

# You're Making A Mistake With Your Pricing If You Don't Do This...

6 min read



## Key Takeaways

- **Optimizing Pricing:** Knowing your true costs and your desired profit margin arms you with the data you need to reprice your jobs to hit your target goals.
- **Improve Employee Management:** Understanding your true overhead costs will help you identify your top-performing employees, reward and recognize them accordingly, and develop new strategies for motivating and training lower-performing employees
- **Overhead Expenses Can Be Allocated To Specific Jobs With Job Costing:** They include costs from the following categories: general and administrative, sales and marketing, management, and product and industry.

You don't rent out an office to complete a single job. The benefits you offer don't directly affect a specific client, but they do attract top talent, resulting in better quality service. You don't invest in employee training to carry out a specific job, making it an overhead expense, but you do invest in employee training to improve or expand the services you provide.

So, while these expenses aren't considered direct, they're still necessary operating costs and your pricing should reflect them.

These expenses are Overhead Expenses -those that are not directly attributed to a specific job or client. They include items like your office expenses, utilities, and indirect labor costs. Although they're not directly billable or directly related to the services you provide, they're still necessary for business operations and the costs need to be covered somehow.

But how do you build overhead expenses into your rates and pricing structure to ensure you cover your net and also generate a profit?

We're here to answer that.

Use [indirect cost allocation \(job costing\)](#) to reveal your true costs and structure your prices accordingly.

## **What You Can Do When You Know Your True Costs**

When you reveal your true costs with overhead cost allocation, you can improve your business operations in the following ways:

### **Optimize Pricing**

Not only is pricing one of the most important decisions a business owner will make, it is also oftentimes the most difficult.

What's even more challenging? Attempting to do so without allocating overhead expense- especially in a service business. This is because the most significant portion of costs is indirect costs and/or employee-related expenses.

To optimize pricing in a service business, using [time-driven activity-based costing](#) is a must. This strategy enables you to track employee time, allocating each hour or minute to specific tasks. You can then accurately divide overhead expenses based on the percentage of time dedicated to completing certain jobs.

Knowing your true costs and your desired profit margin arms you with the data you need to reprice your jobs to hit your target goals.

With microscopic insight into their finances, this service-based business was able to make pricing decisions that helped them jump from **break-even to seven figures of profit in less than a year**. How did they do it? When they renegotiated pricing on their lowest margin clients, the difference went right to their bottom line. [Read the full story here.](#)

*"I now have insights into my numbers that helps me maximize my people and increase our profits."* - Peta Hoyes, COO, Tag1.

## Laser-Focus Revenue Channels

By properly allocating overhead costs, you'll be able to pull accurate profit and loss statements on specific clients, client types, jobs, or job types to determine which are actually your most profitable.

It's necessary to look at the profit and loss statement after accurately allocating costs so that you'll have a reliable way to rate jobs and clients based on not only revenue but also profits.

For example, it's often the case that the [larger jobs and big-fish clients](#) tend to put a much larger strain on your company's resources.

Even though these major projects generate a considerable amount of revenue, their profit margins aren't always equally impressive.

Accurately determining which types of jobs and which clients are the most profitable will help you focus your marketing strategy to potentially end relationships with less-profitable clients, eliminate services that are costing you money or weakening your overall profit margins, and strengthen your most profitable revenue channels.

## **Improve Employee Management + Boost Productivity**

Cost allocation enables business owners to evaluate profit and loss statements on a granular level.

By looking at the unit economics of a single employee's performance or a department's performance, CEOs can identify the management strategies that work and those that do not and finally make decisions to improve productivity.

Understanding your true overhead costs will help you identify your top-performing employees, reward and recognize them accordingly, and develop new strategies for motivating and training lower-performing employees. [People drive profit.](#)

When your employees constantly feel motivated to increase their productivity and do the best they can during their billable hours, you'll see a boost in your ROI.

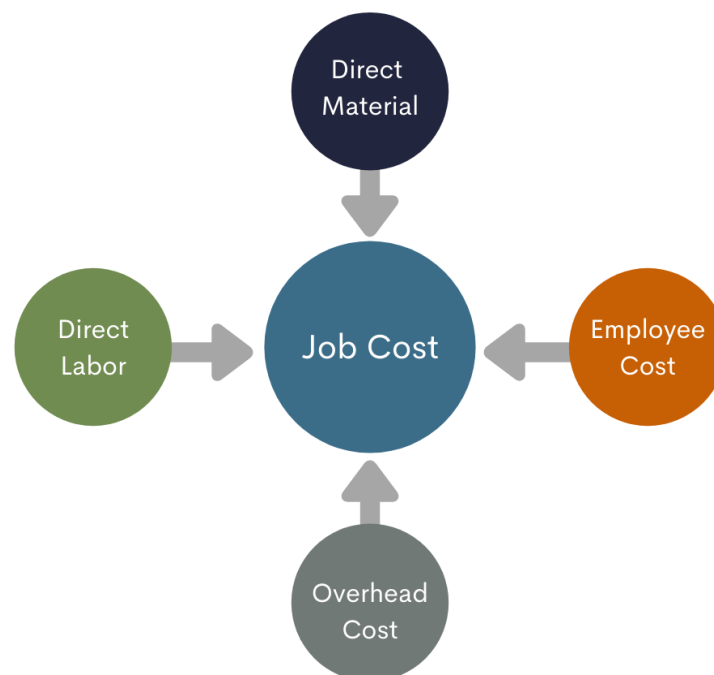
It can also help you determine when letting go of an employee might be necessary and when, on the other hand, hiring additional staff will be beneficial to overall employee performance.

## **Why Job Costing Is Essential – Especially in Service Businesses**

Overhead expenses can be allocated to specific jobs with job costing, and they include costs from the following categories: general and administrative, sales and marketing, management, and product and industry.

Sure, in a product-based business, allocating indirect expenses to the products produced will provide a clearer picture of true costs- but the difference is likely negotiable. In these product-oriented businesses, material and direct labor costs usually comprise the most significant portion of the cost of goods sold and simply marking up prices by a certain rate is an adequate strategy for building overhead expenses into pricing.

On the other side of the coin, in a service-based business, you might have some direct materials costs, and you'll definitely have direct labor costs. Your people, however, are your product and total employee costs are by far your biggest expense. Additionally, all jobs and clients in a service business are not equal. Some jobs and certain clients will use up more of your resources than others, and your pricing should be designed to reflect this.



These employee costs include the time employees spend working on specific jobs, in addition to general employee-related expenses like time spent on other tasks, payroll, and employee benefits such as paid time off, health insurance, and retirement contributions. Additionally, in a service business, it's easy for time to pass by unaccounted for and unbilled, and services are often unintentionally handed out for free.

For these reasons, job costing is essential to the success of a service business because your largest overhead expense – the cost of your people – needs to be properly allocated to ensure strong profit margins that will bolster your business's future.

## **Cost Tracking, Allocation, and Interpreting With The Right Team + Technology**

This detailed cost allocation is not possible without a robust bookkeeping and accounting system. On top of that, we recommend working with an experienced management accountant. A professional's expertise will help you identify and implement the tools your business needs for proper tracking, allocating, and coding.

Most importantly, working with an experienced accountant will help you interpret your findings. These deep insights are a moot point if you aren't using them to make decisions. Working with an expert, remote team will help you understand unit economics and interpret your management reports- so you can take control of your business drivers to cut costs, optimize pricing, and achieve the strong profit margins that will grow your business.