

Definition of Adjusted Gross Profit

Adjusted Gross Profit (AGP) is gross revenue less the direct cost of producing this income. The direct cost of producing income is all expenses that have a one to one relationship to producing income. This concept is like but not identical to gross profit.

By way of several examples:

1. Retail business, revenue of \$28,000,000, cost of products sold \$12,600,000. Adjusted gross profit is \$15,400,000 (\$28,000,000-\$12,600,000).
2. Construction business, revenue of \$35,000,000, material cost to produce said revenue \$12,000,000, labor to produce revenue \$14,000,000, equipment rental specific to construction jobs generating revenue \$1,000,000, equipment rental for administration expenses \$250,000. Adjusted gross profit is \$8,000,000 (\$35,000,000-\$12,000,000-\$14,000,000-\$1,000,000). The equipment rental that is used for administrative is not included as there is not a one to one relationship between revenue and this equipment rent.
3. Real estate sales, revenue \$30,000,000, commissions paid to agents \$25,000,000. Adjusted gross profit is \$5,000,000 (30,000,000-\$25,000,000).

Using AGP as an alternative of Gross Revenue

Assume two managers with equal education and experience working in different industries: Manager A works in Construction and Manger B works in Professional Services.

Assuming all parameters for determining their reasonable compensation are identical except Industry and Gross Revenue

Scenario One:

Manager A

Construction Firm
Gross Revenue \$25m
Employees 10

Manager B

Professional Services Firm
Gross Revenue 2.5m
Employees 10

In Scenario One Manager A would command a higher reasonable compensation figure because gross revenue is significantly higher than Manager B's

Scenario Two:

Manager A

Construction Firm
Adjusted Gross Profit \$2.5m
Employees 10

Manager B

Professional Services Firm
Adjusted Gross Profit 2.5m
Employees 10

In Scenario Two both Manager A and Manager B are placed on more equal footing. Theoretically Manager A and Manger B could swap places with the appropriate industry knowledge.