3.6 · FINANCE

Lesson 7: Analysing financial performance

KNOWLEDGE ORGANISER

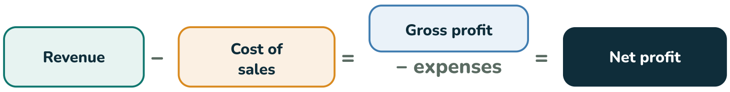
🎯 Learning goals

- ✓ Read an income statement
- ✓ Calculate gross profit and net profit
- ✓ Calculate gross and net profit margins
- ✓ Interpret performance and know the limits of the figures

🔑 Key words

- **Income statement** A statement of revenue, costs and profit over a period.
- **Cost of sales** The direct cost of the goods that were sold.
- **Gross profit** Revenue – cost of sales.
- **Net profit** Gross profit – other expenses.
- **Profit margin** Profit as a percentage of revenue.

📘 What you need to know



An income statement works down from revenue to gross profit to net profit.

1. The income statement

An **income statement** shows how a business performed over a period. It works downwards: **revenue – cost of sales = gross profit**, then **gross profit – expenses = net profit**. **Gross profit** is profit before running costs; **net profit** is what's left after them.

Revenue	£80,000
Cost of sales	(£50,000)
Gross profit	£30,000
Expenses	(£18,000)
Net profit	£12,000

2. Profit margins

Margins show profit as a **percentage of revenue**, which makes comparing years or businesses fair. **Gross profit margin = (gross profit ÷ revenue) × 100**. **Net profit margin = (net profit ÷ revenue) × 100**. Using the table: gross margin = (30,000 ÷ 80,000) × 100 = **37.5%**; net margin = (12,000 ÷ 80,000) × 100 = **15%**.

> *"Gross profit = revenue – cost of sales. Net profit = gross profit – expenses. Margin = (profit ÷ revenue) × 100."*

3. Interpreting — and the limits

A **higher net profit margin** means a business keeps more of each pound as profit and is usually more efficient. But financial statements have **limits**:

- they show the past
- not the future
- ignore non-financial factors like staff morale or reputation

So they should be read alongside other information

✅ Test yourself

Cover the answers below, answer Q44–Q50, then check.

Q44 What is an income statement?

Q45 What is gross profit?

Q46 What is net profit?

Q47 How do you calculate gross profit margin?

Q48 How do you calculate net profit margin?

Q49 What does a higher net profit margin show?

Q50 Give one limitation of financial statements.

ANSWERS

A44 A financial statement showing revenue, costs and profit over a period.

A45 Revenue – cost of sales.

A46 Gross profit – other expenses (running costs).

A47 (Gross profit ÷ revenue) × 100.

A48 (Net profit ÷ revenue) × 100.

A49 The business keeps more of each pound of sales as profit / is more efficient.

A50 They show the past, not the future, and ignore non-financial factors.