It is time to pay bills, then compare Gross & Net Margins!

After a very sucessful sale you owe money for operational expenses and for credit that had been issued.
$20.00 to the grocer for the ingredients
$1.00 for rent on your lease with Mr. Green.
$1.00 for advertising for your banner sign space to Mr. Morales
$3.00 for wages and payroll to your helper (who earned every penny with excellent customer service)

A TOTAL OF $20.00 is owed to the grocer for the lemons, sugar, and limes. These are the cost of the raw goods and then sold as finished inventory after convering them into your tasty lemonade. (remember) C.O.G.S

Step 1 use this to establish the Gross Profit by subtracting the C.O.G.S from the Gross Revenue.
Gross revenue $50.00 minus C.O.G.S $20.00 = Gross Profit of $30.00

(step 2) Gross Profit $30.00 divided by Gross Revenue $50.00 = Gross Margin 60%.

You have learned that the Gross Margin in lesson one was 67% and now it is at 60% because of the cyclical change in the cost of the ingredients going up even though you raised the price of your lemonade.

Time to pay that $20.00 invoice to the grocer and post it on your balance sheet.

To post/pay this subtract $20.00 from cash leaving you with $42.00 and OOPs you are out of balance. That is because you must Subtract $20.00 from Accounts Payable (AP) in the liabilities section, as you pay the grocer. ***AP*** now has a balance of ZERO 0. Good job on keeping your word and paying on time!

You establish the Net Profit and the Net Margin.
There were other other bills such as payroll, rent, and advertising that were not taken into effect when you calculated the gross profit and gross margin.

(step 1 for this equation)You have a TOTAL of costs and operational expenses (sometimes called OPEX) of $5.00 You will subtract this from the Gross Profit
Gross Profit of $30.00 minus expenses (OPEX) $5.00 = Net Profit (Revenue) of $25.00

Then to estsablis the Net Margin you divide the net profit by the total revenue

(step 2) Net Profit $25.00 divided by Total Revenue $50.00 = Net Margin 50%.

To post on your balance sheet subtract $5.00 from the $42.00 in cash and allocate that money to pay your bills as itemized above. That leaves you with $37.00.00 in cash

OOPs you are out of balance... That is because your must subtract $5.00 from revenues to date. That amount changes from $30.00 to $25.00. Net Revenue is a key metric! (sometimes called the net profit or N.O.I. Net Operating Income) The Net Revenues is what is left-over after itemizing both the C.O.G.S and the Operating Expenses. This is a very important component of measuring how a business is actually doing!

Scroll down below to continue & your balance sheet example

In our lemonade example (repeated to make the point indelible) you had $20.00 in C.O.G.S. and have $5.00 in other expenses as outlined That leaves you with $25.00 in total expenses subtracted from the $50.00 in gross revenue. The result is $25.00 in Net Revenues (Net profits).

Them we divide the $25.00 in net revenue by the $50.00 in gross Revenues leaving you with a net Profit Margin of 50%   EXCELLENT!

Some of the myriad of expenses that a business may also incur include insurance, maintenance, utilities, accounting fees, legal fees, licenses, professional costs and much more. In your personal life it will include interest on credit cards, automobile expenses, food and meals, school loans, phone bills, energy, travel and other cash out flows.

Balance Sheet

example (after posting)

Your Take Away

Gross Margin = 60%
Net Margin = 50%

Remember business related out flows may be investments in the business and posted in the FFE or another journal entry classification in assets (such as Real Estate). Some could be capital expenditures (CAPEX) which are generally items invested in the business like the pitchers you purchased earlier. In other business, like managing income property it could be items such as a new roof or upgrading the appliances and cabinets. Or in commercial organizations perhaps a new compressor or delivery truck etc. Compare this with utility bills, payroll, regular maintenance, or insurance premiums which are a few examples of (OPEX) operational costs. The above terms are important to understand as you continue forward in your financial literacy education. They are reflected here to give you an idea of how to expense costs (or investments) on your balance sheet and be familiar with the vocabulary.

In a few chapte you will learn more about Profit and Loss statements (P&L) also called income statements. Having a solid understanding of OPEX and CAPEX is critical for keeping track of outgoing money including taxable deductions, property basis and depreciation. (stay tuned afew more chapters)

The game's purpose at a deeper level is to introduce you to the ordinary terms used in business. Little by little gradient learning is taught in small dosages and made applicable to our story, and your entrpreneurial experience while keeping it fun.