

Markup vs. Discount: The Difference Can Break You!

$\$100 + 50\% \text{ markup} = \150

$\$150 - 50\% \text{ discount} = \75

by Steve Bodofsky

One equals one. Two equals two. Fifty equals fifty. Any schoolchild can tell you that. In fact, there's even a name for this in mathematical terminology: the *identity element*. Simply stated, it says that everything is equal to itself. Sound reasonable, right?

The problem comes in when you start to compare different items, or measure from different starting points. Back in elementary school your teacher probably told you, "never compare apples with oranges." And while that bit of advice didn't make a bit of sense at the breakfast table, it's of vital importance when comparing quantities or numbers. In fact, it's so important that the failure to recognize the difference between two amounts — markup and discount — has been known to put people right out of business.

Sound strange? Okay, let's look at a simple hypothetical situation: A business owner buys a device — let's call it a widget, since that's what you call all hypothetical devices — to resell in his shop... hopefully for a profit. He pays \$100 for each widget, and marks them up 50%. So the sale price is \$150... a price that should earn him \$50 per widget. He's happy with that profit margin.

The next day, his neighbor walks into the shop, sees the widget on the shelf, and says, "I have to have one of those widgets!" (He's really into widgets).

The shop owner, being a good neighbor and friend, figures he doesn't

need to make a profit on his buddy, so he offers to sell the widget to him at cost. So the shop owner discounts the price of the widget by 50% — the same percentage that he applied to his cost.

The sale price is \$150, and 50% of that is \$75. Subtract \$75 from \$150, and he's left with a price of \$75. So he sells the widget to his friend for \$75... and loses \$25 on the deal.

Now wait: He marked it up 50%, then discounted it 50%. Shouldn't the price have returned exactly to his original cost for it? Why is there a difference of \$25? And how long do you figure it'll be before the shop owner ends up going bankrupt?

The problem — and the reason for the difference — is the starting point. The shop owner started with a cost of \$100 and then applied his 50% markup. Later, when he discounted the widget, he was working with a different starting point: \$150. That's where the difference came in: 50% of \$150 is \$75.

Of course that was a pretty obvious example. We had only one item to consider, we had the original price on hand, and the numbers were pretty simple to work with. Think about a store with hundreds — or maybe thousands — of items in stock, with costs like \$14.52 and \$56.47. And, instead of a simple 50% markup, consider working with maybe 38% or 42%. All of a sudden it's easier to find yourself in trouble, selling products for less than you paid for them.

For example: A shop owner who stocks thousands of items in his store

uses a standard markup of 42%. At the end of the year, right before inventory, he decides to clear out as much as possible with a storewide sale: 25% off everything. That still leaves him with a profit of 17%, right?

Wrong. Let's use \$100 as an example. With a 42% markup, that comes to \$142. Discount that by 25%, and you're left with just \$106.50, or a 6.5% profit: a far cry from the 17% he was expecting.

But hey, it's still a profit, right? That is, until the customer hands him a credit card to pay for the merchandise. With about a 5% discount rate on the credit card (unless he happened to be an ATRA member, and was taking advantage of the special, ATRA-member-only credit card processing program through Bank of America — contact ATRA's membership office for details), and he's left with about \$101.17... or about 1% above his cost.

17% might have been enough to cover his expenses during the sale. But 1%? Probably not. With that kind of a profit range, there's a good chance he'll be out of business before long.

Think this is a contrived set of circumstances? The numbers, maybe. But the situation is real. That difference between markup and discount may not be the only condition that causes a business to fail, but you can be sure that it's a contributing factor in a large percentage of the businesses that go belly-up in their first five years.

So how can you avoid becoming one of the many markup-discount fatal-

ities? There are dozens of different formulas out there, designed to help you calculate the ratio of discount to markup, and avoid becoming a statistic. Unfortunately, most of them are fairly involved, and require very specific calculations.

But there's a really simple way to avoid this problem altogether: Always work from your cost perspective. If you're always aware of your actual cost, figuring out a useable profit range is easy.

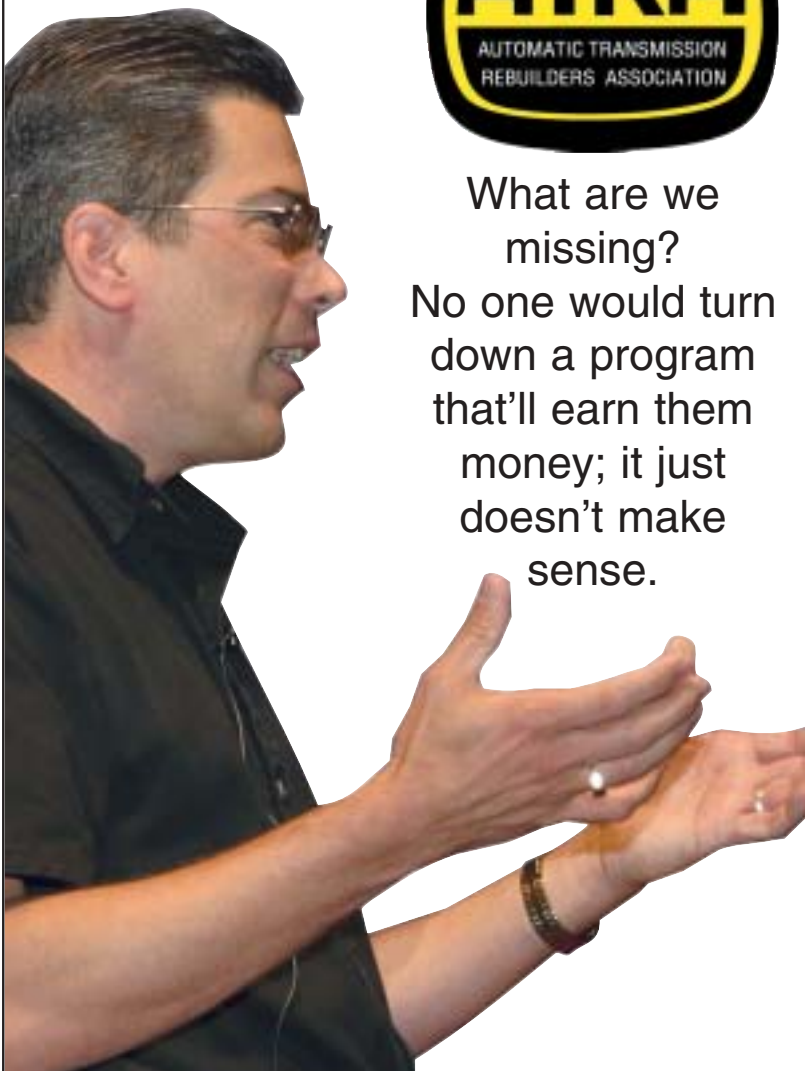
For example, suppose you have a part on your shelves that goes for \$125. As long as you know exactly what you paid for that part, you'll always be able to work out a price that suits any customer, and still keeps you from losing your shirt.

If you want to sell it to your neighbor for less than \$125, and that part cost you \$80, all you have to do is decide how much you want to make on it. 25%? No problem: Just add 25% to the original cost — 25% of \$80 is \$20 — and you're right on target. Don't forget to add on something to cover any additional costs for the sale, such as the credit card or bank fees.

Many of the shop management programs available keep track of your parts' costs for you. If you're not sure whether yours does, check the documentation or contact the software distributor.

Of course, none of this accounts for your hourly cost of doing business. Those costs will vary, depending on your location, the size of your business, the number of hours you're open and so on. This is strictly to prevent you from selling product for less than you paid for it because of a simple error in arithmetic. From there, it's up to you to work out a reasonable markup... one that has the potential to keep you profitable.

But as long as you always work from the original cost, you'll never have to worry about whether you're losing money because of the difference between markup and discount.



What are we missing?
No one would turn down a program that'll earn them money; it just doesn't make sense.

If there's something missing... something we don't provide... or something we forgot to tell you about... we want to know what it is. Even if we are the best — and we believe we are — we want to become better. And we need your input to get there. Drop us a line or give us a call, and let us know how we can make ATRA better... how we can make ATRA the association that you'd like to be a part of.

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