

Gross and Net profit

Judging the success of a business

- * During the last year, two businesses have made the following amounts of profits
- * Business A £250,000
- * Business B £150,000

- * Which is more successful?

Judging business success

- * Business A has more profit so it would seem it is more successful but
- * Business A may be 3 times the size of B – if we take the size of the business and its sales revenue into account then Business B may generate more profit per pound.
- * It is important to not just look at profit figures alone but consider other factors such as sales revenue.
- * Ratios/Margins allows us to do this.

Gross Profit Margin

* Gross Profit Margin =

$$\frac{\text{GROSS PROFIT}}{\text{SALES REVENUE}} \times 100$$

- * It is a % figure
- * It shows the business for every £ of Sales Revenue how much is Gross Profit.
- * For example a GP Margin of 25% means that for every £ of sales revenue 25p is gross profit.

Gross Profit Margin

- * Is 25% a good figure??
- * It needs to be compared with other factors to judge this

Gross Profit Margin – good or bad

- * The business's target for GP
- * GP Margin in earlier years
- * The gross profit of similar businesses

To improve GP margin

- * Increase Selling Price
- * Decrease costs of sales

Net Profit Margin

- * Net Profit Margin

$$\frac{\text{NET PROFIT}}{\text{SALES REVENUE}} \times 100$$

- * This shows for every £ of Sales Revenue what amount is profit.
- * Again comparisons to earlier years, targets and competitors will help to judge whether it is a good figure.

How can net profit be improved?

- * Increase selling price
- * Decrease cost of sales
- * Decrease overheads/expenses

Activity 1

Detailed below is a simplified profit and loss account for the 6 months ending 27/7/08 for JJB Sports.

Sales Revenue	£344.7m
Cost of Sales	£166.49m
Gross Profit	£
Overheads	£177.21m
Net Profit	£

- 1) Complete the P&L account.
- 2) Calculate JJB's Gross profit margin and net profit margin.
- 3) In the 6 months to August 2008, its closest competitor increased sales to £300m and net profit by 54% to £12.4M. Which company performed more successfully? Fully explain your answer.

Activity 2

These are the profit and loss figures for Acme Builders Ltd for 2008.

Sales revenue	£115,000
Cost of goods sold	£ 90,000
Overheads including rent and interest	£ 15,000

- 1) Calculate gross and net profit.
- 2) Calculate gross and net profit margins.
- 3) In 2008 Redgate Builders Ltd's gross profit margin was 20% and its net profit margin was 10%. Compare the profitability of this company with Acme Builders Ltd.
- 4) Suggest three ways in which Acme Builders Ltd could increase its profitability.