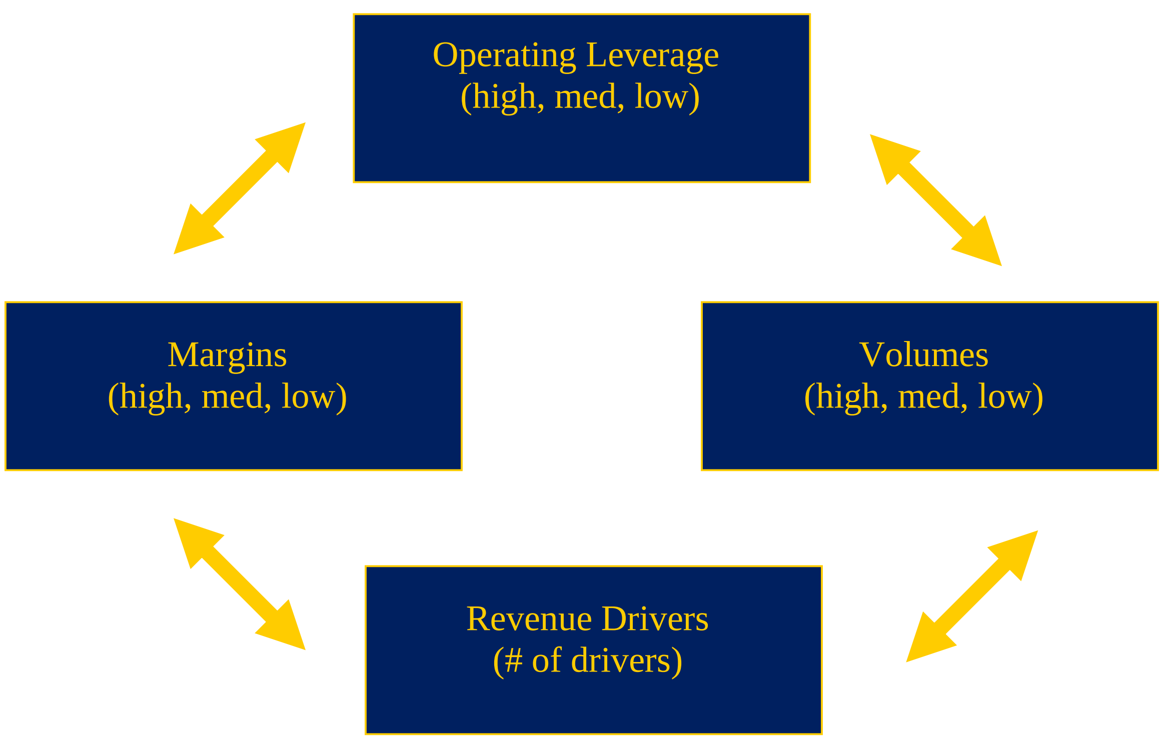
Playing with Ziyanda's Profit Model

Class Exercise Created by Prof. Michael H. Morris, University of Notre Dame

Beautiful Bibies is a home-based business launched by Ziyanda, a single mom who lives in deep poverty. The business is based in Guguletu township outside Cape Town, South Africa. Ziyanda is involved in making baby bibs. She produces baby bibs in 3 different styles – full, bandana or regular. She sells these for $10, $7, and $5 (far and away the most popular seller), respectively. Most have animal designs on them. She has also considered making adult bibs (e.g., for those with severe physical and mental disabilities). The business currently has 4 sewing machines, a heat seal press and one employee beyond Ziyanda (a woman from the neighborhood who works when there is money to pay her). However, she plans to train young girls to operate the sewing machines. Ziyanda sells through her personal network, her Facebook page and at craft markets and community events. She would like to get into some stores. She buys her materials at retail, and cannot afford to hold much inventory, usually keeping about seventy-five bibs in stock at her home at any point in time.

Ziyanda has been in business for two years, and struggles to make money. She currently sells about 100 bibs a month. After covering her expenses, she thinks she makes a margin of about $1.20 per bib on the regular bib, but she is not really very good about separating her personal from her business expenses.

The model has four basic components, as picture below. These include margins, volumes, operating leverage, and revenue drivers. Let us briefly examine each component.



Margins are the price a customer pays minus the cost to the business of providing that product or service. Margins can be manipulated by finding more efficient ways of making or providing the product/service, or by adding value to a product/service so that the entrepreneur can raise the prices. ***Volumes*** capture the activity levels in the business. Volumes deal with the number transactions the business has over a period of time (e.g., daily, monthly) and the average value or quantity sold per transaction. Volumes are limited by the capacity of the entrepreneur to produce. ***Operating leverage*** concerns the firm's cost structure. The basic question here is the extent to which the overall cost structure consists predominately of fixed costs or variable costs. So operating leverage is the ratio of total fixed cost to total variable costs at a given level of volume (say breakeven volume). A firm with high fixed costs has high operating leverage, where one having costs that are predominantly variable has low operating leverage. Fixed costs stay the same regardless of volume, while variable costs change in direct proportion to the core activity of the firm. For Ziyanda, she has little in the way of fixed costs (her sewing machines are relatively old and paid for, and she works from home), while her variable costs are labor and materials, plus the cost of public transit to get to markets where she can sell. So she has low operating leverage. Finally, ***revenue drivers*** refer to all of the major ways in which the company makes money. Consider an automobile dealership. Money might be generated from car sales, auto leases, repairs, parts, and warranties. In this instance, the dealer has five revenue drivers. With Ziyanda, she currently sells three different versions of her bibs.

Of these four variables, the most critical issue concerns the relationship between volumes and margins. A comparison of two types of restaurants will make this clear. A fast food restaurant operates on the premise that it charges low prices for relatively standardized goods produced en masse, and will have high volumes or a large number of transactions per day. Conversely, an exotic high-end restaurant will emphasize customized service, a relaxed, luxurious atmosphere, and a talented chef. This high-end restaurant will expect to have much lower volumes than a fast food establishment, but will expect the value of each transaction (and hence the margins) to be much higher. Expected volumes affect such decisions as staffing needs, quantities to keep in inventory, and space requirements. Once these decisions are made, they limit how much activity the business can handle.

For Ziyanda, she is experiencing relatively low volumes and not making much in terms of profit margins. Consider each of the variables in her profit model, and identify how she might improve her ability to make money from this business.