

# Improving Your Small Business Skills

Published by DJC Accounting Pty Ltd (ABN: 67 149 046 104)  
PO Box 4020 Carlton NSW 2218. Ph: (02) 9588 3471  
E-Mail: david@djccounting.com.au

Information to Increase both the Wealth and Lifestyle of Your Family

## You Should Know What Your “Breakeven Point” Is

This is one of the most important financial formulas for **every** small business owner to know.

### What is the “Breakeven Point”?

It is where Total Revenue equals Total Expenses (your Net Profit is \$Nil). The formula is:  
*Sales - Variable Expenses = Fixed Expenses.*

### Explanation of Terms

**Variable Expenses:** They increase with the level of activity of the business. It costs \$0.50 for every can of lemonade sold - if you sell 200 cans of lemonade it costs \$100. For every meal selling for \$15, it costs \$5 to produce it.

**Examples:** *Cost of producing an article of clothing, shoes, car, meal. These items normally also form part of your business' Gross Profit. It can also include selling expenses such as commission for each product or house sold and delivering the goods to the customer.*

The level of variable expenses for consulting businesses such as solicitors, accountants or computer advisers, would be either small or nil.

**Fixed Expenses:** They do not increase with activity. The rent for your premises does not change with the number of meals produced. The rent is \$300 per week no matter if you sell 100 restaurant meals a week or 400 meals per week.

**Examples:** *Rent, printing and stationery, staff amenities, wages and salaries, advertising, accountancy, motor vehicle expenses. These expenses do not increase with every dollar increase in sales or consulting fees earned.*

**Example:** John Dory owns a local seafood restaurant. Before he sells a meal, he incurs the following yearly fixed expenses:

Rent	30,000
Advertising	10,000
Cooking staff	60,000
Waiters	20,000
Finance Costs	15,000
Insurance	10,000
Other Fixed Costs	12,000
<b>TOTAL FIXED EXPENSES</b>	<b><u>\$157,000</u></b>

To breakeven ( $\text{Sales} - \text{Variable Expenses} = \text{Fixed Expenses}$ ), the following number of meals must be achieved.

**On Average:** Each meal's Variable Expense (cost of food ingredients) is \$10. The Average Sale Price of each meal is \$30.

*Breakeven is: \$30 per meal (sales) - \$10 per meal (Variable Expenses) x (M) Meals = \$157,000 (Fixed Expenses).*

*Breakeven is: 7,850 meals per year or 22 meals per day. (7,850 meals x \$20 per meal, after Variable Cost = \$157,000).*

### It is Important to Do Your Planning

If this analysis was done before every business opened its doors, the failure rate would significantly reduce. They would realise they cannot achieve their breakeven point for that particular business. They would then choose a better geographical location or maybe another industry.

The breakeven point formula could assist in determining the number of meals per day to achieve a Certain Net Profit. In the above example, to achieve \$60,000 Net Profit, the meals per day would have to increase from 22 to 30 meals. This assumes no increase in fixed expenses is required to achieve the increase in meals.

*This information is for the benefit of our clients and interested parties. The commentary contained does not purport to be comprehensive advice. Please contact David Chambers if specific assistance is required in this area.*