Markup vs Gross Margin; Which is Preferable?

Though markup is often used by operations or sales departments to set prices it often overstates the profitability of the transaction. Mathematically markup is always a larger number when compared to the gross margin. Consequently, non-financial individuals think they are obtaining a larger profit than is often the case.

By calculating sales prices in gross margin terms they can compare the profitability of that transaction to the economics of the financial statements.

Steps to minimize Markups vs Margin Mistakes

Terminology and calculations aside, it is very important to remember that there are more factors that affect the selling price than merely cost. What the market will bear, or what the customer is willing to pay, will ultimately impact the selling price.

The key is to find the price that optimizes profits while maintaining a competitive advantage. Below are steps you can take to avoid confusion when working with markup rates vs margin rates:

1. Use a pricing model or pricing tool to quote sales. Have the tool calculate both the markup percentage and the gross margin percentage

2. Relate gross margin percentage per sales invoice to income statement

3. Organize your chart of accounts to compare gross margin rate to sales quotes

4. Educate your sales force on the differences. By targeting the gross margin percentage vs the markup percentage you can throw an additional 2 - 3 percent profit to the bottom line!