Profitability Ratios

Gross Profit Margin (GPM)
- Performance of a firm in terms of profit generating ability
- To see if business can cover the expenses

\[ GPM = \frac{\text{gross profit}}{\text{sales revenue}} \times 100 \]

To improve:
- Increase price of product → customers unhappy
- Cheaper supplies → not to compromise quality
- Aggressive promotional strategies → very expensive
- Reduce labour → not to decrease morale

Net Profit Margin (NPM)
- Profit after deducting all the costs from sales revenue
- To see if business can control the costs

\[ NPM = \frac{\text{net profit before i+t}}{\text{sales revenue}} \]

To improve:
- Almost unless indirect cost → managers may be demoralized
- Negotiate enough rent/raw materials → affect customer image.

Efficiency Ratios

Return on Capital Employed (ROCE)
- How well a firm internally utilizes assets + liabilities (performance of firm)
- Efficiency + profitability of a firm's invested capital, incentive to inject money

\[ \text{ROCE} = \frac{\text{net profit before i+t}}{\text{capital employed}} \times 100 \]

To improve:
- Reduce loan capital → used to purchase fixed assets (machinery)
- Pay additional dividends → reduce retained profit → increase ROCE
- Reducing retained profit means less money for investments