The Difference Between Making Money & Losing Money Is In The Gross Profit

GROSS PROFIT, GROSS MARGIN, NET PROFIT, NET MARGIN & YOUR MONEY

Gross Profit is the money you make…in Dollars

Gross Profit tells you if you are making money or not. If there is enough Gross Profit to cover your expenses and leave you with some money for yourself, you are doing well (i.e., you are making money), if not, you may be losing money.

You make money by selling a product at a price higher than what you paid for it. What you paid for it is not just the Cost of the Product but its Transportation Cost, too. After all, it had to be delivered to your store for you to sell it and that costs money. The Cost of your Product plus Transportation Cost is what's referred to as your **Net Landed Cost**. Some chain store retailers will also include an Internal Distribution Cost in this amount.

So, what is your **Gross Profit** if you paid $52.50 Net Landed Cost for that pair of shoes that came from Hong Kong that you are now selling in your store for $98.95? Just subtract from your Selling Price ($98.95) your Net Landed Cost ($52.50) and you will get your Gross Profit or the money you make on the sale of that shoe ($46.45).

Selling Price	$98.95
- Net Landed Cost	-$52.50
Gross Profit	**=$46.45**

Gross Margin is also the money you make…but in Percentage

Gross Margin also tells you if you are making money or not.

It is the same measure as the Gross Profit, only expressed as a Percentage of your Selling Price, (NOT COST PRICE*). It is calculated by dividing your Gross Profit by your Selling Price. So, if your shoe sold for $98.95 and your Gross Profit was $46.45, how much was your Gross Margin? Just divide $46.65 Gross Profit by $98.95 Selling Price and you will get 47% which is your Gross Margin.

$46.45 (Gross Profit Dollars) ÷ $98.95 (Selling Price)	**= 47% Gross Margin**

**That is what makes the Retail System different from the Cost System used by Accounting Departments: everything is a percentage of Selling Price NOT Cost. Why is this important? All major retail companies use a Retail System and if you want to benchmark your business performance to theirs, that's what you will need to use.*

Net Profit is the money you make…FOR YOURSELF

$46.45 for the sale of that shoe from Hong Kong would be good profit, if only you could keep it all for yourself! But, you actually need to use some of that money to pay your bills (your Operating Expenses such as, staff, store rent, electricity, etc.). The money leftover is your **Net Profit**.

Selling Price	$98.95
- Net Landed Cost	-$52.50
- Operating Expenses	- $25.00
Net Profit	**=$21.45**

What should your **Gross Profit** be for you to have a **Net Profit**…

…and, not be out of business?

Your Gross Profit needs to cover both your Operating Expenses and leave you with a Net Profit for yourself. However, if in our example, your Operating Expenses were $52.50, you would not be making any money and you would not want to run a business this way. Worse, if your Operating Expenses were $60, you would be losing money and soon be out of business!

When do you know if **you may be losing money**?

Often, we will use what is called a "**Break Even Percent**" to help us understand **how much Gross Margin we NEED TO MAKE on the products that we sell**.

Although seldom completely accurate, the **Break Even Percent** can come very close to helping you understand when you may be losing money.

The formula for Break Even is very simple: Last Year's Total Expenses for the Store (all costs except Cost of Goods Sold - transportation - and Cost of Inventory - product cost) divided by Last Year's Total Sales.

$385,000 (Last Year Total Expenses) ÷ $980,450 (Last Year Total Sales)	**39% Break Even Percent**

What the Break Even Percent tells you in the above example is that you need to have a **Gross Margin This Year of at least 39% to break even** or, in other words, to be able to pay all your bills, assuming, of course that your Expenses are close to Last Year. However, if your Expenses have been trending significantly higher than Last Year, you may want to increase the Break Even Percent (your Gross Margin) by a few points.

Ultimately, it is the **Selling Price** that determines your **true Gross Margin**

You may buy that shoe from Hong Kong and land it at $52.50, and then try to sell it at a **Selling Price** of $98.95 and think that you are going to make a 47% Gross Margin on it, but if it doesn't sell at that price and you have to reduce it by, let's say, 20%, that will cause your Gross Margin to decline to a **true Gross Margin,** called **Maintained Margin,** of 33.7%*.

Original Selling Price	$98.95
- 20% Markdown	-$19.79
Actual Selling Price	=$79.16
- Net Landed Cost	-$52.50
Gross Profit	**=$26.66**
True Gross Margin/Maintained Margin (Gross Profit ÷ Selling Price)	**=33.7%**

**Maintained Margin is the margin you make after all inventory price reductions have been accounted for such as, regular markdowns, promotional markdowns, employee discounts, allowances, etc.*