

BREAKEVEN ANALYSIS

Case Study:

James Waters owns 'Carzwash', a successful car wash and valet business located near a large shopping centre in Newtownabbey. He has built up a good reputation since opening the business three years ago, and many of his customers return on a regular basis. Carzwash offers a good quality service at a competitive price.

James charges £30 per car for a wash and valet. This price attracts an average of 60 vehicles per week. James estimates that he could wash and valet up to 100 cars per week, depending on weather conditions and parking spaces on the premises. The variable costs associated with washing/valeting 60 vehicles are £1200 per week, whilst the fixed costs are £400 per week at present.

James is satisfied with current customer numbers. However, a local newspaper has printed a story suggesting that a competitor intends to set up nearby, at a filling station. James is investigating two options in order to ensure the long term viability of the business:

- (i) Reduce Selling Price: this option open to him would mean reducing the price of each car wash and valet to £25; or,
- (ii) Aim for a weekly profit of £200.

Activities:

- Explain what is meant by the terms: 'variable cost', 'fixed cost', 'breakeven point' and 'margin of safety'.
- Calculate the number of cars that currently have to be washed/valeted each week in order to breakeven.
- Calculate the weekly profit that would accrue to James Waters, based on washing 60 vehicles per week.
- Analyse the implications for Carzwash, of lowering the price of each wash and valet to £25 per vehicle (Option (i)).
- Calculate the number of additional vehicles to be washed/valeted in order to achieve the desired weekly profit (Option (ii)).
- Evaluate the usefulness of breakeven analysis to a business such as Carzwash.

Key Terms:

Breakeven Analysis; Variable Cost; Fixed Cost; Contribution per Unit; Breakeven Point; Quantity; Sales Revenue; Profit; Loss; Margin of Safety; Desired/Target Profit.

