

SAFA Entrepreneurial Lesson

Danger of profit margins being too high or too low

Profit Margins being too high???

A lot of you will think that having profit margins too high should be a good thing, and you are absolutely correct. If you can ethically produce profit margins which are extremely high, you are doing amazing as an entrepreneur. The problem is when these profit margins are increased artificially by blindly increasing the price you sell for.

This causes a reduction in the demand for your product, and will cause customers to be unsatisfied with your brand.

Consequences of blindly increasing the price you sell for.

Demand will decrease and your customers will be unsatisfied. What does this mean?

It means that over a long period of time, your amount of orders will surely drop. Eventually this drop in orders because of the decrease in demand for your product will lead to your business being unprofitable.

It is important to avoid a steep markup for these reasons. Having very high profit margins is only good when the price you sell for is reasonable enough to maintain demand, and you were able to decrease the price you pay through negotiation.

How do your profit margins become too low?

Another thing that entrepreneurs need to worry about is having profit margins that are too low. This means that difference between the price you pay and the price you sell for, isn't large enough to cover the expenses of your company. This is often a result of unprofitable problems (think back to the previous lessons). This is because there is naturally little demand for your product, and you wouldn't be able to charge much without risking potential sales.

Activity Time

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In your entrepreneur journal, reflect on why trying to solve an unrealistic or non-existent problem with a product would cause you to have very low profit margins.

The best way to increase profit margins

The BEST way to increase profit margins without making sacrifices is to negotiate with the manufacturers. This is a crucial skill to have as an entrepreneur as it can make or break your company. By reducing the price you pay through negotiations, you can keep the demand high while also increasing profit margins. This win-win situation is why it is crucial to know how to negotiate, or have a representative of your company who knows how to negotiate.

Activity Time

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With a partner or group of three, start a role-playing game. Have one person pretend to be a manufacturer, and the other person be the buyer. Have the buyer try to negotiate with the manufacturer, and then switch roles after 2 minutes. As a manufacturer, it is important to realize that you also need to make money so you shouldn't just say yes to everything or no to everything the buyer proposes.