

Setting Prices for Your Small Business

Accurate pricing is essential for your business's survival. There are many things to consider beyond just undercutting the competition

Small-business owners are often confused about where to set prices. They tend to look at what their competition is charging, rather than at the actual costs of their products or services. Unfortunately, bad pricing decisions can kill a company before it has a chance to profit and grow. Consultant [Andy Birol](#), based in Solon, Ohio, spoke recently to Smart Answers columnist Karen E. Klein about the crucial nature of pricing. Edited excerpts of their conversation follow:

You do consulting with hundreds of small firms. How often do you see them pricing themselves out of business?

Oh, all the time. I call it "dead man walking" syndrome. When I ask business owners, "How did your company do last year?" and they say something like, "Well, we survived," that's evidence that they're living hand to mouth. If they don't start to price their products to maximize the value to their customers and their subsequent profits, I know they are going to ultimately run out of time.

What's the biggest problem small businesses have with pricing?

More than anything, small businesses look to similar companies and price against them as opposed to pricing against the value that they're bringing to their customers. When they price against their perceived competitors, they're finding the lowest common denominator in the marketplace.

Entrepreneurs seem to feel that if they don't undercut their competition on price, they will go out of business. Why is that?

Unfortunately small-business owners often feel some sense of inferiority or inadequacy about their companies. They don't have the confidence to say, "I'm better, I'm different and here's why. What they need to do is develop the poise to ask their customers to make a greater investment with them, and then assure those customers that their returns will be meaningfully higher than if they go to the competition.

How do you advise your small-business clients to set their prices?

They need to start by quantifying the value their customers derive from using their products or services. Next, they should assure themselves that any materials they buy or any time they expend directly on meeting a sale should be accounted for in the pricing.

This sounds easy, but it's not always. For instance, I have a client who insists on going to his largest customer's accounting department in person to pick up every check he gets from them. He claims this is worth his time because he gets paid right away and it brings him new business opportunities. But I pointed out to him that if this practice is imperative for him, he should add the time he spends doing that into his direct labor costs for that account. Otherwise, his pricing isn't accurate!

Where else do entrepreneurs miss costs?

Let's say that you're a large company that's installing satellite radios into automobiles. If you're installing radios in a line of Subarus that are leased by a large corporate customer, you can predict what that job is going to cost you in terms of your total service, marketing, sales, and everything else.

But if you're a small firm installing radios on a one-off basis, your costs are going to be different for each job. Maybe one customer wants his radio installed close to the brake, which is easy and quick to do. But another customer wants his closer to the windshield, which takes more time and expertise. Another customer may need a detailed explanation on how to work the radio, which your technician will have to spend time doing. So the small-business owner needs to calculate costs much more individually and meticulously.

What's the bottom line about where to set prices?

You've got to make sure that your pricing, purchasing, staffing, and servicing decisions are based on real facts and current information—not emotion or old data. Remember that pricing is fundamentally a measure of your confidence as a business owner and it's the only validation of the value you provide to your market. If you can't price your products high enough to run a legitimate business, you've either got to grow your confidence, change your products so you are providing that value, or get out of the business.

What do you advise your clients to do if they're really confused about how to price their goods or services?

They've got to make their business run by the numbers. Most people who have these problems don't have plant accountants or business managers working for them. They need to hire knowledgeable people who can uncover their direct materials and labor costs and help them forecast their overhead as well. Once they get a handle on the true numbers involved, things really clear up. Regardless of whether a company's margins and prices are high or low, you cannot manage your business if you're not managing your costs.

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