

# You Can't Fix Your Pricing Problem Without Doing THIS First

4 min read



## Key Takeaways

- **Know Your True Costs With Job Costing:** When it comes to optimizing a service business's prices, you have to face the challenge of quantifying the employee time and value associated with each of your services.
- **Understand Your Value:** The perceived value of your business directly affects the amount a client is willing to pay in exchange for your services.
- **Evaluate Proven Pricing Strategies and Choose One That Works for You:** There are a variety of pricing strategies to choose from – value-based pricing, cost-based pricing, dynamic pricing, package pricing, retainer pricing, etc...

In a retail business, pricing is fairly straightforward. You know how much you pay wholesale for a product, so you can add a markup to ensure you have an ample profit margin that allows you to cover your nut and still turn a profit.

In a service business, however, pricing is not as clear-cut because determining the costs you actually incur when providing a service is challenging. Costs are largely based on time and value in a service business – two expenses that can be quite difficult to quantify.

As a result, business leaders in service-based industries struggle to determine the true costs of their services, quantify the value of the services they provide and optimize their prices to generate healthy profit margins while remaining attractive to potential customers and clients.

If you find you're struggling to maintain a healthy cash flow, reinvest in your business, or turn a profit, you might have a problem with your pricing – and you simply cannot fix your pricing problems until you know your true costs.

## **Pricing Strategy Guide: 5 Steps to Optimized Prices**

### **1. Know Your True Costs With Job Costing**

When it comes to optimizing a service business's prices, you have to face the challenge of quantifying the employee time and value associated with each of your services. The only way to do this is to determine your true costs with job costing, a process that allows you to allocate indirect expenses (like labor costs) to specific jobs in addition to the direct costs to determine an accurate figure for cost of goods sold. <sup>[1]</sup>

To job cost in your business, first, you'll need to get with your accounting function to determine how to allocate your direct expenses including both materials and labor. While dividing materials costs between certain jobs or services is relatively straightforward, it can be difficult to parse out direct labor to determine the percentage of time (and percentage of direct labor cost) that your employees spend on a particular job. (To accurately track employee time, it's best to employ a simple-to-use time-tracking tool like [TSheets](#).)

**Read More:** [Expand Your Profit Margins with Job Costing: Learn How!](#)

Next, ask your accountant to allocate indirect expenses (overhead costs) to specific jobs or clients. This calculates your total overhead expenses and then allocates a portion to each job based on the percentage of direct labor hours dedicated to the job.

Now, you have the tools and data to reveal how much each of your services or jobs costs you.

## 2. Pull Profit & Loss Statements by Class to Identify Your Most Profitable Client

Once you've successfully implemented bookkeeping and accounting processes that enable accurate job costing, you'll be able to review profit and loss statements by class. This makes it possible to evaluate profit margins by service or job type/size and or by client to determine which services, jobs, and clients are your most profitable.

We strongly encourage business owners to do this before making changes to a pricing strategy because most business owners are often surprised to learn which of their revenue streams is actually the most profitable.

As a result of these findings, they typically make pricing changes that they wouldn't have even considered before looking at a P&L by class.

For example, many service business owners find that their big fish clients or larger jobs tend to be much more costly because they demand more time from the company's highest-paid employees than smaller clients and jobs do. These large jobs and important clients might be the biggest revenue streams in your business, but they also might produce the weakest profit margins – or you might find that you're actually taking a loss.

**Read More:** [3 Steps To Fix The Pricing Problems In Your Service Business](#)

Before you make changes to your business's pricing strategy, instead of assuming you know which jobs or clients are your strongest profit drivers, you must evaluate your P&L statements by class to determine which prices actually need to be adjusted and whether certain services are even worth continuing to offer.

## 3. Consider the Market

Unless your service business is the only one of its kind in town, pricing cannot happen independently from the market. You need to look at the market, find the competitors that are most closely aligned with your business model, and keep track of how much they're charging.

When you evaluate your competition's prices, you should be looking at it as a guide – not as a model to copy, undercut, or exceed for no reason. Consider their pricing model and

determine whether it's a good guidepost for your clients, as well. Do you appeal to the same market group or are you offering a higher-end service model with greater value?

Whether you charge more or less than the competition, make sure you maintain healthy profit margins and can justify your prices to your client base.

#### **4. Understand Your Value**

The perceived value of your business directly affects the amount a client is willing to pay in exchange for your services.<sup>[2]</sup> For example, a fancy car wash that offers all the bells, whistles, waxing, and hand-polished mirrors can charge more per carwash than a drive-up, self-service car wash bay.

In the same way, a luxury spa can usually charge more for the same manicure or pedicure that a person can purchase for half the cost at other nail salons because customers perceive the spa experience as offering a higher value.

This same principle applies to all service businesses, and it's important to understand how much perceived value your service model and branding earn among your client base before you establish your prices. This type of pricing model is called value-based pricing, and it's a great way to ensure you're charging what your services are truly worth.

**Read More:** [Improve Cash Flow in Your Business with Value Pricing](#)

Depending on how your value is perceived, you might consider raising or lowering prices compared to competition offering different value levels or you could always look for innovative ways to offer your clients more value in the services they receive from you.

#### **5. Evaluate Proven Pricing Strategies and Choose One That Works for Your Service Business**

When you're ready to fix your pricing problems, you can start by determining the proven pricing strategy that'll work best for your business. There are a variety of pricing strategies to choose from – value-based pricing, cost-based pricing, dynamic pricing, package pricing, retainer pricing, etc. – and most service businesses end up using a combination of strategies. [3]

A good place to start is to determine whether you will charge an hourly rate, a project-based rate, or a retainer/subscription fee. If you're confident in the amount of time necessary to complete certain project types, then quoting project-based rates will work well. If the time dedicated to a job can fluctuate greatly depending on unique circumstances, then hourly rates make more sense.

If your services sell better as a subscription package, offer different levels of subscriptions so that customers can scale your services as needed and you continue generating large enough profit margins to stay in business.

Whichever rate structure you choose, be sure to price for profitability by circling back to evaluate your true costs.

## **Do It All – Job Costing, Time Tracking, and Price Optimization – With a Better Back Office**

When you implement a stronger back office that's designed to automate manual processes, you'll not only save time and overhead costs, but you'll also be able to implement a stronger, more successful pricing strategy in your service business.

Whether you charge hourly rates, project-based rates, or are hoping to develop more saleable subscription-based service packages to improve customer lifetime value, having a well-equipped back office will ensure accuracy in the numbers on which you base and measure the success of your pricing decisions.

[1] <https://www.insperity.com/blog/job-costing-how-to-prove-the-roi-on-your-employees/>

[2] <https://hbr.org/2016/08/a-quick-guide-to-value-based-pricing>

[3] <https://academy.getjobber.com/resources/articles/pricing-strategies-service-business/>