

Case study

Is it still worthwhile?

The meeting with the bank's Small Business Manager had not gone well. The manager had appreciated the work that Lena and Boris had put into their business plan but the assumptions behind the break-even analysis had been criticised as being too optimistic. The manager had redrawn the break-even chart with new assumptions about contribution per unit and the business seemed much less viable. 'Why should his figures be any more accurate than ours?' moaned Boris. 'That's not the point – he won't lend the money unless we make this business proposal seem more profitable,' explained Lena. 'What we need to do is rethink the figures behind the break-even and see if we can convince him that the business is worth the risk'.

The couple were planning to set up a home fitness business which offered specific, personalised get-fit courses for people who were not keen on traditional gyms. They both intended to keep their own gym jobs going but would employ others to provide the 'home service'. The main variable cost was going to be the employment of hourly paid well qualified fitness instructors. The main fixed costs were the leasing of vans and keep-fit equipment. The bank manager had doubted the low hourly wage rate included in the break-even calculation and the pricing levels forecast by Lena and Boris. 'You need to charge more than that if you expect to make much of a profit,' had been the manager's last comment.

Two weeks later the couple had revised their figures and had redrawn the break-even chart. They were prepared to do battle with the manager once more. The revised data used by Lena and Boris is in the table below – together with the manager's own estimates.

Table 12.3 Boris and Lena's financial data

	Bank Manager's estimates	Boris and Lena's revised data
Fixed costs – weekly	£2,100	£1,500
Variable cost per customer hour	£15	£12
Average price to customer	£45	£37
Expected number of customer hours per week	80	80

Boris and Lena had decided they could recruit less well-qualified fitness instructors and lease second-hand not new vans in drawing up their new revised figures.

Questions

- 1 What do you understand by the terms:
 - a contribution per customer, and
 - b break-even level of output?
- 2 Explain two benefits to Lena and Boris of undertaking break-even analysis in this case.
- 3 Analyse the viability of this business proposal by undertaking break-even analysis using either the formula or a chart. Compare the break-even points, the forecasted profit levels and the margins of safety (at assumed expected number of customers) using the data.
- 4 Using your results and any other information in the case, would you advise Lena and Boris to go ahead with this business proposal? Justify your answer.
- 5 Research topic: Use the BBC business website to research a company that is struggling to meet its break-even point. For example, search for the Airbus A380.