

Breakeven with IQ Retail - Smart Accounting Systems for SME's

Understanding Break-Even, Gross Profit and Net Profit

To calculate whether your business is profitable you have to know your business break-even. Break-even in a business is the point where the net profit of the business is neither positive nor negative, but equals zero.

Net profit is reached after all costs and expenses have been taken into account and subtracted from the sales or turnover of the business.

Gross profit is calculated by subtracting your costs of sales or purchases from your total sales or turnover. Cost of sales are those costs associated with the acquisition of products or raw materials. This would include the purchase price of those items minus discounts and returned items plus additional costs like delivery. A high gross profit is not indicative of a profitable business, and we regularly see businesses with gross profits of millions of Rands going bust.

Once you know your gross profit, you subtract all the business expenses, and this will give you the net profit of the business. Expenses are those costs associated with the running of the business, and usually include rent, electricity, phone costs, vehicle related costs, marketing, salaries and wages, and similar costs. This is also known as the overhead costs of the business. If the value between your gross profit and expenses is negative, you are losing money somewhere.

How Profit Is Calculated in a Business

You need to increase your gross profit or reduce your expenses in order to ensure you are getting a net profit in the business. There are three ways to increase your profit. The first is to cut costs – and again I urge all small business owners to consider this the last option – as you probably already have cut your costs wherever you could. The second option is to increase your sales over time, and the third is to increase your prices. Remember, price is very seldom THE issue, but usually only one of a number of issues. To consider price as the most important factor in running a business is a grave mistake and has unfortunately led to the downfall of many potentially good businesses.

Improving Profitability

As part of your expenses, remember to include your salary as well. The business might not be able to afford you at this point, but if you don't include it in your break-even calculation chances are that you will miscalculate the break-even point. For a small business, a net profit – also known sometimes as the margin of safety - should be at least 10%, but preferably between 10% and 20%. If your business has a net profit of between 25% and 35%, you are doing very well. Set this as a target for your business. Don't be too concerned if you're not exactly sure where an expense or cost should go, as long as all of it is taken into account.

Sound Business Planning (Luke 14:28)

Luke 14:28 provides the following sound business advice

” Suppose one of you wants to build a tower. Won’t you first sit down and estimate the cost to see if you have enough money to complete it? For if you lay the foundation and are not able to finish it, everyone who sees it will ridicule you saying: This person began to build and wasn’t able to finish.”

It is extremely important to calculate the costs of running your business, and that includes all costs, including cost related to the owner(s) of the business. Only if you know the costs of running your business you can start growing the business beyond just break-even and reach a profitable state.

Using the Right Accounting System for Your Business

Make sure you use an accounting system that can assist you with establishing the break-even for your business. Using IQ Retail can assist you in managing your business and providing you with the relevant information to make the right decisions to ensure profitability and sustainability.

Systems, Accountability and Business Responsibility

Your business should not adapt to your accounting system, but your accounting system should adapt to your business. Your accountant is very important for your business, you have to have one, but your accountant is not responsible for your business being profitable, but rather for being compliant and for paying taxes.

NetRisk, in consultation with you, will be able to offer a fit for purpose system with related processes to take your business to the point of profitability.