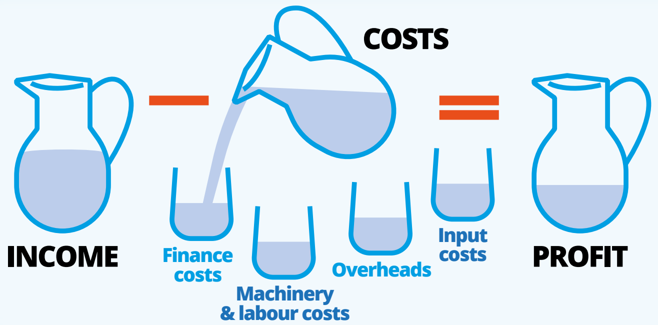
GCSE Business
Finance

Profit and Loss

Profit

Definition: The difference between the total revenue of a business and the total costs of a business, when revenue is greater than cost. It is important in being precise in using this term: stating “money made” can be confusing.



Ways to Increase Profit

- Decrease price
  - ☑ increase market competitiveness
  - ☒ looks like poor quality ➔ no increase in sales means lower profits.
- Increase the price charged
  - ☑ will increase the revenue that is made per sale/ customer
  - ☒ but may lose customers if they don’t want to pay the higher price.
- Reduce costs / example of cost reduction
  - ☑ this will ensure that the business makes more profit per customer
  - ☒ but the quality of the service may fall resulting in a loss of customers and less revenue.
- Increasing marketing
  - ☑ may attract more customers / increase sales revenue
  - ☒ but it will increase costs.

Profit and Loss Accounts

Definition: A financial statement showing a business’ sales revenue and costs and thus its profit or loss over a period of time. Profit and loss accounts are also called income statements.

	Sales Revenue
(minus)	Cost of Goods Sold
(equals)	Gross Profit
(minus)	Expenses
(equals)	Net Profit

Gross Profit: The profit made before expenses have been paid.

Calculation: Total Revenue – Costs of Goods Sold

Gross Profit Margin: The gross profit expressed as a percentage of sales. It is calculated using the formula:

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

Net Profit: The final profit made by a business after all costs have been paid.

Calculation: Gross Profit - Expenses

Net Profit Margin: The net profit expressed as a percentage of sales. It is calculated using the formula

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}} \times 100$$

Reasons for changes in the Gross or Net Profit Margin:

- Sales Revenue has increased or decreased
- Costs of Goods Sold have increased or decreased
- Expenses have increased or decreased.

Financial Performance

Stakeholders Interested in Business Accounts

- **Directors** ➔ security of position ➔ to measure whether past planning has been a success ➔ and to aid decision-making for future
- **Worker** ➔ to see whether the business is successful ➔ which will impact on job security ➔ also could business afford wage increase
- **Managers** ➔ to see whether the business is successful ➔ which will impact on job security ➔ also could business afford salary increase ➔ do they qualify for bonus? ➔ has their management been effective?
- **Shareholder/investors** ➔ to see whether the business is successful ➔ which may effect value of shares ➔ influencing shareholder wealth ➔ and level of dividend ➔ which adds to shareholder income ➔ decisions on keeping, buying or selling
- **Customer** ➔ may want to know about survival of business ➔ which will decide whether it is worthwhile being a customer ➔ or should contracts be negotiated elsewhere? ➔ also might high profits suggest business charging high prices?
- **Supplier** ➔ also may want to know about survival of business ➔ to find out whether the business is likely to be able to pay its trade credit
- **Bank** ➔ may also want to know about survival of business ➔ to find out whether the business is likely to be able to pay its loans/ overdraft
- **Government** ➔ as customers ➔ to find how much tax will be collected from the business ➔ does it consider profit to be excessive? ➔ should more tax be levied?
- **Competitor** ➔ to make comparisons ➔ to aid planning/competitive strategies.