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

$$NPM = \frac{\text{Net profit before i + t}}{\text{sales revenue}} \times 100$$

To improve :
- Avoid useless indirect costs → managers may be demoralized
- Negotiate cheaper 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

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

Capital employed = long term liabilities + share capital + retained profit

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