

## Math to help your bottom line

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### Demystifying Mark Up Verses Margin

One of the best components of a solid relationship is to understand what the other party is saying and how they operate. Producers and processors are instinctively focused on production and retailers have the same level of focus on selling. For these reasons, many producers look at their profit as mark up, while retailers look at their profit as gross margin.

### Mark up and margin is not the same thing!

Unfortunately many people think they are the same. This can cause problems, mis-communication and potentially lost profits.

Suppliers typically think in terms of mark up percentages, the amount necessary to cover the total costs of doing business, plus a profit. A problem when basing selling price on mark up calculations is that people think that they are making more because the markup percentage is mathematically greater than the margin percent. There is also the risk when using a standard percent mark up that the retail price gets set too high, or possibly too low.

Retailers think and use margins because it is more representative of what they actually earn from both a price and cost perspective. It is a top down calculation based on the selling price. Margins are what results from the sale, not on how the price was set. Monitoring retail margins gives the retailer more accurate information to manage a product's performance and overall bottom line value to the store.

Take a look at the calculations in Table 1, the table to the right; you'll see the difference between the mark up percentage and a margin percentage. A 50 % mark up is only a 33% margin. Confusion between the mark up% and margin% can lead to serious and costly miscommunication and miscalculations between you and your customer.

### It is important to understand both calculations

Mark Up %	Margin %
10	9.90
15	13.05
20	16.67
25	20.00
30	23.08
35	25.93
40	28.57
45	31.03
50	33.33
55	35.48
60	37.50
65	39.39
70	41.18
75	42.86
80	44.44
85	45.95
90	47.36
95	48.73
100	50.00
105	51.22
110	52.38
115	53.49
120	54.56
125	55.56
130	56.52
135	57.45
140	58.33
145	59.18
150	60.00

Table 1 %Mark up vs. %Margin

## Mark ups

A mark up is defined as the profit you make expressed as a percentage of the total cost of goods. In other words you start with the total cost of goods and add a percentage to arrive at a selling price. Many producers and processors use this method to arrive at their selling price. The concept of a mark up is illustrated in Table 2.

As mentioned earlier suppliers typically think in terms of mark up percentages, because it is straight forward and a fairly simple way to calculate a selling price that covers the cost of doing business plus a profit. A standard mark up percentage assures the supplier that even when there is a change in the cost structure, the selling price will cover their costs plus give them a profit. When using a mark up strategy, you need to monitor if the retail selling price is pushed to a level that is too high to attract customers, or too low to make a profit, impacting if a product will sell, or how much it will sell.

<b>Mark up</b>	
Total cost of production	\$1.00
Mark up	40%
Selling price	\$1.40

In Table 2 per unit profit in our example is 40 cents. The mark up is 40% but the margin is only 28.6%, see the markup verses margin comparison in Table 1 for reference.

Table 2 Mark Up %

## Gross margin

A gross margin is defined as the profit expressed as a percentage of the selling price. For gross margin, the starting point is the retail selling price as opposed to the cost of goods. Retailers will use this method to ensure they achieve the desired level or profit in a category or a department. They know to successfully operate the department, they need to achieve a specific level of gross profit, and so prices are set accordingly. The gross margin required will vary between different retail departments. When the retailer knows what a product needs to sell for and they know their margin%, they also know what they can pay for products.

<b>Gross margin</b>	
Cost of goods	\$1.00
Selling price (retail)	\$1.40
Gross margin	28.6%

The concept of gross margin is illustrated in Table 3. We will use the same selling price and cost of goods from Table 2 to illustrate the difference between mark up and gross margin. In this example the gross margin is calculated by dividing the 40 cents profit by the retail price. The cents per unit profit is still 40 cents.

Table 3 - Gross Margin%

Retailers in the food industry think in terms of gross profit. A solid relationship depends on both parties understanding each other. Retailers perceive suppliers who say, "You are

making 40%” as people who do not understand their business. The retailer will only see this as a 28.6% margin.

Retailers usually want to control retail pricing. There are four factors that will impact a retail price:

1. Product cost
2. Category margin
3. Retail prices in competitor’s stores
4. The right price to deliver the sales that will maximize profit

Supplier’s mark up will impact the product cost to the retailer and the category margin will also impact the retail price.

**The Problem**

A 35% margin and a 35% mark up are not the same thing and it can be a serious problem if you have to cover the difference because of some misunderstanding on your part. We hear people say, “I don’t seem to make as much as I should selling to retailers”. Getting this right is a big opportunity to have a positive impact on your bottom line. Calculating your margins before the negotiation will put more dollars on your bottom line.

The following shows step by step how to calculate a gross margin percent and how to calculate a selling price when given a margin percent.

<u>Step By Step How to Calculate a Gross Margin %</u>		
	Example	Your Numbers
<b>Step#1</b> What is the selling price?	(A) \$ 15.00	(A) \$ _____
<b>Step#2</b> What is the cost?	(B) \$ 10.00	(B) \$ _____
<b>Step#3</b> Calculate Gross Margin (A - B=C)	(C) \$ 5.00	(C) \$ _____
<b>Step#4</b> Calculate the % (C ÷ A=D)	(C) 5 ÷ (A) 15 X 100 = (D) 33.3 % margin	(C) _____ ÷ (A) _____ X 100 = (D) _____%

Table 5 – Calculate Gross Margin Worksheet

This calculation will show you what your product will sell for at particular retail margin%.

<u>Step By Step How to Calculate a Selling Price from a Given Gross Margin %</u>		
	Example	Your Numbers
<b>Step#1</b> What is the gross profit margin?	(A) 35% (.35)	(A) ____% ( ____ )
<b>Step#2</b> Subtract the GPM from 1.0	(B) 1.0 -.35 = .65	(B) 1.0 - (A) ____
<b>Step#3</b> What is the cost?	(C) \$ 10.00	(C) \$ _____
<b>Step#4</b> Sell Price = C ÷ B	\$10.00 ÷ .65 = \$ 15.39 Sell Price	(C) ____ ÷ (B) ____ = \$ _____ Sell Price

Table 6 – Calculate Selling Price Given Margin %