

## SECTION 2: Manipulating Profit Variables: Merchandising for a Profit

### Part 2: Skeletal Profit and Loss Statement: Calculating the P & L Components

#### *Part 2: 2-6 Net Operating Profit*

(Net) operating profit is the end result of manipulating all of the other P & L Statement components.

**(Net) operating profit** is the difference between gross margin and total operating expenses and is profit before taxes. As previously explained, gross margin must cover both operating expenses and profit for the retailer to operate a successful business. If the operating expenses are larger than gross margin, the retailer does not make a profit. Some retailers denote profit as **net income** or **net earnings**.

The formulas for calculating net profit dollars and percent are illustrated below.

$$\text{(Net) Operating Profit \$} = \text{Gross Margin \$} - \text{Operating Expenses \$}$$

$$\text{(Net) Operating Profit \%} = \text{(Net) Operating Profit \$} \div \text{Net Sales \$}$$

$$\text{(Net) Operating Profit \%} = \text{Gross Margin \%} - \text{Operating Expenses \%}$$

**Problem:** Calculate (net) operating profit dollars and percent with figures provided below:

#### Example Figures for calculating the skeletal P & L Statement

Gross Sales = \$210,000.00	Customer Returns & Allowances = \$10,000.00
Net Sales = \$200,000.00	Cost of Goods Sold = \$116,000.00
Gross Margin = \$84,000.00	Operating Expenses = \$72,000.00
(Net) Operating Profit = \$12,000.00	

$$\text{(Net) Operating Profit \$} = ?$$

$$\text{Gross Margin \$} = \$84,000.00$$

$$\text{Operating Expenses \$} = \$72,000.00$$

#### Profit and Loss Statement Form

Component	Dollars (\$)	Percent (%)
Net Sales	\$200,000.00	100.00%
- Cost of Goods Sold	\$116,000.00	58.00%
= Gross Margin	\$84,000.00	42.00%
- Operating Expenses	\$72,000.00	36.00%
= (Net) Operating Profit		

1. Calculate (net) operating profit dollars.

$$\text{(Net) Operating Profit \$} = ?$$

$$\text{(Net) Operating Profit \$} = \text{Gross Margin \$} - \text{Operating Expenses \$}$$

$$\text{(Net) Operating Profit \$} = \$84,000.00 - \$72,000.00$$

**(Net) Operating Profit \$ = \$12,000.00**

2. Calculate (net) operating profit percent.

**(Net) Operating Profit % = ?**

**(Net) Operating Profit % = (Net) Operating Profit \$ ÷ Net Sales \$**

**(Net) Operating Profit % = \$12,000.00 ÷ \$200,000.00**

**(Net) Operating Profit % = 6.00 %**

**OR**

**(Net) Operating Profit % = Gross Margin % - Operating Expenses %**

**(Net) Operating Profit % = 42.00% - 36.00 %**

**(Net) Operating Profit % = 6.00%**

#### **Profit and Loss Statement Form**

<b>Component</b>	<b>Dollars (\$)</b>	<b>Percent (%)</b>
<b>Net Sales</b>	<b>\$200,000.00</b>	<b>100.00%</b>
<b>- Cost of Goods Sold</b>	<b>\$116,000.00</b>	<b>58.00%</b>
<b>= Gross Margin</b>	<b>\$84,000.00</b>	<b>42.00%</b>
<b>- Operating Expenses</b>	<b>\$72,000.00</b>	<b>36.00%</b>
<b>= (Net) Operating Profit</b>	<b>\$12,000.00</b>	<b>6.00%</b>

Some retailers lease floor space or departments in their stores to other retailers who sell merchandise that complements their stores' merchandise mix. The compensation (i.e., rent money) for leasing this space is considered as other income. Also, some retailers receive interest on their investments or income from other sources, that must be accounted for on the P & L Statement. Other income and other expenses not directly related to operating the business must be illustrated on the statement. All of these are posted after (net) operating expenses.

The formulas for calculating the **net profit dollars before income taxes** and **net profit dollars after income taxes** are given below:

**Net Profit \$ before Income Taxes \$ = (Net) Operating Profit \$ + Other Income \$ – Other \$ Expenses**

**Net Profit \$ after Income Taxes \$ = Net Profit \$ before Income Taxes \$ - Income Taxes \$**

Each retail organization has its own accounting procedures and handles other income, other expenses and tax allocations according to a predetermined business decision. These aspects of the P & L statement will not be elaborated upon in this course.

It is critical that a retailer makes profit, since profit allows for replenishment of inventory, replacement of equipment, the renovation of stores or opening of additional stores, investment of monies realized from profit, and return on investments to the stockholders.

In the next segment, interrelationships of the components will be investigated. And, additional formulas will be provided for calculating the various components.