

What Do I Charge?

Are You Selling It Or Giving It Away?

Jimmy Lamb

Hirsch International

The State Of The Industry

Pretend, just for a minute, that you are starting a new business. (I'm sure you can relate.) After a study of business opportunities and the corresponding marketplaces, you decide to open a kiosk in a retail shopping mall to sell Cellular Telephones. One of your first steps is to order inventory. You decide to carry one style of phone that does everything, wireless internet, two-way messaging, etc. You place an order with Acme Cell Phone Systems for 100 units. When they arrive, you place the phones on your shelves and then decide on an aggressive pricing strategy. After carefully surveying the competition, you find that similar phones sell for an average price of \$49.95. Thus, you decide to price your phones at \$39.95 as this will surely drive customers to you. With the pricing task finished, you open the doors for business and start making sales. About two weeks later, your invoice for the initial inventory of phones arrives and you find that they actually cost you \$45.00 each wholesale. But since you are selling them for \$39.95, it becomes painfully obvious that you aren't making any money.

Sounds ludicrous that anyone would do such a thing, right? Guess again. The commercial embroidery industry is full of shops that have an unprofitable pricing strategy, simply because they don't know what it costs to produce embroidery. Far too many Embroiderers set their prices based on what everyone else is charging. In fact, just look at some of the email lists. Everyday you see Shop Owners asking other Shop Owners what to charge for something.

My response to any such question is another question; "what does it cost you to produce that item?" Usually the answer is "I don't know". Sadly, our industry is not very in tune with profitable pricing strategies. In fact, I would say it's the number one problem facing commercial Embroiderers.

What Makes Embroidery Pricing So Difficult?

You are on a sales call and things are rolling along smoothly. The client is interested in your products and appears ready to make a deal. He pulls out a business card with his logo and says, "so how much will it be to sew this logo on those polo shirts you just showed me?" You take a hard look at it and reply "well, I'm going to have to figure out what the stitch count is before I can give you a price." The customer looks at you curiously and says, "ok, so figure it out and give me a price." It dawns on you that he means he wants a fixed quote right now, something you aren't really equipped to do. After an uncomfortable pause, you respond that you will have to give the logo to a digitizer who will estimate the stitch count, before you can figure out what it will cost to sew. WHAT KIND OF AN ANSWER IS THAT???

Without a firm answer on the spot, it is highly unlikely that you can close the sale. In fact, without being able to provide an important detail like price, the chances that you will turn the prospect into a client are remote at best.

Stitch count pricing has been the mainstay of this industry since the beginning. More stitches do mean more production time, and thus higher costs, but since stitch count is an unknown quantity before a logo is digitized, the concept makes it difficult to present a

logical price during the sales process. Even if the stitch count is estimated correctly, most Embroiderers don't know what it costs to generate a stitch, thus they still can't give a reasonable price to the customer. It takes considerable time and effort to calculate what it costs for you to generate embroidery, and no two shops are just alike. Because of the tedious nature of calculating operational costs and the fear of coming up with a price that is hard to live with, most Embroiderers simply ignore this very important detail and just try to wing it when it comes to the pricing game.

Common Pricing Mistakes:

- \$ *Prices are based on competitors prices.*
- \$ *Prices determined by "seat of the pants".*
- \$ *Prices are based on "FEAR".*
- \$ *Prices are not based on business costs.*
- \$ *Prices are never updated.*
- \$ *Prices are same for wholesale and retail.*
- \$ *Prices are not written (no price sheets).*

Cost Analysis – Getting A Grip

The first element of a profitable price strategy is the most important: cost. If you don't know what it costs to operate your business, then it's highly unlikely that you can create a pricing system that works. Perhaps the simplest way to do this is to perform a cost analysis as follows: (Refer to Attachment A)

Step 1 - Determine Operational Costs

Add up all of the projected costs for operating your business for one year. Keep in mind that some costs are variable, while others may be changing as your business grows. Thus, you should put everything in a spreadsheet so that you can constantly update as your business changes. Also, costs such as merchandise for resale will be recovered in the sales process, so don't include it here, unless you are entering into a payment plan for purchasing such merchandise. In addition, be sure to include your desired paycheck! The final result will be the total estimated dollars that you need to pay all of your yearly bills plus your paycheck. But always keep in mind that there will be unexpected costs and fluctuations in some of your costs, so don't assume this number is carved in stone. But it is a reasonable starting point for your cost analysis.

Step 2 - Break Down The Costs Into Usable Increments

Let's say that your estimated yearly costs of operation totaled \$60,000.00. What does that tell you? Pretty much nothing at all, so you need to break this number down into something that is easier to deal with.

Decide how many weeks you plan to operate your business per year. Most people go with 48 initially, as this equals two weeks of vacation and ten business holidays. Divide \$60,000.00 by 48 and you come up with \$1250.00, which is your weekly cost of operation. Said another way, you need to bring in at least this amount of money in net dollars each week, 48 weeks per year, in order to reach your yearly number. Divide this

number by 5 to see what the daily figure is (\$250.00) and by 40 to determine the hourly figure(\$31.25) .

Step 3 - Compare Production Against Costs

Once you have usable operating cost figures, then its time to compare them against your “logical” production capabilities in order to see what it really costs to sew a stitch.

Assuming you have a modern commercial single head machine, you are probably sewing at an average speed of 800spm. Furthermore, you are probably producing stitches no more than 30 minutes out of each hour, assuming you have enough sales to keep your equipment busy. (Remember you lose production due to thread breaks, color changes, thread trims, machine setup, hoop swap, setup, finishing, etc.) This equates to 24000 stitches per hour.

Dividing your cost per hour to operate (\$31.25) by the total number of expected stitches per hour yields a cost per stitch of \$0.001302. If you multiply this by 1000, it will give you the cost per 1000 stitches to produce embroidery - \$1.30. Don't get too hung up on this number as it is a break-even figure at best. Also, it is ballpark as production and sales are cyclic in nature.

This is a good starting point, however, you need to always look at the bigger picture. In reality, your production levels will not be consistent, as your sales may not always be steady enough to keep the machine running at the levels predicted in your calculations. Because of this, you must realize that the calculated break-even figure is probably a bit low. Therefore you shouldn't use this as a price, but just what it is – a rough break-even point.

If you play with the figures, you will also see, that if you increase your production output per hour against the same overhead, you will reduce the cost per stitch. This confirms the fact that a multi-piece job is cheaper to sew than a single piece job, because you will keep the machine running more minutes out of every hour.

Time Is Money

Now set aside everything we just discussed. So far we have assumed that you are going to make all of your revenue from stitching alone. But that's not really the case, as most shops sell the garment along with the embroidery, so the garment revenue is also an important part of the picture. Rather than focusing on stitch count alone, it makes better sense to look at how many units (rather than stitches) can be produced in an hour. This will be referred to as the widgets per hour method.

With this concept, you calculate how many units of apparel can be sewn per hour, then divide this into the hourly operational cost to determine what it costs to sew each unit. Then you add in your cost to purchase each unit (including shipping, taxes, COD, etc) in order to determine what the total investment is per unit. Add your desired markup to this figure to come up with a final selling price.

Of course, the key factor is to accurately determine what it costs to produce each unit. It might be tempting to calculate this figure by dividing stitch count by machine speed, but there is much more to it than that.

During the course of sewing a job, the machine does not run non-stop at a constant speed. The following functions interrupt or have an affect on the sewing time:

1. Thread Trims
2. Color Changes
3. Thread Breaks
4. Stitch Length

In addition, every job requires a certain amount of setup time and finishing time, both of which result in the machine NOT running. And of course, every time you remove a hooped item and replace it with another one, the machine is not sewing. When all of these items are taken into consideration, it becomes apparent that each job takes much longer to produce than indicated by stitch count and machine speed alone.

The most accurate method of pricing a job involves an all-inclusive approach, where all of the variables are addressed and compensated for. When done properly, you can insure that the correct price is calculated, such that the job is profitable.

Discounting By Volume

Everyone expects a lower price when buying a larger volume of goods. Thus, you should give them a discount, right? No way...unless of course you are able to produce larger orders for a lower rate. If this is the case, then it is acceptable for you to do so. But the question still remains – can you do so?

Suppose you had three caps to embroider, each with a different logo. This would require a separate setup for each design, which translates into machine downtime. For example, assume that each cap is a 5000-7000 stitch design which is composed of a stock design and keyboard lettering. You could expect to spend about 15 minutes setting up each cap, then about 15 minutes of production time to sew it. Simply put, 15 minutes of downtime and 15 minutes of run time for 1 cap. The same timeframe is repeated for the second cap and again for the third cap. Over the course of 1 hour, you will encounter 30 minutes of downtime and 30 minutes of runtime, with 2 caps being produced. If the hourly cost of operation is approximately \$30.00, then each cap cost \$15.00 to produce. The total production time for all three caps would be 1.5 hours.

Now let's assume the same order of three caps gets the same logo on each cap. Using the same parameters as above you will have 15 minutes of setup time, then 15 minutes of run time. However, because it's the same logo, you will be able to run all three caps back-to-back without any additional setup times. Instead of 2 caps in one hour, you will produce 3 caps in one hour. With the hourly cost of \$30.00, that means each cap cost \$10.00 to produce in this scenario. This shows that producing the same thing over and over again does yield a lower production cost per piece.

Closing A Sale Versus Covering The Details – The Flat Rate Method

Up to this point, it would appear that a conservative all-inclusive method of pricing is the best bet for ensuring a profit on each order. Unfortunately, such methods do not allow for fast on-the-spot quotes during a sales presentation. Closing a deal depends on being able to offer a price without having to research all the parameters. Your inability to do this can lead to lost sales.

To do this effectively, you must create a Flat Rate Pricing system. With this approach, you will first calculate stitch count rates for various volumes of production, then you must assume that every (like) job has the same average stitch count. For example, many Embroiderers assume that the average left chest corporate logo has 5000 stitches. Using this standard, you can calculate fixed (or flat) rates for various volumes of production as follows:

Quantity	1-11 pieces	12-23 pieces	24-47 pieces
Charge	\$2.00/1000	\$1.50/1000	\$1.00/1000
Price (based on 5000 sts)	\$10.00 each	\$7.50 each	\$5.00 each

Of course, the only thing the customer sees is the quantity and price. They don't have to see the stitch count pricing or know that it's based on 5000 stitches. This is quick and simple, but it does have some dangers as follows:

- If the logo ends up with a significantly higher stitch count than the assumed 5000 stitches, you may lose money.
- If the logo ends up with a significantly lower stitch count than the assumed 5000 stitches, you may lose the deal, as your price appears to be too high.

The Market Influence – Perception Is Reality

Marketplace perception does have an impact on pricing. It's only worth what someone is willing to pay for it! Thus, if your cost to produce an item is higher than the perceived worth, you aren't going to make many sales. In this case you should lower your price to meet the market expectations, correct? Definitely not as you have to make a profit with everything you produce. If the price is too high, then look for reasonable ways to reduce the cost of production first. If this can't be done, then your product is probably not a good match for the marketplace. This means you will have to change products or change markets. But you should never lower your price below a profitable level, just to satisfy the marketplace.

On the flip-side you should always try to charge as much as reasonably possible, based on what the market perception is. Don't fall into the trap of going with a standard markup like 100%. If you are offering single caps that cost you \$5.00 to produce for \$10.00, you are probably selling yourself short. Within many markets, single piece custom caps easily command \$20.00 or more, which is quite a bit higher than a 100% markup. Bottomline – know the Market Perception and price accordingly while ensuring a profit!

ATTACHMENT A – Simple Cost Analysis

CALCULATION OF YEARLY BUSINESS EXPENDITURES

	MONTHLY	YEARLY
<i>EQUIPMENT LOAN/LEASE</i>	\$400.00	\$4,800.00
<i>PHONE</i>	\$100.00	\$1,200.00
<i>CELL PHONE</i>	\$40.00	\$480.00
<i>UTILITIES</i>	\$50.00	\$600.00
<i>HEALTH INSURANCE</i>	\$250.00	\$3,000.00
<i>BUSINESS INSURANCE</i>		\$400.00
<i>PROPERTY TAX</i>		\$500.00
<i>BANK SERVICE CHARGES</i>	\$30.00	\$360.00
<i>OFFICE SUPPLIES</i>	\$30.00	\$360.00
<i>OFFICE EQUIPMENT</i>	\$50.00	\$600.00
<i>EMBROIDERY SUPPLIES</i>	\$50.00	\$600.00
<i>INTERNET</i>	\$25.00	\$300.00
<i>ADVERTISING</i>	\$100.00	\$1,200.00
<i>PAYCHECK</i>	\$3,800.00	\$45,600.00
YEARLY TOTAL		\$60,000.00

CALCULATION OF WEEKLY, DAILY, HOURLY COST OF OPERATION

NUMBER OF WEEKS PER YEAR	48
WEEKLY COST	\$1,250.00
NUMBER OF DAYS PER WEEK	5
DAILY COST	\$250.00
NUMBER OF HOURS PER WEEK	40
HOURLY COST	\$31.25

CALCULATION OF PRODUCTION COST OF OPERATION

NUMBER OF SEWING HEADS	1
AVERAGE SPEED PER MINUTE	800
AVERAGE PRODUCTION MINUTES PER HOUR	30
TOTAL AVERAGE STITCHES PER HOUR	24000
<u>MINIMUM</u> COST PER STITCH	0.00130
<u>MINIMUM</u> COST PER THOUSAND STITCHES	\$1.30

**Want to learn more? Tune in for one of our FREE Webinars on
Embroidery Cost Analysis and Pricing.**

You can register online at the EVENTS section of www.hirschinternational.com