

A Level Business

Profitability

revenue

direct costs

operating profit

profit margin

gross profit

indirect costs

end of year profit



A-Level Business: Profitability

Profitability

Measure of financial performance – compares profit to other financial factors or revenue

Profit margin

Ratio showing business's profit as a percentage of sales revenue

Analysing profits

A profit of £10 million for company A compared to £5 million for company B might suggest that company A is more successful, but this might not be true if company A is more making a loss. TWO factors are to be considered:

1. What was the total of sales needed to achieve that profit?

How much investment did it take to achieve that profit?

Profit margin

Profit margin allows comparison of a business's profit to its sales revenue
$$\text{Profit margin} = \frac{\text{profit}}{\text{revenue}} \times 100$$

Note: Not all businesses have aims to be as profitable as possible



A Level Business: Profitability



Which business is the better performing company based on profit?



Cycle Company

Profits:
£13.2 million

Revenue:
£96.6 million

Profit margin:
13.66%



Clothing Company

Profits:
£13.3 million

Revenue:
£242 million

Profit margin:
5.4%

Profit margin = profit/revenue x 100

Which business is the better performing company based on profit margin?

£

€

\$

Examples

PREVIEW

A Level Business: Profitability

Gross profit margin

Includes: Revenue minus direct costs (costs of sale)
Useful: crude overview can compare previous years

BUT: Not includes all the costs of the business (indirect costs e.g. interest payments)
A negative gross profit - a loss = negative profit margin

Formula: $\text{Gross profit margin} = \frac{\text{gross profit}}{\text{sales revenue}} \times 100$



Operating profit margin

Includes: Revenue minus direct and indirect costs
Useful: assess and compare performance in relation to sales revenue
A negative operating profit margin = loss = negative profit margin

Formula: $\text{Operating profit margin} = \frac{\text{operating profit}}{\text{sales revenue}} \times 100$



Profit for the year

Includes: Revenue minus direct and indirect costs + taxation, interest payments (loans) etc
Useful: assess and compare performance in relation to all costs

BUT: some costs may be one-off costs for that particular year

Formula: $\text{Profit for the year} = \frac{\text{profit for the year}}{\text{revenue}} \times 100$



A Level Business: Profitability

Types of profit margins

Gross
profit margin

Advantages



Disadvantages



Operating
profit margin



Profit
for the year



PREVIEW

A Level Business: Profitability

Calculating profit margins

	December 29, 2018
Net sales:	
Products	\$ 73,435
Services	10,875
Total net sales ⁽¹⁾	84,310
Cost of sales:	
Products	48,238
Services	4,041
Total cost of sales	52,279
Gross margin	32,031
Operating expenses:	
Research and development	3,500
Selling, general and administrative	4,783
Total operating expenses	8,685
Operating income	23,346
Other income/(expense), net	590
Income before provision for income taxes	23,906
Provision for income taxes	3,941
Net income	19,965



1. Calculate the gross, operating and net profit margins for Apple in 2018

£
€
\$

A Level Business: Profitability

Calculating profit margins

Jewellery Company

Revenue	\$5,000
Cost of Goods Sold	\$800
Gross Profit	\$4,200
Operating Expenses	\$500
Operating Profit	\$3,700
Interest Expense	\$185
Earnings Before Taxes	\$3,515
Tax Expense	\$1,750
Net Income	\$1,765

Grocery Store Company

Revenue	\$40,000
Cost of Goods Sold	\$2,000
Gross Profit	\$38,000
Operating Expenses	\$4,000
Operating Profit	\$34,000
Interest Expense	\$200
Earnings Before Taxes	\$33,800
Tax Expense	\$1,900
Net Income	\$31,900

1. Calculate the gross, operating and net profit margins for both companies



2. Give three possible reasons why the jewellery company has a higher net profit than the grocery store company

£

€

\$