

What is Break Even and Why Should We Care?

“WHETHER OR NOT WE USE THEM, THERE IS A BREAK-EVEN COMPONENT TO EVERY BUSINESS DECISION WE MAKE.”

WHAT IS BREAK EVEN AND WHY SHOULD WE CARE?

The overall break even for our companies is the amount we have to sell to exactly pay all of our expenses. It is the point at which net profit or loss equals zero. Our break-even sales number may be of passing interest, but other than that, why should we care about it?

We should care because understanding break-even disciplines our thinking.

Many of us go to work on the first day of the month believing everybody's making a little money that day, and the next, and the next after that. Every day we make a little profit; our employees make their wages; our landlord makes some rent; our suppliers, insurance providers, utility companies, and all the people we do business with earn their daily cut.

It's true that everyone earns a little revenue, but it is not true that everyone makes a little money.

Neither we, nor anyone else, make anything - not even a tiny whiff of profit - until we have paid all of the bills for the month, and that doesn't happen until we have reached break-even sales. It is dangerous to think otherwise because if we don't break-even until the 29th of the month, we had better not go fishing on the 30th.

If we do, we forfeit our last opportunity to earn a profit before all those monthly bills begin anew.

OUR PERCEPTION OF PROFIT

Changing our perception of profit is not the only use for break even. Thinking in terms of break-even also affects our decisions and actions.

We can use break-even to find how much we must sell to pay all of this expense, or to budget for a planned increase in that expense, or to earn a budgeted profit, or to pay for a piece of new equipment.

We can use it to tell us how much more we have to sell when we reduce our prices, or how much less we have to sell when we increase our prices.

Whether or not we use them, there is a break-even component to every business decision we make. The applications are endless.

TRANSFORM OUR THINKING

The way we use it most often, break-even transforms the question "How much does it cost?" into "How much do I have to sell to pay for it?" The difference is far more than semantics.

The re-formed question focuses our attention on the fact that we have little influence over the cost of our purchases, but have a great deal of influence over how much we have to sell to pay for them.

Controlling cost is essential, but we can't merely save our way to prosperity. If it were that easy, we could just close up shop, shed all of our expenses, and get rich. We all know that doesn't work. We have to spend money to make money, and the challenge is to get the most in return for the money we spend.

REFOCUS AND FLOURISH

An hour of labor, a square foot of shop space, and a pallet of material costs about the same for all of us competing in the same market. In spite of that, some people flourish while others languish.

That's because some people get more in return for what they spend.

Instead of focusing entirely on what things cost, they concentrate on spreading cost over higher sales, getting more production from each dollar of labor, eliminating waste and using materials more efficiently. They concentrate on what they can influence most and are more productive than their peers.

As a result, they earn **higher** gross profit margins, which lead to **lower** breakeven sales, which lead to **higher** net profits achieved **earlier** each month, which leads to **more time** to earn even more **more profit**.

A BREAK EVEN MENTALITY

Thinking in terms of break-even rather than cost is fundamental to improving productivity.

A break-even mentality affects our productivity by focusing our attention on the things we have the most control over. It suggests actions we can take to improve the future, and it tells us how well our past decisions have worked.

The information is all there in one simple, powerful number. When our break-even goes down, we know we have become more productive.

When break-even goes up, we know we have become less productive. All of us in business need to know.

HOW ABOUT YOU?

Do you focus primarily on cost, or on productivity? How do you measure productivity? How much do you have to sell to break even?

If you have any further questions, please don't hesitate to mail me at Martin@annealbc.com or visit www.annealbc.com



Martin Holland

Martin Holland is the son of a successful entrepreneur. He grew up hearing about margins and markets, R&D and sales, risk and return on investment. He learned to love the language and rigors of business and grew to believe that business is both the most human of all endeavors and the highest calling. After selling a company in 2011, Martin became a coach in order to help other owners build profitable businesses that do not require their day-to-day involvement.

A native of Norman, Martin earned a B.A. degree from Hastings College in Hastings, Nebraska and a Masters in Business Administration degree from the University of Oklahoma. Over the past 7 years he has written business plans that have raised over \$52.4 million in bank and investor financing. He has helped 157 (and counting) business owners reduce stress and increase performance through clarity of purpose, better marriages, more money, and more free time away from the business.