## CHAPTER 7
### PROFIT MARGIN

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CHAPTER 7
PROFIT MARGIN

7.1 MEANING:

Profit making at an increasing rate can only be the aim of a company. Profit margin depends on various industry and is also influenced by different items related directly or indirectly with the affairs of the company. All the activities of a company lead to profit making. Of course, it depends on the performance of the company but at the same time it is a reflection of the progress and achievement of a company. Analysis of profitability reveals the progress of performance of automobile industries in Thailand.

In the words of Samuel Paul (1974) "In any case progress towards the achievement of objective may be judged by measures such as capacity utilization unit, cost of production and profitability"

Ezra Solomon and John J. Pringle (1978) wrote in An Introduction to Management that "Profit Margin is the return generated by a company's assets and represents the difference between revenues and total expenditure"

S.B. Choudhary (1977) said that Profit margin has direct relevance with the sales of products of a company. "Profit Margin is the key figure in the income statement or profit and loss account"

Profit Margin figures can, best, be evaluated by expressing them as percentage of net sales (i.e. sales minus return, discounts and rebated etc.) Each baht invested is an effort to achieve the expected goal or target of profit making.

In profit and loss account the first item given therein
is the figure of sales of gross income from sales in monetary terms. The later when substracted from the former gives gross profit and cost of goods sold normally consists of the cost of raw materials consumed, industry wages, manufacturing expenses etc. salaries, administration expenses, selling and distribution expenses and interest on financial charges but not income tax or any kind of return on capital employed in the business. If operating expenses are deducted from the gross profit the balance is called the operating profit. In the operating profit thus obtained, non-operating surplus (non-operating incomes minus non-operating expenses) is added and from this total when income-tax is deducted the result is termed as the net profit. This sum is available for the disbursement as dividend or is added to the surplus for strengthening the financial health of the business.

7.2 IMPROVEMENT OF PROFITABILITY

Improvement of profitability is an outcome of profit margin or assets turnover or both. More the sales, more the profit margin. Lower the cost of sales more the profit margin. Cost of sales depends on cost control. Return of investment is a profit.

7.3 MANIPULATION OF PROFIT MARGIN

Management can influence the profitability position of an enterprise merely by inflating its income through different ways e.g. by changing the basis for valuation of closing stock, by charging
the inadequate depreciation, by failing to replace obsolete fixed assets with new or more efficient equipments and by changing methods of valuation from LIFO to FIFO method in case of inventory during the period of inflation. By implementing the above method, the reported income gets inflated and therefore, profitability may be influenced favourably.

Despite of this criticism it has been accepted fact that it is the most used measure of performance. Investors employ it for evaluating a company.

7.4 OPERATING PROFIT MARGIN

Operating profit is the difference between net sales and operating cost. Operating profit margin varies with the disproportionate variations in the sales revenue in comparison to cost and vice versa. Operating profit on sales can be increased either by marking up prices or by reducing costs or both. The ratio measures the efficiency of management in managing the business.

Table 7.1 shows the overall position of operating profit margin in selected automobile industry during the period under study. TOYOTA witnessed fluctuating trend in the operating profit margin ratio during the period under study. It was 11.94 percent in 1993 which stepped up to 12.41 percent in 1994 which again increased to 13.09 percent in 1995 and fell down to 11.59 percent in 1996 which again increased to 12.56 percent in the final year under study. So it fluctuated between 11.59 percent, being the lowest in 1996 and
13.09 percent, being the highest percent in 1995.

NISSAN Motors Co.Ltd., witnessed fluctuating trend in the operating profit margin ratio during the period under study. It was 10.69 percent in 1993 which stepped up to 10.53 percent in 1994 which again increased to 11.34 percent in 1995 and increased to 11.61 percent in 1996 which again increased to 12.12 percent in the final year under study. So it fluctuated between 10.53 percent, being the lowest in 1994 and 12.12 percent, being the highest percent in 1997.

ISUZU Motors Co.Ltd. recorded a declining trend in the operating profit margin ratio during the first years. It was 11.91 percent in 1993 and increased to 12.56 percent in 1994 and reached to the highest level of 13.11 percent in 1995. The percent of 1995 was the highest one during the period under study. So it fluctuated between 11.91 percent, being the lowest in 1993 and 13.11 percent, being the highest percent in 1995.

MITSUBISHI witnessed fluctuating trend in the operating profit margin ratio during the period under study. It was 10.72 percent in 1993 which stepped up to 11.43 percent in 1995 which again increased to 12.35 percent in 1996 and fell down to 10.58 percent in 1994 which again increased to 12.28 percent in the final year under study. So it fluctuated between 10.58 percent, being the lowest in 1994 and 12.35 percent, being the highest percent in 1996.

MAZDA Motors Co.Ltd., witnessed fluctuating trend in the operating profit margin ratio during the period under study. It was 10.68 percent in 1993 which stepped up to 11.45 percent in 1995
which again increased to 12.41 percent in 1996 and fell downed to 10.39 percent in 1994 which again increased to 12.17 percent in the final year under study. So it fluctuated between 10.39 percent, being the lowest in 1994 and 12.41 percent, being the highest percent in 1996.

Table 7.1
Operating Profit to Net Sales Ratio in Automobiles
Industry Under Study During 1993-1997 (In Percentage)

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<thead>
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</thead>
<tbody>
<tr>
<td>Toyota Motors</td>
<td>11.94</td>
<td>12.41</td>
<td>13.09</td>
<td>11.59</td>
<td>12.56</td>
</tr>
<tr>
<td>Nissan Motors</td>
<td>10.69</td>
<td>10.53</td>
<td>11.34</td>
<td>11.61</td>
<td>12.12</td>
</tr>
<tr>
<td>Isuzu Motors</td>
<td>11.91</td>
<td>12.56</td>
<td>13.11</td>
<td>12.52</td>
<td>12.64</td>
</tr>
<tr>
<td>Mitsubishi Motors</td>
<td>10.72</td>
<td>10.58</td>
<td>11.43</td>
<td>12.35</td>
<td>12.28</td>
</tr>
<tr>
<td>Mazda Motors</td>
<td>10.68</td>
<td>10.39</td>
<td>11.45</td>
<td>12.41</td>
<td>12.17</td>
</tr>
</tbody>
</table>

FIGURE 7.1

Show the Operating Profit to Net Sales Ratio in Automobile Industry Under Study During 1993–1997 (In Percentage)
7.5 **NET PROFIT MARGIN**

The net profit margin ratio is an indication of efficiency in the management. It also measures the ability of a firm to turn each baht of sales into net profit. In case of adverse economic condition this ratio helps for improvement. High net margin is an indication of favourable condition such as increase in sales prices, decrease in cost of production and increasing demand. The ratio has been calculated by dividing the net profit after tax by sales.

In the word of M.Y. Khan and P.K. Jain (1981) "Net profit margin is indicative of management's ability to operate the business with sufficient success".

Table 7.2 brings the net profit margin in the selected Automobiles Industries

The ratio in Toyota Motors Co.Ltd. declined in the first year of the period under the study and had an improvement during last year under the period of study. 7.62 percent was the highest net profit in 1997.

The ratio in Nissan Motors Co.Ltd. declined in the second year of the period under the study and had an improvement during last two years under the period of study. 7.38 percent was the highest net profit in 1996.

The ratio in Isuzu Motors Co.Ltd. declined in the first year of the period under the study and had an improvement during last four years under the period of study. 7.97 percent was the highest net profit in 1996.
The ratio in Mitsubishi Motors Co.Ltd. declined in the second year of the period under the study and had an improvement during last two years under the period of study. 7.78 percent was the highest net profit in 1996.

The ratio in Mazda Motors Co.Ltd. declined in the second year of the period under the study and had an improvement during last two years under the period of study. 7.42 percent was the highest net profit in 1996.

Table 7.2

Net Profit After Tax to Net Sales Ratio in Automobiles Industry Under Study During 1993-1997
(In Percentage)

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Toyota Motors</td>
<td>6.97</td>
<td>7.44</td>
<td>7.36</td>
<td>7.18</td>
<td>7.62</td>
</tr>
<tr>
<td>Nissan Motors</td>
<td>6.00</td>
<td>5.65</td>
<td>5.70</td>
<td>7.38</td>
<td>6.98</td>
</tr>
<tr>
<td>Isuzu Motors</td>
<td>6.79</td>
<td>7.62</td>
<td>7.45</td>
<td>7.97</td>
<td>7.47</td>
</tr>
<tr>
<td>Mitsubishi Motors</td>
<td>6.16</td>
<td>5.75</td>
<td>5.85</td>
<td>7.78</td>
<td>7.11</td>
</tr>
<tr>
<td>Mazda Motors</td>
<td>5.74</td>
<td>5.25</td>
<td>5.97</td>
<td>7.42</td>
<td>7.23</td>
</tr>
</tbody>
</table>

FIGURE 7.2

Show Net Profit Tax to Net Sales Ratio in Automobiles Industry

(In Percentage)
7.6 OPERATING RATIO

According to Ralph Dale Kennedy (1968) operational efficiency is reflected in operating ratio. The percentage of sales consumed and margin left are also calculated on the bases of operating ratio.

Higher operating ratio regarded as unfavourable because very low amount of operating profit is left for interest and dividend.

Ralph Dale Kennedy put it in these words, "The operating ratio should be low enough to leave a fraction of the sales bahts sufficient to give a fair return to investor".

Toyota Motors Co.Ltd. witnessed fluctuating trend in the operating ratio for the whole period under study. It fluctuated between 86.91 percent in 1995 and 88.41 percent in 1996 (Please see Table 7.3). Operating ratio percent was 88.14 in 1993 which stepped down to 87.59 percent in 1994 and further declining to 86.91 percent in 1995 and finally increasing to 88.41 percent in 1996 and again declining to 87.44 in 1997.

Nissan Motors Co.Ltd. witnessed fluctuating trend in the operating ratio for the whole period under study. It fluctuated between 87.88 percent in 1997 and 89.47 percent in 1994 (Please see Table 7.3). Operating ratio percent was 89.31 in 1993 which stepped up to 39.47 percent in 1994 and further declining to 88.66 percent in 1995 and finally increasing to 88.39 percent in 1996 and again declining to 87.88 in 1997.

Isuzu Motors Co.Ltd. witnessed fluctuating trend in the operating ratio for the whole period under study. It fluctuated between 86.89 percent in 1995 and 88.09 percent in 1993 (Please see
Table 7.3). Operating ratio percent was 88.09 in 1993 which stepped down to 87.44 percent in 1994 and further declining to 86.89 percent in 1995 and finally increasing to 87.48 percent in 1996 and again declining to 87.36 in 1997.

Mitsubishi Motors Co.Ltd. witnessed fluctuating trend in the operating ratio for the whole period under study. It fluctuated between 87.65 percent in 1996 and 89.42 percent in 1994 (Please see Table 7.3). Operating ratio percent was 89.28 in 1993 which stepped up to 89.42 percent in 1994 and further declining to 88.57 percent in 1995 and declining to 87.65 percent in 1996 and again increasing to 87.72 in 1997.

Mazda Motors Co.Ltd. witnessed fluctuating trend in the operating ratio for the whole period under study. It fluctuated between 86.61 percent in 1994 and 89.32 percent in 1993 (Please see Table 7.3). Operating ratio percent was 89.32 in 1993 which stepped down to 86.61 percent in 1994 and further increasing to 88.55 percent in 1995 and declining to 87.59 percent in 1996 and again increasing to 87.83 in 1997.
Table 7.3
Operating Ratio in Automobile Industries
Under Study During 1993-1997
(In Percentage)

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Toyota Motors</td>
<td>88.14</td>
<td>87.59</td>
<td>86.91</td>
<td>88.41</td>
<td>87.44</td>
</tr>
<tr>
<td>Nissan Motors</td>
<td>89.31</td>
<td>89.47</td>
<td>88.66</td>
<td>88.39</td>
<td>87.88</td>
</tr>
<tr>
<td>Isuzu Motors</td>
<td>88.09</td>
<td>87.44</td>
<td>86.89</td>
<td>87.48</td>
<td>87.36</td>
</tr>
<tr>
<td>Mitsubishi Motors</td>
<td>89.28</td>
<td>89.42</td>
<td>88.57</td>
<td>87.65</td>
<td>87.72</td>
</tr>
<tr>
<td>Mazda Motors</td>
<td>89.32</td>
<td>86.61</td>
<td>88.55</td>
<td>87.59</td>
<td>87.83</td>
</tr>
</tbody>
</table>

FIGURE 7.3

Show Operating Ratio in Automobile Industries
Under Study During 1993-1997 (In Percentage)
7.7 CASH PROFIT RATIO

The cash profit ratio is an indication of cash profitability of a firm, showing the profit after interest and taxes but before depreciation and other non-cash items like provision etc.

It also shows the relationship between cash profit and net sales.

\[
\text{Cash Profit Ratio} = \frac{\text{Cash Profit}}{\text{Net Sales}} \times 100
\]

The higher cash profit ratio of a company shows a good liquidity position of a company.

Table 7.4 shows position regarding the cash profit ratio in the selected automobiles industries under study period 1993 to 1997.

The cash profit ratio was 4.13 percent in 1993 in Toyota and it had a marginal decrease in the following year as it was 3.55 percent in 1994. It fell to 3.39 percent in 1995 and still decreased to 3.46 percent in 1996 and increased to 3.57 percent in 1997. 4.13 percent in 1993 can be considered as the highest percent under the period of the study.

The cash profit ratio was 4.05 percent in 1993 in Nissan and it had a marginal decrease in the following year as it was 3.56 percent in 1994. It fell to 3.48 percent in 1995 and still decreased to 3.37 percent in 1996 and increased to 3.49 percent in
1997. 4.05 percent in 1993 can be considered as the highest percent under the period of the study.

The cash profit ratio was 4.21 percent in 1993 in Isuzu and it had a marginal decrease in the following year as it was 3.66 percent in 1994. It fell to 3.51 percent in 1995 and still decreased to 3.30 percent in 1996 and increased to 3.45 percent in 1997. 4.21 percent in 1993 can be considered as the highest percent under the period of the study.

The cash profit ratio was 3.75 percent in 1993 in Mitsubishi and it had a marginal decrease in the following year as it was 3.45 percent in 1994. It fell to 3.52 percent in 1995 and increased to 4.41 percent in 1996 and decreased to 3.51 percent in 1997. 4.41 percent in 1996 can be considered as the highest percent under the period of the study.

The cash profit ratio was 4.01 percent in 1993 in Mazda and it had a marginal decrease in the following year as it was 3.31 percent in 1994. It fell to 3.30 percent in 1995 and still decreased to 3.28 percent in 1996 and increased to 3.41 percent in 1997. 4.01 percent in 1993 can be considered as the highest percent under the period of the study.
Table 7.4
Cash Profit Ratio in Automobile Industries
Under Study During 1993-1997
(In Percentage)

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</tr>
</thead>
<tbody>
<tr>
<td>Toyota Motors</td>
<td>4.13</td>
<td>3.55</td>
<td>3.39</td>
<td>3.46</td>
<td>3.57</td>
</tr>
<tr>
<td>Nissan Motors</td>
<td>4.05</td>
<td>3.56</td>
<td>3.48</td>
<td>3.37</td>
<td>3.49</td>
</tr>
<tr>
<td>Isuzu Motors</td>
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<td>3.66</td>
<td>3.51</td>
<td>3.30</td>
<td>3.45</td>
</tr>
<tr>
<td>Mitsubishi Motors</td>
<td>3.75</td>
<td>3.45</td>
<td>3.52</td>
<td>4.41</td>
<td>3.51</td>
</tr>
<tr>
<td>Mazda Motors</td>
<td>4.01</td>
<td>3.31</td>
<td>3.30</td>
<td>3.28</td>
<td>3.41</td>
</tr>
</tbody>
</table>

FIGURE 7.4

Show Crash Profit Ratio in Automobile Industries
Under Study During 1993–1997 (In Percentage)