Profit & Loss Statement (P&L)

Below is P&L statement for an organisation (all figures are in £ sterling)

Twelve Months Ended December 31, 2020	
Sales and revenues:	
Sales	52,694
Rental Income	2,962
Total sales and revenues	55,656
Operating costs:	
Cost of goods sold	40,727
Selling, general (e.g. advertising) & administrative expenses	5,547
Research reports for marketing plan	2,773
Other operating expenses	981
Total operating costs	50,028
Operating (Gross) profit	5,628
Interest	500
Consolidated profit before taxes	5,128
Provision (benefit) for income taxes	1,319
Profit	3,809

It is possible to calculate things from a P&L statement:

1) **Gross Profit Margin** = (Gross Profit/sales) x 100

    5,628/(55,656) x 100 = 10.11%

How is Gross Profit Margin Useful?

A wildly fluctuating Gross Profit Margin might be a sign of poor management practices and/or inferior products. However, fluctuations may be justified when an organisation has to make major operational changes, and this results in a temporary period of volatility.

For example, an organisation introducing robotics into its activities may add significant initial investment costs but in the longer term the cost of making products will decrease due to lower wage and salary costs as well as reworking faulty products.

Changing unity product prices may also affect gross profit margins. If all else remains equal, the increasing unit prices will result in higher gross margin. But if the unit price is too high there may be fewer customers who are willing to buy the product, and competitors may take more of the market share.

The Gross Profit Margin enables comparisons to be made with similar organisations around cost of goods produced and product prices.

2) **Net Profit Margin** =

$$\frac{\text{Total Revenue} - \text{Cost of Goods Sold} - \text{Other Expenses (fixed costs)} - \text{Interest} - \text{Taxes}}{\text{Total Revenue}} \times 100 =$$

$$\frac{55{,}656 - 40727 - 9301 - 500 - 1319}{55656} \times 100 = 6.84\%$$

How is Net Profit Margin Useful?

Net profit margin is a key indicator of an organisation's financial wellbeing. Because net profit margin is expressed as a percentage, it is possible to compare the profitability of two or more businesses regardless of size. By tracking increases and decreases in net profit margin, you can assess whether current practices are working, and forecast profits based on revenues.

Growing sales revenue may appear to be a good thing but if the cost of making goods (operating costs) is increasing at faster rates than sales revenue then the net profit margin will shrink.

A Step-by-Step way to develop the Profit and Loss Projection is shown below:

1. Define your expected sales figure for each year. Your expected sales figure should be based on the business that you believe you will do throughout each year (informed by your market research, your marketing plans, and your business goals). It will be helpful to look at this on a month-by-month basis in order to build up to the total per year.
   Basically, this is **total units sold (or expected to be sold) x price of each unit**
2. Next define the costs associated with making and selling your product, or delivering your service. These are called 'variable costs' as they are dependent upon output levels e.g. materials, labour, credit card fees, utilities for the production site, shipping etc. These costs often fluctuate(vary) and so should be looked at on a monthly basis to build up to the annual figure.
   Basically, this is **total units made x cost of each unit to make**
3. Gross profit is then calculated as sales (or expected) - costs associate with making and selling your product, or delivering your service
4. Gross profit margin is a percentage and is calculated as gross profit divided by expected sales x 100
5. Net profit is the profit made by a company after ALL explicit costs have been deducted. Net profit = gross profit - fixed costs

Fixed costs are the costs that must be paid regardless of the level of output of the company. Examples of fixed costs are rent, insurance, salaries of employees who are not directly involved in the production of goods, office supplies etc.

6. Net profit margin is a percentage and calculated as net profit divided by expected sales x 100.
7. You need to identify your break-even point. This is the point where your annual expected sales equal the sum of ALL explicit costs. Break-even is key as it reminds you to focus on two key components of your business. First delivering your sales targets to ensure income is achieved or exceeded and second, the management of your costs so you do not overspend. The aim of the game is of course to move past the break-even point and start to make meaningful profit. To do this you will want to maximise your sales and minimise your costs.

Need help?

You can contact at us and arrange a call at: sedg@tsdg.co.uk