Profitability

- Gross Profit Margin

  Gross profit / Sales x 100

  Shows gross profit as a percentage of sales. This is the profit made from buying and selling before paying expenses

  - 40% Gross profit percentage tells the manager that 40% of the money received from customers is profit, but the business still must deduct expenses
    - A decreasing ratio means that selling price is falling or cost of making/buying is increasing

      Can be corrected by increasing the selling price or buying from a cheaper supplier

- Shows how successful management was in making profit for the business

  100,000 profit for a company with two employees

  100,000 profit for a company with 300 employees

- Net Profit

  Net Profit / Sales x 100

  Net profit as a percentage of sales
  Profit made after payment of expenses

  - 40% net profit percentage tells the manager that 40% of the money received from customers is profit to keep
    - A decreasing ratio suggests that expenses are increasing
      Can be corrected by cutting overtime or other business expenses

- Return on Capital Employed

  Net Profit / capital employed x 100

  %

  Shows return on total amount of money invested in the business

  - E.g., ROCE = 10 %. For every 1 invested in the business , the business made 10 back
  - Capital employed = ordinary share capital + retained earnings + long- term loans + preference shares (if any)
  - Importance

    A decreasing ratio means that mangers are not as good at turning business resources into profit

    Increasing net profit or reducing capital employed or hiring more efficient managers

    Should be compared with return from risk-free investments from financial institutions.