Case study 31

Assess the extent to which Razia achieved her objective by raising the price of the courses from £600 to £800.

Introduction:

- Razia's profit in 2013: £32 000 (sales 200 course)
- Razia's aim: raise profit by 10%
- She could
    - Charge more
    - Reduce travelling time

Aim would be achieved if profit increases by £3 200 (= 0.10 * £32 000).

We know that she spent £3 000 for advertising and increased price of courses to £800.

The profit in 2014: profit=total revenue-total cost=£800 * 150 -(£12 000+(150*£500))=£33 000

Profit only increased by £1 000 (from £32 000 to £33 000), there Razia did not reach target.

However, the advantages for Razia are:

- Number of courses fell from 200 (in 2013) to 150 (in 2014) --> she has to work less --> more leisure time
- We assume sales were closer to Birmingham --> less travelling time --> more leisure

Conclusion:

- Razia did not reach her target after raising prices (10% increase of profit)
- However, she increased profit by £1000 for less work.
- Her satisfaction with this result depends on how much she values leisure time with respect to profit

Chapter 32

Assess the usefulness of break-even analysis to Gowda Chanda Ltd.

Introduction

[Def.] 'break-even analysis' …

[Describe chart] shows amount of plastic that must be sold every month to break-even. It shows total cost, total revenue and profit/loss made for different levels of output. It shows that Gowda Chanda needs to sell 800 tonnes of pellets each month to break-even

Break-even charts help to answer '*what if*' questions. **If** price goes up, what will happen to break-even point. If variable costs increase, what will happen to the break-even point.

Break-even analysis can be used in *business plans*. Here, break-even analysis shows clearly the impact of machine breakdown on profit (loss of £2 500).

However, break-even analysis has limitations:

- Too simplistic and unrealistic assumptions (e.g., output equals sales, no stocks are held). Gowda Chanda may produce and stock in time where demand is low in order to avoid laying off employees
- Effectiveness of this tool depends on quality of data used to construct cost and revenue functions. These functions will affect the position of the break-even point.
- Both functions are asumed to be linear, which is rarely the case in reality.
    - Offering discounts on large orders will make the revenue curve non-linear.
    - Economies of scale will make the cost curve non-linear.

Conclusion

Overall, break-even analysis is a helpful tool.

Break-even chart shows how many tons must be sold to break-even.

The chart also showed the effect of the breakdown on the profit.

As long as Gowda Chanda is aware of the limitations, break-even analysis can be a powerful too.

Case study 34

Assess the measures a company like Salwell plc might take to improve profitability

Introduction

Salwell would like to take action to protect the financial performance of the company for the future --> increasing profit margins will improve performance

Improving profit margins may be done by:

- Raising prices --> generates more revenue for every unit sold --> might have impact on sales: if PED is close to zero, increase in price will generate more revenue.
    - Raising prices is risky: competitors may profit from this by gaining market shares
- Lowering costs --> by buying cheaper resources + using the existing ones more efficiently
    - Buy raw material + resources from new suppliers for cheaper

    - Find new suppliers of services where there is a lot of competition (e.g., gas, telecommunication)
- Finding cheap labor --> move business to locations with cheap labor (e.g., China, Eastern Europe)
- Increase efficiency --> buy new machines that are more efficient --> would raise **capital productivity** --> reduce waste
- Offer training to employees to increase **labor productivity**

Downside of these measure:

- Cheaper suppliers may also mean raw material of lower quality --> unreliable + not guaranteed --> may cause disruption in production --> may damage the image of the company
- Workers may resist to new working practices (e.g., learning new technologies, changing old habits)

Conclusion:

- Raising prices is not an option for Salwell --> difficult global trading conditions (e.g., competition, ...) --> may loose market share
- Redundancies my be necessary --> some workers are already on shorter working weeks --> will loose highly trained staff --> Salwell might want to avoid this knowing that economy will do better in the future