**2.3.1 Profit**

1. Which one of the following is a measure of profitability?
   1. ~~Profit variance analysis~~
   2. **Gross profit margin**
   3. ~~Margin of safety~~
   4. ~~Profit for the year~~

Explanation:

Profitability measures the efficiency of a business in generating profit. It therefore measures profit in relation to another variable. Gross profit margin measures gross profit as a percentage of sales revenue.

1. Explain each of the following statements.
   1. Offering longer payment terms to customers can improve profit but have a negative effect on cash flow

Offering longer payment terms may give the business a competitive advantage hence attracting more customers and improving profit. However it will slow down the speed with which cash is coming into the business.

* 1. Paying suppliers quickly can improve profits but have a negative effect on cash flow

Paying suppliers quickly may earn the business discounts hence lowering costs and improving profits. However it will speed up the flow of cash leaving the business.

* 1. It is difficult to improve profits without having a negative effect on cash flow in the short run

Action taken to improve profits such as increasing promotional spend or changing a feature of the product are likely to require cash to flow out of the business in the short term. The benefits will not be seen, in terms of increased revenue, until after the actions start to take effect.

1. Use the following words and numbers to complete the table below.

|  |  |
| --- | --- |
| Revenue | £300 000 |
| Cost of sales | £85 000 |
| Gross profit | £215 000 |
| Expenses | £170 000 |
| Operating profit | £45 000 |
| Interest and taxation | £33 750 |
| Profit for the year | £11 250 |