

# Pricing Yourself to Get and Stay In Business

By Elena Fawkner

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It goes without saying that the bottom line of any successful business is profit. Don't make a profit and you won't be in business for very long.

Making a profit is pretty simple really.

You just have to make more than you spend. The trick is to know how much you have to make to exceed what you spend.

And you spend more than money when running a business. You spend something infinitely more valuable. Time. And, as we all know, time is money.

To maximize profits, accurate pricing is absolutely critical. Your prices must be high enough to cover costs and enable you to earn a reasonable return but low enough to remain attractive to prospective clients.

New entrepreneurs often have difficulty accurately pricing the value of their time and expertise. Some take the approach that they can work cheaply because they're fast and they're prepared to take any work, now matter how low-paying, to fill in the time between more lucrative assignments.

For this group, the mindset appears to be that any work is better than no work. Although this may seem reasonable when you're first starting out and you just want to make your mark as early as possible, the downside is that this short-sighted approach can create in customers a "cheap" mindset that is difficult to shift once the business becomes established.

Another group of entrepreneurs, though, takes the approach from the outset that they are worth top dollar and demand fair pricing for the value they provide and won't accept anything less. This group appears to be more successful than the former in the longer run. Sure, they may find it slow to start with. After all, they are new in town, they can't rely on repeat business and they can't ride the wave of their own impressive reputations. But by setting the bar high to start with, when their businesses DO become established, they've set the tone and their businesses usually have a firmer foundation for it.

This article looks at the fundamentals of pricing for the new home-based business entrepreneur.

## BASIC PRINCIPLES OF PRICING

Here are some basic principles to keep in mind when considering your pricing strategies:

= Prices must at least cover costs.

If you don't at least cover costs, and this includes an amount for your time, you will incur a loss. If your business is incurring a loss it's a hobby.

= The best way to lower price is to lower costs

As price equals costs plus profit margin, it's obviously better to reduce the cost element than the profit element if, for any reason, you find that you must reduce your prices.

= Prices must reflect the environment in which they operate

Any price, whether yours or your competitors', necessarily reflects the dynamics of cost, demand, market changes, competition, product utility, product longevity, maintenance and end use.

= Prices must be within the range of what customers are prepared to pay

It's all very well having the best bread slicer in the western world but if your price is more than customers are prepared to pay for it, so what? On the other hand, there is absolutely no reason to charge less than customers are prepared to pay either.

= Prices should be set at levels that will shift products and services and not to beat competitors alone

It's easy when you start delving into all of the sophisticated analysis and research around about optimum pricing levels

to forget that, at the end of the day, you set your prices as high as you can while still shifting your products and services. So don't think that keeping pace with competitors is enough. It isn't. You may have competitive advantages that mean you can charge more than your competitor.

= The price you set should represent a fair return for your time, talent, risk and investment

Don't be coy about demanding a reward for what you bring to the table. Your expertise and talent has objective worth. Don't just give it away. Charge for it.

## PRICE = COST + PROFIT MARGIN

The basic price you will strike is simply your costs plus a profit margin. It follows that before you can set your prices you must know exactly what your costs are. Costs fall into three main areas:

= Direct Costs

Direct costs are those things directly related to the creation of your product such as raw materials, parts and supplies.

= Overheads

Overheads are business costs not directly related to production and include things such as taxes, rent, office supplies and equipment, business related travel, insurance, permits, repair of equipment, utilities (electricity and telephone) and professional advice (accountant, lawyer).

= Labor

Labor costs include all wages paid to employees \*including yourself\*. It's amazing how many home-business owners forget to include their time as a cost of business!

Calculate your labor costs by multiplying the number of hours worked by an hourly wage. You should also include fringe benefits (typically 15% plus).

Once you have ascertained your total costs, add a profit margin. A 15-20% profit margin is standard for most home-based businesses. Although you have included your own wages in your labor costs, if you don't add a profit margin there will be no money for growth or expansion of the business.

## RELATIONSHIP BETWEEN PRICES AND PROFITS

The easiest way to increase your profit is to raise your prices.

But you can't just raise prices indiscriminately. Look for ways to manipulate niche pricing instead. This means looking for specific areas of your business where you have some latitude to increase prices.

The way to do this is to identify the areas where the perceived value of what you are offering is higher than the price you are currently charging. Start by carrying out a competitive analysis of your business. Find out how your product compares with your competitors' on the basis not only of price but costs as well.

If you are going to source this information by approaching competitors directly, a word of caution ... DON'T. The Sherman Act in the US (and similar legislation in many other jurisdictions) prohibits businesses of any size from entering "contracts, combinations or conspiracies" in restraint of trade. In other words, it's illegal to make deals with competitors about what price you'll charge or what services you'll offer. Merely discussing prices with competitors can be construed as an attempt to conspire on prices. This is one area where you just don't want to give even the \*whiff\* of an impression of doing anything of the sort.

So, be circumspect in your research. Never discuss prices with competitors and avoid frequent communications with them at all if possible. Instead, to keep tabs on what your competition is up to, read their ads, talk to their suppliers, engage mystery shoppers or send an employee to make observations.

Once you have completed your competitive intelligence, analyze your competitive advantages and disadvantages. If, as a result of your analysis, you learn that you have an advantage over your competition because your business is website design and you know how to do cgi-scripting but your competition has to outsource this function and this means a delay of one to two weeks, then this advantage is something your customers will likely pay more for. Adjust your prices accordingly.

## WHEN YOU'RE THE PRODUCT

Some businesses don't offer tangible products at all. Sometimes, YOU are the product. So, how do you price yourself if you're, say, an ecommerce consultant and your business is assisting brick and mortar businesses make the transition to ecommerce?

One perfectly reasonable approach is to start with a calculation of your actual expenses and your salary needs and then divide the total by a reasonable estimate of billable hours. An article entitled "Setting Fees" by David Dukoff

gives a good overview of how to go about doing this.

Let's say your expenses and salary needs mean that your business needs to be generating \$100,000 a year. Let's also say you prefer to charge clients by the hour rather than by quoting on projects. How much do you need to charge per billable hour to generate \$100,000 per year?

Dukoff uses the following approach. To start with, how many billable hours do you have? Let's start with 2,080 work hours in a year. Deduct 100 hours for vacation time (2 weeks), a further 80 hours for popular holidays, 40 hours personal time and sick leave and 20-40% of time for marketing and administration. This leaves you with around 1,000 billable hours in a year. You therefore need to charge \$100 per billable hour to achieve your goal of \$100,000 income.

## OTHER PRICING STRATEGIES

Other pricing strategies to include in your structure include discounts to encourage prompt payment or quantity purchases, seasonality issues (for example, end of season "sales"), offering senior citizen and student discounts and other promotional incentives.

As you can see, setting the "right" price for your products and services is absolutely crucial to the profitability (read survival) of your business in the longer term. But with careful analysis and a methodical approach, you should be able to arrive at reasonable pricepoints without too much difficulty. Then it's just a matter of monitoring demand in response to price changes to settle on the optimum pricing for your business.

But don't rest there. Your prices operate within a constantly changing environment and you need to be ever-vigilant to ensure that your prices remain at their competitive maxima.

One final piece of advice: if in doubt, price high rather than low. It is much easier to discount prices than it is to increase them.

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