

PRICING AND COSTING

This guide has been compiled to step you through the process of pricing and costing your products and services. However, actions taken as a result of this document are at the discretion of the reader and not the Hawkes Bay Chamber of Commerce.

The important question to ask is – do the prices I am charging cover all the costs associated with the product or service?

REMEMBER:

- a retailer or wholesaler will add a certain percentage mark up on the purchase cost to return a profit
- manufacturers will cover all their costs of manufacturing and a profit
- you need to factor in a profit margin which covers all the costs of supplying a service
- you need to remember to include the rate for your time, including GST

Before you price your product or service you need to consider how much the customer is prepared to pay. This will depend on the type of product or service and who you are targeting – eg. a luxury product versus a basic good.

If you set your price too low you risk missing out on profit – but if you set it too high then you could end up with excess stock. For this reason it is important to consider the demand for your product. If demand is high you can probably charge a higher price and vice versa. You also need to consider what your competitors are charging. A lower price may cheapen your product or service as well as reduce profits. Sometimes it is better to charge the same or a fraction more and add extra value through the service you can provide or some other differentiating factor that makes you stand out from your competitors.

The main point is, make sure you cover all your costs and add a profit.

PRICING METHODS

There are four basic methods that you can use to determine the selling price of your product or service:

- **Cost plus pricing**
After calculating the actual cost of your product or service you add the desired amount of profit to reach the selling price.
- **Demand pricing**
Prices using this method are determined by a combination of sales volume (ie. units or a dollar amount of what you actually sell) and desired profit (ie. profit left after subtracting the cost of the goods and doing business). You need the ability to calculate in advance the price that generates the optimum ratio of profit to volume.
- **Competitive pricing**
There are times when the market establishes the price for your product or service. At times like this you are best to follow along with this price. It is important under this pricing structure to track what your competitors are charging, and find out how price aware your customers are.
- **Mark-up pricing**
This method generally involves adding a mark up to the 'into store' costs of products. It is not usual for this to result in a recommended retail price determined by the market. Different products can have different mark ups depending on supply and demand or market position.

If you have any questions, please call 0800 CHAMBER (0800 242 623).

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CALCULATING YOUR COSTS

To calculate your full cost price there are four cost components you need to consider:

1. Materials / variable costs

These vary depending on the number of units of your product produced. If you produce goods, or use any product in providing your service, you need to work out the variable and material costs.

2. Labour costs

This could be the income a working proprietor/sole trader requires, and is worked out at an hourly rate.

3. Overhead / fixed costs

These do not vary with production costs – e.g. rent, insurance, etc. They should include your working from home costs.

4. Profit / mark up

This percentage will be determined by the market. For example, it is not uncommon for a retailer to add 50%-100% mark up, depending on the product, although some products are as low as single digit percentages.

For this example we are operating a business which makes high quality essential oil bath salts, and are assuming all prices are **GST inclusive**.

Assume you require an annual income for being self employed for \$40,000 (A).

The bath salts are made in batches of 50 large glass containers.

Time involved:

Mix the oils with the salts	10 minutes
Package the salts into glass containers	60 minutes
Label and package the containers	<u>50 minutes</u>
<i>Total time take to produce a batch of 50 containers</i>	120 minutes (or 2 hours)

1. Cost of materials

Material costs:

Example		Your Workings	
Glass containers @ 50 x \$2.00	\$100.00		
Labels and packaging	\$50.00		
Bath salts	\$10.00		
Essential oils	\$40.00		
<i>(B) Total cost per batch</i>	<i>\$200.00</i>		

2. Direct labour costs

	Example	Your Workings
Number of hours intended to work per week	40	
Multiply by number of weeks	52	
<i>Total number of hours</i>	<i>(C) 2,080</i>	
Divide by the desired annual income	\$40,000.00	
<i>Charge per hour</i>	<i>\$19.23</i>	

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You will probably not work all 52 weeks, so for how many of the 2,080 hours do you actually charge?

You need to deduct at least the following:

	Days	Days
Holidays (4 weeks)	20	
Statutory holidays	11	
Sickness	5	
Bereavement / other	4	
<i>Total days</i>	40	
Multiply by number of hours worked per day	8	
<i>Total number of hours not at work</i>	(D) 320	
Number of hours chargeable (C – D)	(E) 1,760	

Of the 1,800 hours per year you tend to spend around 25% of your time on non chargeable activities (e.g.) administration, breaks, toilet, waiting for work, marketing, etc). This percentage varies from business to business so you will need to assess this yourself.

Number of hours charged (E)	1,760	
Percentage of time spent on non-chargeable activities	25%	
<i>Hours of non-chargeable time (E x F)</i>	(G) 440	

Actual time worked therefore is

Total number of hours (C)	2,080	
Less the total number of hours not at work (D)	320	
Less hours not chargeable to customers	440	
<i>Total time chargeable</i>	(H) 1,320	

If you aim to earn a minimum of \$40,000 and charge only 1,320 hours per annum (which equals 75% of your productive time) you must charge:

Desired annual income (A)	\$40,000.00	
Divided by total number of hours actually chargeable (H)	1,320	
Hourly charge (A ÷ H)	(I) \$30.30	
Add ACC levy (J)	3%	
Charge out rate (I x J)	\$31.21	

Therefore for your time your charge out rate must be least (rounded up) **\$32.00 (K)**.

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3. Overheads cost

Accounting fee	\$600.00	
Advertising	\$1,000.00	
Depreciation	\$500.00	
Insurance	\$300.00	
Legal fees	\$600.00	
Motor vehicle	\$1,500.00	
Power	\$500.00	
Printing and stationery	\$800.00	
Rent and rates	\$2,600.00	
Repairs and maintenance	\$200.00	
Subscription	\$100.00	
Telephone	\$600.00	
Other	\$200.00	
<i>Total</i>	<i>(L)</i> \$9,500.00	
Overheads (L)	\$9,500.00	
Divided by total time chargeable (H)	1,320	
<i>Proportion of overhead costs (L ÷ H)</i>	\$7.20	

Therefore the overhead cost on an hourly basis is at least (rounded up) **\$7.50 (M)**.

From the first three steps you can work out your overall cost.

Cost of materials (B)	\$200.00	
Add the cost of labour (K x 2 hours to produce a batch)	\$64.00	
Add proportion of overhead cost (M x 2 hours)	\$15.00	
<i>Total cost (of producing a batch of 50 containers)</i>	<i>(N)</i> \$279.00	

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4. Mark up

If you intend to sell your product through a retail outlet you will want to check out what their mark up percentage is, and if they sell other similar products what these retail at. There is no point adding a profit margin on for yourself which will price your product significantly higher than that of competitors and therefore out of the market.

Once you find out what a 'normal' mark up rate is you need to add this to your total cost

Total cost (N)		\$279.00	
Add mark up (e.g. 50%)		\$139.50	
Marked up price (of producing a batch of 50 containers)	(O)	\$418.50	

On top of this you also need to consider wastage, breakage and unsaleable products.

For example, assume only 48 of the containers are saleable due to glass breakage. The cost per container is therefore the marked up price per batch divided by the number of saleable containers

Total cost (O)		\$418.50	
Divided by number of saleable containers		48	
Final wholesale price per container	(P)	\$8.72	

If retail shops then add a 100% mark up your product would be:

Wholesale price (P)		\$8.72	
Add retail mark up (e.g. 100%)		\$8.72	
Final retail price per container		\$17.44	

The retail price would probably be rounded up to \$17.95

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