Financial Learning Pathway

Session 4: Leveraging Break-Even Analysis and Unit Economics

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Session 4 Outline

- Break-Even Analysis
- Unit Economics: Tangible insights for you as the owner
- Key Performance Indicators (KPI's)
  - ➢ X Factor
  - ➢ Team KPI's

Break-Even Analysis:
A Tool in your Business

WHAT is the Break-Even Point?

Simply put: Reveals the amount of revenue you need to make per month to break even and cover all of your costs

$$\text{Break Even Point} = \frac{\text{Fixed (Indirect) Expenses}}{\text{Gross Margin \%}}$$

Rub-a-Dub Break-Even Example:

Break Even Point =

<u>Fixed (Indirect) Expenses</u>

Gross Margin %

Average Monthly Break Even = $67,108

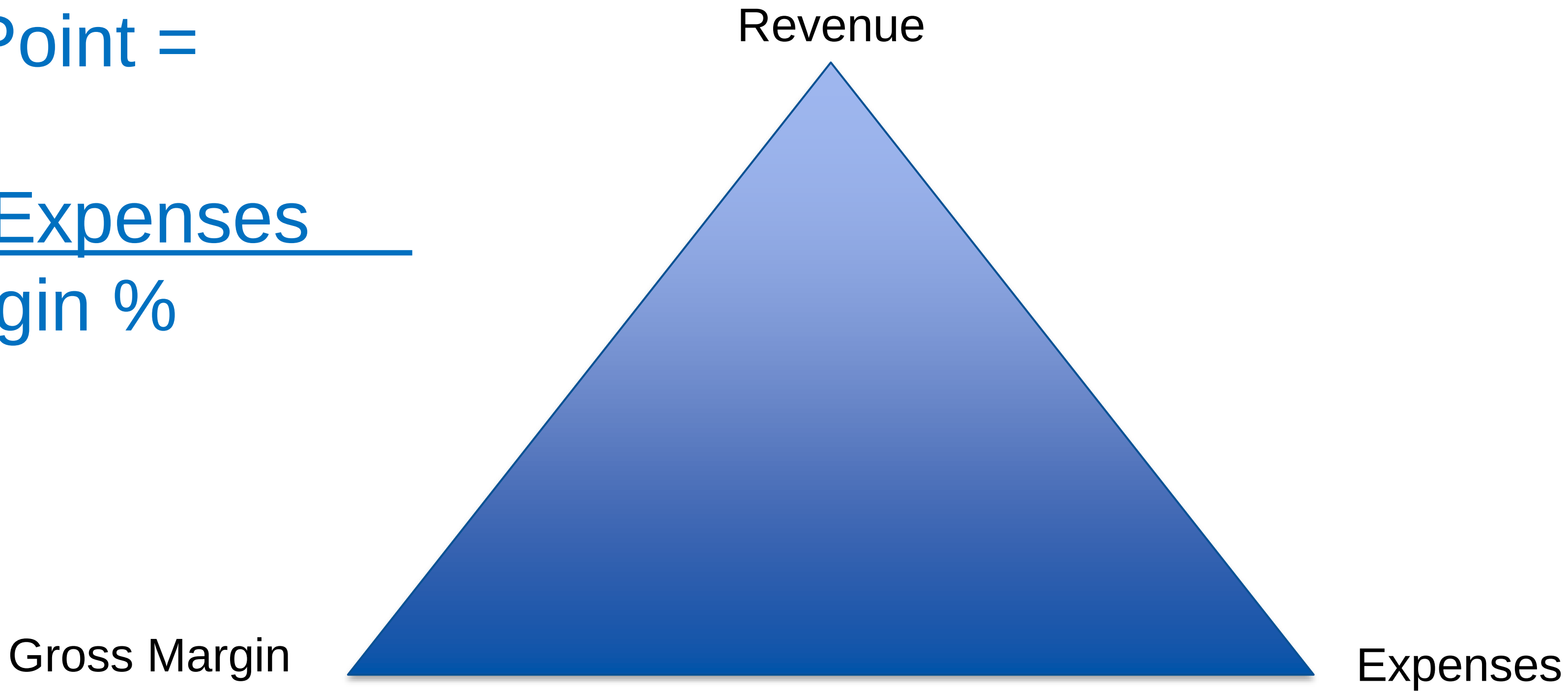
.<u>Average Monthly Expense = $21,072</u>

Annual Overall Gross Margin = 31.4 %

Traditional Break-Even Analysis

Break Even Point =

$$\frac{\text{Fixed (Indirect) Expenses}}{\text{Gross Margin \%}}$$



Break-Even Formula as a Tool: The WHY

- **Make decisions:** Shows how much money you need to A) Hire B) Buy Equipment C) Pay yourself, etc.
- **Improve Margins:** A piece of equipment might reduce labour, as an example.
- **To Build Capacity:** When you're trying to build capacity in your company to deliver more goods and/or services

Break-Even Formula as a Tool: The **HOW**

Break-Even Point =

$$\frac{\text{Fixed (Indirect) Expenses}}{\text{Gross Margin \%}}$$

Or stated a different way:

$$\frac{\text{New Expense}}{\text{Gross Margin \%}}$$

= Revenue Needed to Cover Expense

Using Break-Even to Evaluate Business Decisions

Break-Even Formula:
Break-Even Revenue = New Expense ÷ Gross Margin %

Gross Margin Example: 31.4% (or 0.314)		
Business Decision	**New Expense**	**Break-Even Revenue Needed**
New Hire	$50,000	$159,235
Marketing Campaign	$15,000	$47,770
Equipment Purchase	$6,000	$19,110

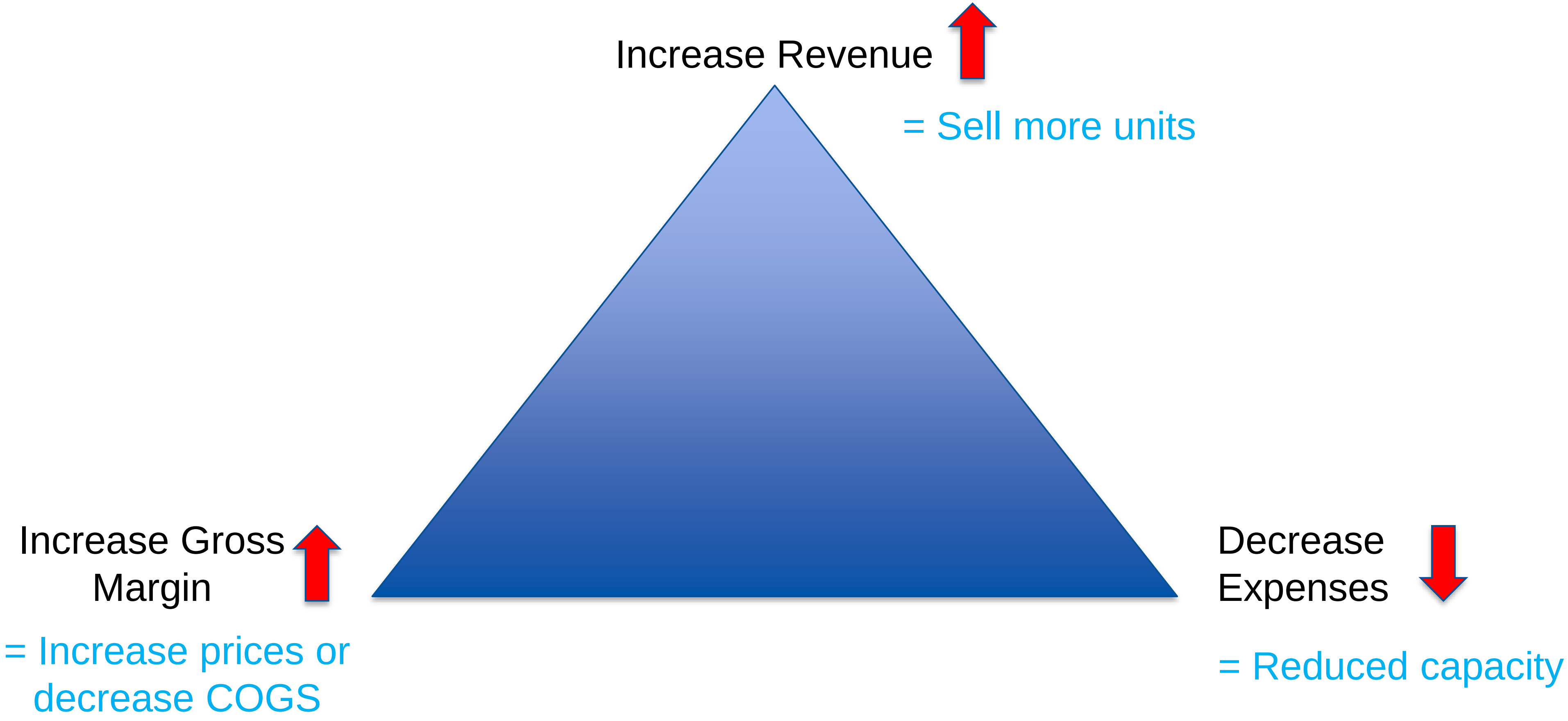
Break-Even Comparison by Gross Margin %

Break-Even Formula:
Break-Even Revenue = New Expense ÷ Gross Margin %

Business Decision	New Expense	GM%: 31.4%	GM%: 35%	GM%: 40%
New Hire	$50,000	$159,235	$142,860	$125,000
Marketing Campaign	$15,000	$47,770	$42,860	$37,500
Equipment Purchase	$6,000	$19,110	$17,140	$15,000

Questions?

Using BE as a Tool: Three Ways to Make More Profit



“Three levers. One goal: Profitability.”

HOW to Use Break-Even

Use BE to make hiring or purchasing decisions

- Use the Fixed (Indirect) Expense as the new Expense (The new hire's annual salary or price of piece of new equipment)
- Divide by your overall Gross Margin
- Show how much you need to generate in revenue to pay for the Fixed expense (whether it be a salary, piece of equipment, etc.)

Example:

How to Impact the Three Points of the Triangle

Questions?

Unit Economics: Tangible insights

WHAT Is Unit Economics?

- **Way to measure your business on a per unit basis** that is tangible and that everyone can understand

- **Clarifies Revenue:** Breaks revenue down into **what you're actually selling**

- Measurement tool that **bridges the gap between financial reports and day to day operations**

What Unit Are You Selling?

- A "unit" represents a tangible revenue-generating entity in your business. This could be a product, measurement, or even a single transaction
- It's important to define what constitutes a unit for your specific business or Revenue Centre, as a clarity and simplification tool
- **Note:** There are often different units for each revenue centre

WHY Is Unit Economics Important?

1. Staff Alignment
2. Measuring Profitability
3. Budgeting and Forecasting
4. Setting KPI's (Key Performance Indicators)

1) Staff Alignment

- Really hard to motivate staff on Revenue Goals – not tangible and may have a negative perception
- Really easy to motivate staff on Unit Goals – very tangible and sounds logical
- Everyone can see a unit sold
- Simple to measure effectively in your POS

2) Measuring Revenue Per Unit

- By measuring units, it facilitates the measurement of basket size or order size (retail or restaurants). Small items need to be grouped together toward a single transaction
- Have a measurement you can act upon to drive improvement. Example: Set a target to increase basket size from $20 to $25

3) Supports Budgeting and Forecasting

- Unit economics is a predictive tool for forecasting future performance
- By setting Unit Targets, marketing efforts can be measured
- By setting $ per Unit targets, sales processes can be measured
- By understanding the economics of each unit, businesses can better predict how changes in scale will impact overall profitability
    - For example, instead of setting a target to increase revenues by 10%, you set a target to sell X more units, OR increase order size from X to Y.

4) Setting Key Performance Indicators (KPI's)

Unit economics provides a solid foundation for setting realistic, growth-driven KPIs that teams can aspire to, and be measured against.

Examples of KPIs derived from unit economics:

- **Operational KPIs**:
  - **A spa** may target **6 treatments per day**
  - A **hotel** may focus on improving **room utilization rates**, using unit economics to optimize resources and drive team performance

- **Customer Lifetime Value (CLV)**: The total revenue a business expects from a customer over the course of their relationship

Measure Your Unit Economics - Examples

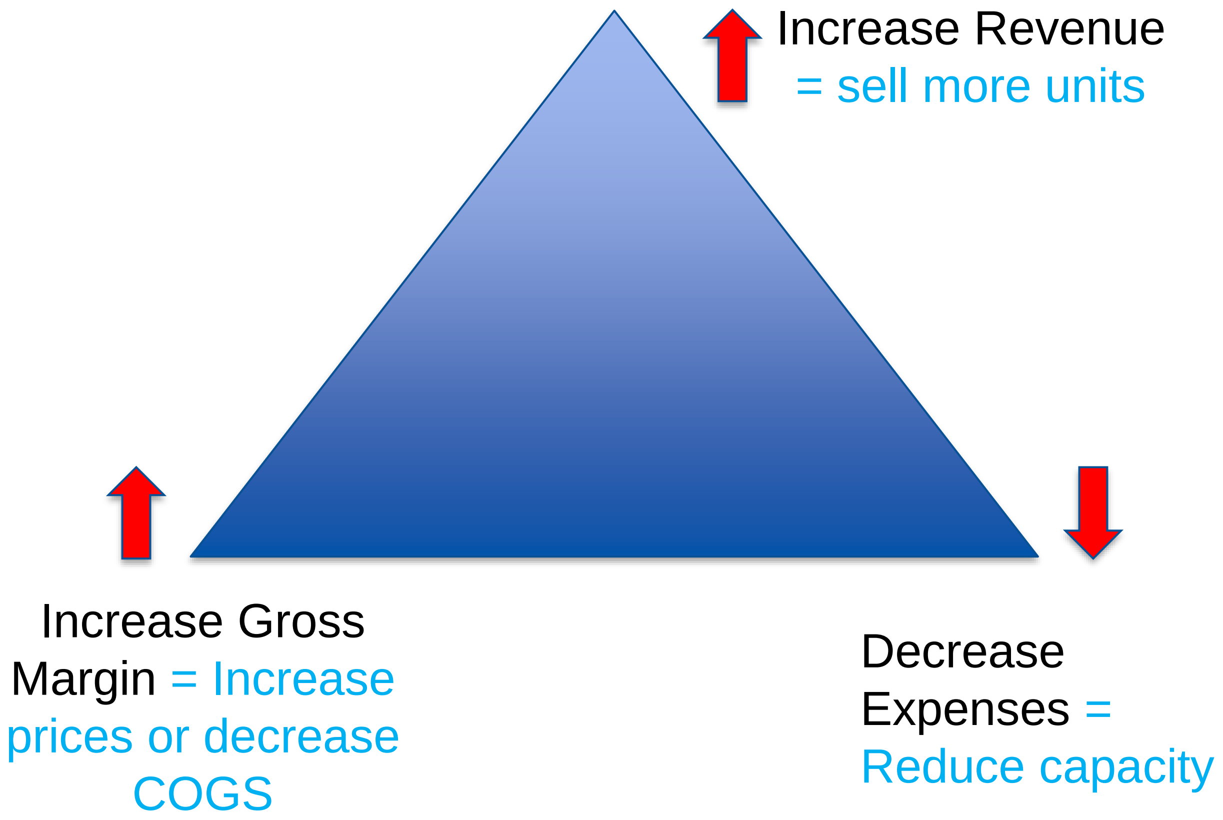
- Service Company –
  - Roofing Co: # Square Feet
  - Salon: # of treatments
  - Restaurant: $ per order

- Product/Retail Company–
  - Grocery Store: Basket size $ per transaction
  - Hot Tub Co: # hot tubs sold

Unit Economics for Marketing and Sales

Bringing back the 3 points to the Triangle:

- Marketing is to **increase the number of units,** which **increases revenue**.
    - Set a unit goal for marketing campaigns
- Sales processes are **to increase is dollar value per unit,** which **increases Gross Margin**
    - Set a $ per unit goal for sales team.
- This will Turn unit economics into KPIs



Questions?

HOW You Use Unit Economics

- Define the unit you are selling
- Break down revenue per unit
- Track on the TTM
- Set goals
- Turn unit economics into Key Performance Indicators

Example:
Unit Tracking

Questions?

Setting Key Performance Indicators (KPI's)

Understanding KPI's

KPIs (Key Performance Indicators) are measurable values that demonstrate how effectively a company is achieving its business objectives

WHY?

- **Track progress t**owards specific goals, measure success, and guide strategic decision-making
- **Strategic Alignment**: They ensure that everyone in the company is aligned with the overarching business objectives

HOW KPI's are Used

- **Measuring Performance**: KPIs track how well the company, teams, and individuals are performing against their goals

- **Strategic Alignment**: They ensure that everyone in the company is aligned with the overarching business objectives

- **Decision-Making**: KPIs provide data to make informed decisions, adjust strategies, and allocate resources effectively

The Ultimate KPI: The X Factor

What is Profit per X?

- **Profit per X** is a unique KPI concept introduced by Southwest Airlines in Jim Collins' book *Good to Great*. It shifts the focus from traditional metrics to a singular, optimized factor that drives profitability

- **Example (Southwest Airlines)**: Instead of measuring "Profit per seat," they shifted to **"Profit per plane"**, which helped them find economies of scale.
  - They ordered identical planes for their fleet, streamlined operations, and made staffing more flexible, leading to lower costs and higher efficiency.

Setting Your X Factor

- **Identify Your Core Driver**: To set your own "X factor," find the one key metric that most directly impacts profitability and operational efficiency in your business. Examples:
  - For a restaurant: **Profit per Table**
  - For a service company: **Profit per Technician**

- **Align with Business Goals**: Choose a metric that aligns with the company’s strategic objectives

- **Scale Efficiency**: Focus on something that can be scaled across your operations, much like Southwest streamlined their fleet to achieve greater economies of scale

Setting Team KPI's Based on Profit per X

Every department or team should have a KPI tied to the company's **main KPI** (e.g., **Profit per X**). This helps align their day-to-day actions with overall company goals.

1. **Start with Profit per X**
2. **Break It Down by Team**
3. **Set Clear, Measurable Targets**
4. **Incentivize Based on Progress**

Rub-A-Dub KPI Examples:

Rub-a-Dub **X Factor** = Profit per Customer (LTV)

Other KPI's:

- # Hot Tubs Sold/Month (Variable Monthly, Annual Target of 72 tubs)
- $250 Accessory sales/ Hot Tub Sale
- Non-Warranty Repairs @ 40%GM
- Maintenance club up to 12 visits per day
- Overall GM target of 38% (CEO)

Result of $240,000 of Net Income!

In Summary

Topic	Key Focus
Break-even Analysis	Understanding and calculating your break-even point, and using it as a tool for business strategy.
Unit Economics	Breaking down business data into actionable units to drive performance.
Key Performance Indicators (KPIs)	Setting measurable goals to track progress and align team objectives with business goals.

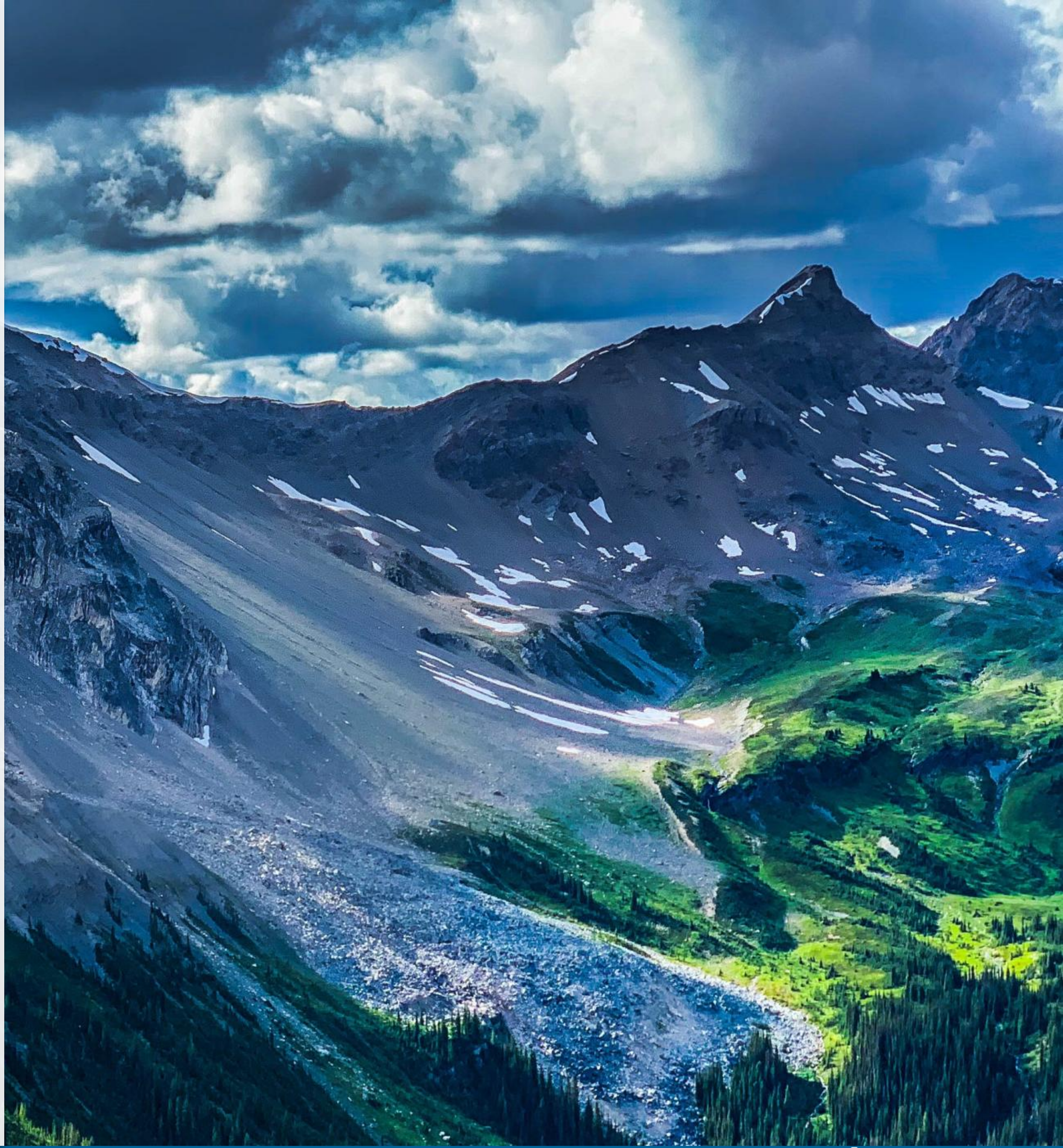
Questions?

Homework for Session 4

- Calculate your monthly Break Even and do a BE analysis on a new hire (annual salary $65K)
- Determine your units to track. If ready, set a unit target or revenue per unit target.
- Determine your Profit per X. What is your X?

Thank You

Q & A



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