



The Basics of Costing and Pricing

With any product or service, there are four cost components you need to consider:

- **Material costs** – these are the costs involved in buying the raw materials used for making your product. This cost varies directly with the amount you produce.
- **Overhead costs** – these are fixed costs which do not vary, or only vary a little with your level of production, eg. rent, insurance.
- **Your labour costs** – how much you are paid per hour for your work.
- **Profit** – the amount you make over and above these other three costs.

General Considerations

When you start out it's easy to undersell your goods – maybe you feel guilty about making a profit or you are just chuffed that people respond to your work. To run a profitable business you need to get past these feelings and a good way to do that is to consider these three things:

- 1 People aspire to good taste and acquire a sense of prestige, status and confidence through their material possessions.
- 2 You are not supplying your customers with a mundane, mass-produced item. Your pieces will often be luxury items that benefit your customers in intangible ways – satisfying cultural and aesthetic needs.
- 3 Customers will assess the value of your work on a range of factors other than price. These factors will include your personal credibility, the style of your work and the style with which you present it – these things, when done well, help to inspire your customers with confidence in the value of your work.

You may think that what customers want is low prices (and retailers WILL be more focused on that as they need to make good margins too) but when trading directly with the buying public price is unlikely to be the prime factor. You are a customer too – what do you look for when the roles are reversed? When you shop are you motivated primarily by price or are you motivated by other factors too?

Calculating your costs

Do your prices cover costs? Many businesses fail due to a lack of understanding of their true costs.

Costing correctly

As mentioned originally there are four key elements in the cost of any product or service.

- 1 Direct labour costs
- 2 Overhead costs
- 3 Material costs
- 4 Profit

This fourth element should be added and is what allows you to enhance the scale of your work and business but to start with and while you are home-based business with no staff you may decide that your labour costs are sufficient compensation.

A Calculating a charge out rate for your time (labour costs)

Let's say you want to earn \$30,000 p.a (gross).

We'll assume you are willing to work 50 hours a week on your business.

There are 52 weeks in the year or in this case, 2600 total hours. Although it would be great to think we could work all of this time the reality is not all of these hours will be productive. You should anticipate realistic time off for sickness and unforeseen events that take you away from your work and you should allow yourself some holidays and days off throughout the year. Your schedule for down time might look like this:

Christmas – 2 weeks	100 hours
Holidays/Days off throughout the year – 2 weeks	100 hours
Sickness – 1 week	50 hours
Statutory Holidays & unforeseen events – 2 weeks	100 hours
Total	350 hours

So, from your total 2600 hours you subtract 350 hours, which leaves you 2250 hours.

On average a self-employed person spends about 25% of their time performing non-chargeable duties such as administration, tea/lunch breaks, planning, waiting etc.

25% of 2250 is 562 leaving you 1687 hours.

[Keen mathematical eyes will note that I have rounded these figures for simplicity's sake]

So your total chargeable time is 1687 hours.

The salary you want is \$30,000.

To recover your desired salary you must divide it by the number of hours you plan to work.

In this case your hourly rate is now determined as \$17.78 per hour – round it to \$18 if you wish. You now have your labour charge out rate to apply towards your costs. Put it into box A.

A

B Calculating your overheads and fixed expenses per year

Firstly add (or estimate) your yearly overheads:

Accounting Fee	1000.00
Advertising	2000.00
Cleaning	0.00
General expenses	500.00
Power / Electricity	1000.00
Insurance	600.00
Legal Fees	600.00
Motor Vehicle	3000.00
Printing	800.00
Rent	6500.00
Repairs & Maintenance	900.00
Telephone	1200.00
Other	200.00
Depreciation	1000.00
Total Overheads	\$19800.00

Round off to \$20,000 (unseen expenses) and divide by total working hours (1687 in our example).

This gives our example an overhead cost of \$11.85 per hour. Put this into box B.

B

C Adding your material costs to your labour and overheads

Let's imagine you sell hand-beaded necklaces. The beads, cord and clasp for each necklace cost you \$10. You pack each one in a small decorative box which cost \$0.70 per box. Your material costs are therefore \$10.70.

Put your material costs into box C.

C

So, using the prices we've established above:

A. Time

\$18 per hour divided by 2 (because a necklace takes you half an hour to make) 9.00

B. Overheads

\$11.85 divided by 2 5.92

C. Material Costs

\$10 + \$0.70 10.70

Total **\$25.62**

A + B + C = D

D Adding profit

What about profit?

Even if you decide not to work a profit into your pricing right away you should always keep it in mind and start adding it on as soon as you feel comfortable doing so. Adding this extra amount is what allows you to take risks and enhance your business, buy new equipment, upgrade your existing equipment, increase the quality and scale of your work and your working life.

For the necklace example, let's say you decide to add on 20% profit per necklace. You take your total cost price (\$25.62) and multiply it by 1.2 to add 20%, giving you \$30.74 per necklace.

This is now your minimum sell price. You will probably want to round it off to \$31.

Take the figure in box D, and multiply by your chosen profit margin (eg. 20% = 1.2) and write the outcome in the box below.

Your minimum sell price

This process gives you a starting point for your pricing. You may need to tweak your numbers, your costs or your product to achieve a balance between your pricing and marketability.

Tips

- If you're looking at selling wholesale, make sure you have allowed for retail markup.
- Consult a focus group! Find a few people who will give you an honest assessment and see if your pricing aligns with their perception of the value of your product.

Notes