

# Improving Your Pre-Production Profits

by Kenneth F. King and Craig L. Press

## Measuring Profitability

Over the years, we have seen printers use many interesting methods for measuring profitability. Some companies gauge profitability by the amount of money left in the bank after paying the bills. Others measure profitability using their monthly financial statements. Both of these methods may give you an idea of your profitability, but they are reactive rather than proactive and don't give you any lead time to prevent undesirable results. By measuring profitability daily or from job to job, a company can take proactive action toward losses or achieving larger profits.

## Estimating True Costs

Estimating is a critical part of the process of selling work. A true time, material, and cost estimate is the best tool for measuring a job's profitability. A job estimate is derived from production standards, budgeted hourly cost rates (BHRs), material costs, and buy-out costs. Production standards include the time and materials required to perform a given operation, such as make-ready, running, or washups. BHRs are the costs associated with owning and operating equipment, including wages, rent, electricity, insurance, overhead, and other costs.

Most companies have some sort of computerized estimating system, but companies that don't have a *cost* system can't produce accurate profit or loss information for individual jobs. They end up basing estimating accuracy on how they are competing on individual jobs, not on what they're really doing.

The monthly financial statement is another measure of estimating effectiveness but this leaves a major gap in the information needed to run the

company. True cost is a system where your standards and BHRs are current and accurate, and you can create an estimate that accurately reflects your costs. An estimate of your "out-of-pocket" costs will reveal which operations, cost centers, employees, and departments are making or breaking the company.

## Processing Estimates

Many companies make the mistake of producing cost estimates and adding a "standard" markup to arrive at a price without further consideration. This often results in lost sales, minimal estimate wins, and an overloaded estimating department. Instead of just producing estimates and submitting prices or "processing estimates," carefully review each estimate, taking in consideration the following questions:

- Can we offer the customer size, stock, or other alternatives to reduce the price?
- Do we want to sell the job at our out-of-pocket cost to win a new customer?
- Will this job fill excess plant capacity?
- Will securing this job lead to future, more profitable opportunities?

## Value-Added Pricing

Value-added pricing focuses on the value a company adds to the finished product through services rather than focusing just on the total estimated cost of producing the job. The example on this page demonstrates the value-added difference between two jobs

with the same selling price and profit amount.

## Pricing Based on Competition

One of the keys to knowing how to price is the ability to track competitive pricing. This is difficult, as few companies have the ability or discipline to collect the necessary information. We have seen individual star salesmen collect information on the competition and the marketplace. It's a matter of asking customers for feedback about all jobs you win and lose. Knowing why you lost a job and the competitive margin between you and the competition will tell the story. Information about how busy your competitors are is also a factor in pricing. Knowing whether your competitors are working overtime or if they are slow will tell you what future pricing might be. Getting information through feedback can be difficult, especially when you find that you made a mistake in strategy or pricing when you quoted the job.

### The Value-Added Difference

	Job A	Job B
Sell Price	\$15,000	\$15,000
Materials & Outside Services	10,000	5,000
<b>Value Added</b>	<b>5,000</b>	<b>10,000</b>
Manufacture Costs	3,000	8,000
<b>Contribution</b>	<b>20%</b>	<b>53%</b>
<b>Profit</b>	<b>2,000</b>	<b>2,000</b>

Job B is a much better job because it requires fewer materials and more of your company's own services, providing a 53% contribution toward overhead. This contribution is the billable charges that cover your fixed costs such as administration, rent, taxes, depreciation, and insurance.

The contribution of Job A is only 20% and has a much greater production risk than Job B. Consider adding additional profit to the higher risk job to cover the risk.

## Comparing the Job to the Estimate

If you are like most printers, chances are when a customer awards you a job, the specifications have changed since the original job quote. When the job enters your shop, compare the actual job specifications against the original estimate. Identify the differences and create a new estimate based on the actual job. If the newly estimated costs exceed the original quote, you will need to decide to either accept the job as is and “eat the additional cost” or re-quote the customer for the additional charges. It is easier to rectify an estimate and justify additional costs as soon as you receive the job than it is after the job has been produced.

## Quote AAs Before Doing the Work

Almost every job ends up having some author alterations (AAs). Depending on how they are handled, AAs are either a significant profit source or an unpleasant customer relations problem. Most companies have had the unpleasant experience of negotiating away part of the profit when a customer notices an unexpected dollar amount for AAs on the invoice. Even worse, many companies don't bill for all AAs because they have inferior tracking systems or because they are afraid to bill customers for additional charges.

The best time to ask a customer for additional money is when the customer first brings you the changes. At that time, produce a new cost estimate and quotation, indicating the price for the changes. In some cases, the customer

may elect not to follow through with the changes because of the additional cost. For example, a customer may be willing to accept a color build rather than spend additional money for a fifth color.

## Counts and Saleable Overs

Many customers will permit the shipment and billing of product quantities greater than the amount ordered. This is known as “saleable overs.” According to *Graphic Communications Trade Customs and Business Practices* (1994, GATF, NAPL, PIA), overruns up to 10% of the quantity ordered are acceptable. “If the customer requires a guaranteed quantity, the percentage of tolerance should be stated at the time of quotation.” Once the amount of acceptable saleable overs is established, incorporate the overs into the job order quantity and net production counts.

## Charging for Overtime

At times it is justified to charge a customer for overtime. Say there is a set schedule and the customer is late with the copy or some other part of the job but still wants it delivered on the original date. As a result, your schedule is somewhat empty on Monday and Tuesday, but your staff end up working overtime on the weekend in order to meet the job's original completion date. The overtime wages are out-of-pocket expenses that would not have had to be paid if the customer had been on time and the job had run during the week. Tell the customer if overtime hours will be necessary and get

the customer's approval prior to working the time and spending the money. Tell the customer after the overtime has been worked, and you stand little chance of collecting the money.

## Job Costing

Knowing the profitability of each job and product is important for determining prices, core business, and future equipment investments. Have plant personnel record their production time and materials consumed on the back of job tickets or in a computer system. When the jobs are done, cost them and produce a job cost sheet. A job cost sheet typically provides a complete breakdown and comparison of the job's estimated vs. actual time, materials, and costs. A job costing system will identify the profit and loss for each job and its components.

## Tracking the Winners

The best method we've seen for analyzing jobs involves listing all the jobs produced in a given month and then running the list two ways. First, run it from the most profitable job to the biggest loss, then from the biggest sale to the smallest sale. Both lists contain sales and profit and loss information. Some include value-added, percent of profit, and materials cost. Don't spend time analyzing the jobs that are hitting your target profit margin. Focus your attention, instead, on the largest percentage losses. And share this information with all your supervisors. It provides valuable information about the performance of their people, equipment, and systems in producing a job—and allows a company to take proactive control of costs and profits.

## PIA Ratio Studies—Financial Benchmarking Information

The Printing Industries of America Ratio Studies are a compilation of detailed financial information from hundreds of printing and related graphic arts firms—information about assets, liabilities, working capital, salaries, sales, and profits. All this data has been converted into statistical ratios that printers can use to benchmark their company's financial performance against industry averages and profit leaders. Among other financial benchmarks, printers can compare their expenses and sales with those of other firms of like size and geographic location.

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