

3.3D: Break-Even Analysis: Activity



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3.3 BREAK-EVEN ANALYSIS: ACTIVITY D

Read the case study information below and answer the questions that follow.

BRYONY'S PASTA



Bryony Miller runs a small pasta-making business, called *Bryony's Pasta*. She has borrowed funds to purchase a property, leased machines and employed two staff. Her main competitor is called *Fasta Pasta* but there are also a number of general food shops selling fresh pasta as a small part of their product range. Bryony sells her pasta for a premium price of \$7 per kilogram. Full capacity is 12 000 kilograms of pasta per year. She incurred the following expenses in 2007:

- Lease costs \$200 per week
- Mortgage payment \$500 per month
- Bryony's salary \$300 per week
- Raw materials \$1.25 per kilogram (kg) of pasta produced
- Wages \$1.60 per kilogram (kg) of pasta produced
- Electricity/gas/water \$0.15 per kilogram (kg) of pasta produced

Bryony's Pasta is currently producing an output of 10 000 kilogram per year. A large hotel chain has approached Bryony and offered to purchase 4000 kilograms per year of pasta at a price of \$4.50 per kilogram. Bryony is considering the offer and believes that it may be worthwhile as she is concerned about sales falling in the future.

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QUESTIONS: 20 MARKS, 30 MINUTES

1. With reference to Bryony's Pasta, distinguish between fixed costs and variable costs. **[3 marks]**
2. Construct a break-even graph showing the break-even level of output, the margin of safety and the amount of profit at current output level. (Show any relevant workings) **[5 marks]**
3. Bryony is considering changing the price of her pasta. Describe **two** possible pricing strategies and advise Bryony on the most appropriate to adopt. **[6 marks]**
4. Evaluate whether Bryony should accept the offer from the hotel chain. **[6 marks]**