Pricing and costing accurately

The price you set for your products or service should be high enough for you to make a profit, but realistic enough to encourage people to buy. It's not as simple as adding a margin to your costs, or charging what the competition charges, as it may not be enough to cover your overhead.

To price accurately there are a number of steps.

Overhead + profit

First work out the cost of your overhead. These are the fixed costs you have to pay out every month, regardless of your level of sales. Complete a cash flow forecast which will include:

- Lease or mortgage payments on your premises.
- Wages and salaries of permanent staff.
- Connection costs for phones and internet.
- Power and other utilities.
- Your salary or drawing from the business.
- Inventory (if applicable)

Then add what profit you'd like for the year to come up with an overhead plus profit amount.

The main pricing options

Cost-plus pricing

Calculate all the costs in producing your product or service, add a margin (a percentage of profit you want to earn), determine how much you can produce, does this price cover overhead and profit?

For example if you're selling outdoor furniture, and the cost of manufacturing is $200, and you add a 50% (or $100) as a margin the total price will be $300 per piece. If your overhead + profit are $200,000, then you'll need to sell 2,000 a year ($200,000 divided by the $100 profit margin).

This method doesn't take into account what the competition is charging or market expectations (and that you can physically make 2,000/year).

Retail margin

If you re-sell products as a retailer or wholesaler, you'll add a margin to your inventory you've bought as a percentage of what you paid. For example if you buy an item for $100, and re-sell it in your store for $150, your 'mark-up' is 50%.

Your 'margin' is different. This time you divide the mark-up profit of $50 by the sale price of $150. In this case your margin is 33% ($50 divided by $150).

The benefit of knowing your 'margin' is that you can use it to work out your sales target to cover overhead. Divide this margin (33%) into your overhead ($200,000) and you will get your sales target ($606,000).

Hourly rate

If your business is service-based and you charge per hour, it's much simpler as you won't have any physical costs of materials or inventory. If you charge $100 an hour then dividing this into overhead gives you the number of hours you need to work each year. In this case 2,000 ($200,000 divided by $100/hour).

What does the market say?

Of course you deciding what to charge doesn't always work; more often than not every industry has a current 'market price'. If electricians all charge a similar hourly rate, you will be hard pushed to charge twice as much, and you wouldn't want to be half the price either.

Research what the current price structure is in your industry;

- Which businesses do customers see as offering the best value?
- What do customers expect to pay?
- Which products are likely to be the most successful?
- What are the lowest and highest prices? Where do you want to be positioned?

You just may need to work backwards–take the market price, then see how much you can do/sell physically, and then see if that covers overhead and profit.

How to get the best deal

Most businesses try to make as much profit as they can, while providing value for money for their customers. If you are struggling to get your business model to work then consider:

- Offer extras that the competition doesn't such as guarantees, delivery, wider range, more expertise, better after sales support to justify a higher price
- Try to lower your overhead so you don't have to sell as much
- Reduce your input costs such as raw materials, staff, inventory

Summary

Review all the pricing options and decide which one suits your business best. When you're deciding on your strategy, consult with your accountant, to make sure you're not missing anything, and that you're charging enough. Pricing is a balancing act between selling at a price where customers will buy, with enough margin for you to cover costs and make a fair profit.

118092 (09/2017)