

# Understanding mark-ups



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This article explores the concepts of mark-ups; what they are, how to gauge where to set mark-ups and how to monitor the market's response to them.

Setting mark-ups correctly will ensure you're getting the maximum return, maintaining happy customers and not losing undue sales because the market doesn't agree with your price. Achieving this balance between profit and price perception can be the most challenging part of running a successful business.

Many picture framers are familiar with marking up their materials by a factor (Gross mark-up) to arrive at a selling price. The problem with this method is that it does not accurately separate variable cost (cost of goods) and fixed costs (running costs). If your mark-up is to be accurate you need to know both, as a mark-up based on inaccurate costs is meaningless.

It's important to understand that mark-up is often expressed in two ways.

**Gross mark-up** is achieved by taking the cost of goods (materials) and applying a percentage mark-up.

£10.00	Cost of goods
X 3.6	<b>Gross mark-up (260%)</b>
<u>£36.00</u>	Sale price

**Net mark-up** looks at the cost of goods as well as the cost of bringing the product to the consumer. These include overheads such as rent, wages, and electricity and are known as running costs.

£10.00	Cost of goods
£20.00	Running costs
<u>£30.00</u>	True cost
X 1.2	<b>Net mark-up (20%)</b>
<u>£36.00</u>	Sale Price

Whilst these both give the same selling price there is a fundamental difference as to how the profit is recorded. With gross mark-up, when the cost of goods is deducted from the sale price, the £26.00 difference gives a false impression that a healthy profit is being made. However, the net mark-up which is applied to both cost of goods and running costs shows that the true profit is £6.00. This is the real indicator of profit and allows the business to make an accurate judgment of where to set their margins.

This article will talk about mark-ups as a net amount, because this is where the true profitability of a business comes from, after all variable and fixed expenses have been covered.

## What should my Mark-up be?

When it comes to setting your mark-ups, unfortunately there is no magic number. Consumers will pay a price based on perceived value.

Manufacturers and retailers set their prices based on the unique benefits and desirability of their product. They compare it against other products on the market and make a decision on what they feel the consumer will be prepared to pay.

The final price is determined by the scarcity of the product and/or service offset against demand, as well as the affluence of the market it is being sold into. If there are more people selling than there are buying then this will drive the price down, inversely, if there is more demand and less availability this will drive the price up.

Now you may be thinking... well, picture frames aren't scarce at all. The thing is; you're not selling frames! You're selling an experience; the picture frame is just a means of providing that experience for the customer. You're preserving a memory, decorating a home or bringing someone's creation to life, these attachments or desires are what create a perception of value for the service you offer.

People buy benefits. The key is; understanding the benefits your product/service brings to your customers. The greater the benefit a product/service brings to a consumer the more desire they have for it. This is known as perceived value. The more desire a person has for a benefit the greater their perception of value for money will be.

Benefits offer advantage and solutions to the lives of consumers.

### Examples:

"This car has headlights". The benefit is that car can be driven in the dark.

"This is a mahogany frame with timber inlay which will match your Edwardian furniture". The benefit is that the frame will maintain a desired unity within the room.

We need to be aware of the meaning picture frames bring to the lives of our customers and focus on these desires when interacting and designing frames with them. When you understand their needs, it becomes easier to sell the benefits that fulfil their desires, creating a perception of value and thereby earning a profit.

Picture framers like all small businesses have a limited amount of time and money they can spend on advertising the benefits of their picture frames. However there are many things you can do to

## What shapes the market?

- Scarcity of product or service
- Demand for product or service
- Wealth of consumers



create a higher perception of value in your frames which can then be driven into increased margins and I've listed some below.

### **Store presentation:**

Store presentation immediately forms a price perception in the customers mind. From shop signage and external window displays through to entrances, lighting and internal displays; these are just some of the stimuli that create a price perception in the customers mind. A clean well-presented store with good displays creates desire and builds confidence that you offer a professional service. Think about the market you want to attract to your store and create an atmosphere in which those customers will enjoy and be comfortable in.

### **Be interested in the customer:**

Without doubt, customers buy service and advice; they appreciate that a sales person has taken the time to help them. In general people place greater value on time than money and the fact that you have spent time with a customer indicates that you value them. This does not mean that you have to spend hours with someone, just that the time given was quality and focussed on their needs. Did the customer feel they were offered the correct advice and that their needs were properly attended to? Catering to customer's most precious resource, their time, can be more persuasive than even the most drastic of price reductions.

It's worth considering that customers do not always walk away because the price is too high, they often walk away because the service is poor. There have been a number of times I have walked away from buying a product because the service left me feeling undervalued.



### **Be interested in the customer's item:**

Quite often customers want validation that the item is worth getting framed; they see you as somewhat of an expert and therefore quite often seek your affirmation. If you don't think it is anything special or don't appear to appreciate it, what incentive does this give them to go with the best framing choice? "I'm not sure it's really worth framing..." Have we all heard that before?

Customers do not always refuse a quote because they feel your price is high in general, it can be that they feel the price is greater than the value they place on the object to be framed. There is a distinct difference between these two outlooks; try to gauge the customer's sense of value so you can either build a greater perception of worth towards the object or design a frame that will satisfy their preconceived budget.

### **Be an expert on design:**

Gaining expertise in matters of design will allow you to guide the client into a frame that will be captivating and a talking point. People love to surround themselves with beautiful items that they can admire or show off. Being able to competently explain the design process, create visual images and stunning designs will enthuse and inspire the customer. In most cases, foremost in the customer's mind is; what will it look like? It's not unreasonable to think that many people seek

the service of a picture framer to come up with something that is unique and beautiful. Designing a frame that fulfils this desire and looks more valuable than what has been spent creates a perception of true value for money.

**Quality:**

We all love a quality product, from the look to the feel and weight; these are just some of the sensory stimuli that give the impression of quality. Using better quality and more unique materials often costs only a little more yet creates a strong perception of a quality product. It's worth avoiding materials that you see used in cheap production frames as these have already set a price perception in the customers mind which will be difficult to sway.

**Convenience:**

According to analysts there is massive growth in the number of people who shop online. Whilst many online shoppers are simply after the lowest price, a large number are time-poor and use the internet as a time saving medium that also offers a wide and diverse choice.

Luckily picture framing tends to be one of those services where people need to see and touch to get the true experience of what they are buying. But this doesn't mean framers can be lax in the convenience they offer their customers. In fact the internet and digital world has created a perception that people can get almost anything instantly and delays or hindrance can cause irritation.

There are of course the obvious conveniences to offer customers such as location and availability of parking. Opening times also need to be considered. Can you offer opening times that allow full time workers to access you? Are you consistent so that when a customer turns up at your business the door will be open? A customer having to return because you are not open creates a great deal of inconvenience and frustration.

A good website should present the services and products you offer, opening times, location and contact details. This allows customers to do their research from the convenience of their own home before deciding to visit the shop. It also allows the business to have a professional presence online.

Offering a good selection which allows customers to make a choice that best suits their needs helps to both draw and retain customers. People don't want the hassle of travelling between various shops looking for the right choice, it's time consuming and expensive. If a customer knows the business can cater for their every need they have a strong incentive to shop with them.

Making the design process easy allows customers to come to you with a problem which they hope your expertise will solve. It's important not to put obstacles in their way by making it look as if they have brought you an insurmountable problem. This makes them feel like the bearer of bad tidings, when in fact the experience should be enjoyable for them.

It's also important to get completed frames back to people in a reasonable time. People more and more are used to instant gratification and their lives are busy. If the delay is too long the customer may have moved onto their next project and have lost interest or motivation in picking up (and paying for!) their frame. Giving people a definite pick-up date and/or contacting them when the frame is completed gives the customer a date to look forward to, and eliminates any frustration of coming in and the frame not being ready for them.

### **Give pricing examples:**

It's makes good business sense to offer transparent and consistent pricing. Often new customers are worried about what a frame will cost. They're concerned that they will take up your time and then not feel able to walk away if the price is more than they're willing to pay. This emotion can dissuade consumers from approaching framers in the first place. You can reduce this apprehension by having examples of different frame types with their prices clearly displayed; this will give customers price comparisons and help in normalising your prices. When people constantly see the advertised price of a product they become desensitised to the pricing and focus more on the products benefits and points of difference.

How the price is delivered has a massive bearing on the customer's price perception. If your head and eyes are downcast and the price is mumbled in apology, the customer will feel that you believe the price is unjust or at least unconsidered. It is important that you believe in the price you are quoting and being sure of your costs and knowing that your mark-ups are reasonable gives you certainty and confidence when delivering the price.

These are just some key factors which affect the perceived value of your frames and the service you provide. The better you are at selling the benefits and fulfilling the customer's desires the greater your right to ask a higher price, after all if the customer has received a superior product and service it is reasonable for you to be rewarded accordingly.

### **Setting Mark-ups**

What we want to do with mark-ups is gain a Return on Investment (ROI). Your ROI should be proportional to the risk. Investing in a business of your own involves considerably more risk than putting your money in a bank or managed fund. You should therefore expect a better return than these.

A bespoke framing business has relatively low turnover compared with off-the-shelf retail businesses. There are two reasons for this; firstly framers create high spec made-to-order items, limiting their production and therefore the number of frames they can sell in a day. Secondly, the demand from the consumer sector is relatively small, so even if you were able to create vastly greater efficiencies in production the demand would most likely not be there.

For these reasons a 20% ROI is really the minimum you want to achieve. Anything less and you're buying yourself a lifestyle business; you may be better off putting your money in the bank and getting a job.

This can be easily demonstrated. If ABC picture framing’s turnover was £120,000.00 and their mark-up on costs was 20% their profit would be £20,000.00, a reasonable, but not fantastic return on their risk.

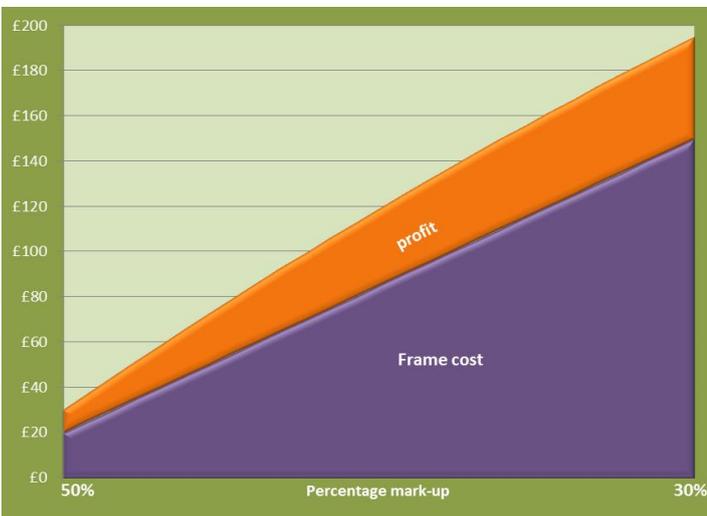
£100,000.00 total cost of overheads and materials  
 X 1.2 20% mark-up  
 £20,000.00 Profit  
 £120,000.00 Total turnover

How do we achieve ROI of 20%? That is 20% mark-up. Easy: if you have captured all of your costs in the time you charge out your mark-up will equate to ROI.

If you achieve 20% ROI you are doing OK. If you achieve 30% ROI, you are doing well. If you achieve 100% ROI, give up framing and write a book on how you did it.

Be wary of setting your mark-ups too tight. If you want a 20% return on your business investment it would be insufficient to set mark-ups by only 20%. It is the nature of business that things will go wrong; jobs won’t get picked up, there will be returns, redo’s and underestimated time to name a few. If you set your mark-ups too tight your profits will be eaten away by these and other unforeseen circumstances.

You may also consider creating a variable mark-up for your frames. For instance applying a small 20% mark-up on a £20.00 cost returns a profit of £4.00, this hardly seems worth the effort, and you will certainly lose out if any errors are made. Applying a 50% mark-up gives a much better



profit of £10.00 whilst not affecting the final selling price excessively. At the other end of the spectrum however, you may find that applying a 50% mark-up on a £150.00 cost may make it price prohibitive if sold at £225.00. A 30% mark-up on the same £150.00 may help the price appear more realistic to the customer at £195.00, and the £45.00 may be a reasonable return for your time and effort. As stated earlier there are no standard rates to which mark-ups should be set, but you need to consider what is a reasonable return for your effort, as well as what your market perceives as value for money.

**The actual £ profit becomes greater on the larger cost even though the % mark-up is decreased**

When all is said and done the best we can do is estimate mark-ups based on factors such as those above; then monitor and measure the result. In the end your market will tell you what your mark-up should be. If you’re too expensive, your customers will tell you, they’ll also tell you if you’re too cheap. Yes they do! Sometimes they’ll actually say, “That was cheaper than I expected”, or maybe they’ll accept the price without hesitation. These are just some of many indicators customers will give in relationship to your mark-ups and whether they are valid. There will be

customers who greatly value the service you offer and there will be customers who see less value in what you offer, you need to be prepared to let some people go.

There is a bit of a rule of thumb for getting your mark-up right: If one in five customers doesn't hesitate at the price, then you may be too cheap. None of your customers complaining about the price is a good indicator that you're too cheap.

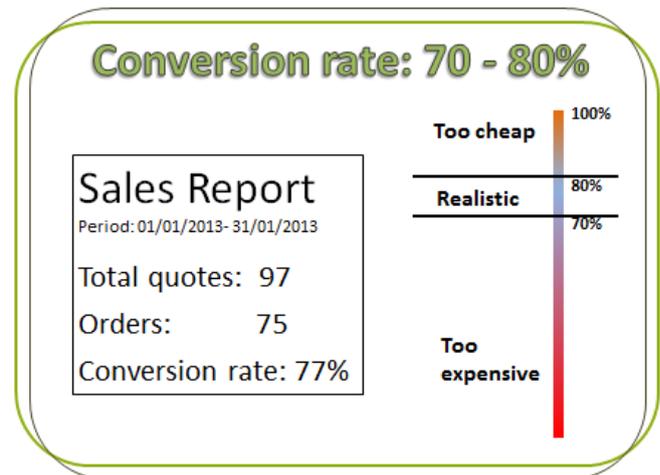
Have a look through your quotes for the last month. At least one in five customers should have told you that you are too expensive and not gone ahead with the quote. At most, you may expect 80% of your quotes to be converted to orders. We call this the conversion rate.

You may consider the minimum conversion rate to be 80%, but also some customers will change their mind; some will get sick; some will forget; some will leave town; so the conversion rate may even be closer to 70%.

If almost every job you price is accepted, then perhaps you're too cheap. If your conversion rate is much lower than 70%, then you may be too dear.

### In summary

- Know your true costs of making the frame so you can be confident of your margins.
- Think about what is unique about your products/service.
- Decide who is to be your main market.
- Consider your minimum required ROI.
- Become an expert on design and sell the benefits of your frames.
- Create perceived value to increase your margins.
- Monitor your conversion rate.



FramR allows you to save both quotes and orders. The client report will then advise you of your conversion rate from quotes to orders.