



## Why You need to Increase Your Margins

Typically, we want to concentrate on growing our sales to increase our bottom line. The problem with a purely sales-focused growth model is that we need to fully consider the cost of new customers. How much does it cost to get new customers? How will the increase in business affect our current levels of staffing? Can our location handle more customers? We also need to consider whether or not we are more profitable with more customers. In other words, if our gross profit margin is too low or our expenses too high, every sale is costing us more than we actually make. Let's put it more plainly. Our goal is to increase sales by \$100,000 next year by focusing on getting more customers. Let's assume that promotions to get those customers cost us \$10,000. Because of the increase in customers we need to add another staff member – let's say that we end up paying \$36,000 a year for that. Our cost of the new business is now \$46,000. If our gross margin is 35%, this means that we bring in net \$35,000. Therefore the cost of our new business is in effect losing us money

Sales	100,000
Cost of Goods Sold	<u>-65,000</u>
Gross Profit	35,000
Advertising	-10,000
Increased Labor	<u>-36,000</u>
<b>Profit or Loss</b>	<b>(-11,000)</b>

As business owners intent on growing our business, we put so much energy in the growth of sales that we forget that if we tweak our business slightly, we may not need to work as hard to get better results. As my friend Deane Parkes so rightly said in his article, If business owners increased their margin by 1% on \$1 million in sales, this would mean another \$10,000 in their pocket (Parkes, 2016). So how do we do this? Well, that is the \$10,000 question, isn't it?

## What You Need to Understand about Margins

Many business owners and their staff get mixed up with mark-up and margin. To put it simply, a mark-up is the difference between the purchase price and our selling cost. For example, if we buy a product from our supplier at \$100 and we sell it at 165% of cost, it will be \$165.00. In this case, the mark-up is 65% Margin is the difference between our selling price and our mark-up value as a percentage. In the example above, our gross profit amount (\$65) divided by our selling price (\$165) gives us a margin of 39%. So, in other words, the margin is the percentage of our selling price that is profit.

Mark-up and margin can cause problems in pricing because we think we are getting more money when we talk in mark-up. Additionally, if we try to price our product or service using margin we can run into difficulties, as it is easier to multiply than to divide for most people. Therefore, I advocate pricing using mark-up but understanding what you are doing in terms of margin. This means that once you determine what profit you need (let say it's 50% margin), you would tell your staff to price your offering with a multiple of 2 or 100%.

To increase our margins, we need to increase the difference between what we are selling a product for and the actual cost of that product. There are two ways to do this: 1) reduce our actual cost of the products we sell, or 2) increase the price we are selling it for. But how do we determine the best margins? One way is to use benchmarking. What you are doing here is looking at similar businesses to yours in your industry to see how you compare (see full list in *Profit Yourself Healthy*, page 126).



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What is your current gross margin? (Figure this out by looking at your income statement and taking your gross profit/Revenue as a percentage (Revenue less cost of goods sold/ total revenue))

Look for your industry most similar to yours in the list in Chapter 10 and compare it to your current margins. What is the difference? Is there room for improvement?

Which suppliers can you negotiate better pricing with right away?

List 3 ways you think could improve your margin.

1.

2.

3.



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Which one are you going to work on first?

How much would your profits increase if you increased your margin by 3 per cent (multiply your total sales by .03)?