

Pricing and Break-Even Exercise – Hot pepper jelly

You make hot pepper jelly, which you sell in your stand at a local farmers' market. None of the other stands sell anything like this, but at nearby stores, a similar product could be purchased for around \$5.00. You would like to sell your hot pepper jelly for \$7.00 a jar, trading on its *uniqueness*. You will need to do some computations to see how many jars you need to make, and sell, to pay for your fixed and variable expenses (in other words, to "break even").

You know that your expenses are:

Raw materials -- \$1.50/jar	Loan payment per month -- \$150.00
Market Stand Fee -- \$50/month	Telephone/DSL line per month -- \$90.00
Hourly labor -- \$1.00/jar	Packaging costs -- \$1.90/jar
Insurance per month -- \$50.00	Transport 8Xs a month -- \$95.00

Sort out the expenses into variable and fixed expenses:

Variable Expenses

Total Variable Expenses

\$
\$
\$
\$
\$
\$
\$

Fixed Expenses

\$
\$
\$
\$
\$
\$
\$

Total Fixed Expenses

(per unit) \$ _____ (per month)

\$ _____

The "Contribution Margin" is the Selling Price per unit minus the Variable Expenses per unit.

What is the Selling Price of a jar of hot pepper jelly? \$ _____

What are the Variable Expenses associated with one jar? (-) \$ _____

What is the Contribution Margin per jar? (=) \$ _____

The Contribution Margin represents how much is "contributed" from each unit of sales toward paying for fixed expenses and profits. **Every time you sell a jar, how much is it contributing toward paying for your fixed expenses?** \$ _____

What are your total Fixed Expenses for a month? \$_____ per month

What is your Contribution Margin per jar sold? (÷) \$_____ per jar

How many jars must be sold to pay for your monthly Fixed Expenses? (=) _____ jars

(Fixed Expenses divided by the Contribution Margin equals the number of jars it will take to “break-even.”)

What happens to the “break-even” number of jars if you raise the price to \$7.25?

Answer Key – Hot pepper jelly

Sort out the expenses into variable and fixed expenses:

Variable Expenses

<u>Raw materials</u>	\$ <u>1.50</u>
<u>Labor</u>	\$ <u>1.00</u>
<u>Packaging</u>	\$ <u>1.90</u>
_____	\$ _____
_____	\$ _____
Total Variable	
Expenses (per unit)	\$ <u>4.40</u>

Fixed Expenses

<u>Market Stand Fee</u>	\$ <u>50.00</u>
<u>Insurance</u>	\$ <u>50.00</u>
<u>Loan payment</u>	\$ <u>150.00</u>
<u>Telephone/DSL Line</u>	\$ <u>90.00</u>
<u>Transportation</u>	\$ <u>95.00</u>
Total Fixed Expenses	
(per month)	\$ <u>435.00</u>

The “Contribution Margin” is the Selling Price per unit minus the Variable Expenses per unit.

What is the Selling Price of a jar of hot pepper jelly? \$ 7.00

What are the Variable Expenses associated with one jar? (-) \$ 4.40

What is the Contribution Margin per jar? (=) \$ 2.60

The Contribution Margin represents how much is “contributed” from each unit of sales toward paying for fixed expenses and profits. **Every time you sell a jar, how much is it contributing toward paying for your fixed expenses?** \$ 2.60

What are your total Fixed Expenses for a month? \$ 435.00 per month

What is your Contribution Margin per jar sold? (÷) \$ 2.60 per jar

How many jars must be sold to pay for your monthly Fixed Expenses? (=) 167 jars

(Fixed Expenses divided by the Contribution Margin equals the number of jars it will take to “break-even.”)

What happens to the “break-even” number of jars if you raise the price to \$7.25? Variable

Expenses stay the same; contribution margin increases from \$2.60 to \$2.85; by dividing this into the 435 fixed expenses (which don't change), you learn that you need to sell 153 jars per month to begin making a profit (down from 167 jars).
