Executive Summary - Gross Profit / Gross Margin

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Gross margin or Gross profit margin can be defined as the amount of contribution to the business enterprise, after paying for direct-fixed and direct-variable unit costs, required to cover overheads (fixed commitments) and provide a buffer for unknown items. It expresses the relationship between gross profit and sales revenue.

It can be expressed in absolute terms:

Gross Profit = Revenue − Cost of Goods Sold

or as the ratio of gross profit to sales revenue, usually in the form of a percentage:

Gross Profit Margin = ((Revenues - Cost of Goods Sold) / Revenues) x 100

Cost of goods sold includes variable and fixed costs directly linked to the product or service, such as material and labour. It does not include indirect fixed costs like office expenses, rent, administrative costs, etc.

Higher gross margins for a manufacturer reflect greater efficiency in turning raw materials into income. For a retailer it will be their markup over wholesale.

Larger gross margins are generally good for companies, with the exception of discount retailers. They need to show that operations efficiency and financing allows them to operate with tiny margins.

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