Are You Tracking Your Net Profits?

When it comes to managing your business, knowing and understanding your financials is key to making it successful. However, there are many business owners today who find themselves struggling to understand all the different aspects of their financials. Their consulting accountant or consulting accounting firm might be able to track different data that could be key to your business, but you might be unclear what to ask them to produce.

For instance, tracking profit margin might seem like a minor part of your financials. However, there are multiple benefits to tracking your profit margin. Here are three reasons why you need to track profit margin.

What is the Difference Between Profit vs Profitability?

First, it is important to understand the difference between profit and profitability. These terms have been used interchangeably, but the truth is that they are actually very different. Profit is the amount left after subtracting the total expenses associated with a business from its total revenues. The profit margin, on the other hand, is the ratio between the net income and total sales, often measured as a ratio or percentage. Determining your profit margin is just one of several profitability ratios that help you to gauge your company's ability to make a profit.

There are several types of profit margin, although most consulting accounting firms tend to focus in on the net profit margin. The point is several different quantitative measures that compute the gains and losses of your business. You can use it to judge the performance of your business over specific time periods or even to do comparisons with your industrial competition.

Now that you know the difference, let's talk about the benefits of tracking your profit margin.

1. Finding Minor Cost Shifts

When you look at your business, you rightly are focused on whether you are making a profit. Obviously, most businesses have that profit reinvested into the company, allowing them to grow slowing and consistently. Adding up all your expenses and revenues gives you the profit for the year, but it might not show you where costs have increased.

Tracking your profit margin is a way to determine if your business is yielding a financial gain. You are essentially using profitability or profit margin to compare and contrast a number of areas in your business, thus allowing you to find areas that may be draining the profit from your business.

You can also use this information to judge your expenses against industry standards. Think about how restaurants often use specific food cost ratios to determine if their business is healthy from a cost perspective. If that ratio is significantly higher than the industry standard, then it can tell them where to tackle their expenses to increase profits.

2. Get a Realistic Perspective of the Health of Your Business

Think about a business (Company A) that makes $100,000 in net revenue after 1 million in total sales. Another business (Company B) makes the same $100,000 in net revenue but does it with just $500,000 in sales. The result is that Company B has a higher profit margin, even though they made less in sales than Company A.

Both companies were profitable. Yet, Company B is clearly doing a better job of managing expenses and is in a healthier position than Company A. However, that might not be as apparent without looking at profit margin.

3. Find Expenses that Negatively Impact Your Business

Profit margin gives you a clearer picture of the financial health of your business, allowing you to start drilling down into your expenses. Increasing profit can happen by increasing sales, but you also need to manage the related expenses that come with increasing sales. This process can involve looking at how much each unit costs for your business to manufacture and find areas where costs can be reduced.

Another benefit of cutting costs is that it can leave your company less vulnerable to a decrease in sales. Often, your profits will increase more by cutting expenses and costs than by increasing sales.

While there is no single strategy for increasing a company's profit and profitability, the truth is that by knowing your numbers and working with a seasoned consulting accounting firm, you can develop one that works for you. The most successful companies perform their analysis on the behavior of their clients to price their products at the best price, but also spend time focused on finding the best cost-cutting options for them.

By using profit margin to help you in that process, you can be sure that your business is healthy or identify areas where it might be struggling. When is the best time to compute your profit margins? Depending on the size of your business, you may find it beneficial to compute them on a weekly or bi-weekly basis. Bigger companies may opt to do them quarterly or even annually.

If you have taken on debt for your business to grow, then your lender may also require that you compute and report your profit margin on a regular schedule, perhaps along with your monthly debt payment. Knowing your profit margin can also help you when planning for your business taxes.

By learning more about these types of profitability ratios, you can grow a better understanding of your business and its financial well-being. Our knowledgeable and experienced team are ready to help you better understand the financials of your business.

Source: Parker Business Consulting & Accounting, P.C.