The Right Approach to Pre-Job Costing

The **Intentional Success**® Series

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Before you sell to the customer, sell to your company

WHAT IS THIS JOB WORTH?

Look at My Proposal…

- Is this too much discount?
- Is the price too low?
- What is my competitor doing?
- I don't want to look cheap.

The Right Questions

- What are the resources worth to you as seller?
- What is the outcome worth to the buyer?
- Do you have the skills to overcome this gap?

What We Will Learn Today:

- How to evaluate the financial impact of your next proposal
  - Post-job cost is not an indicator of value
- Normalize internal discussions about value
- Make better decisions about pricing, discounts, and 'walking away'

THE BASICS

Contribution Margin

- Net Sale Price minus Total Variable Cost
- Gross Profit (Margin) is used to pay for overhead
  - It is not a direct replacement for overhead as used
- Easy to calculate after the fact…
  - Not always a reflection of the value to the business before the fact

Pre-Job Cost

- Predict the value of the potential contribution
- This will not equal post-job costing measurements
- Some projects offset overhead used by all projects

Profit is Dynamic

- The same project at different times of year will not have the same expected gross profit
- The gross profit you are willing to accept will also vary according to timing
- Pricing is strategic, so gross profit is also strategic

Key is Utilization

- Service companies measure the Return on Resources
- Unsold resources still have to be paid for
- Tying up too many resources at low margin is risky

Most Common Mistakes

- Overthinking what longtime customers will do if you change
- Considering GP on a project without context of all concurrent projects
- Misunderstanding trunk slammers
- Worried about what you don't know

Three Methods

1. Retail less Discounts (Retail)
2. External Cost plus Margin (Reseller)
3. Substitution Cost plus Margin (Replacement)

METHOD #1: RETAIL

Traditional (Retail)

- Retail price less discounts
  - Retail pricing generally comes from outside your company
- Market price less discounts
  - Adjusted "retail"
- Column pricing
  - Variation on the above

Traditional (Retail)

Retail Price	Discount	Net Price	Est Costs	Est GP	Est GP%
$1,000	25%	$750	$500	$250	33%
$1,000	25%	$750	Rental stock	$750	75%

Which of these is the better deal?

Concerns About Retail Model

- Retail Price is arbitrary. Consumers know no one pays retail.
- Discounts are the new Pricing. Consumers expect the discount.
- In rental, unrealistic GP per Job results
  - Sub-rentals trigger "no bid"
- Doesn't help you close more business

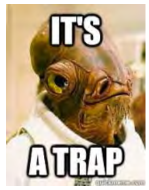
METHOD #2: RESELLER

External Cost (Reseller)

- Cost plus Margin
- Variation is Cost plus Markup
  – Not the same, "It's a trap!"
- Only considers variable direct costs
  – "Salaried" services are free to the job

Why Markup is Bad for You

Cost	Markup	Sell	Yield	Net
$100	25%	$125	$25	20%
$100	50%	$150	$50	33%
$100	100%	$200	$100	50%



Note: Your business has 40% overhead.
What's wrong with 50% GP?

Why Margin is Good for You

Cost	Margin	Sell	Yield	Net
$100	25%	$133	$33	25%
$100	50%	$200	$100	50%

If Cost = $100 and expected margin is 25%, then
(Cost)/(1-margin) = Sell Price
$100/(1-0.25) = $133
$33 profit
33/133 = .25 = 25% profit

Blended Margin

Item	Cost	Margin	Sell	Yield	
Equipment	$1,000	25%	$1,333	$333	
Labor	$500	50%	$1,000	$500	
Expenses	$100	50%	$200	$100	
Total	$1,600		$2,533	$933	36.8%

SI - Misplaced Risk

Revenue Source	Box Sale	Installed Product	Design	Labor	Accessories	Total
Cost	$1,000,000	$4,000,000	$250,000	$2,000,000	$500,000	$7,750,000
Traditional Margin	25%	22%	0%	16%	11%	18%
Net Revenue	$1,333,333	$5,128,205	-	$2,380,952	$561,798	$9,404,289
What If Margin	20%	5%	50%	25%	40%	18%
Revised Revenue	$1,250,000	$4,210,526	$500,000	$2,666,667	$833,333	$9,460,526

SI – Better Selling

Revenue Source	Box Sale	Installed Product	Design	Labor	Accessories	Total
Cost	$1,000,000	$4,000,000	$250,000	$2,000,000	$500,000	$7,750,000
Traditional Margin	25%	22%	0%	16%	11%	18%
Net Revenue	$1,333,333	$5,128,205	-	$2,380,952	$561,798	$9,404,289
NEW Margin	20%	10%	50%	33%	50%	24%
Projected Revenue	$1,250,000	$4,444,444	$500,000	$2,985,075	$1,000,000	$10,179,519
Actual Results	$1,493,333	$6,051,282	$591,000	$3,380,952	$1,179,775	$12,696,343

Concerns About Reseller Model

- Doesn't scale well
  - Tend to fuel growth with lower margins
- Transactional and hard to negotiate
  - Buyers reverse engineer your math
- Ignores the inherent value of the Outcomes
  - Resellers tend to talk about process instead of end results

METHOD #3: REPLACEMENT

Trunk slammers are right about value

Start with Outside Costs

- The cost of outsourcing plus margin
  - Assume you have no overhead
- Services and reduced risk to buyer are what set you apart – so use higher margins
  - How much more? 5%, 10%, ?

SI Model

- Contractor plus Service

Rental Model

	Retail	Discount	Net Price	Cost Factor	Cost	Gross Profit
Equipment	$10,000	25%	$7,500	40%	$4,000	$3,500
Labor	5,000	0%	5,000	80%	4,000	1,000
Expense	2,500	0%	2,500	80%	2,000	500
Total	$17,500		$15,000		$10,000	$5,000

Cost Factor

- The internal cost of using an asset
- Derived from market cost
  - 80-100% of market cost

My Method

PRODUCT	Wholesale Net	Margin	Retail	Discount	Net Price	Gross Profit
Projector	$500	50%	$1,000	40%	$600	$100
Projectionist	500	33%	$746	0%	$746	246
Trucking	500	25%	$667	0%	$667	167
					$2,013	$513

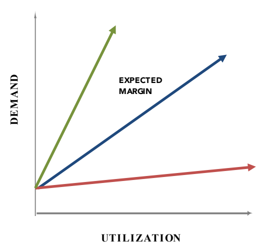
Classic Burden Model

Cost	Add Burden (OH)	Add Margin	Sell	Net	
$100	20%	25%	$160	$60 or 37.5%	Overpriced
$100	20%	0%	$120	$20 or 16.7%	Cash Flow

TIMING

Margin Expectations

- Seasonality
  - Slow season, lower margins, increase utilization
  - Busy season, higher margins, increase prices
- Utilization
  - Higher utilization allows higher margins
  - Goal is always to maximize utilization at a fair margin
- Strategy
  - The right job at the right time



If demand and utilization are in sync, then margins are consistent.

If demand is low and utilization is high, then margins will be low but accumulate faster.

If demand is high but utilization is low, margins should be high.

Example

- Busy Season, Busy Month
  - Pockets of under-utilized resources
- Perfect fit job
- Good reason to accept a lower margin to win the job
  - <u>You cannot replace income for unused resources</u>

Example

- Traditionally slow month
- Only low margin work available
- Any positive contribution margin should be accepted

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Concerns?

- Devaluing your services?
  - Presumes your customers aren't smart
- What if a better job comes along?
  - Learn to oversell
- Longtime customers will balk
  - Learn how to have thoughtful conversations

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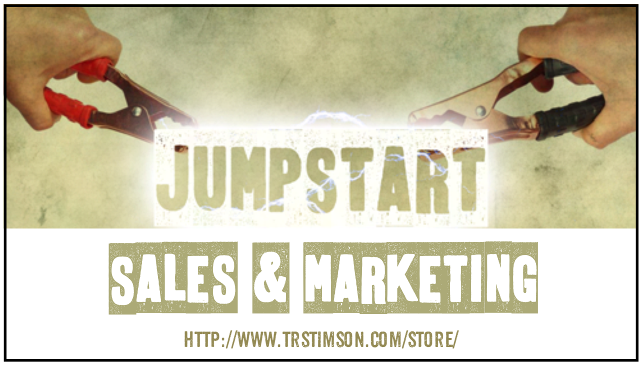
Questions?

- Standby for some tips on how to start this today...

TSG



Mindset

- You are not products. You are services.
- Sell the end result (outcome) not the plan (process)
- Balance the value to you and the customer
  - You won't always agree on a price

Tips for SI

- Lower margins on equipment
  - Shift profit to high value services
- Higher margins on labor
  - High risk in estimating
- Highest margins on IP
  - High value in Design and Project Management

Tips for Rental

- Internal cost of owned equipment is ~80% of wholesale rate (to you)
- Calculate the negotiable profit (treat internal cost as hard cost)
- Apply "discounts" where the customer appreciates them

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