



Setting Your Price

Understanding Gross Margin

Understanding Gross Profit Margin, Percentages and Calculations

- Gross profit margin is the **difference** between the **value** a product is **sold for** and the value it is bought or **produced for or cost**.

Dissecting a 50.0% Gross Margin at a \$5.00 Selling Price and a \$2.50 Cost

Selling or Retail price	\$ 5.00
Your Cost	\$ 2.50
Gross Profit Margin	\$ 2.50
Gross Profit Margin %	50.0% ($\$2.50/\5.00)



Setting Your Price Based on Your Cost

Now, assume that you know your cost is \$2.50 and you need at least a 60.0% gross margin to make your business work (pay for your expenses)

Starting with wholesale or produced price:

Wholesale or produced price	\$ 2.50
Divide by reciprocal to targeted margin (targeted margin 60.0%, divide by 40.0% or .40)	/ .40
Selling price	\$6.25 (\$2.50/.40)

The reciprocal of a 60.0% gross margin is 40.0%. The two must always equal 100%.



Setting Your Price Based on Your Cost

What if you needed a 65.0% gross margin to make your business work?

Starting with wholesale or produced price:

Wholesale or produced price	\$ 2.50
Divide by reciprocal to targeted margin (targeted margin 65.0%, divide by 35% or .35)	/ .35
Selling price	\$7.14 (\$2.50/.35)

The reciprocal of a 65.0% gross margin is 35%. The two must always equal 100%.



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DON'T USE MARK-UP!!!

Mark-up used to be an industry norm... BACK IN THE 1960S AND BEFORE!!! Let's discuss the difference.

MARK-UP

Product Cost	Mark-up	Product Price
\$1.00	25%	\$1.25
	(multiply \$1.00 by 1.25)	

GROSS MARGIN

Product Cost	Gross Margin %	Product Price
\$1.00	25%	\$1.33
	(divide \$1.00 by .75)	

Everyone in every industry has used gross margin for pricing for about 50 years. Here's why...



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Why Is It Done With Gross Margins?

HYPOTHETICAL WHOLE FOODS STORE P&L		
		% of Sales
TOTAL SALES	\$ 30,000,000	100%
COST OF GOODS	\$ 19,200,000	64.0%
GROSS PROFIT MARGIN	\$ 10,800,000	36.0%
EXPENSES		
Labor	\$ 5,550,000	18.5%
Occupancy	\$ 1,800,000	6.0%
Administration	\$ 1,800,000	6.0%
Marketing	\$ 450,000	1.5%
TOTAL EXPENSES	\$ 9,600,000	32.0%
NET PROFIT	\$ 1,200,000	4.0%
MARK UP OF 36% ON \$19,200,000 COST OF GOODS		
COST OF GOODS	\$ 19,200,000	Mark-up
SALES	\$ 26,112,000	1.36 (36%)

The difference between a gross margin of 36% and a mark-up of 36% to calculate sales on \$19.2M in cost of goods is \$3,888,000. (\$30,000,000 vs. \$26,112,000)

All costs and expenses in a profit and loss statement can be related as a “percentage of sales or revenue.” Doing this helps a business to assess the impact of fixed and variable expenses, as well as quickly see and understand the impact of expenses by category (labor, occupancy, etc.) The table to the right assumes that all of the lines (sales, COGs, expenses are “actual” and each line is divided by Total Sales to calculate the % of sales column.

Gross profit margin is what a business has to pay all of its bills, thus the math down this P&L conforms. If you used mark-up, it wouldn't . Plain and simple!



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Selling Through a Distributor

				GP%	Reciprocal	GP \$
1)	You	Your Cost	\$ 2.50			
2)		Distributor Price	\$ 3.85	35%	65%	\$ 1.35
3)	Distributor	Distributor Cost	\$ 3.85			
4)		Wholesale Price	\$ 5.13	25%	75%	\$ 1.28
5)	Retailer	Wholesale Cost	\$ 5.13			
6)		Retail Price	\$ 9.32	45%	55%	\$ 4.20
Assumptions and Notes:						
1) Your Cost is from the previous table						
2) Distributor Price provides You achieve a 35% gross margin or \$1.35 gross profit						
3) Distributor Cost is the price paid to You (same as line #2)						
4) Wholesale Price assumes Distributor gets a 25% gross margin when product is sold						
5) Wholesale Cost to the Retailer is Distributor's Wholesale Price						
6) Retail Price is what the Retailer's customer pays based on a 45% gross margin						



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From The Retail Perspective

RETAIL MARKET ANALYSIS-In this scenario the producer thought about selling to large supermarkets but realized the cost of production would have to be lowered.

PRICING/MARGIN MIX WITH RETAIL APPLICATION						
				GP%	Reciprocal	GP \$
1)	Retailer	Competitive Selling Price	\$ 5.99	40%	60%	\$ 2.40
2)		Expected Wholesale Cost	\$ 3.59			
3)	Distributor	Wholesale Price	\$ 3.59	25%	75%	\$ 0.90
4)		Your Price to Distributor	\$ 2.70			
5)	You	Your Cost	\$ 2.50			
6)		Your Profit	\$ 0.20	7%		\$ 0.20
Assumptions and Notes:						
1) The competitive retail selling price for your product is \$5.99 (determined by retailer)						
2 & 3) The expected Wholesale Cost to the Retailer is \$3.59 because the retailer was willing to take a 40% gross margin in this category of products. This is also the Distributor's Wholesale Price						
4) Your Price to Distributor is \$2.70 is based on the Distributor's margin requirements (25%)						
4) Your Cost is based on Your Cost						
6) Your Profit of \$0.20 is a \$1.15 less than the previous scenario						