



PATHFINDERLINK
PRACTICAL PROJECT MANAGEMENT SOFTWARE

MARGIN VS. MARKUP

WHAT'S THE DIFFERENCE, AND
WHAT'S MORE IMPORTANT?



Are You Making Money On Every Project?

How do you know if you are making money on each of your projects? Many people think that if there's money in the bank that they are making money. That's a problem because money in the bank ebbs and flows depending on what is being paid for and when it's getting paid. Wouldn't it be nice to know the margins you are making on every project? First, the difference between margin and markup must be understood. Spoiler Alert! They are not the same. The amount of money you end up with in the bank will be a lot less than you expect if you don't know the difference between margins and markup.



Margin

Margin is a percentage that shows profit compared to revenue. This is the actual money that is made on a project. So, the margin doesn't manifest until after a project is finished and you know what your profit is and can compare it to the revenue that came in.



Markup

Markup is a percentage you mark something up, with the hope that after all bills are paid the company will make some money. Markup is not the profit because markup happens before the project is even started. Without knowing all the pitfalls and changes that happen throughout a project you can't be sure that markup will stay consistent.

A Contractor's Mistake

There was a contractor (Jack) who ran the numbers for a project and came up with an estimate. He considered all the man hours it would take to finish the project, and he priced out the materials. Jack took all things into consideration and came up with \$1600 as the total cost for all expenses. His general plan was to make 20% on projects, (that was the going rate), so he added 20%, or \$320, to his expenses and charged his customer \$1920. Jack didn't have any shortage of work because, as he found out later, he was often the lowest bid by quite a bit. He had a good reputation, but felt like he was working more, harder than others, and not getting any further ahead. It wasn't until later that Jack learned the difference between margin and markup. He quickly realized that many of his competitors either knew the difference, or simply charged more on their projects. Jack knew that he needed to shoot for a 20% margin, which he now knew was different from simply marking expenses up by 20%. Upon learning the formula for margin vs. Markup, Jack learned that his margin for the project above was only 16%. If he had understood the math before, he would have charged his customer \$2000 and still been competitive with his peers. The difference was only \$80 for this project, but a lot of Jack's jobs were around \$20,000, and for a job that size the difference between a 20% markup and a 20% margin would be \$800. It became obvious that with a consistent increase like that Jack would be able to grow his company like he would like.



Here's The Math

Consider a project where all your expenses add up to \$160. If you mark the expenses up by 25% (MARKUP), your total revenue will be \$200, and your profit will be \$40.



160...Cost of Goods Sold

X .25...Markup

= 40...Profit

160...Cost of Goods Sold

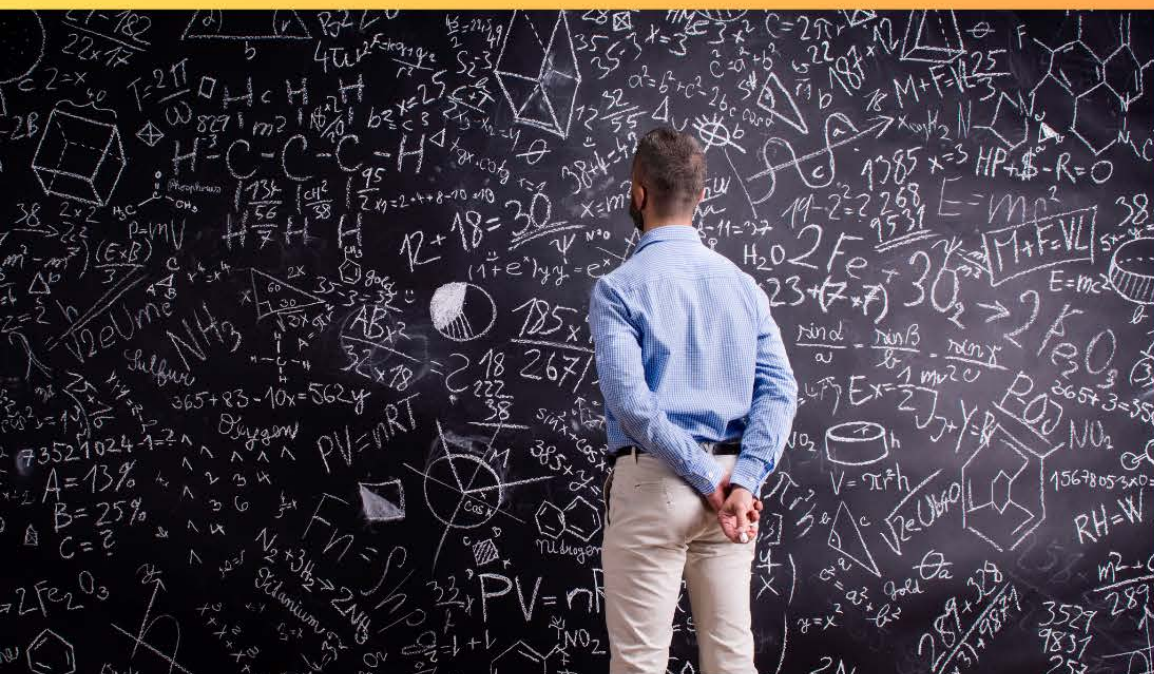
+ 40...Profit

= 200...Total Revenue

Now if you divide \$40 by \$200
you get 20% (MARGIN).

20%...Margin

Total Revenue...200 / 40...Profit



You can see that in order to get a 20% MARGIN,
you must have a 25% MARKUP.

The Contractor's Mistake Using The Numbers Above

160...Cost of Goods Sold
X .20...Markup
= 32...Profit

160...Cost of Goods Sold
+ 32...Profit
= 192...Total Revenue

Total Revenue...192 / ^{16%...Margin}
32...Profit

You can now see that a 20% markup only provides a 16% margin.



Why Is Margin MORE Important Than Profit?

Profit margin will better reflect long-term profitability and the vulnerability of a business to unexpected increases in fixed costs like insurance, office expenses and taxes. It's important to pay close attention to profit margin and implement strategies to keep it as high as possible.

Summary

Markup percentage is the difference between the cost of goods sold and the price the customer will pay. Gross margin percentage is the percentage difference between the price the customer pays and the profit. Markup is less effective than gross margin when pricing your work.



Sources:

Dan. (2016, October 12). *Should You Use Margin or Markup Percentage for Pricing?*. The Strategic CFO®. <https://strategiccfo.com/articles/profitability/should-you-use-markup-or-margin-for-pricing/#:~:text=50.0%25%20Gross%20Profit-,Conclusion,comes%20to%20pricing%20your%20product>