By expressing each item on the income statement as a percentage of sales, you'll start to see the relationships between the items. A dollar is made up of 100 pennies, so a percentage also helps you express each item as part of a dollar. For example, suppose that 40 cents of every dollar of your sales was spent on cost of goods sold. Your gross profit per dollar of sales would then be 60 cents (60 percent). Your net profit, after 30 cents were spent on operating costs and 10 cents on taxes, would be 20 cents (20 percent). These percentages are referred to as a business's **financial ratios.**

By analyzing your income statement items as percentages of sales, you can see how costs are affecting your net profit. Apple Computer, Inc. noted, in its financial overview for 1994, for example, that it reduced operating costs that year to 21.2 percent of net sales, down from 28.8 percent in 1993. Net profit rose 15 percent in 1994, and a portion of that increase was probably due to a 7.6 percent reduction in operating costs. (P.S. Talk like this and you'll definitely impress a few people!)

A Fast-Food Restaurant's Income Statement

Given below is an income statement for one year, for a fast-food restaurant in New York City. Successful entrepreneurs know it's important to keep track of costs *each month* in order to make sure profits aren't getting eaten up. For a real challenge, cover the last column and try doing the financial ratio analysis of this income statement. (*Hint:* Divide sales into each line item.)

Income Statement		1 Year	Ratio Analysis
Sales		**$2,600,000**	**100%**
Cost of Goods Sold:			
Food	**$792,000**		
Paper	**108,000**		
	$900,000		
Less: Total Cost of Goods Sold		**900,000**	**35%**
Gross Profit		**$1,700,000**	**65%**
Less: Operating Costs		**1,000,000**	**38%**
Profit		**$ 700,000**	**27%**
Less: Taxes		**233,000**	**9%**
Net Profit/(Loss)		**$ 467,000**	**18%**