

Back-of-the-Envelope Breakeven Analysis

Finding your breakeven point – the sales point where you cover all your expenses – can be one of the most helpful exercises you can do for business success. Knowing your breakeven point informs your goals, marketing strategy, pricing, and product development.

It is a number you can tinker with over and over, as you morph your business elements, respond to market circumstances and grow your understanding of your industry and your niche in it.

Many projection or sales goals formats leave you with a lump-sum, annual sales number. The problem is that an annual or even a monthly number is hard to translate into a daily sales/marketing reality that you can get your head around. I've also simplified the process here, so it feels accessible for most small business owners.

This breakeven exercise is set up to give you a daily sales goal, not in terms of dollars, but in terms of the number of 'things' -- hours, meals, haircuts, classes, home inspections -- you need to sell each day to make a comfortable living. For most business owners, this is an invaluable number for you to know well and use every day.

And that's the other thing: The definition of a breakeven point is when sales equal expenses. That's fine for a sole proprietor if you don't need to eat or pay your taxes. My breakeven analysis accounts for your 'take home' pay needs, savings, taxes and future growth.

Here are the steps:

- I. Determine Overhead
- II. Determine Net Profit Goal
- III. Calculate Your Total Sales Goal
- IV. Determine Your Sales Unit & Average Price
- V. Calculate Your Breakeven Point and Play With It
- VI. Strategies to Achieve Breakeven: Strategic Mark-up, Product Lines, Competition, Niche and Customer Satisfaction

So have fun. ;-) Play with this exercise so that you explore possibilities for your business.

Cheers,



II. Determine Your Net Profit Goal

One of the key elements of success in business is setting clear financial and sales goals. This will also allow us to work on your pricing and breakeven point.

Let's review what is Net Profit:

$$\begin{array}{r} + \text{ Sales} \\ - \text{ Expenses} \\ = \text{ Net Profit} \end{array}$$

But what does Net Profit need to cover? You need enough Net Profit for:

- ◆ Take Home Pay
- ◆ Savings
- ◆ Income Taxes
- ◆ New Business Investment
- ◆ Loan Payments

Fill this in and add it up to calculate your Net Profit Goal:

1. How much money do you need each month or year for your household and personal expenses? _____
2. How much do you want to save each month/year? (This is has to be greater than zero!) _____
3. How much do you need to set aside for taxes?³ (If you don't know, start with 15 – 20% of #1.) _____
4. How much do you need for additional investment to grow your business? _____
5. What are your monthly /annual loan payments? _____
6. Do you need to buy health insurance? Monthly or annual cost. _____
7. Any other expenses you need to cover? Savings for college, dental work, child support payments, etc. _____

8. Add it all up

That's your monthly or annual **Net Profit goal**. This will allow you set sales goals and pricing strategies.

³ Sole proprietors pay around 13% for self-employment tax, and another 10-25% for Federal income tax, depending on taxable income. State taxes vary by state.

III. Calculate Your Total Sales Goal

1. What is the monthly Net Profit Goal
From page 3 _____
2. What is your monthly business Overhead
From page 2 _____
3. **Add these two together: Your Sales Goal**
Transfer this number to page 5 _____

IV. Determine Your Sales Unit and Average Price

Now let's calculate how many 'things' you have to sell each month to reach your Net Profit Goal. First let's determine your "sales unit." Some examples:

- ♦ One guided trip
- ♦ One workshop
- ♦ One typical retail purchase
- ♦ One web site design
- ♦ One hour of your time
- ♦ Once hair cut

What is the average price of your "sales unit"? _____
Transfer this number to page 5

This can be hard in the case of some types of businesses. "Every sale is different," you say. Yes, I know. If you run a restaurant, every meal is different. If you run a retail shop, each total sale to a customer is different.

But just do your best to take a typical or average customer sale. You can adjust this later if you end up thinking this is too high or low. Remember, this is a "back of the envelope" breakeven analysis. It's going to serve you to get in the ballpark.

V. Calculate Your Breakeven Point

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Total Sales Goal	divided by	Average Price	=	Monthly or Annual Breakeven Point

That's your Breakeven Point: the number of hours/items/jobs/trips/websites/haircuts you need to sell per month/year to make your income goals.

Now divide that number again to get a **daily** breakeven point:

	÷		=	
Monthly or Annual Breakeven Point	divided by	30 days or 365 days	=	Daily Breakeven Point

It's also a good idea to do this exercise again: once with a slightly lower price and once with a slightly higher price:

Lower Price:

Divide Total Sales by a Lower Average Price

Your Breakeven Point has gone up.

You need to sell more items to make the same Net Profit.

Higher Price:

Divide Total Sales by a Higher Average Price

Your Breakeven Point has gone down.

You need to sell fewer items to make the same Net Profit.

Now think about your breakeven point. Does it feel feasible or do-able? Can you sell that many "units" per day?

If your breakeven point is high, you've got three choices:

- Increase sales -- marketing, positioning, new product lines, sales training
- Increase margin -- increase prices, lower cost of inventory purchases
- Lower Overhead or Net Profit requirements

Play around with some of the ideas on the following pages to come up with strategies to make your breakeven point – and your business -- work for you.

VII. Strategies to Achieve Breakeven

Breakeven point feel a little unattainable? Review some of these strategies to help you design a business model that can lead to success and profitability. Your financial success depends on a combination of product/service quality, marketing, target market perceptions, economic conditions and financial management. Your pricing strategy needs to take all these elements into consideration.

Strategic Mark-up or Pricing

Different products or services can support different mark-up or pricing. Some products will sell even with a stiff price; others need to be priced with a small margin in order to sell. So don't apply blanket pricing or mark-up to each item. Consider each item or service you sell and price it according to its place in your product line (see below) and the price/value perceptions of your customers.

Product Lines and Sales Strategies

Carry products or offer services that can support each other to add up to your breakeven point. For example, a clothing store could carry a line of jeans that are popular, priced low to sell, but also could carry a variety of accessories with a larger margin. Sales staff are then trained to suggest accessories with every jeans purchase.

Another example: A health food store owner wants to carry home-made, organic bread, but can't really make much profit because the price-per-loaf would be too high. So he also carries nutritional supplements that enjoy brisk sales in spite of significant mark up and high prices.

Competition & Your Niche

Where do you stand compared to your competitors? Depending on how you define your market niche, if you want to charge higher prices you must provide higher quality products and services. And it's your customer who decides whether your product/service is of high quality.

What do your competitors charge? List three competitors. Write down how you think their prices and quality compares to yours.

Competitor _____ Compared to My Prices and Product/Service Quality

- 1.
- 2.
- 3.

Client Satisfaction

How can you know what your customers feel about the quality of your product or service? Whether they like your product/service? If they think it's worth what you are charging? You need a pro-active strategy to find out. You can't assume you know or that customers will volunteer this information. List three strategies to get direct (and honest) feedback on client satisfaction:

- 1.
- 2.
- 3.

**Hope this was helpful.
Good luck and contact me if you have questions.**