Margins versus Markups (or Markdowns)

In today's business arena, it is key that one understands the difference between a markup and a margin. While similar and while they are both used in bidding, the differences are significant. They are also very powerful in acquiring work, analyzing bids, and in understanding the marketplace trends.

In its simplest definitive form, markups and margins are the difference between the total costs associated with a job and the actual selling price. How markups and margins are applied to a bid in construction can be confusing if one does not understand the proper place to use each of these in the bidding process. Tax rates, for example, are a markup. So to find out what a 6% tax rate for materials is a multiplication process.

Costs or materials x .06 (6% sales tax markup) = amount of sales tax dollars

$10 x 6% = 0.6 or 60 cents

Applying this to a final selling price of a job is calculated as follows. Let's assume that you want to achieve a 25% profit margin on all of your work. For simplicity let's use $1000.00 as the total of the costs.

$1000 x .25= $250.00 Adding the $250 to $1000 = $1250

If we were to check that mathematically by dividing the final price into the **markup** price, we should get 25%, right?

$250 divided by $1250 = 20%. OOOOPS! It is only 20% profit.

Using a **markup** calculation to achieve a true 25% profit does not compute mathematically. We are losing 5% of our profit on every job.

Using the same example but applying the mathematical formula for a **margin** is as follows:

$1000 divided by (1 - 0.25) or $1000 divided by 0.75 =$1333.

Is this a true 25% profit? By using the formula by dividing the final price into the margin amount we get 25%, right?

$333 divided by $1333 = 25% That is a true 25% profit.

If we subtract the markup price from the margin price in this example, it is a difference of $83.00 per bid on $1000.00. If the bid were for $40,000 we would leave $3320 on the table. If this same company had sales of $250,000 a year in sales, it would equate to $20,750 per year in lost revenue, or in 25 years it would equate to ***$518,750.00***. That is significant amount of revenue that is being lost because the bidder did not use the proper calculation formula.