

Attention Small Business Service Entrepreneurs: Are You Charging What You're Worth?
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If you plan to start a small business selling services, don't invest a single dollar in start up capital until you do these simple price planning exercises. The time you spend now is a small price to pay for averted sacrifice and hardship down the road.

Whether you plan to charge by the hour, by the project, or some combination of both, you need to place a dollar value on your time before you can confidently sell your services. The marketing gurus say the key to pricing is research, research, research. "Know your competition," they say, and "talk to people in your target market." While market research is indeed a required step, it is not the first, nor is it even the most important.

While it may be tempting to simply set your prices according to what the Jones are doing, this approach could spell big losses over the long run. You, your personal circumstances, and your professional ambitions are unique and may look nothing like that of the Jones. As a small business entrepreneur, your goal in price planning should be to arrive at a price structure that will ensure your venture is not only self-sustaining but can sustain *you* for a long time to come. Therefore, do not invest a single dollar in start up capital until you have taken the time to conduct the following easy-to-do price planning exercises. The hours you spend now may avert unnecessary personal sacrifice and hardship down the road.

Step 1: How much do "you" cost?

If you do nothing else to prepare for the launch of your small business, do put a price on your blood, sweat, and tears. This exercise alone will reduce your risk exposure dramatically. Time is money, yet most entrepreneurs forget this critical fact in their zeal to acquire new business. This is especially true for those offering services and understandably so. In an economy constructed upon material wealth and consumption, the concrete paradigms of retail—where the object of desire can be touched and seen—are almost intuitive. Setting prices according to basic equations like cost-plus-markup or cost-plus-perceived value is the obvious approach.

But why should pricing your services be any different? Like a product on the store shelf, there are costs incurred by getting "you the product" to market and, more importantly, keeping you there. Even if you are just sitting at your desk typing emails and writing reports, you are incurring an *opportunity cost* by not making yourself available elsewhere for a dependable salary, a benefit package, a comfortable office that doesn't take up space in your home, and state of the art computer equipment that will depreciate at no expense to you. By striking out on your own, you are also giving up the ability to mentally punch out at five o'clock each night. That, you will quickly find out, is probably your biggest opportunity cost of all.

Your opportunity cost calculations will form the foundation of your pricing strategy, giving you a base cost (much like wholesale cost in retail) to which you will add various other "markups" in the steps that follow. Start by asking yourself some simple questions:

- What am I willing to give up to be an entrepreneur, and what is "non-negotiable?"
- What will it cost to sustain a standard of living that is acceptable to me?
- For how long can I live by that standard if I do not turn a profit as soon as I expected?
- What contingencies must I plan for (illness, time off, insurance, etc.)?
- Is this base cost sustainable, or will my "costs" increase over time?

If you can answer the above questions plus a few more that are specific to your personal circumstances, you can now estimate how much your time costs. For the purpose of this exercise, apply your figures on an annual basis. Onto step two.

Step 2: What will it cost to operate and market your small business?

Sit down with a calculator (or even better, a spreadsheet), and work out an annual budget for marketing and operating your business. Be generous. Most entrepreneurs gravely underestimate how much it is going to cost to get their small business noticed by qualified prospects, let alone amortize computer and office equipment, retain a lawyer, and renew things like post office boxes and business licenses each year. Much as you may not want to think about it, you will probably need to draft a business plan in order to come up with realistic totals. Your plan need not be complex or convoluted, but it does need to be thorough. Realistic cost projections are empowering and will save you from trying to mark up your prices later in order to cover unexpected expenses.

***TIP:** Pricing is like gravity. Going down is easier than going up. It is also a bonus to your clients when you can offer a discount because you have left room to move within your price plan.*

Step 3: Make them pay for the value-add

Consider the added value your unique talents and efforts will bring to your clients. This is your profit margin and is generally measured as a percentage of total revenues or sales. Profits are reward for a job well done, for a service provided with your personal touch, or for anything else that makes what you do difficult to replicate. As a small business entrepreneur, you are free to think independently and even be rogue in your ideas and offerings. You also have the ability to rapidly adapt your service portfolio to changes in the marketplace, something larger operations cannot do. These things provide incredible value to the customer, value he or she will not find anywhere else—but especially not from an hourly employee.

***TIP:** If you are unsure about where to begin with your profit goals, you can often find industry specific figures on the Internet and by searching statistical websites such as Statistics Canada.*

Add together your totals from Steps 1, 2, and 3. This is your annual revenue target.

Step 4: How much time can you really spend producing billable services?

Think about how many hours in a week you are willing to work to keep your small business operating smoothly and at a profit. Again, for the sake of this exercise, take this number and multiply by fifty-two to arrive at an annual figure. Remember to be realistic in your weekly estimations. Unless you have a very large nest egg, chances are you will spend the first three to five years doing most of the work yourself.

From your total annual hours, subtract the number of hours in a year you will *not* be productive due to vacation and sick days. These things cost your business in terms of lost revenue opportunities (i.e. billable time) and must be factored into your plans. If you suffer burnout because you are over scheduled, you will soon find you cannot mentally sustain the pressures of running a small business, and all will be lost.

A big chunk of your billable time will also be lost to marketing, administration, and downtime. Most successful small business entrepreneurs spend approximately 25% of their workweek on marketing activities. This may sound like a lot, but it isn't, especially if you are new to the marketplace. Downtime and administration can easily take up another 15 to 20% of your work week. Subtract annual hours required for these activities to arrive at the actual number of hours you will be available to produce billable services each year. Please do not avoid this step. Otherwise, you may find yourself burning the midnight oil seven days a week just to make ends meet.

Here comes the fun part! Take the annual revenue target you came up with in Step 3 and divide it by the annual hours you will be available to produce services. This number is your internal rate. You can also think of it as your hourly rate, but I advise against this approach. The rate you just came up with is "internal" because this is the number you may choose not to ever divulge to your competition or your clients. It is not necessarily a price but a threshold that determines the minimum hourly revenue you must earn in order for a project or service to be viable and profitable for your small business. If you cannot generate this amount of money for each hour you are providing a service, you will need to reconsider the client, the project, or even the venture itself. This brings us to the final step, validating your prices.

Step 5: Validate your prices

Once you have considered all of the above variables without the taint of external opinion or research, do as the gurus say and research the marketplace to see how companies similar to yours are pricing their services. You will probably find that the price you have arrived at is reasonably aligned with that of your closest competitors. If it is not, revisit your cost projections as well as your estimated opportunity cost. Chances are you will only need to do some minor tweaking at this point.

Although the end result of this price planning exercise is to put a hourly price on your time, do not get caught up in the concept of hourly compensation or you may paint yourself into a corner. While there are only sixty hours in a work week (you want to be an entrepreneur, right?), it is a mistake to limit your revenue potential to billable hours. This is because there will be opportunities to charge a flat fee instead of by the hour, thus improving the profit potential of your business. In those instances, you will rely on your internal rate as a guideline from which to build upward price-wise.

Congratulations. You have just created a sustainable price plan for your small business. That wasn't so tough, was it?

To make your price planning even simpler, try my *Pricing to Income Goals Worksheets for Small Business Services*. See below for contact information.

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