



Article 27

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Know Your Business Breakeven Before Responding to the Economy

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During economically fragile times – when consumers and businesses are holding their collective breath – survival can sometimes be found by fine-tuning key expense areas. In my household we are eating out less, driving our economy car instead of the more comfortable but gas-hogging SUV, and turning out the lights when we leave a room.

Businesses can also benefit from examining expenses in key areas and cutting costs where possible. They might also respond to a slow market by lowering the selling price of their products or services to spur increased sales. But before a business owner adjusts pricing, he or she needs to be able to answer these questions – how do I know I am operating at a profit, and what are the lowest sales I can have and still break even?

At WESST Corp., we work with many small businesses whose owners have never taken the time to truly account for all the underlying costs of getting their product or service to market. They haven't identified their breakeven point.

One of my first clients when I started working at WESST in 1990 was a well-known and highly respected artist who made ceramic dishes. She came to WESST for help because even though she was selling well at art and craft fairs, she was having trouble paying her living expenses – things like rent, car payments and even groceries. Once I guided her through a pricing evaluation, she discovered she was only charging about \$2.00 on top of the cost of her product. More importantly, she realized she had neglected to add the time of her own labor to her costs.

Most entrepreneurs are highly skilled and passionate about what they do, yet are hesitant – and sometimes downright resistant – to understanding and tracking the true costs of their business. Many are unaware that they are actually operating at a loss. They blame poor cash flow, which they try to finance through credit card debt and small business loans.

First, understand all of your costs, including things like time. Then focus on setting the appropriate price for your product or service. This is where things get tricky. Pricing is both an art and a science.

A few variables to consider when setting price are your competitors' prices, the relative quality of your product or service, the convenience it provides, and customers' emotional buying habits. If you set the price too high, some customers may turn away, while others may justify the

expense because they feel they are getting higher quality. Lowering the price sometimes translates into larger sales volume, but if the price is too low, the business won't be profitable.

Once you know your costs and your potential price, determine your breakeven point. Only then can you adjust the price based on expected volume to achieve profitability.

Ultimately, almost every business owner wants to operate at a profit. Profits can be reinvested in the business to finance growth and avoid debt. They can be used to help build retirement plans or to accumulate a cash cushion for economically tough times or other unforeseen bumps in the road.

I worked with two women who wanted to open a salsa dance studio. After performing a break-even analysis, we determined they would need to conduct six to seven well-attended classes per day just to cover their costs. This was unrealistic and they decided to change directions.

It's tough out there. Taking the time to truly understand the pricing model of your business is one of the best investments you can make. This kind of financial savvy can help you successfully navigate the rough waters of the economy and changing markets.

As one client said as we were listing the fixed and variable costs associated with different business plan models, "I do this for my own household; I don't know why I've never done it for my business."

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