

Don't Undercharge for Your Services

by Jeffrey Moses

During the start-up phase of a business, pricing of products and services is a key issue. In fact, accuracy in pricing is one of the key factors in whether a company will exist through the all-important first few years. For companies that have operated successfully for a number of years, accuracy in pricing is the key to maintaining maximum profitability.

Generally, the tendency is to under price because small businesses are often afraid they won't be competitive if they price at the level of the competition. Maintaining competitiveness is always an issue, of course, but by charging too little a small company runs the risk of not making enough to remain in business.

Take, for example, an individual starting his or her own small company. The person may be moving from full-time employment with a salary of, say, \$30,000 a year. When deciding how much to charge hourly for services in the new company, it might be tempting to follow this line of reasoning: at \$30,000 a year, working an average of 2,000 hours during the year (40 hours per week for 50 weeks), the average hourly pay is \$15. To maintain this level of income, the new business owner might be tempted to simply begin charging \$15 per hour.

But this would be a mistake. Why? Because there are many expenses probably covered by his/her employer when the person was working full-time. When individuals leave full-time employment and begin working at home or in leased space, they'll suddenly be faced with a large array of additional expenses, including health insurance (which may have been paid in full or part by the former employer), business insurance, the cost of leasing or renting a facility, business equipment (including purchase and maintenance), added utilities (even when working at home during the day, utilities will be higher than when working outside the home), accountancy services, payments into retirement funds (which may have been matched by an employer), etc. After a year of paying all these, a self-employed person would very likely find that the \$15 per hour is, in effect, greatly reduced—perhaps by as much as 33 percent or more.

The only way to accurately price your services when going it alone is to total everything that you'll need to pay during the first year. This will include all business expenses, plus personal necessities (including food, education for children, vacations and anticipated medical expenses not covered by insurance). When you've calculated all your expenses, both business and personal, then divide by 2,000 to determine the lowest hourly rate you should charge. Even this figure may be misleading. Most entrepreneurs find that during the first few years they don't have enough business to charge for the full 2,000 hours. Certainly, you can fall back on savings to make up the difference, but it's always better to earn as you go.

When starting a company, you always face the temptation to attract new business by charging less than the competition. Charging less can help you increase your total hours billed, but you run the risk of attracting customers who are looking only for the lowest price. They'll be gone as soon as the next new kid on the block contacts them with an even lower price.

New businesses are really looking for long-term customers who understand the value of what they're receiving. This type of customer realizes that good service needs to be paid for. They won't want to pay more than they have to, but they'll pay for value rendered. These customers will be the foundation for continuing profitability and growth.

To conclude: undercharging can be detrimental to a company in a number of ways. Calculate exactly what you need to make per hour, then charge a little extra to attain a comfortable margin.

If you decide to charge less in the beginning to attract customers, educate them as quickly as possible about value. Then you can move them up to an hourly rate that will allow your company to move forward long-term.

If you would like FREE business counseling, please contact the Lynn Area Chamber of Commerce staff at 781-592-2900 or info@LynnAreaChamber.com