



THE BENCHMARK

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Stretch your capacity rubber band

Part one of a multi-part series.

I promised I would drill down into the high-profit benchmarks from my 2008 survey. So here's the first take-home: High-profit companies operate leaner. Their pricing is not better — market competition sees to that — though they do seem to have fewer larger accounts than the average-profit companies. What they do well is minimize available capacity in labor, equipment and overhead office/management staff. They do the same amount of revenue with fewer people and trucks. They are really tight with their money. How many fewer people and trucks? See the chart on the right.

Using an equivalent \$2 million firm, the average-profit firm achieves about 8% net profit before taxes. By comparison, the highest-profit firms see about 14%. If we assume that 10% of direct cost is for materials, that leaves the difference in direct labor. If we assume an average wage rate of \$12.50 per hour (this includes payroll taxes), the high-profit firms turn the same revenue with 3,200 less labor hours. This is equivalent to about two full-time (FT) people in most markets, given seasonal schedules. Thus, the gross profit margin is higher (54% vs. 52%), with an annual savings of \$40,000.

High-profit firms have an average overhead of 40% of sales, while the average-profit firms are a little higher, at 44%. This dollar difference is equal to \$80,000. The primary expenses in overhead are equipment costs and non-billable staff costs (supervisors, managers, sales, office). By employing one less truck/trailer and one less manager (see chart), the high-profit companies achieve this result.

I calculated the cost of the average annual truck usage — including vehicle depreciation, fuel, repairs, equipment, etc. — and we know the cost of an account manager. These numbers are real, though they may vary +/- 10% for your neck of the woods.

The bottom line is that high-profit companies turn the same revenue with less capacity. Laborers, trucks and managers are capacity you hire to gener-

ate revenue. The highest-profit firms seem to stretch capacity before adding more. It is a tricky thing to do, as you probably have experienced. Almost everyone who works for you will tell you they need more people, trucks and help. The challenge is to add the capacity more slowly than they want it. The capacity rubber band stretches more than most of us think.

My recommendations? If you are not growing revenues this year, reduce labor head count in the field, as well as with supervision and office staff. And if you are adding revenues, do it without adding trucks and supervision/office staff. Try it. It's the lean challenge. You must ask yourself and your key people, "Where can we reduce capacity?" To answer it, you will have to call into question many of your assumptions about running your business. This is a good thing. The payoff in capacity reduction is high.

	Average	High Profit
Revenues	\$2,000,000	\$2,000,000
Gross margin	\$1,040,000 52%	\$1,080,000 54%
Overhead	\$880,000 44%	\$800,000 40%
Net profit	\$160,000 8%	\$280,000 14%

Assume

Average Hourly Wage	\$12.50	\$12.50
Materials Cost	10%	10%

Result

Materials	\$200,000	\$200,000
Labor	\$760,000	\$720,000
Labor hours	60,800	57,600
Labor hour difference	3,200	(Approx. two FT people)
Labor cost difference	\$40,000	
Overhead difference	\$80,000	
Total cost difference	<u>\$120,000</u>	

How it's done

	Annual cost
Two less crewmen	\$40,000
One less truck/trailer setup	\$29,600
One less manager	\$57,600
	<u>\$127,200</u>

(One \$45,00 person with benefits/expenses)