What is margin % and why is it important?

Margin

What is it?

Margin is the profit a company makes expressed as a % of sales. It shows how efficient a company is at converting its sales into profit. In the example below, Company A makes a 75% gross margin, therefore for every £1 of sales, it makes 75p of gross profit. This profit then goes towards paying off "all other expenses" like rent, rates etc.

- **Gross Profit:** Sales - Cost of goods or services.
- **Gross Profit Margin %:** (Gross Profit / Sales) X 100

Why is analysis important?

By only focusing on profit £s it could be suggested that Company B is more efficient than Company A (table 1 & 2) as it has a higher Net Profit of £2,000 vs. £1,100. Although if Company B has more stores then it is plausible that profit would be higher. By using Margin % it shows Company A converts 55p (55%) from every £1 of sale vs. Company B that actually only converts 25p (25%). Company A therefore has a stronger margin %, hence are they more efficient? What if Company A was missing its margin % target and Company B was achieving their target, then is B better?

Naturally there are lots of possible outcomes and good analysis skills will help drive the right understanding and actions.

Company A		
Sales		**£2,000**
Cost of Goods and Services	£(500)	
Gross Profit		**£1,500**
Gross Profit Margin %		***75%***
Other expenses	£(400)	
Net Profit		**£1,100**
Net Profit Margin %		***55%***

Table 1: Company A Margin

Company B		
Sales		**£8,000**
Cost of Goods and Services	£(4000)	
Gross Profit		**£4,000**
Gross Profit Margin %		***50%***
Other expenses	£(2,000)	
Net Profit		**£2,000**
Net Profit Margin %		***25%***

Table 2: Company B Margin