

SIGNAL JOURNAL · DECISION SYSTEMS™

System 02 of 10

Gross Margin Risk Scorecard™

Margin does not evaporate.

It is surrendered — one untracked line at a time.

Signal › Decision › Action › P&L Impact

◆ IN 60 SECONDS, THIS SYSTEM TELLS YOU ◆

1. Which revenue line is actively destroying blended margin — named, scored, and ranked
2. The exact dollar amount of gross profit lost annually if the current trend continues 12 months
3. Where COGS is drifting above revenue growth — and which supplier is responsible
4. Which 3 margin signals require a decision within 30 days

01 · POSITIONING

Gross margin is the only metric that directly measures whether a business deserves to exist at its current price and cost structure. It is not an accounting output — it is a strategic verdict. When margin compresses, the business is either under-pricing, over-paying, or selling the wrong mix. All three are decisions. All three are reversible — if caught before they compound.

If gross margin is declining and no one has been assigned to stop it, the business is funding its own deterioration.

EXECUTION SIGNAL DEFINITION

Declining gross margin is the earliest measurable signal of execution failure.

It reflects one of three breakdowns: pricing discipline, cost control, or product mix.

When margin declines across consecutive periods, the signal shifts from variance to structural drift — requiring intervention, not observation.

02 · WHAT HAPPENS IF YOU IGNORE THIS

Each of the following is already in motion. None of them appear on a current financial statement.

- ⚠ **Margin erosion compounds silently — a 1-point decline in gross margin per quarter becomes a 4-point structural loss within 12 months. By the time it surfaces on an annual review, \$40,000 per \$1M revenue is already permanently gone.**
- ⚠ **The wrong revenue lines get the most investment — without product-level margin visibility, marketing and sales effort defaults to the highest-volume lines, which are frequently the lowest-margin lines. Growth accelerates the destruction.**
- ⚠ **COGS leverage shifts to suppliers — businesses that don't track supplier invoice trends lose early-payment discounts worth up to 36.7% in annualized savings and forfeit the negotiating position that proactive audits create.**
- ⚠ **Pricing decisions are made blind — every discount approved, every quote issued, and every contract signed without current margin data is statistically likely to reduce blended margin, not protect it.**

⚠ **Recovery becomes structural surgery — a 1-point margin decline caught in month 3 requires a pricing adjustment. The same decline caught in month 18 requires a full COGS restructure, a supplier replacement, and a product mix overhaul. The cost multiplies with every reporting cycle it goes undetected.**

03 · WHAT THIS SYSTEM DOES

SYSTEM LOGIC

Product Line → Margin % → Score → Trigger → Decision → P&L Recovery

If gross margin is not tracked at the line level monthly, margin destruction is already underway. This system does not report blended margin — it exposes which specific lines, costs, and pricing decisions are compressing it, forces a verdict on each, and assigns a financial consequence to inaction.

Cost of inaction: A 3-point gross margin decline on \$2M revenue = \$60,000 in permanent annual profit loss. A 5-point decline = \$100,000. Margin does not recover on its own — and every period without a line-level diagnosis extends the loss.

04 · FINANCIAL CONSEQUENCE MATRIX

Studies across mid-market firms show that sustained margin compression of 3–5 percentage points correlates with a 20–40% decline in operating cash flow within 12–18 months.

P&L Impact: Each 1% decline in blended gross margin on \$1M revenue = \$10,000 in annual profit loss — before a single overhead dollar is counted

Cash Flow Impact: Low-margin revenue lines consume working capital at the same rate as high-margin lines — selling the wrong mix destroys cash efficiency without reducing revenue

Cost of Inaction: Businesses with no product-level margin tracking leave 8–15% of recoverable gross profit unrealized annually — a systematic, preventable transfer of value from owner to market

05 · REQUIRED INPUTS

Metric / Input	Source	Purpose in System
Gross profit % by product/service line	Income statement detail	Exposes which lines build and which lines destroy margin
COGS % trend (3-year, common-size)	P&L spreadsheet	Detects COGS creep before it compounds into structural loss
Pricing history per category	Sales records or invoices	Quantifies pricing discipline vs. discounting behavior over time
Volume sold per line vs. prior year	Sales data	Signals mix shift toward lower-margin lines — the most common silent margin killer

Metric / Input	Source	Purpose in System
Top 3 supplier invoice trends	AP records / vendor statements	Isolates COGS pressure from supply side; establishes renegotiation baseline
Blended gross margin vs. industry benchmark	Industry data / comparable P&Ls	Forces the question: is this margin competitive or structurally weak?

06 · SCORING MODEL — Margin Risk Score (0–100)

Five dimensions, each scored 0–20. Total = Margin Risk Score. Any dimension scoring ≤8 triggers an immediate margin decision obligation. Score is recalculated monthly.

The score is not diagnostic — it is a decision trigger. Any score below 60 indicates margin is already being lost, not at risk.

- Dimension 1:** Margin Stability (year-over-year) | **Dimension 2:** Pricing Power (avg. price vs. prior year)
- Dimension 3:** COGS Control (% movement vs. revenue growth) | **Dimension 4:** Product Mix Quality (% revenue from lines >35% margin)
- Dimension 5:** Revenue Concentration Risk (reliance on single line)

Score	Condition	Risk Level	Cost of Inaction
80–100	Margin stable or expanding; pricing controlled; COGS managed	LOW RISK	Optimize mix; reinvest high-margin gains
60–79	1–2 lines under pressure; early COGS drift visible	MODERATE	\$20K–\$80K annual margin at risk if unaddressed
40–59	Visible compression; COGS trending above revenue growth	HIGH RISK	Repricing action required within 30 days or losses compound
0–39	Structural margin collapse; possible negative contribution margins	CRITICAL	\$100K+ annual gross profit at risk — immediate intervention required

07 · WHAT THIS SYSTEM DELIVERS

Converts margin from a lagging metric into a controlled operating variable

- ▶ **Exposes:** the top 3 revenue lines actively destroying blended margin — named, scored, and ranked by annual dollar damage
- ▶ **Quantifies:** gross profit at risk (\$) if the current margin trend continues for 12 months without intervention
- ▶ **Isolates:** the single COGS driver responsible for the largest margin compression — the supplier, category, or cost line to target first

- ▶ **Forces:** a decision on every line scoring in the Critical Zone — reprice, restructure COGS, or eliminate — within a defined deadline
- ▶ **Tracks:** the pricing gap: the exact price increase required on each underperforming line to restore margin to the target threshold

08 · DECISION TRIGGERS

Every trigger is binary: either the condition exists and the action is mandatory, or it does not exist and monitoring continues. There is no middle state.

1. **IF:** Any product or service line gross margin falls below 30%
 - **THEN:** Model three options within 7 days: reprice to restore margin to a minimum of 35%, restructure COGS on that line by renegotiating with the primary supplier within 21 days, or eliminate the line and reallocate its working capital to the highest-margin line. A decision with a named owner is required within 21 days. No extension.
2. **IF:** Blended COGS % increases more than 3 percentage points in one year
 - **THEN:** Initiate a full supplier pricing audit within 7 days. Obtain competing quotes from a minimum of 3 vendors within 21 days. Renegotiate or replace the primary cost-driver supplier within 45 days. Do not absorb the increase — every unaddressed COGS point on \$1M revenue costs \$10,000 annually in permanent margin loss.
3. **IF:** The highest-revenue line carries the lowest gross margin
 - **THEN:** Reallocate a minimum of 20% of marketing and sales investment from the low-margin line to the highest-margin line within 30 days. Revenue built on low-margin lines compounds the problem: more volume delivered at lower profit per unit destroys cash efficiency while creating the illusion of growth.
4. **IF:** Gross margin has declined in 3 or more consecutive reporting periods
 - **THEN:** This is structural drift, not variance. Commission a full pricing and COGS audit within 14 days. Deliver a written margin recovery plan to the owner within 30 days. A 2–4 point margin restoration is achievable within 90 days when root causes are addressed — but the plan must be in writing, with named owners and measurable milestones.
5. **IF:** No product-level gross margin data exists for any revenue line
 - **THEN:** Build a line-by-line gross margin tracker within 14 days. Every pricing decision, every promotional discount, and every product investment made without this data defaults statistically toward lower-margin outcomes. This is not a reporting gap — it is a decision-quality failure with a measurable cost.

⚠ ESCALATION LOGIC

Triggers Active	Status	Required Response
2 triggers	INTERVENTION	Owner review required within 48 hours. Concurrent activation signals structural margin pressure — not isolated line variance.
3 triggers	INSTABILITY	Margin instability event. Engage pricing and cost advisor within 7 days. Commission full COGS and pricing audit. Suspend all promotional discounting immediately.

Triggers Active	Status	Required Response
4–5 triggers	CRISIS PROTOCOL	Structural margin collapse in progress. Engage external financial support within 72 hours. No new product launches or revenue growth investment until blended margin is restored above 35%.

09 · ACTION TABLE

Issue Detected	Required Action	Owner	Deadline	P&L / Cash Impact
Line gross margin below 30%	Model reprice / restructure / eliminate; named owner; decide in 21 days	Owner + Finance	21 days	Recover \$X gross profit per line annually
COGS % rising above revenue growth	Supplier audit; competing quotes from 3 vendors; renegotiate within 45 days	Operations	45 days	2–5% COGS compression; \$20K–\$50K annual savings
High-revenue, low-margin line	Shift 20%+ of marketing spend to highest-margin line	Marketing	30 days	Revenue mix rebalancing; margin recovery
No product-level P&L	Build line-by-line gross margin tracker; update monthly	Accountant	14 days	Decision quality on every future pricing call
Margin declining 3+ periods	Full pricing and COGS audit; written recovery plan with milestones	Owner	30 days	2–4 point margin restoration within 90 days

10 · IRREVERSIBLE INSIGHT

If COGS rises faster than revenue, margin decline is not a risk — it is a schedule. The only variable is how long before the owner notices.

11 · BUSINESS IMPACT

The Gross Margin Risk Scorecard™ answers the question every owner should ask every month but rarely does: are we getting richer or poorer for every dollar we sell? Without line-level margin visibility, a business grows revenue while destroying profit — and the income statement conceals the loss until the bank account exposes it.

On a \$2M revenue business: a 5-point blended margin decline that goes undetected for 18 months represents \$150,000 in permanent, unrecoverable profit loss — enough to fund a complete product line, a senior hire, or 18 months of growth investment. It was funded instead by inattention.

Track the margin. Name the lines. Force the decisions. Every month without this system is a month the business is paying for information it doesn't have.

Gross margin is not a result of the business — it is the result of decisions made inside the business. This system forces those decisions before the P&L records their consequences.