



Realizing Profitable Potential through Change

Profit Margin - What do they mean?

Knowing the numbers in your business can put you into the top group of small business owners. There are so many numbers involved in our business. Three key concepts you need to know are profit margin, working capital, and breakeven point.

Profit Margin

Do you know what your profit margin is? Do you know how to calculate it? Can you provide the definition of profit margin? If you answered no to these three questions...you are not alone. Don't let this group membership stop you from breaking out into the world though. Start running your business instead of getting by on luck. Today is the day to learn the numbers of your business and what they mean.

Profit Margin is defined in *Accounting* by Warren, Reeve and Fess as "A component of the rate of return on investment, computed as the ratio of income from operations to sales." So what does that mean to the average person? It is the amount of profit from each sales dollar. If you sell an item for \$10 and it cost you \$6, then your profit is \$4 and your profit margin would be $\$4/\10 or 40%.

Working Capital

Working capital is the difference between your current assets (items you own of value) and your current liabilities (amounts you owe to creditors). Current assets and liabilities are found on your Balance Sheet. Current assets include Cash, Accounts Receivable, and Inventory. Current liabilities are amounts you owe to creditors within a one-year time frame and include Accounts Payable and short-term Notes Payable. Working capital is the

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amount of money that you have to run your business on in the current time period. Not having enough working capital is one of the most common reasons for demise among businesses. If your current assets are \$50 and your current liabilities are \$30, then your working capital is \$20. This is the amount of money you have to run your business after you pay the creditors.

Breakeven Point

Do you know how much it costs you to produce your product(s)? Do you know how much material, labor, and overhead you use when you are producing your products? Chances are you have an idea, but not a clear understanding of all the costs involved. It is easy to figure the material that goes into the product and the labor that is used to make the product. What about all the other costs involved? How do you allocate your overhead? What is overhead, you ask? Overhead is all the indirect costs of running your business such as Accounting, Marketing, Salespeople, Utilities, etc. Overhead consists of all those expenses that are necessary in running your business, but are not direct expenses of the product. Once you know all these expenses, do you know how to calculate the point where your total revenues equal your total costs? Do you know how to calculate how many items you need to sell and at what price? How can you cover your expenses and get the profit you are anticipating?

There is so much to learn about running our business. Stay tuned for more Accounting concepts! You don't build an empire in a day...you build it one block at a time!

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