you are in the service sector you may be interested in knowing what hourly rate to apply - even if you are charging on a fixed fee basis, you may want to have a notional hourly rate to use when working out what the fixed fee should be.

$$\text{HOURLY RATE} = (\text{Total cost of running your business} + \text{profit}) / \text{Total number of chargeable hours}$$

The total costs of running your business will be as previously defined and will include your drawings/salary. The total number of chargeable hours can be difficult to calculate but it is important you try to get as accurate a figure as possible - it is likely to be lower than you think.

Essentially the calculation will be:

$$\begin{aligned} \text{TOTAL NUMBER OF CHARGEABLE HOURS} = & \\ & (52 \text{ weeks} * 5 \text{ days} * 7.5 \text{ hours per day}) \\ & - \text{holidays (in hours)} \\ & - \text{time spent on non-chargeable activities} \end{aligned}$$

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Non chargeable activities include anything you cannot charge the customer for i.e. admin, networking...

resistance to increased pricing

To make increasing your prices easier, and to avoid customer resistance, make small increases each year.

Many companies will use 1st January as a good date on which to regularly increase prices. If customers know this is your policy they are less likely to object because they know it is coming. You can then increase prices easily by 1-5% - an amount most customers find acceptable. At the very least you can increase your prices by the level of inflation.

A relatively small price increase each year makes a big difference to the level of profitability in your business in the long term.

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pricing with confidence

the four step plan

1. Know your competition

Identify key competitors and find out how much they charge. Don't just concentrate on competitors who have the same product or service, but also look at who you might be competing with for customer spend.

2. Establish value

Once you have a good idea what the market value of your product or service is you can be more confident that your prices are realistic.

If you are charging much less than the market price **PUT YOUR PRICES UP!!** However, make sure you talk to your customers throughout the process to keep them on board.

If you are charging more than the market value this may well be a hindrance to increasing volume **UNLESS** you have established a recognised higher level of value than your competitors - in which case this is great!

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3. Forecast

Do a financial forecast so you are clear of your business expenses - if you need help with this your accountant should be able to help. This will enable you to make sure you are making a profit at the price level you want to set, with the volume of sales you believe this price will achieve.

4. Review regularly

Set a regular time each year when you will increase your prices - and keep to it!!!

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and finally...

Don't file this guide in your drawer never to come out again!

Pricing is something you should be thinking about on a regular basis - after all you are constantly selling and price is a key component of the sales process.

But don't forget that help is at hand and there are professionals who can work with you to achieve the right pricing structure for your business.