Markup vs. Margin Formula: What Business Leaders Need To Know

6 min read

Margin and markup are easily and often confused because both numbers deal with the cost of goods sold, revenue, and the money you actually make on a sale.

Key Takeaways

- **Markup vs. Margin: What's the Difference?:** Markup refers to the amount that you charge a client on top of your cost of goods sold. A margin...
- **Using Markups to Hit Target Gross Margins:** Since markup is based on the cost of goods sold, it is quite useful for salespeople working in a company that knows its costs.
- **Margin and Markup Best Practices:** Although margins and markups are fairly simple concepts to understand, they can be tricky to master due to their many similarities..

However, the two terms are wildly different and refer to different numbers. As a result, it's essential that your sales team understands the difference between margin and markup, how to calculate them both, and your business's markup policies and margin goals.

Otherwise, your business could run into serious pricing errors that wipe out your bottom line.

Markup vs. Margin: What's the Difference?

Let's start with the basics.

A markup and a margin are two different things. Markup refers to the amount that you charge a client on top of your cost of goods sold. A margin (sometimes called gross margin or gross profit margin) refers to the amount that your company keeps out of total revenue after the cost of goods sold is accounted for. [1]

When referring to a dollar amount, these two refer to the same number. However, when they are expressed as a percentage (as they usually are for pricing and accounting purposes), they are quite different.

Here's a great example to share with your sales team. If you sell a service for $100, and your cost of goods sold is $70, then both your margin and your markup equal $30. Expressed as a percentage, however, it's necessary to use the margin formula and markup formula to calculate the different rates.

- Markup = (Sales - Cost of Goods Sold) / Cost of Goods Sold
- Margin = (Sales - Cost of Goods Sold) / Sales

In the above example, the markup equals 42.9%, whereas the margin is 30%.

As you can see, using the terms interchangeably can get you into trouble because the margin is expressed as a percentage of total revenue while the markup is expressed as a percentage of the cost of goods sold.

In addition to the terms being somewhat confusing because they use the same figures to be calculated, they can also be a bit challenging because the markup and margin percentages also change at different rates. So, there is not a standard difference between markup and margin. As your margin grows, the markup increases at an even greater rate.

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Consider these margins vs. markups at various intervals:

- 10% margin = 11.1% markup
- 20% margin = 25% markup
- 30% margin - 42.9% markup
- 40% margin = 66.7% markup
- 50% margin = 100% markup

When you know how to calculate profit margin and markup and understand the differences between margin and markup, you can provide training and education to your sales team so that you can effectively communicate with them regarding your target margin and the markups you need to get you there.

With this information, you can easily use both figures to set optimal prices with healthy profit margins built-in.

Using Markups to Hit Target Gross Margins

Since markup is based on the cost of goods sold, it is quite useful for salespeople working in a company that knows its costs. If your sales representatives know the cost of the products or services they are selling, then they can easily deliver price quotes to clients using a simple markup percentage.

Plus, this pricing model allows you to arm your sales force with a range of target markup percentages designed with your desired margin built-in. This allows them to readily negotiate with and quote prices to customers while remaining in a price range that generates healthy profit margins. [2]

To determine a markup rate based on your desired margin, use the following formula:

- Markup Percentage = Desired Margin / Cost of Goods Sold

If in the above example, you were starting with $70 in cost of goods sold and a desired margin of 30%, you would calculate the desired markup percentage by dividing 30% by $70, which would leave you with the 42.9% markup.

Margin and Markup Best Practices

Although margins and markups are fairly simple concepts to understand, they can be tricky to master due to their many similarities. As a result, handling them in your company might require you to instill a few best practices for margins and markups in your sales policies and procedures.

Read More: Want To Increase Your Profit Margins? Use This Sales Commission Model.

Educations and Training

Make sure each new hire for your sales team (or anyone that deals with prices in your company) is adequately trained and understands the difference between margins and markups, how to calculate prices based on these numbers, and the acceptable markups that they can use in their price quotes. Additionally, be sure to include periodic refreshers on these topics during ongoing training.

Quick Guides or Cheat Sheets

You can also provide your sales team with some quick guides and cheat sheets that quickly break down the markups you expect them to be charging clients, the base costs of the services they're selling, and a quick example and explanation of how to use the information to quote prices.

Internal Auditing

You should also ask your internal auditing or bookkeeping department to periodically inspect a sample of your business's recent sales transactions specifically looking at markups, margins, and how they are being used. This will ensure any issues or confusion is identified quickly – before your gross margin has taken too big of a hit – By catching these issues early on, your sales representatives can be promptly corrected, retrained, and move forward applying the concepts correctly.

Pricing and Sales Support From an Automated Back Office

Automating your back office procedures whenever possible will ensure you collect timely and accurate data on every single transaction that runs through your company.

This ensures you can accurately assess sales, prices, markups, and profit margins to evaluate how well your company is performing and keep a close watch on its financial health. A better back office will help you track the most important key performance indicators in your business and make adjustments to see your profits soar.

[1] https://www.investopedia.com/ask/answers/102714/whats-difference-between-profit-margin-and-markup.asp#:~:text=The%20main%20difference%20between%20the,price%20setting%20is%20done%20appropriately.

[2] https://www.accountingtools.com/articles/what-is-the-difference-between-margin-and-markup.html