BUSINESS ACCELERATOR PROGRAM

IMPROVING PROFIT MARGIN

By James McNamara

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YOUR IDEAS

Improving Profit Margin

Introduction

There are two important profit margins for you to track and improve in your business. Firstly, Gross Profit Margin. This is this is the difference between what a product/service costs you and the price that the customer pays you. Gross Margin is expressed as a percentage of the selling price. For example, if a product/service costs you $200 and the customer pays $300. In this case, the difference between the cost price and selling price is $100. $100 expressed as a percentage of $300 gives a Gross Profit Margin of 33%.

A common mistake is to confuse Gross Margin with Mark Up. These are two different things.

The next profit margin to focus on is Net Profit Margin. This represents how much is left over after all Cost of Goods and all Overheads have been paid. It is expressed as a percentage of total revenue. For example, if at the end of the month, you have created $100,000 revenue and you incurred $60,000 in Cost of Goods, you would have $40,000 Gross Profit, or 40%. After that, you also paid $25,000 as overheads (rent, wages, vehicles, etc.) leaving $15,000 in Net Profit. $15,000 as a percentage of $100,000 is 15% Net Profit Margin.

Ways you can widen your company's profit margin include reducing the purchase price of raw materials, hiring cheaper labour, and installing the most recent technological equipment. If these changes don't affect the demand for your product, you can consider selling your product at a higher price to drive up your profit margin.

10 Useful Margins Strategies Summarised

Below, 10 strategies are summarised for increasing your gross profit margins. This list of margins strategies is not meant to be exhaustive. It does, however, include some practical low cost and no cost strategies that you can implement into your business immediately.

Take notes on the ideas you can implement into your business wherever you see this symbol .

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Here are the strategy summaries.

1. Fix / Eliminate Low GP Sales

Declining Gross Profit (GP) margins result in significant problems for your business. However, understanding the factors that lead to a reduction in your margins puts you in a self-assured position to react decisively. The GP margin percentage is a perfect measure of how efficiently your company produces and distributes goods/services. This percentage, however, must be considered in relation to other businesses in your industry. For instance, software companies tend to have higher GP margins compared with large retail companies that typically tend to have lower GP margins.

Why Should You Eliminate Low GP Margin Sales?

Lower GP margin sales result in less cash being available to cover your company's operating costs, including administrative salaries and marketing expenses. They are detrimental to business growth. If you are not able to spend as much on advertising as your competitors do, over time, it will result in your company growing more slowly. Besides, you'll not have enough money to invest in projects that will upgrade your company's long-range efficiency. Your company will not be able to expand its geographic scope, attract the best talent, or acquire a competitor.

Reorganise Your Company to Fix Low GP Sales

If you are facing persistently low GP margin sales, implement dynamic reorganisation of the departments directly involved in the manufacture and distribution of your company's products/services, including manufacturing, purchasing, and shipping. This restructuring may entail looking at alternative suppliers if your present suppliers are charging you higher rates for raw materials. Negotiating harder with your suppliers is another option. Finding less expensive suppliers will enable your company to experience ongoing positive cash flow. You can also consider eliminating a few personnel if you can do it without any reduction in productivity and decline in morale.

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2. No Discounting

Whether you set off a price war or hit back at one, you'll pay heavily if you ever discount your rates. **Discounting damages your brand immensely.** Besides, lowering your prices to increase sales reduces your gross profit margin. If your company routinely offers discounts and promotions to attract more buyers, you may, no doubt, get more sales. But large price cuts will only minimise your gross profit. Even a small discount makes a big impact on your GP margin. And you'll have to work extremely hard to recover the potential gains you throw overboard in a discount.

Your Alternative to 'No Discounting'

Upholding a strong brand image over time permits you to preserve stable price points. And you can even increase prices. But if you constantly discount, your customers get familiar with declines in your prices. Eventually, they'll be unwilling to pay top rates. This is where **Brand Confidence** plays a huge role. The audacity of charging your customers much more by offering far less is all about your confidence in your brand. Such brand positioning speaks volumes to your buyer. It espouses a belief that your product/service is worth more – far more. And buyers will fall for it. No doubt your D-grade customers will find the valuation of your products/services irrational. Even your C-grade customers may suspect the validity of your valuation. But as long as your A-grade customers devour your products and services, there's no reason you should ever offer discounts.

An Example of a Strong Brand

Inexpensive face crème comes in a big container with a small price. Reputed brands put almost identical ingredients in much smaller containers and wrap it in classy packaging. They give it an exotic name and market it at a huge mark up. So, a strong brand, essentially, sells the same substance that a cheaper packaged brand sells but at a price that's multiple times higher. However, the power of branding sways buyer behaviour.

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3. Increase Your Prices

Increasing the price of your products/services will directly impact your gross profit margin. If your products/services have attained a higher price level solely because of the introduction of superlative features and first-rate quality, it's an indication of your excellent management. However, if the economy has driven up the prices, your role in the price rise is minimal. There's a high probability of the economy moving in the opposite direction. Therefore, you should be ready for the downside as well.

Benefits of Increasing Your Prices

If you can increase your prices without significantly reducing your sales volumes, your gross profit margins will increase. Sit down with your accountant to pinpoint the effect of sales at various levels on your GP margins. A slight decrease in sales volume at higher prices will not hurt you much. Eliminating discounts and rebates you are currently offering is another way of increasing your average price per unit. This may not result in a large-scale decrease in sales.

Lower Price Does NOT Guarantee Customer Loyalty

Contrary to popular perception, selling your merchandise or services at the lowest price or even at a competitive price doesn't increase your customers' satisfaction or loyalty. The customers who pay the lowest price are the ones that cause you the maximum trouble. We have already seen that D-grade customers have a penchant for spoiling your day. So, increasing your prices presents you a golden opportunity to shake them off diplomatically. Anyway, trying to match or beat your competitors on *price* is an ill-fated suicide mission. It just isn't a viable business practice. Your business demands higher GP margins to grow and service customers. Price matters. So, raise yours. It's that simple!

The Effect of Discounting Your Prices

If You	**If Your Current Gross Profit Is…**				
Discount By	**20%**	**25%**	**30%**	**35%**	**40%**
5%	33%	25%	20%	17%	14%
10%	100%	67%	50%	40%	33%
15%	300%	150%	100%	75%	60%
20%	-	400%	200%	133%	100%

** Example: If your Gross Profit is 30% and you discount by 15%, you will have to sell 100% more in order to put the same profit in your pocket!

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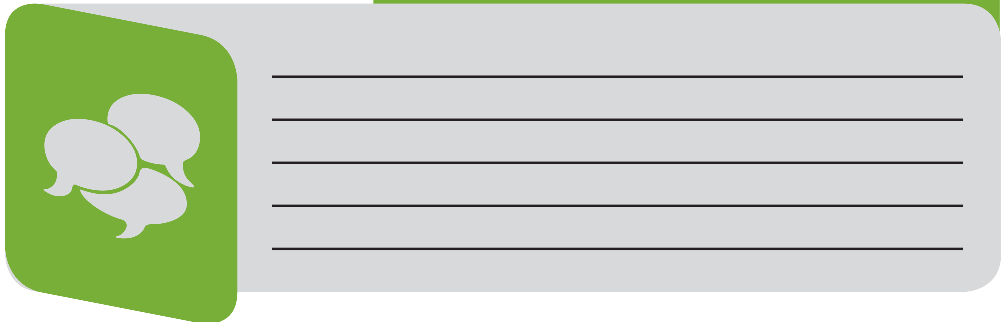
The Effect of Increasing Your Prices

If You Increase Prices By	If Your Current Gross Profit Is…				
	20%	**25%**	**30%**	**35%**	**40%**
5%	21%	16%	15%	12%	10%
10%	33%	29%	25%	22%	20%
15%	42%	37%	33%	30%	28%
20%	50%	44%	40%	36%	33%

** Example: If your Gross Profit is 30% and you increase prices by 15%, you can afford to lose 33% of sales before your profit goes backwards!



4. Reduce All Costs by 10%

Although lowering your overheads means greater profits, reducing costs isn't always easy. However, with concerted effort, it's possible to curtail your total expenses by at least 10%. The first step, of course, is to understand clearly what your costs are right now. While some costs like your telephone bills are easy to scale down, others like transportation aren't easy. Devote time to this area because you'll not be able to achieve a 10% reduction in your costs overnight. It'll take you several weeks or even several months. Target a 1% reduction in costs every week.

Strategies to Cut Spending

Do an expense shakedown every quarter. Take time to scrutinise every small company expense. Remember that it's difficult to change old habits. Look closely at your telecommunication bills, various subscriptions fees, insurance costs, travel expenses, and so on. Eliminate any expense that doesn't contribute directly to your company's profitability. You're certain to find several areas in which you can either reduce costs or cut out costs entirely.

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Look for Great Deals on Business Services

Don't be satisfied with just good deals on business services. Instead, bend over backwards to find great deals. Major brands from Microsoft to Costco and from Target to Wal-Mart are making a beeline to cater to the small and mid-sized business market. Use comparison shopping to your advantage. Make these brands win your business. When you're dealing with telephone or cellular phone plans, this is a great approach. Likewise, you should obtain lower interest rates on your company's credit cards. Lastly, don't forget about getting a better deal from your suppliers.

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5. Measure Productivity and Profitability

Lack of productivity is a silent killer of business growth. After all, if your employees aren't working hard, they are NOT earning the maximum profits for your business. Look at it this way: although your employees are collecting a wage, they aren't contributing to your business growth in the way you'd like.

Why Should You Measure Employee Productivity?

If your company fails to monitor and measure the productivity of employees, you will end up having employees that don't make the sincere effort they should be making in their job. This scenario translates to *low* sales and *high* wages. Since employee productivity is closely tied to company profitability, you need to address any productivity issue that crops up immediately. Surely, no employer wants to pay their employees for work they aren't doing!

Have a System for Measuring Productivity

Look at your employees in an objective manner. Find out if their productivity is optimal. Metrics is the key to understanding the productivity of your business. Factors to be considered to evaluate the productivity of employees in your company include:

- No. of employees
- Full time vs. part time positions
- Annual turnover

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- Gross profit
- Net profit
- Total available work hours for all your employees.

Formula to Calculate Productivity

Divide your company's annual turnover by the no. of full-time equivalent (FTE) employees. You will get the revenue generated by each employee.

Calculate the total hours available to work for each 'production' employee. Include only employees that produce goods, generate sales, or deliver services. If you are involved in production, include your hours too. Don't include the hours of administrative and management staff. Assuming that production employees work for 45 weeks in a year on average and 40 hours per week, you get 45 x 40 = 1,800 hours per employee. Design a Key Performance Indicator around the approximate weekly productivity measure (40 hours) of an employee and try to improve productivity based on this value.

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6. Negotiation with Suppliers / 3 Quotes / Tender

One of the most advantageous ways to increase your GP margins is by renegotiating the pricing of raw materials with your suppliers. You can get the most desirable deal if you go to the bargaining table fully prepared. Since everything is negotiable, you should think beyond the price of raw materials only. If the supplier won't relent on price, don't make a hasty move and dump the supplier. Instead, negotiate for other things such as faster shipping at the same price, more comprehensive warranty, and lower down payment that will reduce your expenses. You can also negotiate for longer term payments to improve your cash flow or additional discounts when you make cash payments.

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Successful Negotiation Strategies

- Market your brand as one that is capable of giving the supplier plenty of business.
- Talk to multiple suppliers.
- Make a bigger down payment (50–60 percent) and bargain for a larger discount.
- Consider making all your purchases from one supplier.
- Suppliers will feel inclined to do business with you when you develop an exceptional reputation in the marketplace.

Getting at least 3 quotes from different suppliers, freight services, and sub-contractors gives you plenty of choices. You get enough bargaining power to get the best deal. And you can improve your GP margins too.

Invitation to Tender (ITT)

ITT will provide potential suppliers information of your company's raw material or services needs. Suppliers will respond to your specific need. You can choose the tender or offer that meets your needs and provides your company with the best value for money. The core principle of tendering and procurement is getting value for money, not just the lowest price. Value for money includes timely supply, competent price, and favourable payment terms.

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7. Set Minimum Purchase Quantities / Amounts

Although minimum purchase requirements are not easy to implement in all industries, many business owners desire to obtain the efficiencies inherent in bigger orders. Tactics such as packaging multiple products or clubbing services together permit you to do this. You could also offer volume pricing. Your customers pay a lower price per unit when they buy

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in larger quantities. In effect, you pass on to your customer the underlying operational savings that come with a large order.

Run a Wholesale Side to Your Business

Offering your products/services in wholesale is a great strategy to fulfil large volume orders. Your business could reward customers who buy in larger quantities. But you should enforce strict rules for your wholesale customers. You should make certain that they meet the minimum requirements of getting the benefits of your lower pricing structure.

Offer Incentives/Gifts to Your Customers

Setting minimum purchase quantities / amounts is easier when you offer incentives. For instance, you could offer a premium gift or free shipping when a customer's order hits a predetermined minimum level. You could set your minimum purchase amounts as follows: For purchases over $100, the customer receives a keychain as gift. And for purchases over $250, the customer receives a mini tool kit as gift.

Offer Bundle Orders

You can package two or more low-cost, complementary items together. You could also package one high-cost item with one cost low-cost item. For instance, you may slash the price of a $99 phone accessory to $49 when it's bought with the phone, which is priced at $1,000. While a bundle order is great for fulfilling minimum purchase amount, you should make certain that your customer wants all the products in your bundle. You should not force the customer to buy an item they don't want. If you commit this error, they may not return to your store/business and repeat purchase.

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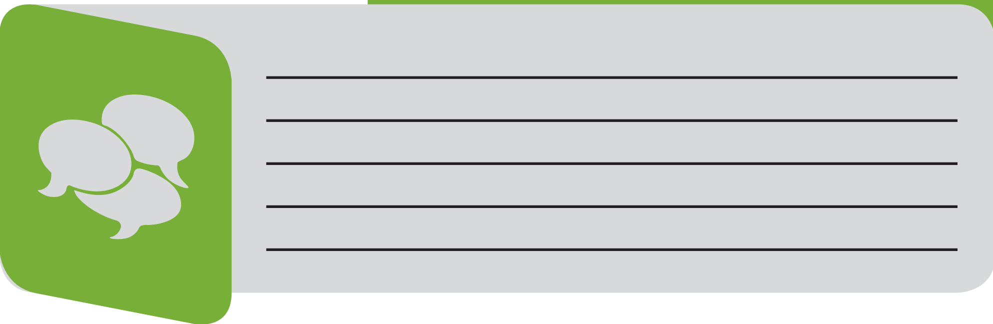

8. Set Price on Value NOT Cost Plus

The term 'Value' is perhaps, one of the most undefined and vague business concepts. Although this term sounds good and important, it isn't easy for you to get your arms around it. When the benefits of your product or service far outweigh the costs, your customer has *value*. Value makes something

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better, faster, sweeter, and stronger. A buyer can opt for a pancake without syrup. But is there any point? So, value is akin to the icing on the cake. When you provide superior value, the result is wildly satisfied customers. What else? Your customers return to you repeatedly and bring their friends too.

An Example of a Business that Delivers Value

Home Depot has the finest selection of virtually every home improvement product. Additionally, the retailer offers current buyers and potential buyers useful know-how via free classes or online resource centre. The retailer has created extremely loyal customers by adding value through these processes and extras. Customers are the retailer's business. The Home Depot goes the extra mile to give its customers exceptional value and the right advice about merchandise. Additionally, the retailer helps its customers use these products to their maximum benefit.

Buyers Favour Businesses that Deliver Value

Your business is essentially a value delivery system – you deliver value to your customers. Your customers deserve to get what they pay for. So, you should sell value and the overall extraordinary experience associated with what you offer. Your customers will always be willing to pay more for a product/service that solves their problem. From a strategic perspective, the only two parameters that matter to your customers are value and money. Customers typically steer themselves towards products/services that provide them more value for their money. So, the delivery of superlative value through more benefits, reasonable prices, or a combination of these two should be at the core of your winning business strategy.

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9. Know the Difference Between 'Mark Up' and 'Margin'

Collins Dictionary defines **Mark Up** as, "*a percentage or amount that's added to the cost of an item to provide the seller with some profit and to cover costs, overheads, etc.*" **Gross Margin**, also labelled gross profit, is total sales minus total cost of goods sold. For instance, if a retailer sells an item for $20 and this item had a cost of $16, the *gross margin* or the gross profit is $4. The

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gross margin ratio or the gross profit ratio expresses the gross margin or gross profit amount as a percentage of sales. The gross margin ratio in the above example is 20% ($4 divided by $20).

The Different Ways that Retailers Use Mark Up

Mark Up is used in different ways. Retailers frequently use Mark Up to indicate the difference between the cost of a product and its selling price. In the example above, the cost of the product is $16 and the Mark Up is $4. This results in its selling price being $20. The $4 Mark Up is the same as the $4 Gross Profit. But the mark up percentage is expressed as a percentage of product cost. In the example, the $4 mark up is divided by the cost of $16 resulting in a mark up of 25%.

Some retailers may use Mark Up to indicate the increase in the original selling price. For instance, if the $20 selling price was increased to $22 due to high demand and restricted supply, they would say the Mark Up was $2.

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10. Reduce Cost Per Lead

All businesses look to generate more quality leads and accomplish cost savings. This remains every company's business model. But the lead generation cost of most companies is so high that they need to make a sale just to cover these excessive costs. You need to reassess your lead generation strategies if you feel your current strategies are counter-productive.

Outbound Marketing vs. Inbound Marketing

Before the advent of the Internet digital marketing blitzkrieg, companies relied on Outbound Marketing – telemarketing, trade shows, and direct mail – to promote their business and secure customers. Outbound Marketing, also labelled Interruption Marketing, involves conveying your marketing message to the widest audience possible via cold calling, advertising, and other aggressive strategies that interrupt people in their everyday lives.

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Inbound Marketing techniques include blogging, social media, and SEO. Inbound marketing focuses on getting found by relevant prospects. These prospects are typically browsing the Internet to learn more about products and services. Implementing an inbound marketing campaign enables you to get more out of your marketing dollars. This campaign essentially focuses on attracting leads instead of pushing advertisements towards them. Your cost per lead is dramatically reduced because your campaign targets only your potential customers. Your company benefits from more sales-ready leads and a higher profit margin.

Note: If you are trying to attract enquiries via "organic search" (i.e. without using paid advertising such as Google Adwords), then you will need to produce a constant flow of quality content. You will also need to be present across a number of online channels to maximise your results. There is a lot of work in getting this right.

Reassess Your Marketing

Inbound marketing-dominated companies experience a significantly lower cost per lead than companies that predominately leverage outbound marketing. The average inbound lead will cost you almost three times as less as an average outbound lead does. Methods to reduce your cost per lead include:

1. Optimise your business website for improved **organic search** results.
2. Drive more traffic to your business website by **blogging**.
3. Share valuable content via **Social Media Marketing**.
4. Reach more potential customers via targeted **E-mail Marketing**.
5. Fix the technical issues in your business website.
6. Increase the speed of your business website.

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Strategy Implementation Summary

In the space below, summarise the best ideas that you have gained for implementing into your business from reading the 10 Margins sub-strategy summaries above. In the right-hand column, prioritise the strategies for implementation, with #1 being the strategy you will implement first.

Ideas I Can Implement Into My Business	Priority

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