BY PAUL WINANS

Making Sense of Markup

When I was selling remodeling services, "What's your markup?" was a question I'd periodically hear from potential clients. Here are some thoughts and suggestions about how to handle that question.

1. Be clear. To respond with confidence, you must be clear with yourself that you, your family, and your company are worth what you've decided to charge. If you aren't confident about this, you won't be taken seriously by prospects when talking about it.

2. Reverse the question. A contractor typically will answer any question a potential client asks. But by doing so, he may lose control of the sales interaction. When a prospect asks "What's your markup?" it's best to respond with a softening statement, "Several of our potential clients have asked me that question," followed by a reverse, "Why are you asking that question?"

You need to find out the question *behind* the question. After all, the client may be asking about markup simply because a friend said that's what he should ask. Your potential client might not actually care about your markup. You just need to walk him through the conversation so he feels he's asked all the expected questions.

3. Ask yourself: What step did I miss in the sales process? One of your goals in the early parts of a sales call is to learn about the client's emotional reasons for undertaking a remodel and all the associated hassles and distractions that are inherent in the process. If a prospect is asking about markup late in the sales interaction, it's likely that an earlier part of the sales process wasn't addressed as completely as it should have been.

If that's the case, work your way back. Ask about the problems the homeowner brought up earlier in the conversation, what he or she thinks about your understanding of them, and why that client believes you and your company are the right partners to help solve those problems.

4. Answer the question. After doing all of the above, here is some of what I would then say to the client:

"We don't expand or contract our business as opportunities present themselves. We do only a certain amount of business a year because we want to deliver a consistently good experience and product to the valued clients who choose to work with us.

"At the same time," I then would add, "we know our costs of being in business—what we have to spend even if we have no work going on. This is our overhead, which includes phones, rent, stationery, training, and so on.

"Additionally, we have expected return—otherwise known as profit—which we hope we will generate as a result of shouldering all the risk we take on by providing a fixed total price for our clients' jobs. Since a project's cost can accurately be known only after the project is completed, we need some security to cover the inaccuracies that are inevitable in any estimate. That expected return [profit] helps us with that and also allows us to continue to improve our systems and tools, all of which help make any project we do more likely to be successful."

I conclude with: "What do you think about what I've said so far?"

5. Offer a second response. However the client answers, respond with something like: "I've heard that from some clients. Why are you bringing it up?" Always probe before responding.

If the prospect is still interested in discussing markup, here's what I would say: "To cover our overhead—the costs of keeping our business open and improving—we charge 30% of the sales price. To provide for the possibility of an expected return, we charge 10% of the sales price."

Notice that I'm not telling him how much we're "marking up" the cost of goods sold. Instead, I'm telling him what portion of the sales price includes the overhead and profit, or in other words, the margin (which in the example I'm giving is 40%).

Now if the prospect says that's higher than what he's heard from other contractors, go back to asking what drew the homeowner to your company in the first place, and ask "To get those characteristics and qualities, do you feel it's worth paying the difference?" If he doesn't think so, wish him well and ask if you can check back in a month or two to see how the project is unfolding.

The main point I hope you take from what I've described here is that you *must* make money when running a business, and to do so, you can't let your potential clients tell you how much to make. After all, *you're* the expert on running the business, not them.

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Markup vs. Margin

It's not uncommon for people to use the terms "markup" and "margin" interchangeably, as if they mean the same thing. And, as dollar amounts, they do; but as percentages, they're very different—and that affects your business.

Imagine that you have estimated a project and have totaled all the costs including labor, materials, and subcontractors. That's everything inside the blue box in the diagram, below. Upon leaving the project, everything inside that blue box stays on the job.

If you plan to sell the job at a 50% markup, the correct method will add half the costs (50% x $1,000 = $500) to the estimated project costs ($1,000) in order for you to determine the total selling price ($1,500).

This constitutes a true 50% markup. Many people believe that's also a 50% margin. Here's why it's not:

Margin is a ratio over the selling price:
Margin = Markup / Selling Price
Markup is a ratio over the cost:
Markup = Margin / Cost

Start with the total selling price.
In our example, markup, which is a percentage of costs, is 50%.

If we have $1,000 in direct costs, our markup is set at $500—thus equaling a total selling price of $1,500.

That's paralleled on the margin side. But, whereas the $500 on the markup side is half of the cost, the $500 on the margin side is one-third of the total selling price. Therefore, a 50% markup is equivalent to a 33% margin.

How would you mark up your costs to get a 50% margin?
Starting once again with the total selling price ($1,500): If we expect to earn a 50% margin, we already know that costs will make up half the equation, and the other half is margin.

How much do we have to mark up these costs to get that 50% margin? If we take 100% of costs ($1,000) and add them on top of the total cost ($1,000) in order to determine a selling price ($2,000), that leaves a 50% margin. So, a 100% markup gives a 50% margin.

If you'd like to earn a 50% margin on your next project, you must double the direct cost amount to achieve it.

Adapted from the "Do the Math" video series at jlconline.com