Pricing for Profit

for CCSA Members

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PYOP Markup and Pricing Matrix spreadsheet
can be found by clicking below

PRICING METHODOLOGY

One of the cornerstones of a successful business is to have a consistent pricing method and to make sure you are pricing for a profit. If your customers love your pricing but you are not profitable, you will not be able to continue in business and serve those same customers.

From an economic standpoint, there are four methods of pricing that can be used:

1. *Cost Plus Pricing*: Set the price at your cost, including both cost of goods and fixed costs at your current volume, plus a certain profit margin
2. *Target Return Pricing*: Set your price to achieve a target return-on-investment (ROI).
3. *Value-Based Pricing*: Price your product based on the value it creates for the customer. This is usually the most profitable form of pricing, if you can achieve it.
4. *Psychological Pricing Based on Fair Pricing*: Sometimes it doesn't matter what the value of the product is, even if you don't have any direct competition. There is a limit to what consumers perceive as "fair."

Studios tend to combine several of these pricing rationales in their standard model. Ultimately, much of the pricing in studios is based on the owner’s rationale. I challenge you to look at all of the pricing methods available and step outside of your own personal thoughts and experiment with pricing using different modes.

WHY SHOULD YOU USE A METHOD?

To properly operate your business, you must have a consistent pricing method that allows you to make sure you are pricing to allow your studio to be profitable and taking full advantage of your market place.

> *"Customers are coming to your studio for the experience and the memories you offer."*

Studios offer a unique business proposition that is often overlooked. Many studios are focused on the products and services they sell. In reality, no one walks into a studio to buy a mug rather than going to Target or Walmart to buy a mug. Customers are coming to your studio for the experience and the memories you offer. Make sure your pricing takes this into consideration. It is suggested that you look more at methods of psychological pricing to maximize your impact.

HOW IS A PRICING METHOD DETERMINED?

As mentioned earlier, studios typically use a combination of the methods of pricing. The base level of pricing should be based on cost plus and then adjusted for psychological pricing.

If we start at the bottom line for profit in a studio, we can reverse engineer the pricing strategy. The cost of goods sold (products for resale like bisque) without supplies (like paint, glaze) should be 15% in order to maintain a 15% profit at the bottom line.

Math Alert! If we make the 15% profit assumption, that means that a piece that costs $2 wholesale should sell for about $13.33. This is determined by dividing the $2 cost by 15%. Dividing by 15% is the same as multiplying by 6.667 ($13.33 divided by $2). This is how the general rule of thumb of multiplying the cost by 7 times is derived.

$$\boldsymbol{Cost/15\% = Selling\ Price}$$

General Rule of Thumb: Multiply cost by 7 for retail sale price.

There are many products that are offered within PYOP studios but initially we will focus on bisque. Once these pricing models are mastered, then you can add other variations easily.

SUGGESTED PRICING MODELS FOR BISQUE

STANDARD MULTIPLIER

Assuming the 15% cost of goods sold and profit model as discussed previously, the standard multiplier is seven times. We often find that smaller items should have a higher multiplier and larger items may be a bit lower.

If the multiplier has to be lower, though, serious thought should be given to the inventory you carry. If you have a piece in inventory that will not produce the 15% profit level, perhaps you should not carry it. An alternative might be to make this a special order project only. Consider the price of “exclusivity” of special orders. You may be able to take this approach to offer the customers who value the experience the most an exclusive opportunity to spend even more with you!

Although this method is easy, it is flawed and should only be used as a quick rule of thumb. I often hear studio owners say, “I can’t charge a 7 times multiplier. My customers would not pay that much.”   The flaw of this method is that it does not take other factors of demographics into consideration. Your rent, cost of living, and market conditions all should play a crucial role in determining proper pricing for your studio. A more accurate method is to include rent as a factor in determining the pricing multiplier. In our upcoming section, we will look at the standard multiplier with demographic variation. We urge you to use the demographic pricing model as your studio specific model. You are in the business to make money and the broad use of a cookie cutter method like the standard multiplier is a poor decision. Please read on for a more educated and precise method of pricing using your demographics.

See Sheet “A Pure Multiplier” in the Pricing Spreadsheet for our calculator.

ADJUSTING YOUR MULTIPLIER FOR A STUDIO FEE

The standard multiplier of 7 times is assuming you are using an all-inclusive pricing model. If you use a studio fee model, you will need to adjust the model slightly. You will need to reduce the pricing by the average studio fee per item.

Math Alert! If your studio charges a $6 studio fee, some customers will pay this fee for one item while others will pay a single $6 for multiple items. To determine the studio fee per item, you can use your point of sale system to look at the number of items sold divided by the number of studio fees collected.

$$\textit{Items Sold}/\textit{Studio Fees Collected} = \textit{Studio Fee per Item}$$

If you do not have enough information to determine this fee, I suggest using 1.5 items per studio fee. The studio Studio Fee per item would be $6 divided by 1.5 = $4.

To further extend our example used earlier, a piece that costs $2 should sell for $14 less the $4 studio fee. The shelf price for this item should be $10.

STANDARD MULTIPLIER WITH DEMOGRAPHIC VARIATION

In cases where the studio owner does not feel that the pricing multiplier will work at 7x, the reasoning is usually that the demographics won't support this pricing. The rent dollars per square foot for these studios is probably not as high as for a studio in a more expensive area.

The 15% profit margin is based on an assumption that the rent is 16% of revenue. If the rent is lower in a more rural setting, then prices do not need to be as high to support the target profit margin. I also work with studios in very expensive marketplaces who pay much higher rent. These studios must increase their multiplier to achieve similar profit levels.

Studios with lower rent typically have:

- Higher advertising needs
- Less traffic (tucked away)
- Lower markup needed
- Lower household income demographics
- Lower revenue

Studios with higher rent typically have:

- Less advertising needs
- More traffic – foot or vehicle
- Higher markup
- Higher household income demographics
- Higher revenue

The multiplier for pricing should be adjusted for your demographics. We use the rent per square foot to determine adjustments to the standard multiplier.

Math Alert! The first step is to determine your rent per square foot. To calculate the rent per square foot, you will divide your annual rent by the square feet that you rent. If you have significant Common Area Maintenance (CAM) charges or property tax payments that would be included in your rent under a triple net lease, you may wish to include these in the annual rent number for your calculation.

$$Annual\ Rent/Square\ Feet = Dollars\ per\ Square\ Foot$$

How to Calculate Rent per Square Foot	
Monthly Rent	$2,000
Convert to Annual Rent	$24,000
Divide by Square Feet	1200
Rent per Square Foot	**$20/SF**

Once you have determined your rent per square foot, use the following table to determine your adjusted price multiplier.

Rent per Square Feet		Pricing Multiplier	$3 cost item sells at
Up to	$10/SF	5x	$15
$11 to	$15/SF	6x	$18
$16 to	$20/SF	7x	$21
$21 to	$25/SF	8x	$24
$26 to	$30/SF	9x	$27

See Sheet "B Demographic Pricing" in the Pricing Spreadsheet for our calculator.

As discussed earlier, use caution when utilizing any of these methods as a template for 100% of your pricing. There are market variables that must be taken into consideration for your final shelf pricing. For example, some lower-priced items should be marked up at a higher multiple than the demographic markup will generate. And some higher-priced items may not be able to sustain quite as high a markup than the demographic markup will generate. A $2 piece and a $10 piece of bisque will not be able use the demographic markup as a calculation without a little intellectual input. A good rule of thumb is the less it costs, the more you will be able to mark it up. The more it costs, the less you will be able to mark it up.

SUGGESTED PRICING MODELS FOR PARTIES & EVENTS

A very successful component to studio operations is offering group events. Some of these events include:

- Birthday Parties
- Ladies Night Out and Bachelorette Parties
- School Spirit Nights
- Corporate Team Building Events

Events can be held in the studio through a private room, reserved tables in the main studio, or offsite. All of these factors need to be considered in pricing the events.

Pricing for classes and events should be determined by the following factors:

- Length of class (in hours)
- Average Hourly Rate of employees (if just one employee, use the current hourly rate for that employee; if multiple employees are required, use the sum of the hourly rates for all employees required)
- Cost of materials used in the class
- Minimum required participants for class
- Cost of food or beverage provided during the event

The calculation is a little more complex as we are backing into the markup for both labor and material costs and then combining them.

A minimum fee for parties should be set and be a part of your contract to assure that attendance is not an issue since you are setting aside resources and reserving time and staffing for the event. The minimum fee should be based on a minimum price per person multiplied by the minimum number of attendees for the event. A non-refundable deposit should be required to reserve the party or event as well. You may also want to consider stating an additional rate for time that the event runs over the allotted time. A contract is an important document to establish a clear understanding of the terms, deposit, minimum fees, and food and beverage costs.

If an event is held offsite, additional fees should be added for travel and additional labor needs to cover the studio and the offsite event. There is also an added cost for setup and clean-up time whereas the studio is already ready for events and setup for this already.

See Sheet "C Class & Event" in the Pricing Spreadsheet for our calculator.

SUGGESTED PRICING MODELS FOR PRIVATE STUDIO EVENTS

There is a lot of variation in practice when it comes to pricing for private studio events. We are referring to closing the studio for an outside event or an after-hours event. Usually, this means that they will have more people than the party room can hold if your studio has a separate room.

You will want to make sure that the private event fee is enough to cover potential losses by closing your studio and possible disappointment or upset customers who arrive as walk-ins during the time of the private event (you will probably want to offer them a discount to return).

When surveyed, CCSA members had many ways to determine the price including some of these methods:

1. Determine sales for a Saturday then mark up accordingly.
2. Use the top-selling item multiplied by the number of attendees plus a markup.
3. Flat hourly rate plus pottery retail price.
4. Determine average sales for the period of time they want to rent the studio and double that.

Other suggestions included:

- Only offer private events on slower days of the week or seasons of the year.
- Have a guaranteed minimum number of attendees.
- Have a written contract and get a deposit up front of at least 50%.

A minimum fee for events should be set and be a part of your contract to assure that attendance is not an issue since you are setting aside resources and reserving time and staffing for the event. The minimum fee should be based on a minimum price per person multiplied by the minimum number of attendees for the event. A non-refundable deposit should be required to reserve the party or event as well. You may also want to consider stating an additional rate for time that the event runs over the allotted time. A contract is an important document to establish a clear understanding of the terms, deposit, minimum fees, and food and beverage costs.

Our calculator includes using your annual sales to determine the average sales per hour. We then determine based on the month of the year and seasonality what your average sales are. You will see the revenue being given up for closing the studio and then can adjust with a multiplier. We suggest at least 1.5, but you can adjust to a larger or smaller number based on the specific event.

See Sheet "D Private Studio Events" in the Pricing Spreadsheet for our calculator.

PRICING STATISTICS THAT YOU SHOULD KNOW

Here are some helpful statistics about pricing that you should be aware of:

1. 30-40% of customers should complain or hesitate about your prices but still buy. That is how you know you are in the “sweet spot” of pricing.
2. Price is not the main reason for customer churn, it is actually due to the overall poor quality of customer service – Accenture global customer satisfaction report 2008.
3. A customer is 4 times more likely to defect to a competitor if the problem is service-related than price- or product-related – Bain & Company.
4. 2% increase in customer retention has the same effect as decreasing costs by 10% – Leading on the Edge of Chaos, Emmet Murphy & Mark Murphy.
5. 55% of customers would pay extra to guarantee a better service – Defaqto research.
6. A 5% reduction in the customer defection rate can increase profits by 5 to 95% – Bain & Company.

CONCLUSION

We have discussed pricing strategies for several common areas in a ceramic arts studio. Please note that we have not talked about the most popular pricing strategy in retail – discount pricing. This is the strategy of a soon-to-be out of business studio owner so please resist the temptation to underprice your competition. Consumers are willing to pay for the experience your studio offers so focus on improving that experience rather than cutting prices and this will lead you down the path to success.

Pricing is a very complex, psychological issue and it will never be perfect. I encourage you to experiment with pricing and push to the point where you are slightly uncomfortable. Try it out and have some fun.