Gross Profit Margin

Frank Howard was frustrated. No matter how hard he worked, the bottom line of his company remained totally unsatisfactory.

Frank's mind wandered back to three years before when his father had suffered from a stroke and became confined to a wheel-chair. That's when Frank realized that no company within a fifty-mile radius built wheelchair ramps. Frank decided he would be the one to offer that service to his community.

Three years had come and gone, and Frank decided to hire an advisor to help him figure out why his business wasn't making the profit he wanted. Actually, to be honest, he wasn't making any profit.

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He was making a few more bucks per hour than he had at his last job, but there was

nothing left after the monthly expenses were paid.

He contacted Gehman Business Advisors and started having monthly meetings. As the advisor explained his numbers, it became clear to Frank that the numbers could tell him much more than just income and expenses.

Frank saw that his sales amounted to $175,000 for the year. His Cost of Goods (COGS) came to $110,000 and his Other Cost of Goods (OCOGS) amounted to $15,000.

When he subtracted the COGS and OCOGS from his sales, he found out that his Gross Profit (GP) was $50,000 (Sales - COGS - OCOGS = GP)

Frank's GP was $50,000, and his Gross Profit Margin (GPM) was 28% (GPM = GP/Sales).

Frank's Ramps

2023 End of Year Review

Income	2023	% Sales
Sales	175,000	100.0%
Cogs	110,000	62.9%
Other Cogs	15,000	8.6%
Gross Profit Margin	**50,000**	**28.6%**

The GPM of 28% showed Frank that after he paid for the COGS and any other direct expenses associated with building the wheelchair ramps, he had 28 cents left out of each dollar to pay his Overhead. Now he could see why he wasn't making any money. The entire 28% was used to pay Overhead, so there wasn't anything left for profit.

This was discouraging news, but at least now Frank understood why he wasn't making a profit. He began to wonder if there was anything he could do to realize a profit.

As he discussed this problem with his advisor, he discovered two ways he could work toward achieving a profitable company.

1. *Go up in price.* When the amount charged for a sale increases, the GPM increases.

2. *Reduce the Cost of Goods.* Reducing the cost of materials is another way to increase the GPM.

If Frank had raised his prices by 20% at the beginning of the year, his sales could have been $210,000, which would have increased his GPM to 40%.

Frank realized that making this price adjustment would add $35,000 to his Gross Profit in one year. Then every dollar that came into his business would have 40 cents to use for Overhead expenses instead of the 28 cents he was currently bringing in. This would allow Frank to cover his Overhead, as well as start turning a much-needed profit in his business.

Frank was thankful to know why his business was not making a profit, but even better, that he also knew how to work toward profitability.

—Ken Nisly

Ken Nisly lives in Due West, South Carolina, and works as a Business Advisor for Gehman Accounting from his home office.