

## STATEMENTS

# Gross, Operating, and Net Profit Margin: What's the Difference?

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## Gross, Operating, and Net Profit Margin: An Overview

Gross [profit margin](#), operating profit margin, and [net profit margin](#) are the three main margin analysis measures that are used to analyze the income statement activities of a firm.



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Each margin individually gives a very different perspective on the company's operational efficiency. Comprehensively the three margins taken together can provide insight into a firm's [operational strengths and weaknesses](#) (SWOT). Margins are also useful in making competitor comparisons and identifying growth and loss trends against past periods.

### KEY TAKEAWAYS

- An income statement is divided by direct, indirect, and interest and tax expenses.
- Gross profit, operating profit, and net profit margins are important measures for analyzing an income statement.
- Each profit margin measure shows the amount of profit per dollar of a company's revenue.

**⚡ Important:** Overall, margin analysis metrics measure the efficiency of a firm by comparing profits against costs at three different spots on an income statement.

## Gross Profit Margin

[Gross profit margin](#) analyzes the relationship between gross sales revenue and the direct costs of sales. This comparison forms the first section of the income statement. Companies



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will have varying types of direct costs depending on their business. Companies that are involved in the production and manufacturing of goods will use the cost of goods sold measure while service companies may have a more generalized notation.

Overall, the gross profit margin seeks to identify how efficiently a company is producing its product. The calculation for gross profit margin is gross profit divided by total revenue. In general, it is better to have a higher gross profit margin number as it represents the total gross profit per dollar of revenue.

## Operating Profit Margin

Operating efficiency forms the second section of a company's income statement and focuses on indirect costs. Companies have a wide range of indirect costs which also influence the bottom line. Some commonly reported indirect costs includes research and development, marketing campaign expenses, general and administrative expenses, and depreciation and amortization.

Operating profit margin examines the effects of these costs. Operating profit is obtained by subtracting operating expenses from gross profit. The operating profit margin is then calculated by dividing the operating profit by total revenue.

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### Related Terms

[Profitability Ratios: What They Are, Common Types,](#)

Operating profit shows a company's ability to manage its indirect costs. Therefore, this section of the income statement shows how a company is investing in areas it expects will help to improve its brand and business growth through several channels. A company may have a high gross profit margin but a relatively low operating profit margin if its indirect expenses for things like marketing, or capital investment allocations are high.

## Net Profit Margin

Net profit margin is the third and final profit margin metric used in [income statement](#) analysis. It is calculated by analyzing the last section of the income statement and the net earnings of a company after accounting for all expenses.

Net profit margin takes into consideration the interest and taxes paid by a company. Net profit is calculated by subtracting interest and taxes from operating profit—also known as [earnings before interest and taxes](#) (EBIT). The net profit margin is then calculated by dividing net profit over total revenue.

Net profit spotlights a company's ability to manage its interest payments and tax payments. Interest payments can take several varieties. Interest includes the interest a company pays stakeholders on debt for capital instruments. It also includes any interest earned from short-term and long-term investments.

Taxes are charged at a flat rate for corporations. Following the 2017 [Tax Cuts](#)

## and How Businesses Use Them

Profitability ratios are financial metrics used to assess a business's ability to generate profit relative to items such as its revenue or assets. [more](#)

## Profit Margin: Definition, Types, Uses in Business and Investing

Profit margin gauges the degree to which a company or a business activity makes money. It represents the percentage of sales that has turned into profits. [more](#)

## Fixed Cost: What It Is and How It's Used in Business

A fixed cost is a cost that does not vary with the level of production or sales. [more](#)

## Cost of Revenue: What It Is, How It's Calculated, Example

The cost of revenue is the total cost of manufacturing and delivering a product or service and is found in a company's income statement. [more](#)

## Understanding Business Expenses and Which Are Tax Deductible

Business expenses are costs incurred in the ordinary course of business. Business expenses are tax-deductible and are always netted against business income. [more](#)

## Economic Profit (or Loss): Definition, Formula, and Example

Economic profit (or loss) is the difference between the revenue received from the sale of an output and the costs of all inputs, including opportunity costs. [more](#)

[and Jobs Act](#), the corporate tax rate was reduced from 35% to 21%. Just like individuals, corporations must also identify and account for corporate tax breaks that come in the form of credits, deductions, exemptions, and more.

## **Special Considerations**

The net profit margin of a company shows how the company is managing all the expenses associated with the business. On the income statement, expenses are typically broken out by direct, indirect, and interest and taxes. Companies seek to manage expenses in each of these three areas individually.

By analyzing how the gross, operating, and net profit margins compare to each other, industry analysts can get a clear picture of a company's operating strengths and weaknesses.

Market and business factors may affect each of the three margins differently.

Systematically if direct sales expenses increase across the market, then a company will have a lower gross profit margin that reflects higher costs of sales.

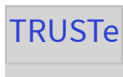
Companies may go through different cycles of growth that lead to higher operational, and interest expenses. A company may be investing more in marketing campaigns or capital investments that increase operating costs for a period which can decrease operating profit margin. Companies may also raise capital through debt which can decrease their net profit margin when

interest payments rise.

Understanding these different variables and their effects on margin analysis can be important for investors when analyzing the worthiness of corporate investment.

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