Erasmus+

Creativity + Innovation & Technology

LESSON CONTENT TEMPLATE

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1. Lesson Document

Topic 6: Financial Ratios
Lesson 1

Profitability

Introduction

Making a profit is very important for small and large companies. In fact for everyone who does business, regardless of area. Whether a company will receive financing from a bank or not, as well as whether it will attract investors who are willing to invest in its business, is affected by profitability. The logic is very simple. If a company does not make a profit, it cannot stay, but it also cannot survive in the market.

The business owner needs to understand the importance of profitability in business management and to develop strategies that can give the company the best chance to make a profit and survive in the desired market. In this lesson, we will learn more about profitability and the formulas we can use.

Resource: Pixabay

Profitability indicators are used to assess a company's ability to generate earnings over time in relation to revenue, operating expenses, balance sheet assets, or share capital, using data from a specific time period.

Gros margin percentage - It measures the profit margin that the company makes by selling. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008)

Gros margin = (Sales - COGS)/Sales Where COGS is Cost Of Goods Sold.

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Return on equity - It measures the return on invested capital. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008)

Return on equity = Net income/Stockholders equity

Net operating income return - It measures business income regardless of company funding and taxes. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008)

Net operating income return = [Sales - expenses (excluding interest)]/Sales

Net profit margin - It measures the net profit margin that a company achieves through sales. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008)

Net profit margin = Net profit/Sales

Conclusions

Profitability is a relative measure of profit. It compares how much profit a company makes compared to total revenue and expenses. In this way, it allows you to have a more complete insight into how well the company is doing.

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