How to Price a Service

By David Selch, MBA BSc

Introduction:

During the summer of 2020 – as Covid-19 was shutting down the world economy – I was invited into a discussion on Linkedin asking how Service providers should price their work.

It's a great question, and in fact the reason that Service Science, the branch of management that deals with Service businesses, exists. This article is the result.

There are about 15 common pricing strategies that are usually covered in first year Marketing courses. Some are straightforward, like Cost-Plus, which is the strategy that says, "Look at all your costs, and then add some profit onto that". Even people who are not marketing professionals are familiar with "Market Rate" which is the strategy of pricing a new offering according to what the "normal" price is for a similar offer.

For readers who haven't finished the first semester of an MBA, many good pricing articles are just a Google search away. I won't repeat their work here.

But the original question was, "How do you price a *Service*?" as opposed to pricing a *Product*.

Praveen M, from SalesAdda, specifically wanted to know "How do I price a service where the main component is completely intangible, like the unique experience of a senior expert?"

In the original discussion, experts (Matthew Toth, Christopher Bowen, Ken Baldo) suggested variations on Market Rate, High-Low, and Value Pricing respectively, and Eric Steeves pointed out that Cost Plus can evolve into a subscription-based discounting strategy that yields similar profits.

Here are my thoughts:

First of all, you should know that every pricing strategy can be applied to any of the four fundamental offerings found on the SIPS grid: Products, Services, Productized Services, and Product/Service Hybrids (including SaaS). Productized Services are priced like Products, and PSHybrids are priced in the same way as Services. Let's look at some examples:

Data Processing is a Service with almost no human component. Data are uploaded, and silicon does the work. Microsoft's million-square-foot data center employs only 57 people. Those 57 hu-mans don't process data, they just keep 27 acres of computer running.
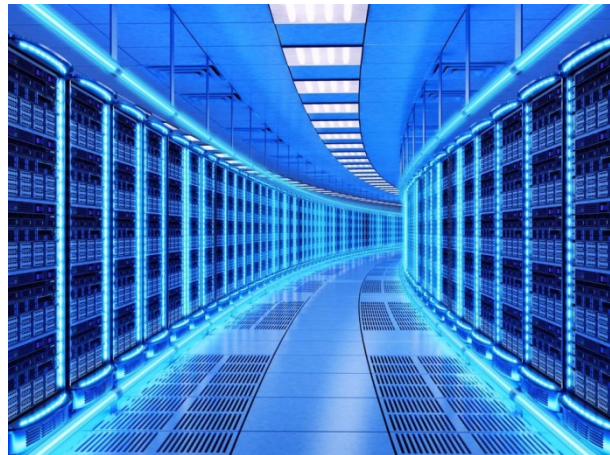
You'd think that Artificial-Intelligence-as-a-Service (a common form of data processing) would command a premium price, but it uses Market Pricing. That is, Microsoft can't charge much more than its competitors, or its customers will switch to other data centers run by Amazon, IBM, HP, Google, or others. Data Processing is priced the same way as chocolate bars at the checkout counter.

Dentists charge per job unit, knowing that all jobs of a certain type will use about the same amount of time. For pricing purposes, the "routine cleaning and checkup" Service is a productized offering, and, like most Products, has one set price for all buyers.

Automobile repair is a Service. My car just needed a new fuel pump. For me as the buyer, I just cared about the overall cost. But the garage broke their pricing down as the cost of a new pump, plus an hourly rate for services. As with other Product/Service Hybrids, the Product component was "swallowed" into the overall Service pricing model.

Pure Service professionals (architects, lawyers, electricians, etc.) use a modified Market-value system, modified by the experience of the professional. The local market caps the maximum price the best professional can change, and less experienced professional may have to charge less.

So to Praveen's question, what about the most expert consultant? How should that person price?

I think you have to apply "Value Pricing" by asking "What is it worth to the buyer, in that moment, under these conditions?

How much is a bottle of water worth? I can buy a six-pack of 1 liter water bottles for $2 at my local big-box supermarket. They have a gas station/convenience store in their parking lot where the same bottles of water sell for $3 each. Same vendor, two shelves a hundred meters apart, but a 9x price differential.

Now imagine your car has broken down on a poorly-traveled desert road. You think you and your kids can walk to the next town before anybody finds you. Several hours later, the two older kids can barely walk. You realize the youngest, who you have been carrying for the last while, is no longer sweating and unconscious. How much would you pay for six liters of water? A year's salary? Five years' salary? Would you give your life for that water? That is value pricing.

This is a model most consultants don't dare to use (or can't). Price your exclusive service to its value to the buyer. Not by the hour, or by the project, but by its value. If you had a magic wand and could magically increase your client's profits by $2 Million a year, wouldn't it seem fair to ask a million dollars for that little wand wave?

MONEY FAIRY MAGIC WAND

Of course, if you are one of 700 wand-wavers in your local market, you might find competition pushing you in a race to "free".

In reality, most experts offer a mix of Services, Productized Services, and Products. On the Service Reboot website, I offer tangible services and products with a fixed price. I also offer six types of intangible services with variable prices that I price by the project.

What you can't see is one particular service I never talk about – except to qualified prospects that I have proactively reached out to. I wouldn't talk about it if a stranger called me to ask. It's my equivalent of the "magic wand", and it's worth millions in profits to the right clients. Top consultants should look for a magic wand that will differentiate them from others in their field by providing a their clients with a competitive edge the clients will want to pay for.

Another Wand Example?

My brother, Zach, is the world's foremost authority on building new global sales channels. When a company makes the leap from being a national leader to selling internationally for the first time, it can be either extremely profitable (when done properly), or extremely costly (when done wrong).

Hint: When I use the term "extremely costly", picture a burning bale of $100 bills.

Zach's ability to mitigate that risk has a value that doesn't translate well to "hourly rate" or "project cost". Zach's clients are willing to pay him a substantial part of that money bale to keep it from catching fire.

And that's all he does. He's got a wand, and he knows how to use it. If you are a consultant who is not – as Praveen put it – "the MOST expert consultant", then you should look at focusing your work until you also have a money wand.

But: If you do have a unique wand you can wave for your clients, I'd advise determining what that wand wave is worth to them, and base your fees on a reasonable fraction of that amount.

So to recap Praveen's original question, when pricing the services of an "expert's expert" with a proven track record, use Value Pricing. If your expertise is being offered by others, price to the higher end of Market Pricing. Definitely avoid pricing by the hour where your value can be compared to the hourly rate of your peers.

Finally, if you are interested in introduction to Service Science as it applies to sales and marketing, you may like my book, Service Reboot – The New Science of Selling, Marketing, and Managing Services.

It covers all the new developments and terms from Service Science since 2004, the year IBM coined the term. You'll learn about the SIPS Grid, POSY and PTSY, Service Inputs, Unified Services Theory, Convergent versus Divergent Needs Analysis, Faceting, and more. You'll find a link to free sample chapters on my LinkedIn page, or just read the back cover here. Comments? Write to me at David@ServiceReboot.com