rapid enterprise development

A RED Guide

Facilitating enterprise

Using Break-even to assess the potential of a business idea

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rapid enterprise development

Rapid Enterprise Development (RED) operates across the health, employment, disability and social care sectors to offer interactive and accessible approaches to the development of enterprise opportunities with and for disabled people. For more information about the RED business guides, training resources and strategic support packages, visit our website:

www.rapid-enterprise.co.uk

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Introduction

Supporting people with learning difficulties to think about self employment and small business ownership is hard. Judging the potential for their business ideas is often even harder - will they work? Are they viable? Are the ideas worth the time and effort needed to develop them?

Yet this an important part of what we can do to help entrepreneurs explore the possibility of enterprise. Therefore, in order to answer questions like these and to get a good sense of whether an idea is worth pursuing, it can be helpful to use the RED Testing Cycle (see diagram below).

At its heart the Testing Cycle seeks to ensure that:

- an idea meets a person's employment goals
- the enterprise idea appears to be viable
- the person and their enterprise has the support needed to be a success

By calculating the point at which an enterprise reaches break-even, this guide offers a quick and simplified way of attending to the second of these, the assessment of viability.

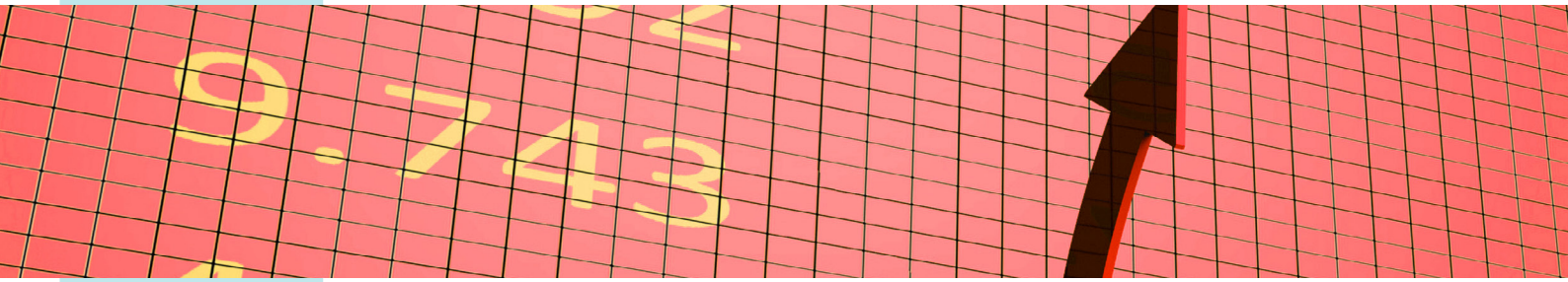
Break-even

The break-even point helps us assess the viability of a business idea by estimating how many sales an enterprise needs to achieve in order to meet its total expenditure. Break-even calculations are useful for both sole traders and small group enterprises.

Used early on, break-even can be a really useful enterprise assessment tool because it offers a sense of the level of sales needed to make a business idea work. At the break-even point, no profit has been made nor loss incurred.

Once the break-even point is known, it is possible to check whether an individual or group can and wants to produce or deliver that many products or services and, later, whether it will be possible to sell that many.

Break-even calculations require information about the business, the sales price, the cost of production and the overheads. Although it is important that the figures are accurate, it is possible to start off with estimates and replace these with the proper figures later.



Step by step guide

Follow this simple process to work out the break-even point:

1. Define the Unit of Sale (sales unit) - try to think about what a typical sales unit might look like for the business. An hours gardening? A piece of jewellery? A sandwich and a drink? A box of eggs? A half day training session? Although in reality business sales will vary enormously, this simplified approach assumes each sale to be the same.

2. Work out the sale price - think carefully about what the sales unit would sell for - remember the different ways to decide what the price should be by bearing in mind the cost of production or delivery, competition and what customers would feel is fair.

3. Calculate what the costs of each sale will be. This might include ingredients and materials, transport, packaging or other people contracted for specific jobs. These are the costs that relate directly to the volume of sale and will fluctuate depending on the number of sales made. These are also sometimes called direct costs or up and down costs.

4. Work out the likely annual overheads. This might include, insurance, rent, utilities, telephone and marketing etc. These are the costs that largely remain the same regardless of sales. These costs are also known as fixed costs, indirect costs or stay the same costs.

5. Using the figures you have worked out above, fill in sections A, B, C and E in the table below.

6. Now complete the other sections (D, F and G) to calculate the number of sales the enterprise will need to achieve each year in order to break-even. You can divide this by 12 to get the average monthly sales needed.

A	**Unit of sale (sales unit)**	
B	**Sale price**	
C	**Costs of sale (also called direct costs)**	
D	**Contribution (sale price - costs of sale)**	
E	**Annual fixed costs (also called indirect costs)**	
F	**Break-even (Annual fixed costs ÷ contribution)**	
G	**Average monthly sales (break-even ÷ 12)**	

7. With the break-even number in mind, think about whether achieving this number of sales is desirable or possible. Is there capacity to do this? Would doing so meet the employment goals of the entrepreneur? Is there evidence of demand for this number of sales?

8. Try altering the numbers and see what a difference it makes. What if the product or service was sold at a higher price? What could be done to change the product or service to justify this? Can the costs of sale (also called the direct costs) be reduced or the overheads lowered? Any one of these will have an impact on the break-even (see example below).

Worked example - Grass cutting business

Unit of sale: Cutting one average size lawn
Sales Price: £12.00
Cost of sale for each lawn cut: Labour £8.00, Transport £1.50, Petrol £0.75 = Total £10.25
Annual fixed costs: Insurance £150, Mobile £200, Marketing £500, Safety gear £200 = Total £1050

Example	Original	Change 1	Change 2
Unit of Sale	One Lawn cut	One Lawn cut	One Lawn cut
Sale price	£12.00	£15.00	£15.00
Costs of sale	£10.25	£10.25	£10.25
Contribution (sale price - costs of sale)	£1.75	£4.75	£4.75
Annual fixed costs	£1050	£1050	£700
Break-even (annual fixed cost ÷ contribution)	600	221	147
Average monthly sales (break-even ÷ 12)	50	18	12

Original - In this example it is unlikely that the business would be cutting 50 lawns a month especially as obviously grass does not grow all year.

Change 1 - It makes a big difference when the price is adjusted. Adding £3 to the price in this case significantly reduces the break-even point.

Change 2 - If we can also reduce costs (if Annual fixed costs were reduced to £700 for example) then the enterprise idea appears even more viable.

Next steps

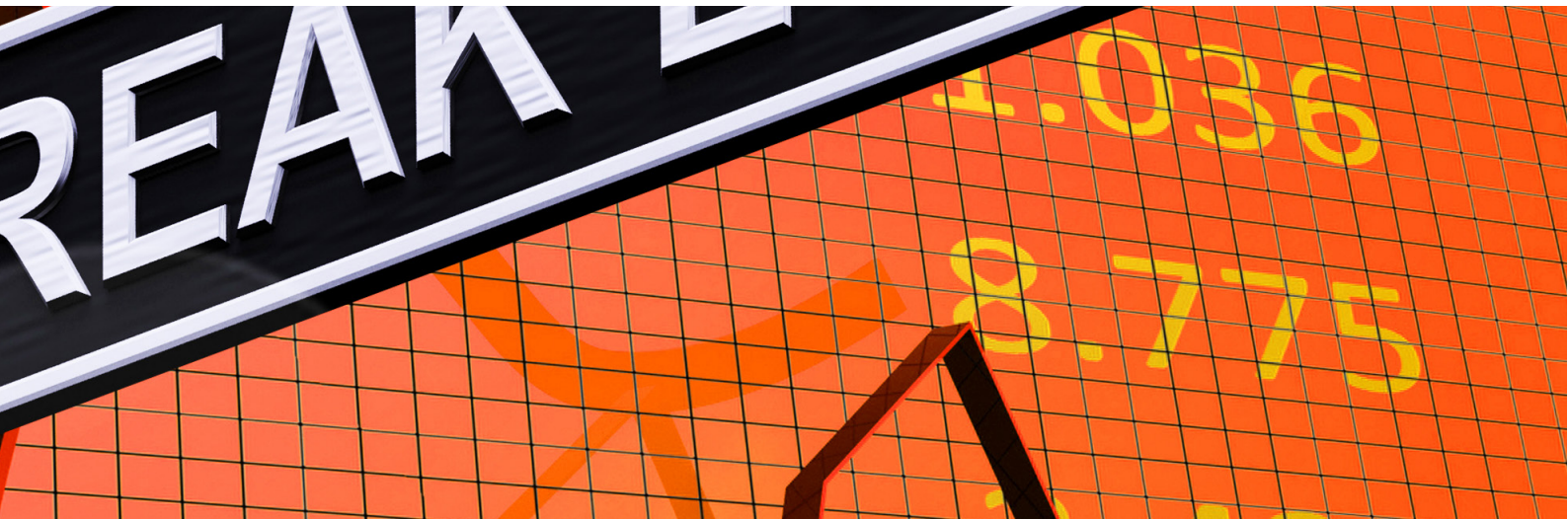
Calculating break-even can give a sense of how many sales are needed in order for an enterprise to meet it's costs. It is important to remember what this tells us (and what it doesn't). Although break-even provides information about what sales are required, it does not confirm whether it is possible to achieve that many sales.

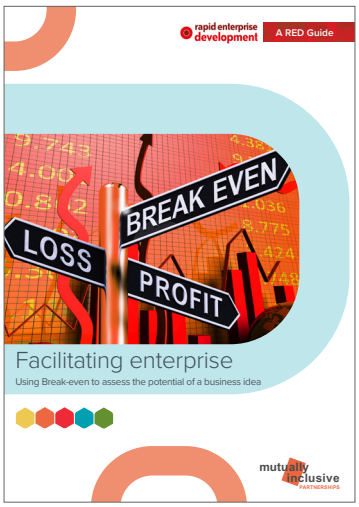
Of course just having one unit of sale has hugely simplified the enterprise, but doing it this way offers a simple approach to thinking about whether a business idea is worth pursuing. If, after making adjustments, the numbers still suggest that too many sales are needed to make the idea work, then it will be important to think carefully about whether to proceed. Although break-even is a tool for business planning, it also gives us some useful information to help people think about whether their self employment idea meets their employment aspirations and preferences.

If things look promising, the next step is to replace the estimated numbers with real costs - get real insurance quotes, rental prices and cost of materials etc. Once the break-even looks OK with these, then it is time to see if there is a market for the goods or services. You may need to keep making some adjustments until things look right.

Don't forget that trying different ideas before finding the one to go for is what it's all about.

Good luck!





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