

Ask Your Banker: *How to find your break even point*

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Dear John,

How can I—*simply*—do a break even analysis?

Jack Palino



Dear Jack,

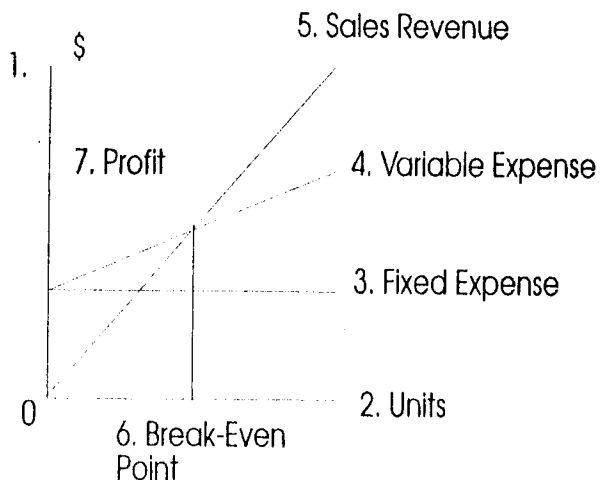
The break-even point is very important to know if you're starting a business. Basically, it's the point where the income equals the outgo. But, you still haven't made any money.

I recall asking a friend a few years ago about the point that he broke even. At the time, he had been in business for eight years. He said he broke even a year previously, and a year later, he just plain went broke. He had no idea of his financial condition during the entire time he had the business. I think his break-even was long prior to seven years, otherwise, he would've gone broke sooner.

It is hoped that a new business will break even sometime during the first year, and this is shown on a cash flow analysis and operating statement projection.

I always ask my students why they would work like a dog for 10 to 12 hours a day in their own business merely to break even? Eventually, one must do better than that. The following diagram plots the break-even and profit points.

1. The vertical line is money earned
2. The horizontal line is the number of units
3. Fixed expenses are those constant monthlies such as rent, utilities, insurance premiums, etc.
4. Variable expenses increase as sales increase, for example items like the cost of the goods or services and payroll.
5. Sales revenue volume shown increasing.
6. The break-even point is when the volume of sales/revenue increases (as a result of the sale of units) to the point that it covers both the fixed and variable expenses.
7. The area above where sales revenue and variable expense meet is your profit.



Break-even should be calculated in a time frame so that you will know when the income equals the expenditures; from that point, you should be profitable.