

The Difference Between Gross Profit, Net Profit and ROI

Gross Profit

Gross profit margin is expressed as a percentage that is based on the Gross Profit of an item you are selling. You first calculate the Gross Profit and then with that number you are able to determine the Gross Margin, as a percentage.

$\text{Sales} - \text{Cost of Goods Sold} = \text{Gross Profit}$

$(\text{Gross Profit} / \text{Sales}) \times 100 = \text{Gross Margin}$

So as an example – if you purchase an item for \$26.50 and sell that item for \$52.95 you will see a Gross Profit of

$52.95 - 26.50 = 26.45$ (Gross Profit)

$(26.45 / 52.95) = .499 \times 100 = 49.9\%$ Gross Margin

Now as Amazon sellers we do not get to keep 100% of the sale price. There are fees involved that affect our NET PROFIT.

Net Profit

Net profit takes in to account all of the costs associated with the sale of an item. This will include all Amazon fees, Acquisition Costs, Shipping Costs, etc.; anything that you had to pay in order to produce the sale of the item in question. A rough Net Profit calculation that, though incomplete with regards to total costs, is still valuable is to subtract the fees Amazon charges for the individual sale. Shipping costs and any other acquisition costs are not included for this example but it will give you an idea of the difference between Gross and Net Profit.

So in this example we use the same sale as above but this time instead of using the Sale amount we use the net proceeds that Amazon pays us.

$(52.95 - 17.50 \text{ (Fees)}) = 35.45$ (Net Sale)

$35.45 - 26.50 \text{ (Cost of item)} = 8.95$ (Net Profit)

$8.95 / 52.95 = .169 \times 100 = 16.9\%$ Net Margin

As you can see there is a big difference between Gross and Net Margin Percentages.

Calculating ROI

The overall profit or loss on an investment expressed as a percentage of the total amount invested. The basic formula is $(\text{net profit} / \text{total investment}) \times 100$.

If you have a net profit of \$8.95 and the total investment is \$26.50 the ROI is:

$$\text{ROI} = (8.95 / 26.50) = 0.34 \times 100 = 34\%$$

ROI unlike Gross Margin can exceed 100%.

Another example of a high return item you might find:

Mighty Blue Limited Edition Widget

Cost: \$2.95

Sell FBA: \$29.95

Total FBA Fees: \$9.15

$$\text{Gross Profit} = 29.95 - 2.95 = 27.00$$

$$\text{Gross Margin} = 27.00 / 29.95 = .90 \times 100 = 90\%$$

$$\text{Net Profit} = (27.00 - 9.15 \text{ (FBA Fees)}) = 17.85$$

$$\text{Net Margin} = 17.85 / 29.95 = .6 \times 100 = 60\%$$

$$\text{ROI} = 17.85 \text{ (Net Profit)} / 2.95 \text{ (Cost)} = 6.05 \times 100 = 605\%$$

So as you can see the ROI number really shows how this item is a home run. Gross and Net Margin can never exceed 100% (\$0 cost would result in 100% profit) but ROI can easily exceed that amount.

All of these numbers are important and have their place in your business analysis. It is important to fully understand the difference between them so that when people are posting results of sales and list any or all of these numbers you know exactly what they mean. It is also important that people who post numbers use the right description of what they are posting. There have been too many times when people have posted numbers that don't make sense only to find out that they are not using the correct formulas...

Hope this helps!