Using Breakeven Analysis

It’s important for a business owner to understand breakeven analysis and how to use it to help make financial decisions in the business. Our webinar discusses the following areas:

- What is Breakeven Analysis
- Classifying Costs
- Calculating Breakeven Point
- How to use Breakeven Analysis

What is breakeven analysis?
Breakeven analysis is about understanding the relationship between price, volume and costs. It can help us answer questions such as:

- Should I upgrade my equipment?
- Does it make sense to put on another employee?
- Can I afford higher rent for bigger premises?
- And many more.

Classifying costs

Costs are classified according to how they behave within a business:

- **Fixed Costs**: are costs incurred regardless of whether you make a sale or not. It includes items such as rent, advertising, insurance, leases, wages and salaries.
- **Variable Costs**: are costs that are caused by making a sale. It includes items such as direct labour, direct materials, packaging, merchant fees, commissions and more.

As our sales increase, fixed costs rise step by step. Whilst fixed costs provide us with the capacity to make a certain level of sales, once sales grow beyond that point, a business needs more resources such as staff or equipment, and this pushes fixed costs up to the next level. Variable costs, on the other hand, rise at the same level and in direct proportion to the increased sales.

The breakeven profit and loss statement starts with sales, and then subtracts the variable costs of making those sales which equals a contribution margin. The contribution margin is what is left over from each dollar of sales to cover the fixed costs and contribute towards a profit.

Calculating breakeven point

You can calculate breakeven point in 4 steps:

1. Classify your costs as either variable or fixed.
2. Calculate your variable cost percentage: or what percentage of every sale covers your variable costs
3. Calculate the contribution margin: how much do you have left over from each dollar of sales to cover your fixed costs and generate a profit
4. Calculate your breakeven point: divide your fixed costs by the contribution margin
How to use breakeven analysis

Breakeven analysis can be used for many purposes such as:

- Calculating the breakeven point of a business (which we’ve already looked at);
- Managing costs;
- Planning for profit; and
- Setting prices.

**Managing costs**

Here breakeven analysis can assist businesses to identify how much additional sales revenue or volume needs to be generated to cover proposed increases to fixed costs.

**Planning for profit**

Here breakeven analysis can assist businesses in planning for profit. By actively choosing a profit target, a business can identify how much additional sales revenue or volume needs to be generated to ensure that it achieves the targeted profit projection.

**Setting prices**

By applying an increased/decreased price per unit, the change in volume required to be sold to breakeven can be calculated. Assuming that there are no changes to costs, when a business changes its selling price, it also changes its contribution margin.

Generally an increase in price will create a higher contribution margin and a decrease will create a lower one.

To calculate a new breakeven point, the business needs to complete the breakeven calculation using the new contribution margin.

*Any information provided is of a general nature. Before making any decisions please ensure you seek appropriate professional advice to ensure it is appropriate to you.*