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## METHODS TO INCREASE PROFIT MARGIN

## Evaluation of different methods

Method to increase profit margins	Examples	Evaluation
Increase gross and operating profit margin by reducing direct costs.	<ol style="list-style-type: none"> <li>Using <b>cheaper materials</b>, e.g. rubber not leather soles on shoes.</li> <li>Cut labour costs by <b>relocating production</b> to low-cost countries.</li> <li>Cut labour costs by <b>increasing productivity</b> through automation in production.</li> <li>Cut wage costs <b>by reducing workers' pay</b>.</li> </ol>	<ol style="list-style-type: none"> <li>Consumers' perception of quality may be damaged and this could hurt the product's reputation. Consumers may also expect lower prices, which may cut the gross profit margin.</li> <li>Quality may be at risk – communication problems with distant factories.</li> <li>Purchasing machinery will increase overhead costs (gross profit could rise but net profit could fall); remaining staff will need retraining – short-term profits may be cut due to these costs.</li> <li>Motivation levels might fall, which could reduce productivity and quality</li> </ol>
Increase gross and operating profit margin by increasing price.	<ol style="list-style-type: none"> <li>Raise the price of the product with no significant increase in variable costs (<b>low marginal cost, inelastic demand</b>).</li> <li>Petrol companies increase prices by more than the price of oil has risen.</li> </ol>	<ol style="list-style-type: none"> <li>Total profit could fall if too many <b>consumers switch to competitors</b>.</li> <li>Consumers may consider this to be 'profiteering' decision and the <b>long-term image of the business may be damaged</b>.</li> </ol>

<p><b>Increase net profit margin by</b> reducing overhead costs.</p>	<p>Cut overhead costs, such as rent, promotion costs or management costs, but maintain sales levels, for example by:</p> <ol style="list-style-type: none"><li>1. Moving to a cheaper head office location</li><li>2. Reducing promotion costs</li><li>3. Delaying the organisation</li></ol>	<ol style="list-style-type: none"><li>1. Lower rental costs could mean moving to a cheaper area, which could damage image (e.g. restaurant).</li><li>2. Cutting promotion costs could lead to sales falling by more than fixed costs.</li><li>3. Fewer managers, or lowering salaries, could reduce the efficient operation of the business.</li></ol>
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