Contribution margin, not revenue: how to decide what to buy, price and sell

Contribution margin shows which products, customers and channels pay. How founders and CEOs use it to decide what to buy, price, discount and sell.

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In brief

Revenue tells you what sold. Contribution margin tells you what paid: what each sale leaves after product cost, freight, fees, returns, discounts and the marketing that won it. Founders and CEOs whose revenue grows while profit does not can measure it by product, customer and channel, then use it to decide what to buy, how to price and discount, and where marketing money goes.

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Revenue tells you what sold. Contribution margin tells you what paid: the money left from each sale after every cost that sale caused, from product cost and freight to payment fees, returns, discounts and the marketing that won it. Decide what to buy, price and sell on contribution margin by product, customer and channel, and the lines that quietly lose money stop hiding inside a growing top line.

This article is for founders, owners and CEOs whose revenue keeps rising while profit stays where it was.

01

Why revenue grows but profit does not

Most businesses plan growth around volume. Simon-Kucher's Global Pricing Study 2025, a survey of more than 2,200 business leaders across 28 countries and 39 industries, found that companies still expect sales volume to be their top profit driver over the next 24 months. The same State of Pricing 2025 report found that companies realize less than half of their price increases on average. The plan is to sell more, while most of each planned price rise never shows up on the invoice.

Volume hides three things:

- **Mix drift.** The fastest sellers often carry the most cost below the gross margin line: refurbishment, freight, returns and marketplace fees.
- **Discount creep.** A discount given to win one deal or one month becomes the price customers expect next time.
- **Spend that follows revenue.** A marketing budget set as a share of revenue rises with sales, whether or not the extra sales pay.

None of these show up in a revenue report. All of them show up in contribution margin.

02

What contribution margin is, in plain terms

Contribution margin is the selling price minus every variable cost the sale causes. The test is simple: if the cost would disappear when the sale did not happen, it belongs in the calculation. Rent, the finance team and the founder's salary do not. They are paid from the combined contribution of every sale, and what is left after them is profit.

Gross margin stops at product cost. Contribution margin keeps going. Two illustrative products, with made-up numbers, show why that matters:

- **A console that sells for $300.** Product and refurbishment cost $210, freight $18, marketplace and payment fees $36, returns $15 and the advertising that won the order $24. Gross margin looks healthy at 30%. Contribution is minus $3. The business pays to make the sale.
- **A cleaning kit that sells for $25.** Product cost $7, freight $3, fees $3, returns 50 cents and advertising $2. Gross margin is 72%. Contribution is $9.50, or 38% of the price.

A revenue report ranks the console first every time. Watch both the percentage and the dollars: what each sale pays toward overheads and profit.

03

How to measure contribution margin by product, customer and channel

Each cut of the same sales answers a different question and changes a different decision.

Cut	Costs to include beyond product cost	The question it answers	The decision it changes
Product	Refurbishment or finishing, packaging, breakage, that item's return rate	Which products earn their place?	What to buy, rebuy, bundle or drop
Customer	Discounts and rebates, payment terms, service time, returns behavior, special freight	Which customers pay for themselves?	Price lists, terms and minimum order sizes
Channel	Marketplace and payment fees, advertising, fulfillment method, the channel's return rate	Which channels add profit, not only revenue?	Where marketing money and stock go

Returns are the cost most often missing. The National Retail Federation and Happy Returns estimated in October 2025 that retailers expected 15.8% of annual sales to be returned that year, and 19.3% of online sales. Booked as one line for the whole business, returns make every product and channel look alike.

You do not need every cost to the cent on day one. Put the five or six biggest variable costs onto each order, label estimates as estimates and improve them every month.

04

How contribution margin changes what you buy

At a pre-owned electronics retailer, buyers chased fast sellers rather than margin. Consoles made up an estimated 80% of the revenue mix and carried refurbishment, labor, shipping and return costs that a sales report did not show. Stock shipped by sea took roughly 60 to 90 days to arrive, so current demand was a weak guide to what would sell when it landed.

Our team worked inside the procurement function and made contribution margin the primary buying input. Profitability thresholds now screen out products unlikely to meet gross margin targets, and warehouse validation comes before any repeat purchase.

Low-margin products are not rebought unless the price, sourcing cost or bundle changes, and the mix is moving over time toward higher-margin accessories. Contribution margin now drives buying at the retailer, not sales velocity.

The lesson travels: sales velocity misleads when margin, handling cost and return risk are left out of the decision.

05

How to price and discount on contribution margin

Price is the fastest lever on contribution, and the easiest to give away. Every point of discount comes straight out of contribution, because the costs of the sale do not fall when the price does. On a product with 20% contribution, a 10% discount halves what the sale pays toward overheads. For price rises, contribution by customer shows where a rise is overdue and where it would cost a customer worth keeping.

Discounting needs guardrails, written down before anyone needs them:

1. **A contribution floor.** No order, deal or promotion goes below an agreed contribution per order without approval.
2. **A named approver.** One person approves exceptions up to a stated limit, and the founder is not the default.
3. **An end date.** Every promotion has one, and it is enforced.
4. **A check afterwards.** Did the discount win new customers at positive contribution, or give margin to people who would have bought anyway?

There is often an alternative to a deeper markdown. A womenswear brand with cash trapped in stale inventory remade unstitched stock into a stitched collection priced near local tailoring and offered bespoke sizing free for a limited period. Most, if not all, of the aged stock cleared between roughly month six and month eleven.

06

How to judge marketing spend on contribution, not revenue

Marketing money is tight. Gartner's 2026 CMO Spend Survey of 401 marketing leaders found budgets effectively flat at 7.8% of company revenue. When the budget will not grow, the way to get more from it is to move it to where it earns contribution.

Revenue measures can hide a loss. A campaign with a return on ad spend of 4x spends 25 cents of every revenue dollar on advertising. On a product that contributes 20% before marketing, it loses five cents on every dollar it sells. Judge each channel on contribution after marketing, and on how long a new customer takes to pay back what it cost to win them.

At the womenswear brand, marketing ran at about 14% of revenue against a 7.5% net margin, mostly influencer and celebrity PR, with no conversion tracking. PR spend fell by about 80% and the money moved into measured paid acquisition and conversion work, with a performance agency paid a minimal retainer plus commission on sales. Conversion doubled from about 1% to about 2%. Over about twelve months the brand grew profit about 2.4x by moving spend it could not measure, and net margin rose from about 7.5% to about 9.5%.

07

How to make contribution margin the rule your team runs on

Knowing the number is not the same as running on it. It becomes the rule when it shapes weekly decisions without the founder in the room.

1. **Agree the definition once.** Write down which costs count, how estimates are made and who owns the number.
2. **Put cost on the order.** Record freight, fees, returns and handling against each order, then roll up to product, customer and channel.
3. **Set thresholds.** A buying threshold, a discount floor and a payback limit for each marketing channel.
4. **Give each threshold an owner.** Clear decision rights with written thresholds keep these calls off the founder's desk.
5. **Pay on contribution.** If commissions and buyer targets reward revenue, people will chase revenue.
6. **Review on a fixed rhythm.** Weekly by channel, monthly by product and customer.

A natural stone manufacturer shows what this looks like over several years. Its owners could not tell what an order cost, so quotes went out without knowing whether the work would pay. Within six months a new system could estimate order cost from the business's own production history, so every quotation could be tested for profit before it was issued. The mandate was to hold EBITDA margin flat while growing. Instead the business grew EBITDA margin by about 10 points, from between 15 and 20% to

between 25 and 30%, while revenue grew 2 to 2.8x in local currency between 2022 and 2025. The case estimates that pricing and order selection discipline contributed 2 to 3 of those points.

A margin goal can beat a revenue goal within one year. A pre-owned electronics retailer with its first loss-making months in 2024 finished the year at about $9M in revenue, short of its $10M target, but moved from losses to about 10% net margin by year end. That is the result a business can build on.

08

Where AI helps with margin decisions, and where it does not yet

AI helps here, but only on cost data the business trusts. Where it helps:

- **SKU and channel margin analysis.** Once costs sit on each order, AI tools can scan thousands of product and channel combinations and flag where contribution is slipping.
- **Demand signals.** Search trends, ad performance, sell-through and return reasons can be read faster and more often. The womenswear brand did this by hand, reading demand from ad performance before scaling designs.
- **Price testing with guardrails.** AI can propose price changes and run controlled tests, as long as people set the floor, the maximum change and the approver, and the system enforces them.

McKinsey's April 2026 article on B2B pricing and the next phase of AI, based on a November 2025 survey of 419 pricing executives, found that 65 to 85 percent of organizations expect to adopt gen AI or agentic AI in pricing within one to three years, up from 10 to 30 percent today. More than half named data quality and availability, and integration complexity, as the most common barriers to agentic AI in pricing.

The honest not yet is cost per order. If freight, fees, returns and handling are not recorded against each order, a model can only optimize gross margin, and it will push products that look profitable and are not. The fix is the costing work first, not a better model. Until cost per order is reliable, keep AI on analysis and demand signals and keep price decisions with a named person. Our AI and intelligent automation work follows that order: data the business trusts, then the tool.

09

What we say no to on growth, pricing and discounts

- **No growth target that ignores margin.** We do not agree outcomes measured on revenue alone. A revenue goal without a contribution floor rewards the products, customers and channels that lose money.
- **No discount without a guardrail.** We advise against blanket promotions to hit a month's number, and against any discount with no floor, no approver and no end date.
- **No AI pricing before cost per order.** We will not hand pricing to an algorithm, ours or a vendor's, until the business can say what an order costs.

Armstrat is a Business Transformation Office (BTO™) that embeds forward-deployed engineers (FDEs) inside a client's business and focuses solely on delivering outcomes. In growth, marketing and sales, that means agreeing the outcomes and measures before work starts, then building the costing, thresholds and reviews with your people and staying until they hold. Most engagements begin with a diagnostic of two to four weeks. A base fee covers delivery, and a contingency is paid on results. How results are measured is answered, with sources, on Ask Armstrat.

10

Frequently asked questions

What is contribution margin in simple terms?

Contribution margin is what a sale leaves after every cost the sale itself causes: product cost, freight, payment and marketplace fees, returns, discounts and the marketing that won the order. It pays toward fixed costs such as rent and salaries, then profit. If a cost would disappear when the sale did not happen, it belongs in contribution margin.

How is contribution margin different from gross margin?

Gross margin subtracts only the cost of the product. Contribution margin also subtracts the variable costs of selling and delivering it, such as freight, fees, returns, discounts and acquisition cost. A product can show a healthy gross margin and still lose money on every order once those costs are counted.

How do you calculate contribution margin by channel?

Take the revenue from one channel and subtract the product cost of what it sold, plus the costs that belong to that channel: marketplace or payment fees, advertising, fulfillment and the channel's own returns. Divide the result by the channel's revenue to get a percentage. Compare channels on both, and label any cost you can only estimate.

How do I stop discounts from eating my margin?

Write the guardrails down before anyone needs them. Set a contribution floor that no order or promotion can go below without approval, name one person who can approve exceptions up to a limit, give every promotion an end date, and check afterwards whether it brought new customers or simply gave margin away. On a product with 20% contribution, a 10% discount halves what the sale contributes.

Should sales teams be paid on revenue or contribution margin?

Tie at least part of the incentive to contribution margin. People chase what they are paid for, and a commission on revenue rewards the deepest discount and the costliest customer as much as the best sale. Paying on contribution, or on revenue above a contribution floor, keeps the team selling what pays.

Can AI set our prices for us?

Not on its own, and not without guardrails. AI can analyze margin by product and channel, read demand signals and run price tests within limits people set. It cannot price well without reliable cost per order, because it will optimize gross margin and push products that only look profitable. McKinsey's 2026 pricing research found data quality and availability among the most common barriers.

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Hashir is Armstrat's managing partner. He runs senior client relationships, sets the firm's positioning and methodology, and decides which engagements Armstrat takes on, and which it turns down. Before founding Armstrat, he led restructuring across retail and supply chain businesses, owning the ERP, the cost structure and the operating cadence that runs across them.

About Armstrat

Armstrat is a Business Transformation Office (BTO™). A partner leads every engagement, and forward-deployed engineers (FDEs) work inside your business across five capabilities: business transformation; operations and supply chain; people and organization; growth, marketing and sales; and AI and intelligent automation.

Engagements are a base fee plus a contingency paid on results, not on documents. We use AI only where it earns its place, and we say not yet when a business is not ready for it.

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