Pricing your Gross Profit Margin

IMPROVING YOUR GROSS MARGIN

Remember that your gross margin is the difference between the price of your product and what it costs you to buy or make it. Therefore, the only way to increase your gross margin is to sell at a higher price or buy/make at a lower price.

In most instances (but not all), you have limited scope to buy at a lower price. For this reason, your selling price is the critical variable.

Without doubt, the biggest single barrier preventing small business managers from making an acceptable profit is their refusal to charge a price that enables them to achieve it. You are not in business to match the price your competitors set; you are there to service your customers.

In fact, studies of the factors that influence people to deal with a particular business indicate that product and price discounting is a lazy competitive strategy. It is applicable only in the situation where you have a definite cost advantage (either variable or fixed) over your competitors and your product or service is one where customers are very price-sensitive.

The following table indicates the increased sales required to compensate for a price discounting policy.

If your gross margin is 30% and you reduce price by 10%, you need sales volume to increase by 50% to maintain your initial profit. Rarely has such a strategy worked in the past, and it's unlikely that it will work in the future.

	If your present margin is								
	20%	25%	30%	35%	40%	45%	50%	55%	60%
And you reduce price by	To produce the same exact profit, your sales volume must increase by								
2%	11%	9%	7%	6%	5%	5%	4%	4%	3%

4%	25%	19%	15%	13%	11%	10%	9%	8%	7%
6%	43%	32%	25%	21%	18%	15%	14%	12%	11%
8%	67%	47%	36%	30%	25%	22%	19%	17%	15%
10%	100%	67%	**50%**	40%	33%	29%	25%	22%	20%
12%	150%	92%	67%	52%	43%	36%	32%	28%	25%
14%	233%	127%	88%	67%	54%	45%	39%	34%	30%
16%	400%	178%	114%	84%	67%	55%	47%	41%	36%
18%	900%	257%	150%	106%	82%	67%	56%	49%	43%
20%	-	400%	200%	133%	100%	80%	67%	57%	50%
25%	-	-	500%	250%	167%	125%	100%	83%	71%
30%	-	-	-	600%	300%	200%	150%	120%	100%

On the other hand, the next table shows the amount by which your sales would have to decline following a price increase before your gross profit is reduced below its previous level.

At a 30% margin and a 10% increase in price, you could sustain a 25% reduction in sales volume before your profit is reduced to the previous level… you would have to lose 1 out of every 4 customers!

And you reduce price by	If your present margin is								
	20%	25%	30%	35%	40%	45%	50%	55%	60%
	To produce the same exact profit, your sales volume must be reduced by								
2%	9%	7%	6%	5%	5%	4%	4%	4%	3%
4%	17%	14%	12%	10%	9%	8%	7%	7%	6%
6%	23%	19%	17%	15%	13%	12%	11%	10%	9%
8%	29%	24%	21%	19%	17%	15%	14%	13%	12%
10%	33%	29%	**25%**	22%	20%	18%	17%	15%	14%
12%	38%	32%	29%	26%	23%	21%	19%	18%	17%
14%	41%	36%	32%	29%	26%	24%	22%	20%	19%
16%	44%	39%	35%	31%	29%	26%	24%	23%	21%

18%	47%	42%	38%	34%	31%	29%	26%	25%	23%
20%	50%	44%	40%	36%	33%	31%	29%	27%	25%
25%	56%	50%	45%	42%	38%	36%	33%	31%	29%
30%	60%	55%	50%	46%	43%	40%	38%	35%	33%

If you're like many small business people who regard price as the only factor influencing the buying decision of their customers, you will undoubtedly reject the proposition that a high price strategy (and by implication, high value) will work.

You may accept that it's right for some businesses, but it sure doesn't apply to your business.

There's no business that doesn't have the potential to command a premium price for its products or services if – and this is the crunch – it is able to market those products or services in such a way that the customer perceives added value.

If all your marketing effort, all of your advertising and all of your sales dialogues focus on price, then you will be beaten on price every time a competitor comes along with a lower one. In other words, if you focus your customers on price as a critical factor, it will be one.

The only way to get out of the price trap is to promote other features and benefits that you can offer your customers (for example, better quality, longer warranty, satisfaction guarantees, 24-hour accessibility, more convenient location, greater resale value, etc).

It may be that your competitors already offer all there things… but unless they also emphasise this in marketing, how will the customer ever know?

Think about it for a moment - Your job as a marketer is to create the perception of value and then to back up what you sell with superb service. Remember, price is only important when all other things are equal.