Profit Margins

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Raj Vable Young Mountain Tea



Me



Grew up in Michigan, studied engineering

Worked between rural India and the US for 5 years

Launched Young Mountain Tea in 2013

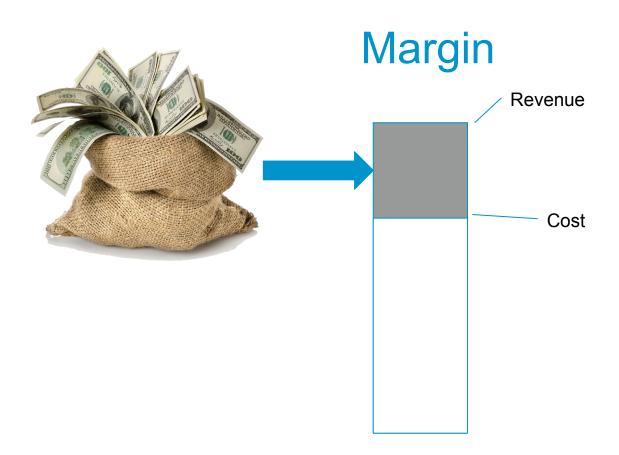
Work on the Oregon RAIN team for 2+ years



When's a time you negotiated a good price, either as a customer or as a seller?

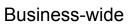


What are margins?



Margin exists at multiple levels







Sales Channel



Individual Product/Service

Two main types of margin

Gross margin

- Gross margin = Revenue Variable Costs
- Variable costs: costs that increase as you sell more.
 - Also called or Cost of Goods Sold (COGS) for product-based businesses or Cost of Sales (COS) for service-based businesses

Net margin

- Net Margin = Gross Margin Fixed Costs
- Fixed costs: Anything that isn't impacted by selling more.

Paul's Plumbing Co. PROFIT AND LOSS

January 1 - September 29, 2016

(4)	TOTAL
Income	
Sales	2,234.00
Services	4,025.00
Total Income	\$6,259.00
Cost of Goods Sold	
Cost of Goods Sold	750.00
Supplies & Materials - COGS	1,000.00
Total Cost of Goods Sold	\$1,750.00
Gross Profit	\$4,509.00
Expenses	
Advertising	8.47
Bank Charges	50.00
Job Materials	2,750.00
Total Expenses	\$2,808.47
Net Operating Income	\$1,700.53

Gross Margin

Net Margin

Revenue

COGS (variable

costs)

Expenses_ (fixed costs)

Margin can be expressed as a percent or a dollar value



Percent
Better for
comparing options



Dollars
Better for knowing where you stand at any one point

People often use "margin" for "gross margin percent"

Looking only at sales price and variable costs

(no overhead/fixed costs)



(Revenue - Cost)



(Revenue - Cost) (Revenue - Cost)

Revenue

Let clean up with an example!

Cost: \$4

Sales Price: \$10

What's the margin?



Photo: Bella's LuvBar in Veneta, owned by Annie Molnar

$$\frac{(10-4)}{10} = \frac{6}{10} = \frac{60\%}{10}$$

MARGIN AND MARKUP ARE TWO DIFFERENT THINGS!

(but they use the same inputs: price & cost)

Margin

Markup

(Revenue - Cost)

(Revenue - Cost)

Revenue

Cost

Margin

6

Markup

6

10

60%

4

150%



Revenue



Increasing Price vs Decreasing Costs

	Original	\$10 more in price	\$10 less in cost
Price	\$100	\$110	\$100
Cost	\$75	\$75	\$65
Original margin \$	\$25	\$35	\$35
		32%	35%
Original Margin %	25%	(+7%)	(+10%)

In both cases, although the margin is \$35, the margin percent is increased more by decreasing cost than increasing price.

So keep your costs low!

How do discounts affect margins?





20% OFF!

(click)

Punchlines

Math is weird.

Discounts affect margins in different ways depending on the original margin.

And if the discount is more than the original margin, you will be losing money.

What should my margins be?

It depends! Varies by industry, geography, and sales channel

- Hospitality: 76%
- Eating & Drinking Establishments: 49%-67%
- Real estate: 52%
- Educational services: 51%
- Apparel: 46%
- Agriculture animals: 35%
- Agriculture crops: 25%
- Brick-and-mortar retail: 20-35%

Check yours out! Ready Ratios and Camino Financial

Any questions so far?

(Price - Costs)

Price

Gross Margin means variable costs only!

Variable costs are anything that will increase as your sales increase.

Generally called COGS for product-based businesses, COS for service-based businesses

Don't include fixed costs that aren't affected by the amount of sales you make (ie "overhead")

What should go into variable costs?

Include:

- Material costs
- Shipping costs
- Storage costs
- Direct Labor (production or service delivery)
- Equipment

Don't include:

- Office space
- Marketing expenses
- Insurance
- Advertising
- Finance expenses (interest)
- IT
- Indirect labor (sales)

What is the most commonly missed variable cost for new businesses?

Your time!

How to calculate labor costs

For service-based businesses; the easiest way to calculate is to determine your hourly rate!

For product-based businesses, it's a simple three-step process

- 1. Give yourself a 3 hour window and see how many products you can make working at a comfortable speed
- 2. Assign a market-value to your time
- Divide the cost of your time by the number of products you made

For service businesses, variable costs are dominated by time delivering services

Example: massage parlors -- time spent providing the service counts as variable, but not time spent booking your services.

(Price - Costs)

Price

Tips for Setting Your Price

Create win-wins for you and your customer!

- Work out your absolute minimum to keep the doors open
 - Based on your fixed costs and COGS

 Give yourself enough room to work in discounts and wholesale services that still have plenty of margin.

Tips for Setting Your Price



Ask your customers

Study the competition

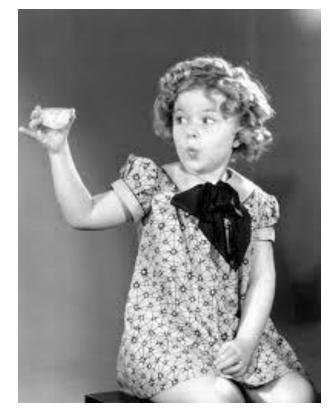


Develop tiers to give options



Give yourself room to grow





Let's put it all together over a cuppa' tea!

Summary

- Margin: (Price-Cost)/Price
 - don't forget the parentheses!
- To increase margin, more bang for your buck to lower cost than increase price
- If you discount more than your margin, you lose money!
- Don't forget to include your own time in your costs
- When setting price, give yourself plenty of room

Resources

- Margin
 - FREE online calculator including margin, discounts,
 - Gross vs Net Margin
 - Industry margins: <u>Ready Ratios</u> and <u>Camino Financial</u>
- Revenue
 - Tips for Pricing
- Costs
 - Variable Costs vs Fixed Costs
 - What should go into Costs?
 - Calculating costs for a service business (Net Hunt)



Time budgeting

Topic	How Long (min)	Start	Stop
Login + Intros	5 min	10:00	10:05
First slides	20	10:05	10:25
Breakout 1	10	10:25	10:35
Activity 2	10	10:35	10:45
Slides	15	10:45	11:00
Breakout 2	10	11:00	11:10
Main Room	5	11:10	11:15