

Is it Worth the Cost?

You have spent so much time researching a franchise model that is right for your lifestyle, now it's time to ask yourself if that business fits with your financial goals and can be financially feasible. Since you now have probably signed a required FDD (Franchise Disclosure Document), and received some basic sales and costs numbers from the Franchisor, it's time to begin a "break-even" analysis. In any start up business, a break even analysis will allow you to determine at what stage the business can become profitable. There is a common misunderstanding among new "wanna be" business owners that this is the point where one actually recoups the initial investment costs. This is not true. That of course does not usually happen until well after the break-even point is achieved and a consistent profit contribution happens so as to pay off the initial investment.

So let's turn attention to the amount required to hit your **break-even point**. The true mathematical definition for a business or product is the point where total revenue received equals the total costs associated with the sale of the product. A break-even point can also be calculated in order to determine if it would be profitable to sell a new product, as opposed to attempting to modify an existing product or buy a new franchise versus and purchase an existing business. First, make sure that you understand and differentiate between fixed and variable costs. **Fixed costs** are expenses that do not change as a function of the "activity" of a business, within the relevant period. For example, a retailer must pay rent and utility bills regardless of sales generation. **Variable costs** are expenses that change in proportion to the amount and activity of a business such as supplies, inventory, and hourly payroll (to name a few)

To calculate a break-even point, follow these 5 steps (I assumed the investment cost is \$1M):

- 1- Begin by figuring the fixed costs (in the example below, it is \$250,000/ year)
- 2- Calculate the variable cost percentage as percent of overall expenses (in this case it's 60%). Note, this will also assume the contribution margin at 40%
- 3- Based on the level of investment, determine an expected ROI goal (I used 20%)
- 4- Calculate targeted profit goal (ROI on \$1M) or 20% of \$1,000,000= \$200,000
- 5- Use formula to calculate Required Sales

$$\text{Required Sales} = \frac{\text{Fixed Costs} + \text{Profit}}{\text{Contribution Margin}}$$

Based on this formula, your required sales for that period will be **\$450,000---your break-even point**

Remember, sales are variable also. For a start up business, in doing pro formas, using projections is also advisable. You can utilize a percentage of sales of an existing location (try to find the most similar) and apply other logic such as marketing efforts, size of store, industry trends, shopping center traffic, hours of operations, etc. Required sales or your break even amount can be calculated, but projecting sales comes from a better understanding of the business, existing trends, and the largest factor- How much marketing dollars can you commit? The best advice: Get the financial facts, do your calculations, and then be realistic about the growth of the business.

An ex-employer used to tell me (when I was much younger and quite overzealous), “The Roman Empire was not build in three days”. I will remember that advice forever! Time, patience, and a little thing called a learning curve are the intangibles—factor those in as well.

Note: There are several online calculators to assist you with your breakeven analysis:

- Case Western Reserve University offers a [breakeven analysis calculator](#) that includes a review of relevant microeconomic terms.
- This [financial calculator](#) allows you to chart your costs and profits appear in a graph.
- Inc.com offers a [breakeven analysis calculator](#) that requires a user to enter in total annual overhead and annual year-to-date sales and cost of sales, and lets the user delineate the period for the YTD calculations in terms of weeks.