BUSINESS MANAGEMENT

GROSS PROFIT OR MARK-UP THE TRUTH REVEALED

fourmative f.

PROFIT IS KING, PROVIDING IT IS CALCULATED, MANAGED, AND MEASURED CORRECTLY

These guides are in place to support your learning and help you improve your knowledge and enhance your business performance.

Enjoy the read and good luck, do let us know of your successes and use our other guides to expand your knowledge and grow your business.

GROSS PROFIT OR MARK-UP
THE TRUTH REVEALED

Over the past 30 years, I am amazed at how many times I have gone through Gross Profit calculations with Sales Staff, Managers and even Business Directors. Many Managers are still getting these calculations wrong every day. To be blatantly honest it has not got much better in recent years as Managers and Sales staff rely upon the computer to work out the profit for them, forgetting that the computer will only report upon the sales decisions already made by the Managers and their staff.

In this short guide, we will help explain the importance of **GROSS PROFIT** calculations and help you to understand the difference between Gross Profit and Mark-Up.

In my consultancy and training support, I have helped many businesses understand this fundamental difference and make business changes that have had a significant impact upon profit.

I remember one particular Car Dealership Service department who had just agreed their budget for the coming year. Part of that budget was to achieve a Gross Profit on all subcontract work of 20%. After one month of trading, the month end accounts showed a gross profit of 16.67% on subcontract work.

We helped the Service Manager understand why this was happening and the steps to take to achieve the target profit and the very next month the 20% target was achieved.

So, let me share with you the pitfalls, misunderstandings and more importantly the fixes to help you manage and improve your gross profit.

INTRODUCTION
WHAT IS GROSS PROFIT?

Gross Profit can be stated as a net value or a percentage. In simple terms, GROSS PROFIT is the difference between what you buy something for and what you sell it for. So, if you buy something for £1.00 then sell it for £1.50 then you will make a gross profit of 50 pence. Quite simple Eh!

So, this would be fine if business was that simple i.e., we always buy at £1.00 and sell at £1.50. However, business involves the sale of lots of different products at lots of different prices, therefore, we need an additional measure. This measure is **GROSS PROFIT %.** Now, this is where the confusion occurs.

Gross Profit % is equal to the Gross Profit made (in this example 50p) divided by the **sales price** (which is £1.50) expressed as a percentage which gives a 33.3%.

Now, this is very different to **MARK-UP%** which is calculated by taking the gross profit made (50p) and dividing this by the **cost price** (£1.00) expressed as a percentage which gives a mark-up of 50%.

In my earlier example at the Car Dealership, the Service Manager was simply adding 20% to each subcontract bill expecting to make a 20% Gross Profit, this was the error that needed correcting.

So, let's look at some simple examples

EXAMPLE 1
CALCULATING GROSS PROFIT

You buy a set of Brake Pads at £32.50 and sell them for £47.50. How much Gross Profit have you made?

Gross Profit = Sales – Cost of Sales

Gross Profit = £47.50 – £32.50

= £15.00

This example shows how simple the calculation is.

Since products vary in price, a universal comparison is required. This comparison is Gross Profit %.

$$\text{Gross Profit \%} = \frac{\text{Selling Price} - \text{Cost of Sales}}{\text{Selling Price}} \times 100$$

$$\text{Gross Profit \%} = \frac{47.50 - 32.50}{47.50} \times 100$$

$$= 31.58\%$$

This means that for every £100 worth of Brake Pads you sell, £31.58 worth of profit is made.

EXAMPLE 2 - CALCULATING THE SELLING PRICE

Now, consider this example:

You buy a product for £25.00. At what price do you sell it to make a 35% Gross Profit?

Gross Profit = Sales – Cost of Sales

This can also be expressed as:

Sales = Gross Profit + Cost of Sales

if the selling price is equal to 100%.

then:

100% = Gross Profit + Cost of Sales
100% = 35% + Cost of Sales

Therefore, Cost of Sales = 65%.

In this instance, the Cost of Sales = £25.00

So, £25.00 = 65%.

Therefore, 1% = $\frac{25}{65}$

So, the Selling Price (which is equal to 100%) would be

= $\frac{25}{65}$ x 100
= £38.46153

Round up to the nearest penny = **£38.47**

The Selling Price of the product costing £25.00 would be £38.47 to achieve a Gross Profit of 35%

GROSS PROFIT %

Let's look at this again with another example

A simple way of visualising GROSS PROFIT can be through using a pie chart diagram as below:

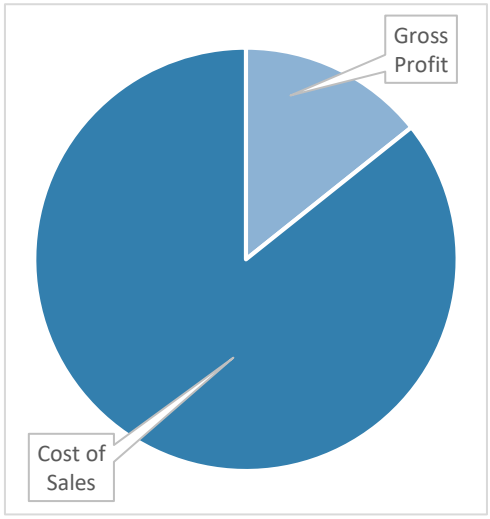
Picture the Selling price as the whole circle = 100%

Therefore

(Cost of Sales) + (Gross Profit) = Selling Price (100%)

Therefore, if you want to retain a 35% Gross Profit, the Cost of Sales must equal 100 – 35 = 65%.

Which is 65% of the selling price.



EXAMPLE 3
RETAINING A GROSS PROFIT

So, consider another example

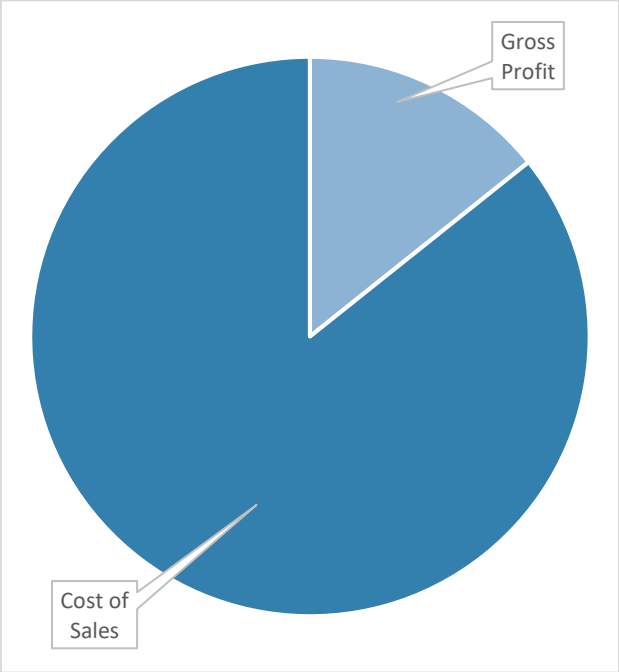
You buy in a product for £47.50

You want to retain 27% Gross Profit. How much do you sell it for?

Cost of Sales = 100 – 27 = 73%

Selling Price = $\frac{£47.50}{73} \times 100$

= £65.07



A selling price of £65.07 would achieve a Gross Profit of 27%

Now try some calculations for yourself.

We have put the answers at the back of this guide

CALCULATIONS
HOW TO CALCULATE GROSS PROFIT

1. You buy a product at £3.42 and sell it at £4.99. How much Gross Profit % do you make?

TIP: remember the formula

$$\text{Gross Profit \%} = \frac{\text{Sales Cost} - \text{Cost of Sale}}{\text{Sales Cost}} \times 100$$

2. You buy some products at £48.00 per dozen. At what price do you sell them (each) if you want to retain a Gross Profit of 18%?

TIP: work out the cost of each product first.

3. You buy a product that retails at £38.52 and you receive a 34% discount. At what price do you sell it if you wish to retain a 24% Gross Profit?

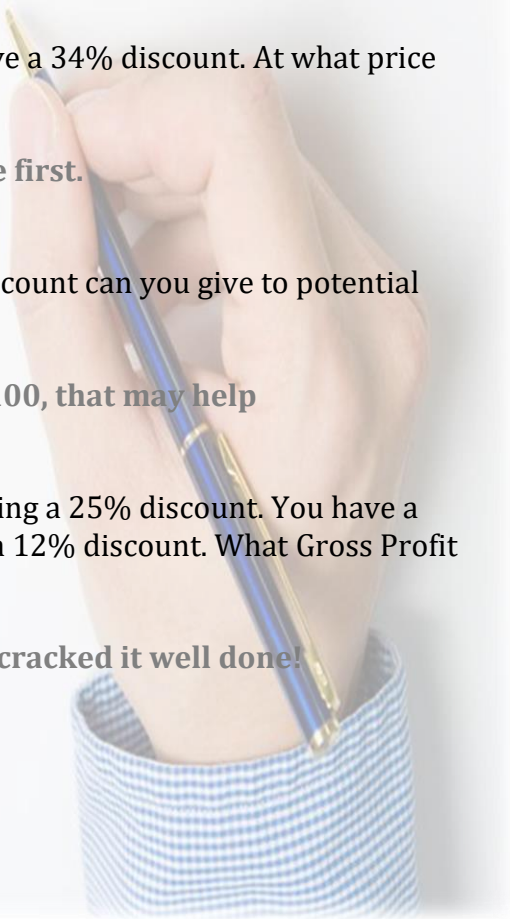
TIP: calculate the cost price first.

4. You buy a range of parts at retail minus 60%. What discount can you give to potential customers if you wish to retain a 28% Gross Profit?

TIP: assume a product retail price is £100, that may help

5. You buy a range of products from your supplier receiving a 25% discount. You have a customer who wants to place a large order but wants a 12% discount. What Gross Profit % will you make if you accept the order?

TIP: if you have got this far then you have cracked it well done!



GROSS PROFIT - SHORTCUT

Gross Profit management is of obvious importance and all sales staff should be able to calculate Gross Profit on sales made and identify selling prices based upon a defined purchase price.

Consider this shortcut method of calculating a selling price from a known Cost Price.

Assume a product costs you £24.26. At what price do you sell it to make a 26% Gross Profit?

STEP 1

Deduct 26 from 100 and remember that figure, i.e., 74. I am sure that everyone could perform this calculation in their head.

STEP 2

Take a calculator and insert the Cost Price in pence, i.e. press the following keys:

2	4	2	6

STEP 3

Press the following keys:

÷	7	4	=

And the selling price will now be displayed on your calculator, i.e. 32.783 = £32.79

NB. When calulating the selling price, always round up rather than down.

This simple shortcut method ensures that the manager keeps control of the profit made.

ANSWERS - LET'S LOOK AT THE CORRECT ANSWERS

1. You buy a product at £3.42 and sell it at £4.99. How much Gross Profit % do you make?

First, calculate the Gross Profit by subtracting the cost price from the selling price.

£4.99 – £3.42 = £1.57 this is the amount of Gross Profit that you have made.

Now take this figure and express it as a percentage of the selling price.

£1.57 ÷ £4.99 x 100 = **31.46%**

2. You buy some products at £48.00 for a box of 12. At what price do you sell them (each) if you want to retain a Gross Profit of 18%?

Now if they cost you £48.00 for a box of 12 then one would cost you £48.00 ÷ 12 = £4.00

So, a single item or unit would cost you £4.00

If you would like to make 18% Gross Profit, then the Cost of Sale would be equal to 82%.

Therefore 82% = £4.00

So, 1% = £4.00 ÷ 82

And 100% = £4.00 ÷ 82 x 100

The selling price is, therefore = £4.00 ÷ 82 x 100 = **£4.88p**

This example is key when setting the selling price of items to ensure that they achieve an acceptable level of profit.

3. You buy a product that retails at £38.52 and you receive a 34% discount off it. At what price do you sell it if you wish to retain a 24% Gross Profit?

First, calculate the Cost Price which is equal to £38.52 less 34% = £25.42

Now if you would like to make 24% Gross Profit then the Cost of Sale would be equal to 76%.

Therefore	76%	=	£25.42
So,	1%	=	£25.42 ÷ 76
And	100%	=	£25.42 ÷ 76 x 100
The selling price therefore is		=	**£33.45p**

4. You buy a range of parts at retail less 60%. What discount can you give to potential customers if you wish to retain a 28% Gross Profit?

First, assume a Retail Price of £100.00.

Therefore, the Cost Price would be £100.00 less 60% - so the cost price would equal £40.00.

Now to make 28% on this sale the Cost of the Sale would be equal to 72%.

Therefore	72%	=	£40.00
So,	1%	=	£40.00 ÷ 72
And	100%	=	£40.00 ÷ 72 x 100
The selling price therefore is		=	**£55.56p**

Now, what discount would you need to give off the Retail Price of £100.00 to achieve a selling price of £55.56?

$$\text{Discount \%} = \frac{\text{Retail Price – Selling Price}}{\text{Retail Price}} \times 100$$

$$= \frac{£100.00 - £55.56}{£100.00} \times 100$$

$$= \mathbf{44.44\%}$$

So, you can give a 44.44% discount off the range of products still retaining 28% Gross Profit.

5. You buy a range of products from your supplier receiving a 25% discount. You have a customer who wants to place a large order but wants a 12% discount. What Gross Profit % will you make if you accept the order?

As before assume a Retail Price of £100 and calculate the Cost Price. £100 – 25% = £75.00. Now the selling price which is £100 less the 12% discount would give a selling price of £88.00

Now to calculate Gross Profit use the formula

$$\text{Gross Profit \%} = \frac{\text{Sales Price} - \text{Cost Price}}{\text{Sales Price}} \times 100$$

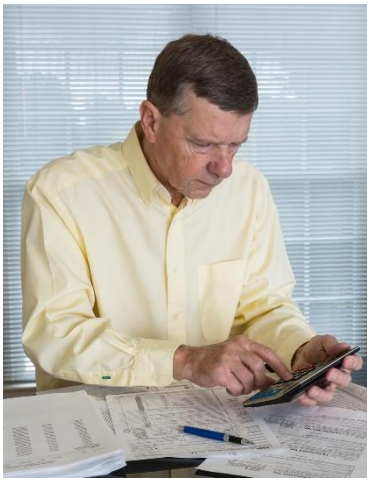
$$= \frac{£88.00 - £75.00}{£88.00} \times 100$$

$$= \frac{£13.00}{£88.00} \times 100$$

$$= \mathbf{14.77\%}$$

So, you would retain a Gross Profit of 14.77% on this transaction which means that for every £100 worth of sale you would make a £14.77 Gross Profit.

GROSS PROFIT CALCULATION SUMMARY



These simple calculations are fundamental for any Sales staff / Managers. Those involved in Parts Sales should be focussed upon the retention of an acceptable level of Gross Profit and examples 4 and 5 are vital. For everyone else, if you are selling then you need to know how to calculate, manage and improve the profit that you are making. Don't forget you can only do that if you are making an accurate measure of that profit.

Should you need any help or guidance in applying these calculations to your business then do not hesitate to contact me.

So, I leave with one final thought

"What you achieve today, can be improved tomorrow, providing you choose to make a change"

Good Luck.

Gary Hodgkiss

Director, Fourmative Limited

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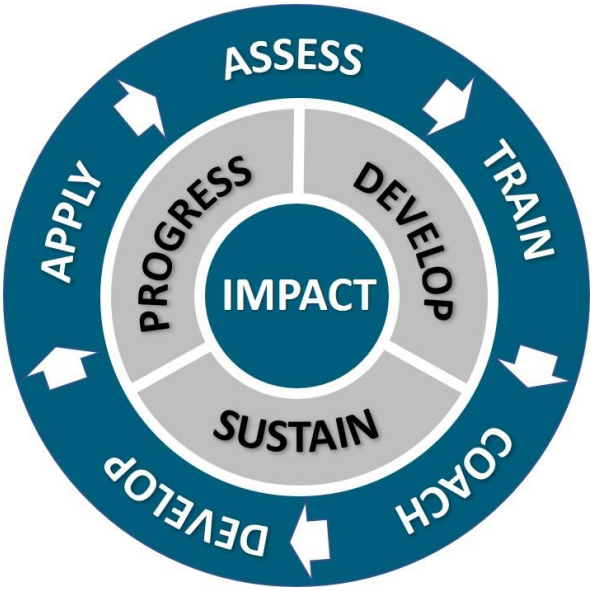
Fourmative is an automotive consultancy and training business with a passion to be different, to extend boundaries and enter new horizons combined with a desire to have an unquestionable impact upon our client's business. This lies at the very foundation of what we do and forms our commitment to you.

Fourmative was founded in 1993 with the underlying principle that still stands today - the desire to truly make a difference.

A difference that helps solve issues, educate staff and managers alike, enhance both your business and individual performance.

Celebrating our 25th year in 2018 and we are still delivering the same business benefit to our many valuable clients.



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