RAISING PRICES WITHOUT RAISING A FLAP

Raising prices is one of the toughest challenges for any company. Whether the company is General Electric or Gene Freelance, the question is the same: will the increase in revenue offset the (possible) loss of customers? Never an easy answer.

In addition, creative firms, especially smaller ones, have two other concerns: In most cases the principal is also the messenger. And unlike manufacturing companies that can blame raising prices on the rising costs of raw materials, creative companies sell mostly time. So justification is never as straightforward either.

Despite these difficulties, price increases are a necessary fact of business life. How often to do it, and how to inform clients when you do, can have a major impact on profitability.

BUT FIRST...

Raising prices is only one way to increase profitability. Other options should be considered first. Most not only provide a more immediate effect, but also skirt the problem of client approval.

Are all clients treated equally? When you charge lower fees to some clients, you must charge higher fees to others, or make up the difference out of your own pocket. Either way, bad practice. Charge all clients—big, small, profit and not-for-profit—equally.

Are you managing effectively? Here are some common trouble spots to look at: inaccurate time recording… workflow bottlenecks… consistently exceeding estimated time by "fine tuning"… high employee turnover… bad cash flow predictions… inefficient employees… too many not-productive meetings.

Are your ratios in line? Keep an eye on key creative business indicators such as: accounts receivable collections (45/60 days)… billable time (>60%)… work backlog (2/4 weeks)… marketing costs (<20%)… salaries & benefits (<70%)… quick ratio—assets÷ liabilities (1.0 to 1.5)… debt to asset ratio (.30 to .60).

Are you charging for everything? Is all job time recorded and billed? Are all pass-on expenses itemized and billed?

Do you have minimum fees? To keep small jobs from being money-losers you probably should have a minimum charge—one or more day's billable time for all jobs; one or more hours for all work on a job.

WHEN IT MAKES SENSE

One of the benefits of being self-employed is that no one else limits how much you make. But it is also difficult to determine what you *should* be making. So here are some guidelines to help you determine when it's probably time to consider a price hike.

The 75% rule. Self-employed persons should be able to pay themselves *at least* 75% of what they could make working for someone else. (A spread of up to 25%, the difference between 75% and 100% of potential, can usually be justified by tax savings and a lifestyle choice.)

If you know that you could be making at least 25% more in a salaried position, and are running your business efficiently, it is probably because your firm is not charging enough.

The numbers don't add up. The price any business charges must be based on a realistic calculation of its costs. This can be roughly established by adding all expenses (labor + overhead) for a given period (6 months or longer) and dividing it by number of hours actually billed. The result is the hourly rate that must be charged just to break even under current circumstances. The hourly rate you charge in the future should be 25% to 50% higher than this to allow for profit, expansion, a financial cushion, new equipment, etc.

Low return on labor investment. Each billable employee should average billable time that is three or four times his or her salary. If not, the employee is either overpaid, or your billing rate is not high enough. (In shops with several levels of employees, use a blended or average rate.)

No price pressure. We all wish for clients who never question pricing. But it's probably better if the wish doesn't come true. When clients never question, it's usually because prices are well below market level. Likewise if you don't occasionally lose jobs on price. (You probably should lose 10% to 25% of all jobs bidded, depending on how qualified are the leads, amount of repeat business, etc.).

Industry norms. What do others charge in your market? Your pricing should be near the top of the level for others *of your level of talent and experience.* Also compare your job prices to those published in *Creative Business*, or the Graphic Artists Guild's "Pricing and Ethical Guidelines" (PEG). (Caution: CB surveys indicate that PEG's prices are often 10% to 15% high.)

Effective hourly rates (what's collected, not necessarily what's estimated) should probably be in the following ranges: $85/$100 for lesser talent or up to 5 years experience… $100/$150 for mid-level talent or 5/12 years experience… $150+ for top level talent or 12+ years experience.

It's been too long. When was the last time? For the past several years business costs have risen an average of about 2% annually. If your prices (or working efficiency) has not risen proportionately, you are making less now than before. Viable businesses are stable or grow, they don't shrink.

HOW MUCH?

When raising hourly rates, it is usually best to do it in $10 or $20 increments and no more often than once a year. If your prices are still below what they should be, plan on an annual increase until they reach the right level.

When considering the effect on job prices, *keep in mind that it is difficult for a client to easily accept a perceived job increase of more than 15%.*

TWO JUSTIFICATIONS

The best way to justify an increase is to view it from the clients' perspective. To them, there are only two universally-supportable reasons, and even these often raise questions.

Higher costs. It is common knowledge that inflation has produced a steady rise in overall prices over the past several decades. So referring to continually rising operating costs (labor, materials, supplies etc.) is a common justification. In addition, the technological revolution in our industry also continues to result in rising costs (new types of hardware, computer training, upgraded software, etc.).

Product quality. The quality of any product determines its value, and its price. (A Mercedes and a Chevy don't sell for the same amount.) If the quality of your work (your "product") has demonstrably improved, rational clients will consider a price increase that reflects the new level justified. How do you improve product quality? Through more specific experience, a higher level of creativity, winning awards, working with more prestigious clients, better service, etc.

It is important to note here that *your desire to make more money, or pay your staff higher salaries, is never a justification for a price increase.* That's your problem, not clients'.

PSYCHOLOGICAL PREP

Whenever discussing pricing it's always wise to remember the role psychology plays in price acceptance.

Be matter-of-fact about it, not defensive. Price increases are a legitimate response to a business' increase in costs or quality. Being defensive won't make the increase any easier to "sell," but it will make it appear less legitimate.

You get what you pay for. It's a cliche, but most people, clients included, believe it. When raising prices, your task is to convince them that your value has increased more than your prices (see the column to the left).

Perceptions affect reality. Whether a client believes your work is over, under, or appropriately priced is strongly affected by impressions. All other things being equal, a well-dressed, personable, and articulate professional can charge more than someone lacking these qualities.

There's no "right" price for a job. Every one is a different challenge that can be addressed in different ways at different price levels. The fact that you have previously done a similar job at a certain price, or that the client has a budget figure in mind, should never be a factor in pricing.

There's always someone cheaper. Clients looking for lower prices can find them. What the client cannot find elsewhere is your quality, service, and dependability at your price. Don't let unnecessary concern scuttle a needed increase. Deal with it.

Most will spend more. A good client will nearly always spend a little more on a service they need from someone they like. It is unlikely that a client who has been pleased with your service in the past will bolt based upon a small price increase.

DOING THE DIRTY DEED

Start using your new, higher pricing structure the first of next month. Don't agonize over implementation. Just do it! Chances are that it will be more significant to you than to most clients.

New clients. Unless new clients have some way of comparing your old with your new pricing structure, there's no need to inform them.

Existing clients. For most competitive projects it is not necessary to inform clients of an increase in pricing. How you arrive at a competitive job price is your business.

For repeat or similar assignments it is probably better not to inform the client in advance. Wait until presenting the estimate. Then say, "By the way, you'll notice that this price is slightly higher than last time. I've had to raise my fees since then because of rising costs."

On jobs where the client is aware of your hourly labor rate, it is best to tell them before estimating on the job. ("Since the last time we worked together, we've had to raise our fees to keep up with our higher business costs. This job will be estimated on our new labor rate of $000 per hour. Even so, I know you'll still find our prices well below the market rate for work of this quality.")

In the case of direct hourly billing it is best to give a month's notice.

CB