

The YEBDC Small Business Information Column

by Sue Gingerich, Business Advisor

"Setting Prices For Services"

For new businesses selling strictly services, determining pricing can often be a difficult exercise. When there isn't a physical object to sell, it seems many people have trouble setting a price high enough to actually make money. Why? Well, often we are selling our own abilities, and there may be a fear that we are not as good as the next guys. But what happens if we start out charging a much lower price? What does that say about what we are selling?

So how should service businesses determine their prices? Should they be priced lower than the competition? When can they actually increase their prices if they are lower?

The very first thing that you can do in determining prices is look at the costs of doing business. What expenses will need to be paid from the revenue you receive? It is really important to include all costs here (rent, staff wages, utilities, insurance, interest costs, etc.). How much of the expenses will be paid when you perform a service? Think about it this way; if all your monthly expenses add up to \$1,000.00 a month, and you expect to perform your service 50 times in a month, then you better be charging at least \$20.00 each time you provide your service.

But that isn't the only cost you need to calculate into the equation. What will you pay yourself for your time? What will your wage be? Don't think you don't need to pay yourself, because what happens if you are sick and you need to hire someone else to do your work? What would you pay them?

Next, you should also consider capital costs into your pricing. For example, you may want to purchase a computer, how long will that computer last? Take the price of the computer and divide it by its life, say two years. Then take the yearly amount and divide it by the number of times you will provide your service. This is how much you should be including in your pricing to cover your capital costs.

The other consideration is adding profit. If you have invested your own money in this company, most likely you should earn a return on it. If you had taken this money and bought GIC's with it, you would be earning some interest. So what was your initial investment? How much interest would you normally gain on it elsewhere? Take the total interest you would gain in a year and divide it by the number of times you would provide your service. This is the amount you will need to include in the pricing of your service.

Obviously if you provide the service more often than you anticipated there will be extra profit, there may, however, also be extra expenses. (Some costs may increase, such as telephone or employees wages, if sales are higher.) Try the same pricing calculation using a much lower and a much higher sales figure. How different is the profit picture?

Of course there is one other major consideration here, when establishing a fair price. What the competition is charging? How is what you are selling perceived when compared to the competition? If you are going to charge the same, then in the customers mind he better feel he is getting the same quality. You could charge less because you are new, but when does it become acceptable or better to increase your prices to the same level as the competition. Especially, if what you are providing really hasn't changed? If the quality and calibre of service does increase, then by all means raise your prices. Just ensure that it is done gradually and justifiably.

So do your homework and set your prices with confidence. If you know you are worth what you are charging you will have an easier time selling your business services. You will also be confident that you are ensuring the future life of your business, by covering all your costs.

If you have a small business and have a question or problem that you think The YEBDC could help you with please call or write to: The Yellowhead East Business Development Corporation, Box 249, Sangudo, Alberta, T0E 2A0
1-800-556-0328 or 1-780-785-2900, e mail: yebdc@yebdc.ab.ca, or access our Website at: www.yebdc.ab.ca

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