Evaluate the use of break even analysis as a decision making aid.

Break even analysis is an important aid within a firm for managers making decisions on such issues as the impact of a changing environment (alterations to cost or price) on the profitability of the business or deciding weather or not to accept an order for products at prices different from those normally charged. It determines the effects that financial plans such as bank loans would have, a change in the level of production or see if a business plan would be viable. These are the main useses of a break even analysis. The important thing to remember when evaluating the use of breakeven analysis as a decision making aid is to remember that it is purely an aid. Thus the impact of it as a decision making aid holds two different foot holds in its use generally and its use as an aid.

Breakeven analysis is useful, not for its use as a major decision making tool but more for its use as a simplistic way in which firms can collaborate a clear and effective method of analysis. Its job is to assist in decisions such as setting prices or accepting one of orders. It shows the consequences of a certain decision by displaying how a certain decision such as raising the price of a product or moving premises would effect the fixed cost the variable costs and the total costs , total revenue. By making it slightly more complicated by introducing a series of 'what if' scenarios it can also show less ideal consequence to a plan since in its simplest form break even is an ideal. Also through comparing two or more breakeven analysis graphs different business strategies can be evaluated to show the difference in the margin of safety and the profit margins, this is obviously extremely beneficial in decision making. It is also important to remember the simplest positive sides to the breakeven analysis from a firms point of view, which are the cost and time of the breakeven analysis. Its cost is unbelievably low compared to that of other decision making tools such as differentiation or low cost strategies. Also in terms of time all that is needed is to gain the information of the costs and sales of a certain time period. In this way breakeven analysis is also useful for many firms that operate in environments that frequently change.

On the other hand it is important to recognize that there are of course limitations to how useful breakeven analysis is. Firstly economies of scale are not illustrated at all. This is shown by the way in which the line of total revenue is constantly straight, if economies of scale were shown it would look something like this:

There are a multitude of internal and external factor that are not taken in to account at all such as the introduction of new competitors or a rise in interest rates or a down turn in the economy all of which would have a considerable impact on the breakeven chart. The introduction of a new competitor might have an effect on a firms own prices pr on its sales and thus it total revenue or on its production thus its costs. Fixed costs are also unlikely to stay the same such as rent which may vary at different times. Thus in the long run fixed costs would become variable. Total revenues will not be liner different prices to different customers such as a long term customer with loyalty compared to a new customer, and sales, such as two for one offers, promotions and dropping prices to increase customers would all effect the total cost. Multi faceted firms such as Heinz or black and Decker would find break even to hard and meaningless with the multitude of different products.

It is obvious that there are both positive and negative sides to the breakeven analysis as a decision making tool. It is a tool which can be useful to some firms and not tom others. In the short term it is useful for varying markets and so on and on small scale operations, also as a good starting point. But in the long run it is to simplified and does not posses the realties of business life to have a major impact on a decision.