Breakeven Analysis

How To Calculate The Breakeven Point On Products Or Services

Calculating A Breakeven Analysis

What is a Breakeven Analysis?

A breakeven analysis is used to determine how many sales your business needs to start making a profit. It should be used when developing a pricing strategy that is part of your marketing or business plan. At the breakeven point, no profit has been made nor have any losses been incurred. This calculation is critical to determine appropriate modifications to pricing or costs for a particular product or service.

Defining Costs

- **Fixed Costs –** These are costs that are the same regardless of how many items are sold. Rent, insurance and computers are examples of fixed costs.
- **Variable Costs –** These are recurring costs for each unit sold. Supplies and labor needed to create each unit would be variable costs as they are specific to the item being sold and fluctuate based on quantity produced and sold.

Sales Price

- **Pricing Strategy –** Determining the price for an item is a mix of qualitative and quantitative factors. For example, a new and unique product could be priced at a higher premium price, but a product sold in a competitive industry will need to be priced in line with the going rate. A **cost-based pricing strategy** calls for determining how much one unit of an item costs to produce and adding a predetermine profit margin. A **price-based strategy** is based on the price that consumers are willing to pay and then getting costs in line to meet that price. This approach allows for flexibility in setting pricing based on the competition.

The Formula

- **Breakeven is fixed costs, divided by price minus variable costs.**
  Breakeven Point Formula = Fixed Costs/(Unit Selling Price – Variable Costs)
- The calculation will tell you how many units of a product you need to sell to break even. Once you reach that point, the costs associated with producing the product will be recovered. Every additional unit sold increases profit by the amount of the unit's **contribution margin**.
- **Contribution Margin** is Sales Price minus Variable Costs and is defined as the amount each unit contributes to covering fixed costs and increasing profits.

Tracking Analysis

- Using a spreadsheet will allow you to easily make adjustments as costs and pricing change. It will also allow you to experiment with different pricing strategies to calculate your breakeven point.

Sample Breakeven Calculations

- **Fixed Costs Product A**
  - $30,000 a year to produce 100,000 units
- **Variable Costs Product A**
  - $2.20 for materials, $4.00 labor costs, and $.80 overhead for a total of $7.00 per unit
- **Selling Price**
  - $12.00 each
- **Calculation**
  - $30,000 divided by ($12.00 – $7.00) equals 6000 units
- **Breakeven**
  - 6000 units must be sold at $12.00 before the product is profitable

This is a simple breakeven analysis. For businesses with a variety of products or services, utilizing an experienced CPA to help determine pricing strategies, cost savings, and appropriate inventory levels will provide your company with the best financial outcome.

SVA experts can assist you with your budgeting, forecasting, breakeven, and business profitability planning. Contact SVA to learn how we can help you grow your business.