

Q: We feel we have to get more price aggressive to drive up our sales volume. How large of a sales increase will be required to offset a price cut?

A: Probably a lot more than you think.

Exactly how much you have to increase sales depends upon a two primary factors: 1) your gross margin percentage before the price cut and 2) your pre-tax profit as a percent of sales. There are a few other factors that come in to play, but these two are by far the most important.

Given these two factors it is possible to estimate how much dollar sales will have to increase just to keep dollar profit where it currently is:

Original Gross Margin (%)	Size of the Price Reduction (%)					
	1.0	2.0	5.0	10.0	20.0	25.0
5.0	31.6 %	94.1 %				
10.0	12.8	29.8	145.2 %			
15.0	7.7	16.9	59.4	369.6 %		
20.0	5.3	11.4	35.7	125.0		
25.0	3.9	8.3	24.6	71.4	1,500.0 %	
30.0	3.0	6.3	18.1	48.0	269.2	3,500.0 %

As can be seen, firms with high gross margin percentages to begin with have a much greater chance of “making it up with volume” than do firms with low gross margins. Even for high-margin firms, though, the required sales increases should give pause.

It should also be pointed out that the sales increase figures are not linear across the chart. As the price cuts become deeper, the required increase in sales becomes increases exponentially.

It is also worth noting that all of the sales increases assume that the firm can generate the additional sales without increasing its overhead. The fact that this is extremely unlikely further dooms the chances of success with this strategy.

The exhibit only presents information for gross margin percentages in five percent increments and for a few selected reductions in price. Many firms may want results for unique situations not covered in the exhibit.

The Distribution Performance Project website provides an Excel template that allows firms to enter any original gross margin percentage and any price reduction to calculate the increase in sales required.

Go to the DPP website shown below. Select the **Programs** tab, then the **Hands-on Tools** header. At that point there will be a list of several Excel templates available. Select **Price Cutting Economics**. Like all DPP resources, there is no cost to download the template.

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