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SBU Presentation – Exceeding Breakeven

Mail or Fax This Form Back to Our Office

(call or e-mail if you would like to talk!)

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Strive to Exceed Breakeven

If you talk to most any individual long enough you will find out what their passion is, what drives them. As you spend more and more time with them the thing that they are passionate about nearly always, at some point, comes up in the conversation. Well guess what? If you have attended any of my seminars, boot camps, conferences or even read some of my monthly articles sooner or later the subject of numbers will come up. Why? Because understanding your numbers is the key to profitability – period! Just in case you missed that last statement let me repeat it again. Understanding your numbers is the key to profitability......period, end of paragraph! There are tens of thousands of small business owners all across this country but the actual percentage that are making a significant profit is pretty small. As a matter of fact if you were to look at the most profitable 5% to 10% of companies you would find that they all have one thing in common, they are all run by owners that understand the business side of their business, and they understand the numbers. That's right; if you really want to be profitable you must understand the numbers.

Today we are going to explore the wonderful world of what happens when the company exceeds its breakeven point. Once the breakeven is exceeded…. profitability literally skyrockets. Once the companies breakeven is exceeded… whatever the fixed overhead is literally disappears and like magic…… it becomes profit.   However, I'm getting a bit ahead of myself. Before the magic takes place we need to understand a few basics. To keep things simple we will look at a couple basic foundation stones. First we're going to create the foundation stone for profitable growth by determining what makes up a company's hourly rate. We will discuss the differences in fixed overhead and variable overhead and we will also discuss projected "billed or budgeted" hours to the customer.   This section alone will provide the basics for profitability. Secondly, we will discuss the huge increase in profitability that occurs once the companies breakeven is exceeded. The goal of every company should be to exceed its breakeven point…. each month. That means setting conservative goals and then exceeding those goals. Once you understand your costs of doing business, and how to determine your breakeven point, the light bulb will go off in terms of understanding profitability AFTER the breakeven point is reached. The final section will deal with creating bonus systems for your techs as an incentive to exceed breakeven. We will take a look at a couple simple, but effective, bonus systems for your technicians both in the service department as well as the installation department.

By the way, we will be using a lot of numbers during this presentation which might make it just a bit difficult to follow. For your convenience, the entire script of this presentation is provided in the speaker content area of the **Small Business University Audio Series**. Feel free to download if it would be of value to you.

Now in order to provide a firm foundation for today's presentation let's discuss the definitions of fixed and variable overhead.

- **Fixed Overhead** – Fixed overhead costs are those expenses that remain basically the same no matter how much work you do, or don't do. Fixed overhead costs are things like rent, utilities, telephone, most insurances and loan payments. Each of these items will remain pretty much the same if you doubled sales, tripled sales or didn't sell anything at all. These fixed expenses are just that, fixed. They continue no matter how much work you do.

- **Variable Overhead Costs** – Variable overhead, by definition, is directly tied to productivity. Variable costs go up when you do more work and go down when you do less work. In theory they actually disappear if the company did no work at all. There are relatively few variable overhead costs, at lease in relationship to fixed costs. Examples of variable overhead costs would be things like gasoline, maintenance on your vehicles, Visa/MasterCard charges and miscellaneous supplies used on jobs. Each of these expenses traditionally goes up when work increases and goes down when work decreases.

Now you might ask yourself why we're even going to the trouble of splitting overhead into fixed and variable costs since the basic hourly rate set by the company will be the same no matter what you call them. The reason is this. When the company bills out as many hours as they projected to bill for the year the fixed overhead is fully covered, no additional fixed cost will occur from that point on. However, variable expenses will continue as long as you are working. From a functional standpoint, once you have worked the number of hours you projected to work the fixed overhead disappears and profitability skyrockets. Any additional work will not have “fixed overhead” attached to it, making the hours billed out over and above the budgeted amount, very, very profitable.

The third key to our breakeven discussion deals with the hours actually billed the customer. As we all know, we pay the installers and service techs from the time they clock in until they clock out at the end of the day. The question is “How many hours that the company pays for can actually be billed to the customer?” Now we could do a whole presentation on billable verses non-billable time but for today, let’s keep it simple.

- **Service Techs Billed Hours** – When talking about billed hours in the area of service we are talking about the hours the tech can actually charge the customer each day. Non-billable time is time we pay the tech for that we cannot charge the customer for.......or at least not directly. Non-billable times includes shop time, travel time between jobs, sick, vacation, holidays, company meetings, callbacks, warranty work and customer no-shows. When looking at an entire year most service techs average about 50% non-billable time and 50% billable time. In simple terms, a service tech usually averages billing out about 4 hours a day to the customer. If they work a 40 hour week that means the tech can bill out an average of 20 hours a week or roughly 1000 hours a year. That is our goal…. we want to bill out 1000 billed hours a year per, service tech.

- **Installers Billed Hours** – When talking about billed hours for an installer the numbers are a lot higher. Let's use a simple example to make the point. Let's take a very simple job that is budgeted to take one installer two days to complete. The tech may sit around in the office for 20 minutes both days and may even have to go the shop or distributor three times to pick up parts, but if he or she completes the job in two days (16 hours) **<u>all</u>** their time is considered billable because that is the amount of time the job was bid for. Therefore non-billable time for an installer is traditionally low…at least compared to our service technician. Non-billable time for an installer normally includes sick, vacation and holiday time plus perhaps 2-3 hours a week that cannot be charged directly to the job. That means a full time "typical installer" averages billing out 35 hours a week, depending on how much sick, vacation and holiday time the company pays for. Now to be able to play with the numbers we need to create a Sample Company. Again, let's keep it simple. Our Sample Company has one service tech and one, two-man, installation crew. That means the company has roughly 1000 hours a year it can bill in service and approximately 3600 billed hours in the installation department. Now that our hours are set we need to go back to fixed and variable overhead costs for a moment.

We defined what fixed and variable overhead costs were earlier, now let's create some numbers to work with. Keep in mind overhead includes more than the typical rent, utilities, office supplies, insurances, etc. Our overhead also includes the two largest…., …but often overlooked…… costs of doing business. The number one cost of doing business is non-billable time. That's the time we pay our tech for that we can't bill the customer for….at least not directly. Our Sample Company has one service tech with approximately 1000 non-billable hours a year. We are going to pay our service tech $18.00/hour so the Sample Companies cost of non-billable time for our service tech is 1000 hours times the $18.00/hour rate or $18,000/year. Yes, the company has matching taxes on that, but again….. to keep it simple….. let's say the cost of non-billable time is $18,000. Our two installers are making $16.00/hour and each has five non-billable hours a week. That means our cost of non-billable time for our two installers is five hours/week x 52 weeks x $16.00 per hour x two installers or $8,320 per year. As I said earlier, the cost of non-billable time is huge and it also just happens to be our single highest cost of doing business.

The second highest cost of doing business in most companies is what we call equipment replacement costs. Equipment replacement cost takes the place of depreciation, from a cash flow perspective. Depreciation is an accounting term and deals with what a vehicle, or piece of equipment, cost the company several years ago when it was purchased. Uncle Sam then lets you write off 20% each year for five years. The problem is that depreciation does not create enough dollars to replace equipment when it's time to replace it. Equipment replacement costs, on the other hand, deals with what it is "going" to cost to replacement the equipment two, three or even five or six years in the FUTURE ....and then builds that future cost into our pricing so the company will be able to pay cash for their vehicles and/or equipment when it's time to replace them.

Now let's assume our service tech is driving a 2010 van that is estimated to last another 3 years and will cost the company $30,000 to replace three years from today. That means our cost of equipment replacement for our service department is $30,000/3 years or $10,000 per year.

Our install team is driving a 2011 vehicle that is estimated to last 6 more years and will again cost the company $30,000 to replace. That means the cost of equipment replacement for our install department will be $30,000/6 years or $5,000 for the year.

The costs of non-billable time and equipment replacement costs were specifically discussed here because they are typically the #1 and #2 highest costs of doing business in the entire company.......and guess what? These two huge costs of doing business are often <u>totally overlooked</u> when most companies are calculating their hourly rates.

Now we could do an entire series of presentations on how to create profitable hourly rates for our service and installation departments. However, that is not our purpose today. Let's assume we have done our homework and we know our costs of doing business in the service department and the installation department. Our service department's hourly rate is made up of three pieces. The first is the technicians average hourly rate which for the service department is $18.00/hour. To that we will add the fixed overhead rate of $64.23/hour and the variable overhead rate of $16.23/hour. The last step is to add in our desired profit which for the sake of example is $17.37. When we add all those numbers together our service departments hourly rate totals $115.83/hour.

Similarity our installation hour rate is made up of the average hourly rate for our two techs which is $16.00/hour. The fixed overhead rate for install is $21.87 and the variable overhead rate is $12.87. When we add in our desired profit of $5.63/hour our installation rate becomes $56.35/hour.

Now before we wrap up this section of the presentation let's ask ourselves two quick questions.

Q: If we bill out less than 1000 hours in service and/or 3,600 hours in the installation department, will the company cover all of its fixed overhead costs?

A: No, each department needs to bill out all of their budgeted hours if they are going to cover all of their fixed overhead.

Q: What drops out of our hourly rate once the 1000 hour in service and the 3,600 hours in installation are billed out.

A: Once our budgeted hours are billed out, ALL of our fixed overhead is covered meaning the fixed overhead costs of $64.23 in service, and $21.87 in installation, will totally drop out of our hourly rate.

Guess what happens when all of our budgeted hours are billed to the customer? Right again, profit skyrockets!

Now for the fun part. What Happens when you exceed breakeven? Once we exceed our budgeted hours 100% of the fixed overhead is covered, therefore it drops out of the hourly rate all together. That means all additional hours billed out for the year, over and above our estimated billed hours, will have NO fixed overhead on them. Guess what, that is huge from a profit standpoint! Let's take a look at our service and installation departments and see what will happen when we exceed breakeven. First let's look at the Service department. The hourly rate for service was $115.83/hour which included $64.23/hour in fixed overhead leaving a net profit of $17.37 or about a 15% net profit. By the way, a properly priced, and properly managed, service department should yield a 15%-20% net profit and that can easily jump to 25% if the company is using a flat rate system. Once the budgeted billed hours are covered the net profit goes from $17.37 per billed hour to….are you ready for this…… $81.60 per hour or a whopping 70% net profit!!!!   I don't know about you, but if it were my company I would make every effort to exceed my budgeted service hours as soon as possible. Think about it.   If our service tech could bill out even fifty additional hours per year, that's only averaging one additional hour per week, that would generate an additional net profit $4,080. The overall principle is this……be conservative when estimating your billed hours.........and then strive to exceed those budgeted hours as soon as possible. Let me repeat that statement because it is foundational. The company’s objective is to be conservative when estimating budgeted billed hours.........and then to strive to exceed those hours as soon as possible

How let's see what’s going on in our Installation department. When it comes to installation, the basic principles are very similar to service but the overall application is a bit different. Like service, we want to strive to exceed budgeted hours. Let's assume it's mid-November and the installation crew has billed out 3,500 of their budgeted 3,600 hours. The company now has a chance to bid on a large job that will require 350 man-hours to complete and they can finish it by the end of the year. Can the company lower their bid price on the job and still make a nice profit? You bet they can. It will only take an additional 100 billed hours to meet their budget for the year at which point the fixed overhead of $21.87/hour will drop out. That means 250 of the 350 man-hours will not have any fixed overhead on them. Now let's do the math. If the company chooses, it could technically lower their bid price by 250 hours x fixed overhead rate of $21.87/hour or $5,467.50. The $5,467.50 represents the fixed overhead that would normally need to be covered but since the fixed overhead is now already covered….. the bid price can now be reduced by that amount while still yielding the same net profit. Now in most cases they will not need to lower their bid price anywhere near that amount to get the job, however they now have the flexibility to lower it if they wish.

If the company were to get the 350 hour job, without having to lower their price, they would actually INCREASE their normal profit margin by the $5,467.50 figure. Either way the company wins…… once they've exceed their budgeted hours for the year!

The same principle holds true throughout the year. Let's say it's May and the company has billed out 43 more hours, year to date, than they were budgeted to bill. That means the sales person now has the opportunity to lower the price of their next job.......if they choose to. They don't have to lower it but they now have the flexibility to lower their pricing if they choose to. We encourage our boot camp attendees to use the built in Budget vs. Actual tracking system that is part of our **Labor Pricing** software. The numbers, and the graph, clearly show how the company stands in terms of how many hours they have billed out, verses what their budget projected.......at any point during the year. Like we said earlier, understanding your numbers can make a huge difference in the company's bottom line profit.

Now that we understand what makes up our hourly rate…… and what will happen if we exceed our budgeted billed hours for the year….. it's time to create a bonus program for our techs to encourage them to exceed their billed hours on a monthly basis. Let's begin with service. If you will remember from earlier, we determined that the average service technician bills out approximately half their time, or roughly 20 billed hours per week. You will also remember the "fixed" overhead rate for service was $64.23/hour. Remember what happens to every hour that exceeds the budgeted 20 hours per week. Right, the fixed overhead of $64.23/hour becomes 100% profit. Now it's time to have a meeting with our service techs. The conversation needs to go something like this. "Hey guys, we have completed our budget for the coming year. Because of the increased cost of doing business we are going to have to increase our hourly rate for service to $115.83/hour. Now for the good news! Our budget is based on each one of you producing an average of 20 billed hours per week. The other 20 hours are what we call non-billable hours which includes shop time in the morning and afternoon, travel time between jobs, callbacks and several other things. So here's the deal. If you can reduce your non-billable time….. and therefore increase your billable hours to exceed the 20 budgeted billed hours a week…… we will pay you one additional hours pay for every hour your bill out over and above 20 billed hours a week. Now we are all aware that some weeks are busier than others so we will pay bonuses on a monthly basis. As an example let's say you bill 24 hours week one, 18 billable hours week two, 22 billed hours week three and 23 hours during week four. That means for the month you had a total of 7 hours over budget. To calculate what your monthly bonus will multiply the 7 hours times your base hourly rate. Now for the really good news. The total billed hours per week will INCLUDE overtime hours. That means during those long summer days when you're traditionally working 5-10 overtime hours per week your bonuses for working those extra hours will be substantial. Now keep in mind we have budgeted 20 non-billable hours a week. If you can get out a little quicker in the mornings….maximize your travel time…. and keep callbacks to a minimum…. exceeding the goal of 20 billed hours a week will be very reachable even without overtime."

When the bonus program is presented in this way to your techs there should be substantial buy-in. It also rewards the techs that are willing to work overtime and encourages the service techs to use their time more effectively each day.

How does this program affect the company's bottom line profit? If you will remember our fixed overhead of $64.23 becomes 100% profit when we exceed 20 billed hours a week. Our service tech is making $18.00 per hour so with taxes he is perhaps costing the company $20.00/hour. If we pay the tech $18.00 and added $2.00 for taxes that means the tech made a nice bonus <u>and</u> company made an additional profit of $44.23/hour for every hour over 20 billed hours per week. That is what I call a win-win. What about those overtime hours? Now we are paying the tech time and a half so with taxes he is costing us $30.00/hour. That still leaves the company with an additional profit of $34.23/hour……. Wow, it's still a win-win!

Now let's take a look at a bonus system for the installation crew. Since most of our hours are billed out each week in the installation department our emphasis for the bonus system will be on increasing our productivity. This is how the presentation might go for our installers. "Guys, we are going to institute a new bonus system. The emphasis is to reward outstanding productivity. As we assign each residential and/or commercial job you will be told how many hours were budgeted to complete the job. A quick change out may be budgeted at 16 hours (two techs 8 hours each) while larger commercial jobs may have a 100 man hours or more. We fully realize some jobs may be tougher than others so we will be paying bonuses on a quarterly basis. One job may take a little longer…..that is it may go over budget…….while good planning on larger jobs can easily be under budget. At the end of the quarter we will pay each installer their current hourly rate for the total hours they are under budget for the quarter."

Again, how does this affect the company’s overall profitability? When the jobs were bid the company used it's required $56.25/hour per man. If a 40 hour job only took 36 hours to perform that means the companies cost for the job was reduced by 4 hours x $56.25 or $225. The additional cost to the company by providing the bonus was $18.00/hour per tech, including taxes, so the net additional profit to the company is $225.00 less the increased cost of $72.00 leaving $153.00 in additional profit.

Again it looks like a win-win to me!   By paying bonuses quarterly the good productivity and poor productivity jobs will cancel each other out so the company is paying bonuses on "net" productivity.

In summary, it's my hope that this presentation has done two things for you. The first is to help you clearly understand the value of exceeding your budgeted hours and secondly to come to the full realization of how important it is to understand your numbers.   Keep in mind that the most profitable companies in the trades industry are run by owners that truly understand the "business side" of their business. That’s right; if you really want to be profitable you need to know your numbers.

Strive to Exceed Breakeven

By: Tom Grandy

Short Description of the Presentation:

The most profitable businesses are run by owners who understand the numbers. Once you understand the numbers the objective is to budget the company's hours conservatively and then strive to exceed those budgeted hours each and every month. When actual hours exceed budgeted hours something absolutely amazing happens. Profit skyrockets!

Why Understanding the Numbers is Important

Understanding What Makes Up Your Hourly Rate

- Average hourly rate
- Fixed overhead
    - a) Cost of non-billable time
    - b) Cost of equipment replacement costs
- Variable overhead
- Net Profit

What Happens When the Budgeted Hours Are Exceeded?

- All fixed overhead is absorbed
- Service profits skyrocket
- Flexibility in installation pricing is possible
- Overall company profitability skyrockets

Bonus System for Service Techs

- Techs make more money
- Company makes more money

Bonus System for Installation Technicians

- Techs make more money
- Company makes more money

Two Basic Business Principles to Understand

- Budget hours conservatively
- Strive to exceed budgeted hours each and every month