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GCSE Business Studies

What is profit?

Profit is the difference between the income of the business and all its costs/expenses. It is normally measured over a period of time.

They are four main types of profit quoted by a business:

- ▶ **Gross profit**

This is the difference between sales income and the direct costs of making those products. Gross profit is used as a performance indicator to help the business make decisions over its pricing policies and use of materials.

- ▶ **Net profit**

Net profit represents gross profit less all expenses associated with the normal running of the business. Net profit shows how well the business performs under its normal trading circumstances. It is used to calculate the “primary efficiency” ratio.

- ▶ **Net profit after interest and taxation**

This is the profit available for the shareholders. Net profit after interest and taxation is all due to the owners of the business. They can choose to take out, in the form of dividends, all, some or none of this.

- ▶ **Retained profit**

Retained profit is the profit left over after the shareholders have been paid their dividends. Retained profit is normally reinvested in the business.

Profit is important to a business because:

- ▶ **It is a reward to the owners of the business.** They have taken risks with their money and time. If there was no profit, then there would be little point in starting up or putting more money into the business, they might as well put the money into a bank or building society
- ▶ **Profits are an important source of investment funds.** Profit can be used to buy more stock, improve technology or expand the premises
- ▶ A business that does not make a profit will fail, potentially affecting employees, suppliers and the local community

Many businesses do not face a dilemma or problem over the amount of profit they make, because they are just happy to make a profit in the first place.

However there are situations where businesses can exploit the customers because there is not much competition from other businesses. A business will need to have an ethical view (what is morally right) on how much to charge and whether they believe their profits to be excessive.

It needs to be remembered that profits are used to reinvest, which leads to better products for their customers, better wages and working conditions for their workers or to help the local community.

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