Do The **Math!**

Selling Low, Making It Up in Volume

By Jay Goltz

When you are doing large amounts of framing, pricing is an important factor in making money. Everyone has their own formulas, including cost projections and mark-ups. If you quote too high, you don't get the job. If you quote too low, you get the job but don't make any money on it. When the economy is bad, some companies start giving lower prices in an attempt to keep their people working.

The core fundamental of making money is to have your gross profit cover your fixed costs. The problem is, when business drops you can no longer be assured of any particular volume of business to cover the overhead. If you could instantly lower your overhead costs it would make it much easier, but they are called fixed costs. If you have made a nice living quoting and getting jobs with a 35 percent gross profit, should you consider dropping the margin to better compete in this more competitive if not desperate market? Let's do the math!

Prior Years

Gross sales	$1,000,000
Gross profit (@35%)	$350,000
Less overhead	$250,000
Net profit	$100,000

Current Year

Gross sales	$600,000
Gross profit (@35%)	$210,000
Less overhead	$250,000
Net loss	-$40,000

Adjusted Sales for Lower Profit Margin

Gross sales x 30% = $210,000 (current gross profit)

Gross sales = $700,000 (to match current gross profit)

Breakeven at Lower Profit Margin

Overhead divided by profit margin = Gross sales needed for breakeven

$250,000/.3 = $833,000

Let's say that your overhead costs (rent, fixed salaries, insurance, etc.) are running $250,000 per year. In the good old days, you were grossing about $1 million a year. At a 35 percent margin, you would be left with a $100,000 profit (35 percent x $1,000,000 – $250,000). Most companies' sales revenues have gone down over the last couple of years. Let's say that you have suffered a sales decline of 40 percent, bringing your sales down to $600,000. Using the same gross profit percentage, your profit formula will be 35 percent x $600,000 – $250,000. You now have a un-profit of $40,000. In addition, you have to lay off some of your production people. Not a pretty picture.

The ever-nagging question is whether you should lower your gross profit number when you bid things out. Let's say you decide that in this more competitive environment you need to lower your gross profit to 30 percent in order to win more bids. Will it help or hurt? I certainly cannot answer that question, but I can provide the breakeven.

The formula is $X x 30% = $210,000 (your existing gross profit). You would have to do $700,000 in business to break even on the decision. You would still be losing money at the same rate. You would have to increase sales to $833,000 to break even ($250,000/30%). There is also the possibility that you could lose more money if the price decrease does not result in enough more business.

This is not so simple. If your sales did go up to $700,000 and you made the same gross profit, it could be good or bad. It could be bad because you had to frame 26 percent more pictures to make the same money. It could be considered good because you could have kept more of your staff. There are other exposures like the “big mistake,” the “company that doesn't pay,” and the other bad stuff that can happen. All I can say is this: it is very easy to drop prices when things are bad. It can help, but it also is one of the ways that people put themselves out of business. We live in interesting times. I wish they would get a little less interesting! ■

Jay Goltz owns Artists' Frame Service in Chicago, IL, which employs over 50 people at its main framing operation. He has received many business honors and is known for his straight talk on succeeding in business.