

Is the Mark-up you use destroying your bottom line?

If you purchase goods for re-sale, it is **crucial to understand** the difference between Mark-up and Gross Profit Margin – they are two very different things and can have a significant impact on your bottom line!

Many businesses have historically used Mark-up of goods as the basis for their pricing – they buy something for \$1000, mark it up 100% and sell it for \$2000. Such an approach being primarily based on industry practices, but the problem is the Mark-up may not be sufficient to give you the gross margin you need!

The difference between Mark up and Gross Margin

Whilst a 100% mark up sounds like a lot – the reality is, it only actually delivers a Gross Margin of 50%! - and therefore if your Operating Expenses (Rent, your wage, electricity etc.) as a % of sales is 40% - then this leaves you with a Net Profit margin of only 10%!!!

To demonstrate how this works if we use the example above of purchasing an item for \$1000 and then reselling for \$2000 – the calculations look like:

Sale Price	\$2,000
Less Cost of Goods	<u>\$1,000</u>
Gross Profit	\$1,000
Gross Profit Margin	50% (Gross Profit \$1000 multiplied by 100 divided by Sale Price \$2,000)

Clearly, if your Operating Expenses as a % of sales were 40% - the residual 10% would be *totally inadequate* unless you were selling in huge volumes!

Such a thin margin leaves you very little room to move to cover normal business operating cycles and if you try to discount to generate sales – very quickly you are in the red –you're your bottom line is obliterated!

The Table below demonstrates the different between Mark Up and Gross Margin.

Mark Up %	Gross Margin
15%	13.00%
20%	16.70%
25%	20.00%
30%	23.00%
33.3%	25.00%
40%	28.60%
43%	30.00%
50%	33.00%
75%	42.90%
100%	50.00%
150%	60.00%
200%	66.60%

Don't follow your competitors over the Fiscal Cliff!

Many business owners fall into the trap of using Mark Up % as the basis of their pricing based on industry practices or because that is what competitors do. However this assumes the other players in the market have a sound basis for establishing their pricing!

In our experience of working with many small businesses – this assumption is incorrect!

Far too many businesses simply have no sound basis for their pricing – other than setting a price point based on what they perceive the market will bear, using industry standard mark-ups and/or copying competitors!

Focus on Gross Margin % not Mark Up

When setting your pricing we strongly recommend that you focus on achieving a target Gross Margin rather than Mark-up – and ensure that the target Gross Margin, provides a large enough Net Margin, for all the effort involved and to cover the normal ups and downs of business cycles.

But what if that means I need to charge more than my competitors?

If this means you need to increase your prices in order to achieve a more acceptable return and this places you at a price point above your competitors – then you need to think about how you can change the value proposition for your clients.

This then becomes an issue of differentiating yourself enough from the competition so that you offer a different value proposition and shift the focus from price!

Where there is no or little differentiation between offers – products and services become commoditized and the focus invariably shifts to price!

The lack of differentiation between businesses is borne out by research – which consistently tells us that price is the primary focus for only 17% of buyers – 83% also consider other factors – however the fact in many industries price has become the primary differentiator – says a lot about the lack of differentiation!

Summary

Unless Mark up is linked to a target Gross Margin the chances are you will be foregoing income and that your Net Margin will be inadequate for all the time and effort you put into your business.

If by increasing your pricing you then need to position your offer differently – then this becomes a marketing and value proposition issue.

If you want to learn more about pricing and managing your business finances, consider enrolling in the TSBI – **Decide Your Income Workshop**.

This information packed workshop includes everything you need to know about the financial side of your business. Crucially, the cost of the workshop also includes a **FREE** session with an experienced Business Mentor!

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