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Is the price right for your services?

How to nail costs

In this ebook:

Section One will discuss general pricing considerations that are common to small businesses.

Section Two will examine some of the most common pricing strategies across all industries.

Section Three homes in on tips for services businesses.

Pricing strategy is a perennial headache for most small business owners. Price your services too high and customers will go elsewhere; price them too low and you'll struggle to turn a profit.

So where does a small business owner even begin when it comes to setting prices? How do you know when to review your prices? And when should you bump them up a notch?

Section One

6 questions to ask yourself when setting prices.

1. Do you know what your customers think?

Before you begin selling, you should first conduct market research to see if there's an appetite for your service, and if so, what price potential customers would be willing to pay.

"You can conduct your own customer survey in-person, and there are even customer research organisations that can help you, or you can simply put it out on social media and seek feedback," says Catherine Plano, who's an SME business coach focused on the factors that drive customers' buying decisions.

2. What are your competitors doing?

Another way to conduct market research is to observe what your competitors are doing.

Don't just simply look to copy their advertised prices though, says Plano, focus on what they are doing well, where they could improve and what you could do differently to them.

"Then tailor your own service and prices accordingly in your business plan," Plano suggests.

3. Do you know what each service really costs you?

Make sure you factor into your pricing all your business's expenses, such as rent, insurance, phone and internet, freight, and so on.

After all, there's no point smashing sales targets if you can't turn a profit and keep your doors open.

Small business coach Samantha Riley says it's not just about deciding how much to sell something for – you also need to determine whether the service is even worth offering.

4. Have you done the math?

If introducing a new offering or changing the price of an existing one, it pays to work out how that will affect your cash flow.

If you've got a good sense of your expected sales and know the direct cost to you of each unit, you can use Prospa's sales forecasting template to get an instant sense of what your sales forecast will mean to the bottom line.

You can also use it to play with different scenarios, such as selling fewer but higher-priced services.

5. Are you listening to your customers?

If your prices are too high, chances are your customers (or missed customers) will let you know.

Rather than thinking they're the problem, consider taking their feedback onboard.

"Don't take things personally – feedback is gold, even if it is negative. And remember the old adage: the customer is always right," says Plano.

6. Are you watching the trends?

It's also important to pay close attention to news and trends that directly affect your industry, says Plano, as changes can happen quickly – especially in service industries such as software as a service (SaaS).

"Keep an eye on the market all the time because quick trend changes can affect market prices," she says.

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Section Two

Popular pricing strategies

Choosing the right strategy means being clear on what you are trying to achieve – from as many sales as possible to cultivating a premium halo. Bear in mind, your pricing strategy can vary for different offerings within your business.

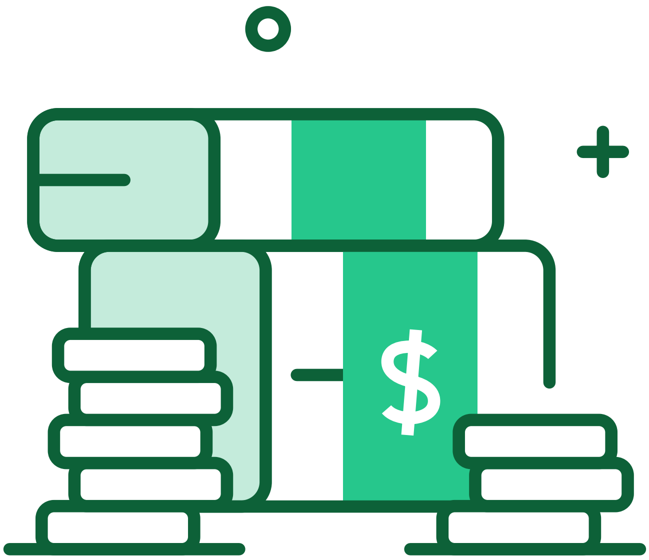
There are dozens of strategies out there, but these are the most common:

Cost-plus pricing

Perhaps the most common strategy, a cost-plus pricing approach starts with you calculating **your direct costs and overheads**, and then adding what you deem to be a reasonable mark-up for you to turn a respectable profit.

Pros: It's simple and assures you of profitability, if your sales forecasts stack up.

Cons: By ignoring the competition, you risk being uncompetitive.



Value-based pricing

Also known as "selling it for what you can get away with", this involves setting a price based on **how much the customer believes what you're selling is worth**.

Say you were a book-keeping firm offering a basic service at $500 and decided to offer an upgraded service that also featured an insights and analysis report.

Rather than pricing based on how much extra resourcing was required, a value-based approach would instead determine how much extra value clients felt the new service offered.

Pros: Done right, this maximises profitability while keeping customers happy and engaged.

Cons: Getting to know your audience enough to nail this takes time, effort and insight.

Competitive pricing

This method uses the **advertised prices of competitors** as a benchmark and closely matching them.

Pros: It's simple and you know you'll be competitive.

Cons: Small businesses can struggle to match large volume sellers and lose out in a race to the bottom.

Bundle pricing

Ah, the mighty combo deal. By bundling, businesses **combine multiple services** to sell them at a lower rate than they would fetch if sold individually. It's most effective for businesses that sell complementary products, such as those in the hospitality industry.

Pros: Bundling can be an effective way to push customers towards higher-margin items. It can also boost customer perceptions of value.

Cons: Bundles won't be attractive to customers who don't want or need all the bundled services.

Penetration pricing

This can also be thought of as selling low but selling often. Penetration pricing offers **services at low prices** with the aim of pricing competitively and gaining as many customers as possible.

Pros: It's a way to quickly gain market share and loyalty, with a view to raising prices to a more sustainable level later.

Cons: Low prices can affect perceptions of brand quality, as well as being very difficult for a small business to sustain.

Price skimming

Commonly used for market innovations and new services, price skimming involves **setting high prices** during the introductory phase and then gradually lowering them as you attract more customers and lower your costs.

Pros: Early adopters are often less price sensitive than the general population, helping maximise profitability.

Cons: It's only ever a short-term strategy, and it's only suitable for market leaders.

Economy pricing

By minimising overheads and other costs, economy pricing aims to **gain market share** by attracting the most price-conscious consumers, whether those discounts are targeted at specific services or across an entire range.

Pros: Tailoring discounts for your most regular customers can help secure their loyalty.

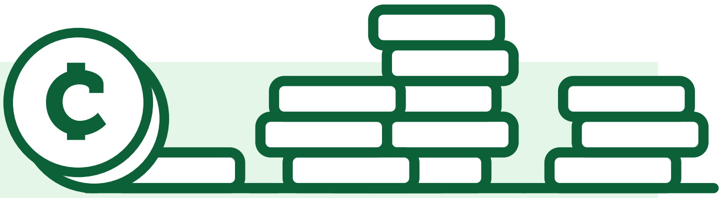
Cons: Small businesses often lack economies of scale or large sales volumes, so can struggle to reap adequate profits with this approach.

Premium pricing

Sometimes, putting your prices higher than your competitors can be very advantageous, if that higher price tag also comes with **a higher perception of value.**

Pros: Well suited to small businesses selling unique services, this approach can bring high profit margins.

Cons: Premium businesses must ensure every aspect of their customer experience matches the premium expectations.



Talking cents

We've all asked ourselves: **does pricing something at $4.99 really sell better than the same item at $5?**

The practice of pricing something a few cents or dollars short of a big old round number is known as psychological pricing. It's been heavily studied and generally found to have a significant effect.

In fact, one review of eight different studies found that an odd price outperformed the nearby round price by an average of 24%.

Research has found prices ending in 9s are the most effective. An oft-cited experiment by the University of Chicago and MIT compared the same woman's dress, priced at $34, $39 and $44. The finding? The dress sold best at $39.

On the flip side, those targeting the high end are increasingly pricing things in whole dollars only, to give an aura of prestige.

Section Three

Services in focus

Setting your prices as a service business poses a whole new set of challenges. To help you tackle them, here's some steps you can tick off.

1. Do your desktop research

As opposed to retail businesses, many professional service businesses don't list their prices on their websites. But as Plano suggests, you can always turn to Google or a relevant social media forum for the answer, and search 'how much would a graphic designer charge per hour'.

"From there it will give you a ballpark figure, say between $20 and $100 per hour, and you pick your entry point based on your experience and what you can offer clients."

2. Be sure to factor in all your expenses

Too many service-based small business owners who work from home fool themselves into thinking they don't have expenses to factor into pricing, says Riley.

"But most of these businesses still have insurance, staff – even if they're outsourced or freelancers – website hosting costs, subscription packages and possibly a CRM," she says.

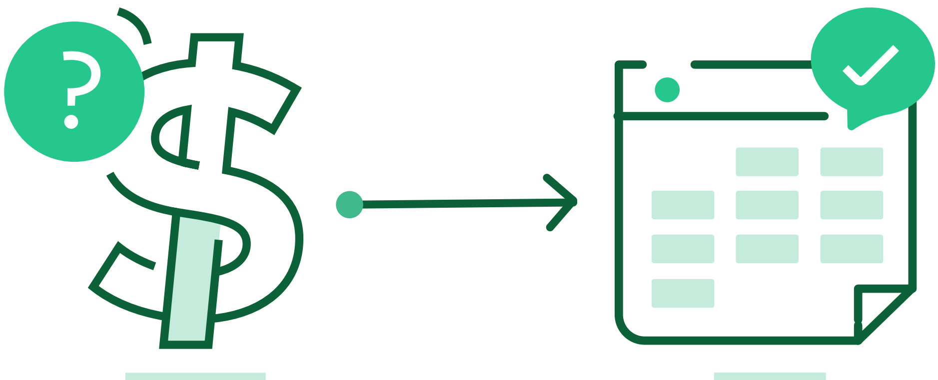
"Those costs add up."

3. Work backwards with bigger clients

It's common to feel like you're prying if you ask a potential client what their budget is upfront. But according to Plano, this is a great way forward with corporate clients.

"Many entrepreneurs and service business owners suffer from a lack of self-worth when it comes to receiving money," explains Plano.

"One way past that is to say 'according to your budget, this is what I can offer you'. So I reverse engineer it. You don't always have to offer an upfront price for every customer."



4. Review your pricing at least annually

How often and when you review your rates and pricing will depend on the service you're providing. Riley says most businesses should review their pricing during a trough period, which for most will occur at least once a year.

"When I had a dance studio, for example, I used to look at my numbers at the end of every school term. Whereas if I ran a swimming pool service, I'd probably review my prices each winter," Riley explains.

And if you do decide to raise prices, it can be helpful to explain to your customers why. Tell them what costs have increased for you and how that affects the price (and if you haven't raised prices in a few years, it wouldn't hurt to remind them of how long it has been since you have).

Want to experiment with how different prices could affect your profit?

Download Prospa's sales forecasting template here

Setting the right prices is one tool to grow your business.

Funding is another.

Talk to one of our small business lending specialists on 1300 882 867 about how a small business loan can help you take advantage of opportunities as they present themselves, or how a line of credit can smooth out cash flow when you need it.

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Sources

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2. Quantitative Marketing and Economics, Effects of $9 Price Endings on Retail Sales: Evidence from Field Experiments, https://link.springer.com/article/10.1023/A:10235819274055