

## Costing and Pricing - Handout

Once you have researched what your average sale might be you then need to cost this.

The process of costing takes in to consideration all the additional factors that need to be accounted for to enable you to provide your service or sell your product, and to then enable you to calculate how much profit you will actually be making from each sale.

**The following pages are a basic guide to costing your products/services.**

When undertaking a costing exercise you need to account for both **direct costs** and **indirect costs**.

Direct costs:	Those expenses which can be identified precisely with a product or process such as: <ul style="list-style-type: none"><li>• Materials/stock</li><li>• Time - your time (labour)</li></ul>
---------------	---

<i>Indirect costs</i>	Those expenses incurred in production but which cannot be traced directly to a product or service such as: <ul style="list-style-type: none"><li>• Rent</li><li>• Administration costs</li><li>• Advertising etc.</li></ul>
-----------------------	---

**Note:** In Retail direct costs include the cost of the stock, but the cost of labour is considered an indirect cost (overhead) together with rent, insurance etc.

### **Direct Costs**

#### **For A Service Based Business:**

Direct costs can be calculated by working out how much stock is used to provide a certain service, plus the amount of time taken to perform the service.

<b>Example:</b>	An Aromatherapist uses the following per massage:		
	Stock (oils)	=	£2
	Time (1 hour)	=	£10
	<b>Direct Costs for service</b>	=	<b>£12</b>

### ***For A Product Based Business:***

Direct costs include the costs of the stock, and labour includes specialist skills, design, purchasing stock and manufacture of the goods

<b>Example:</b>	A Tailored Dress	
	Stock (material and trim)	= £7
	Time (measuring and purchasing 1 hour and manufacturing (2 hours)	= £30
	<b>Direct Costs for product</b>	<b>= £37</b>

### **Task 1 Estimating Direct Costs**

*Using the table below calculate the costs that can be directly related to your product or service. This should be the direct cost incurred per product/service:*

Direct materials	
Direct Labour	
<b>Total Direct Costs (DC)</b>	<b>£</b>

### ***Indirect Costs (Overheads)***

A proportion of the overheads are added to the costing of each product/service to ensure that indirect costs are covered by sales. To work out how much should be added to each costing, you will need to **estimate your total overheads** per month and **your expected number of sales** per month for the first year of trading.

Example: **The Aromatherapist business has monthly overheads of £400.**

**If the business expects to have 40 sales a month, each sale will have to cover £10 of overheads.**

(£400 overheads / 40 sales = £10 per sale)

It is important at this stage to estimate what you think your costs will be, even if you are not exactly sure. Having an idea of how much your premises and bills are going to cost you per month, will help to ensure that overheads are covered by sales.

## Task 2 Estimating Indirect Costs (overheads)

Use the following table to estimate monthly costs (overheads)

Item	Estimated monthly cost £
Rent and rates	
Utility bills – electric/gas/water	
Advertising budget	
Commercial insurance	
Wages (if you're going to have staff)	
Telephone/postage/stationery	
Hire charges	
Running a vehicle (insurance/fuel)	
Other travel costs	
Professional fees (accountant, etc.)	
<b>Total Indirect Costs (IC)</b> (Average monthly overhead figure)	<b>£</b>

Now, **using your average monthly overheads figure (IC) complete the table below to give you your Indirect Cost Per Sale figure.**

Average Monthly Overhead Figure (IC)	Divided By	Average Number of Expected Sales Per Month	Equals	Indirect Cost Per Sale
	/		=	

### Allowing for Profit

Using our example of an Aromatherapist:

The Direct Cost per average sale was £12

The Indirect Cost per average sales was £10

Therefore to **Breakeven**, (reach the point where income covers expenditure) the Aromatherapist would have to charge at least £22 per sale.

**However, this does not allow for any profit.**

To allow for a profit, this business should not consider selling services for less than £25 per sale. Once the Aromatherapist has reviewed the market she may find that her customers expect to pay around £30 per sale.

Therefore the Costings for the Aromatherapist are:

**Direct Costs (see page 20) £12 per sale**

**Indirect Costs (overheads) £10 per sale**

**Profit £8 per sale**

**Total Selling Price £30 per sales**

N.B If her research revealed that her potential clients would not pay more than £20 per sale she would have to review her business idea, as it is not currently viable. The Aromatherapist would then have to consider lowering her overheads in some way or finding another market.

Once you have estimated your direct and indirect costs you need to decide how much profit you can make from each sale. Refer back to your Market Research to estimate how much your customers will be prepared to pay and how much your competitors are charging. This should then indicate what level of profit you can expect from your average sale.

**Task 3 Costing the Average Sales for Your Business**

Direct Cost	
Indirect Cost	
Profit	
<b>Total Price</b>	<b>£</b>

**Task 4 Your Pricing Policy**

**Explain how the pricing policy has been set for your new business, listing all the factors, which have been taken into consideration.**

**You should give an example of your prices and/or include a full price list in the appendices of your business plan. Also you should include information on any discounts, special offer or price banding that you will be using.**

