Edexcel (B) Economics A-level

Theme 1: Markets, Consumers and Firms

1.6 Revenues, Costs, Profits and Cash

1.6.2 The relationship between revenue and costs

Notes

Contribution: selling price – variable cost per unit

Break-even point: total fixed costs + total variable costs = total sales revenue

Contribution is the profit made on each product, calculated by selling price minus variable cost per unit. This can be used to calculate the break-even point. The break-even point is the point where the firm's costs are covered.

The total contribution is the **contribution per unit multiplied by the number of units sold**.

Contribution does not consider fixed costs. Fixed costs do not vary with output, so they are simply subtracted from total contribution. This gives the firm's total profit or loss.

Margin of safety

The margin of safety is the difference between the actual level of output and the break-even level of output. It indicates how much sales can fall by before the firm reaches the break-even point. A falling margin of safety is a bad thing for firms.

Limitations of break-even analysis

The assumptions made for break-even analysis are:

- The selling price per unit is constant and does not change with quantity produced
- The variable cost per unit is the same
- Fixed costs do not change with output
- Everything produced is sold

However, these assumptions are not always true in reality, which limits the accuracy of break-even analysis.