Q&A from Introduction to Pre-Job Costing Webinar

From April 2015

Q: How do you recommend determining "house equipment price"?

> Tom: I am assuming that you mean the retail price for your products and services. There are a number of methods needed to cover commoditized rental products versus specialty products, brand-specific products, items that you package in a systems, etc… The basic process starts with examining the available pricing from wholesale and B2B suppliers for each product. Depending on the type and availability of each item, you will apply a formula that to that wholesale price to get to the retail number. For instance, easy to source, common products might be worth only 1.5 times the wholesale price. While harder to source specialty products might command 2x or even 3x the wholesale price when converted to retail.
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> Things to take into consideration include who your target customers are, how much value you add to each product, and – this is important – how valuable your brand is. Some companies can command a higher retail rate because of who they are and how well their marketing and branding has established them as a market leader.
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> Labor pricing has less overall fluctuation, but you still have to take into account the quality of the overall service you are providing. Not all techs are created equally.
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> My recommendation is to source a pricing advisor to help with determining not only the correct retail price, but your overall pricing strategy in terms of balancing equipment, labor, and miscellaneous revenue.

Q: I find certain Marketing people will give away a gig in order to earn a client, but then that client expects the same freebie on future gigs, thoughts?

> Tom: Yes, and isn't that the point of this webinar? Companies need to understand what the project is worth, what the customer needs to pay, and how seasonal issues affect both. Sales and marketing that "give away" jobs are simply using your very broken pricing system to close a deal. If you truly understand the potential costs for a project, then you can determine exactly how much margin you can afford to negotiate. To your point however, if you fail to change how you present your proposal, it is possible and even likely the client will latch onto individual prices or discounts and expect them in the future.

I mentioned in the webinar to “Stop thinking like a rental company,” and I mean it. This implies that you should stop providing rental “quotes” or rental-based proposals. This is another area where companies can utilize outside assistance in changing market strategies.

Q: Going beyond "capacity", have to be careful of the need to go to the "3rd or 4th string" freelance labor pool. If quality or brand could be compromised, that's a need to say "no" to a job even though it may be profitable?

A: Of course, there is always a practical limit to how much business you can handle. Outside labor is a major part of your business, so it should be a top priority to maintain the large and well-qualified labor pool. Having said that, the point the webinar implies is that you should not worry so much about running out of equipment, because you can always get more. And if your pricing is based on your acquisition cost, you will make money even when you are out of equipment.

Q: The profit margins are based on gross profit of direct production costs. What about the inclusion of admin costs in job costing so that you can derive a net profit.

A: Admin costs are overhead. They are not allocable (though some people have tried). Net profit is a financial accounting concept. It has nothing to do with Job Cost.

However, I understand that many companies struggle trying to draw a line from revenue by job to net profit, but it simply doesn’t work that way. If it did, you would not take any work in slow months because the increase in overhead share would make all jobs unprofitable.

Q: Can you review an example of how to negotiate with a customer who is getting a lower price from a competitor?

A: First of all, you are aware that they have another price so you already have the upper hand in negotiation. Let’s make the assumption (and it’s a big one) that you are actually worth more than said competitor. Clearly your positioning conversations and pre-close agreement did not have the desired effect and your proposal did not highlight the qualities that are important to the customer. Too late to fix that now, so time for salesmanship to do its job:

You: “There is a lot of variety across the industry in products, approach, and overall quality and I have found that our company is almost never the lowest price unless the other bidders completely misunderstood the customer’s needs. So, first of all does the solution I proposed meet your needs?”

Customer: Yes, I think you did a good job of capturing the elements we discussed.

You: Excellent and thank-you. So, other than price what is attractive about the competing proposal?

Customer: The product categories and solutions seem to be similar, so I am not seeing much difference between the two.

You: Then I suspect you have done a good job of conveying your needs and I hope we have done a better job of acknowledging the quality and service that are important to you.

[Now is the time that you recap the priorities that were identified in the discovery process and how your solution specifically addresses those needs.]

You: If the process of talking to suppliers has helped you better define your budget, then I can help you modify your needs and expectations to get the most value…

Q: Isn't the market price the retail price? How can I change that?

A: The glib answer is that you simply need to NOT be a commodity then you can change the retail price. Even commodities have fluctuating prices. How many rates for a gallon of gasoline can you spot during your daily commute?

To be fair, the question is probably stemming from the historical context of treating rental prices as a transparent line item on a proposal or budget. The easiest way to effect change on the "market price" is to raise the expectation of value for that product. You can do this through a combination of marketing and branding, value-added services, and packaging.

Q: You mentioned a balance of equipment to labor on a job. What do you recommend as acceptable?

A: There is no one answer to this. It depends on the type of project, supplier, and technology. For companies that do a lot of mixed event staging, rental production, general sessions, and breakouts, my target is 55-60% of the total job revenue should come from equipment (net of discounts), 35-40% should come from labor, and 5-10% from other expenses measured across all jobs. Individual jobs will vary widely. Breakouts or lighting heavy jobs have more gear to labor. High end video takes more labor to gear.

Q: How do you factor - keeping up quality when being outside your capacity. Flawlessness is the number 1 for clients and your company reputation.

A: Actually, no reasonable person expects flawless. What customers really value is consistency. Having said that, I am not advocating that you accept lower quality. I am suggesting that you may need to increase your capacity for doing more good work.

Q: Any tips for adjusting your rental quoting system to account for Seasonal Pricing? That is a lot of data to manipulate in the system to adjust seasonally.

A: You do not have to adjust prices to have seasonal pricing. You simply adjust your margin expectations. If you average gross profit annually is 35%, then in a busy month you may want to set a 40-45% gross profit expectation. In a slow month you might be prepared to accept 20-25%. And even if you are in a busy month, you may have a job pop up that fits nicely into the schedule. This should allow you to accept a lower GP% than the jobs around it, if that is what it takes to win the business.

Additional Questions From September 2014 Webinar

Q: I just watched our Operations Manager head out to a sub rental company to pick up two LCD stands for a pair of monitors we rented earlier today to supplement our inventory. The ones we picked up had the wrong mounts on them so we had the wrong stands. This should, of course, be a line item cost added to the job and it's all too easy to hide it as a "warehouse expense" and have a false profit margin on the job. Running back and forth to job sites needs to be costed out as well if you're looking for true margins.

Tom: I witness stories like this all the time. Technically, problems such as missing parts, sub-renting the wrong item, and other mistakes in fulfillment are not job costs; they are operational costs. Or, what I like to call the House's Money. The job did nothing wrong. The supplier to the job (ie: your operation) screwed up. It could have happened to any job. That mistake affects the company's gross profit – not the job's.

As an industry we are great at solving problems – just get it done, whatever it takes, go the extra mile, etc… - but, we seem to struggle with avoiding these glitches. One of the biggest reasons is that we often neglect to calculate the cost of the solution, which allows us to place a lower value on prevention.

My favorite example for this is a company (no longer in business) that was so under-invested in cable and accessories that it had to regularly sub-rent VGA to BNC adapters. At the time this was a $29 piece that instead of purchasing, the firm sent a van across town to pickup (and later, return). In fact, 50% of all local pick-up and return activity was for sub-rentals or inter-office inventory swaps. The solution was obvious: buy more cable and accessories, but management was steadfast – because not *every* job had this problem and "Hey, it only costs $3 to rent!" I was told repeatedly. So, I calculated the cost of all the van runs, plus overtime, plus the sub-rental cost (it was actually $9/week) and determined that the firm spent well over $350,000 per year supporting this stance instead of the $50,000 it needed in small items that would eliminate this extra cost year after year.

My point is that without the math, it looked like everyone was just doing their best to overcome a one-time problem created by the job at hand. Jobs don't create these problems, the company simply didn't provide for the normal course of its business. Sub-rental for normal needs is not a job cost, it's a shortcut to solving a systemic problem in order to fulfill the order.

We shouldn't punish the job by lumping fees and expenses on to it that the job didn't create. After all, the poor thing is just trying to make us money.

Q: We use an "MRP" - Minimum Rental Price for our "House Equipment" - a calculated number that takes into consideration the purchase cost, the anticipated lifespan and what it costs us to take it out, use it and get it prepped and back on the shelf. That has made a tremendous impact on our true job costing.

> Tom: Awesome! You have set a minimum net price by line item, drawn a line in the sand, and communicated it to the team. This is a good policy. Other companies can effect the same result simply by controlling any one of the 3x3 pricing variables (retail rate, duration, discount). This will always have a positive impact because it encourages your negotiators to fight for more margin. Keep it up. You need to take it one step further: take that MRP price and add margin to it to create a retail price. Common items will support a smaller margin than specialty products. Also, be sure that the right labor is applied for specialty products.

Q: Better define "substitution costs"...please

> Tom: Substitution cost is the expense you will incur when you run out of a house resource: for instance, equipment, labor, or a service. See the next question:

Q: I don't believe internal cost for house equipment can be equal to substitution cost. If it were, there'd be little incentive to purchase gear. how can we place an accurate value on owned gear (both new and fully depreciated)?

> Tom: You are absolutely correct that internal cost for house equipment cannot be equal to substitution cost. In our pre-job cost system, substitution cost applies to labor (all kinds) and services (such as freight), and turnkey or specialty sub-rentals.
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> The cost of "house" equipment is based on the wholesale rate, which is a substitution cost that the house will incur when it sub-rents to fulfill "house" needs. However, the house rate for gear (or the discount price the house extends to the job to use its gear) is ideally lower than sub-rental rates. In other words, the job gets a better deal by renting from the house. If the house runs out of standard products, it can either choose to purchase more to fulfill the order or sub-rent. The house incurs the sub-rental expense. If the job needs non-standard gear, the salesperson has to determine the price to acquire it (sub-rent) and add a reasonable margin to that figure.
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> In our webinar examples, we used 50% of retail as the charge to the job for all house equipment. This is the same as a 50% discount off of retail price. If sub-renting the same products costs more than half of retail, then the house is motivated to buy more instead of sub-renting to eliminate that outside cost. So in practice, companies will want to buy more gear – not less – assuming the retail rate is correct and the company is not over-discounting.

Q: In your example, you showed the $5K discount as an expense in COGS. This is really a sales discount which should be netted with gross revenue. While it doesn't affect the overall gross profit on the job, it does affect the GP% analysis.

> Tom: I agree that discount is an adjustment to revenue – in financial accounting terms. I think your point is that the dollar value of the gross profit does not change because we show the discount – only the gross profit percentage changes (eg: gross profit of $2,500 is 25% of $10,000, but only 16.7% of $15,000). If we follow that logic, then any discount is acceptable. We only need to add up the gross profit dollars. However, I hope we all agree that a project that retails for $15,000 and earns $2,500 is less valuable than a job that retails for $10,000 and earns $2,500.
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> In order for these discounts to matter to us in job cost terms, they need to represent real money that we are "spending" to win the job. We have to understand that discounts DO affect the overall gross profit of the job. That's why we need to understand where all these pricing decisions come from and get them under control.
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> If you get nothing else out of this webinar, simply adjust your job cost gross profit formula to calculate from retail pricing (adding back retail for all the "free" stuff too). At least then your jobs will be on a level playing field in terms of comparing the value of one over the other.

Q: Include spares at full retail price?

> Tom: We calculate the job cost of spares just like any house item. If you "no charge" spares, the job still needs to pay for them. Free spares is just another form of discounting (think about the 3x3 matrix). This job cost system requires a major shift in your perception of costs. House equipment is not free, staff are not free, and company vehicles are not free. Whether you "charge" for them or not is a choice. Think about those "free" car mats the auto dealer gave you in your new car. I'm pretty sure someone paid for those!

Q: That was great, thank you. Very valuable information. Did you say you had a template set up for the pricing model?

> Tom: The template for pricing and job cost calculations varies by company. Here's where I start: Develop a spreadsheet with product code, description, quantity owned, current price low, current price high (ie: retail), substitution costs A, B, C (check three sources), and the new retail price. Each line will have a toggle for "house" and "non-house" designation.

Q: I agree with your pre-proposal costs assessments, the biggest variant in costing for events seems to be rigging? There has been a extremely high increase in some markets. This has become harder to calculate when you are costing a job opportunity 3-6 months in advance. How do you see the market handling this?

Tom: Based on your question, rigging is not your core product and "some markets" means those where the hotel has contracted an in-house rigging supplier. So, the cost is based on when and where the job is. In other words, you can't "bid" rigging without access to the rigging supplier. There is no easy solution other than call the in-house provider, get a quote, and mark the price up. I would also add language to my proposal that you are not responsible for changes in the prices for venue-based services.

Q: Doesn't the house's money change with depreciation on the gear? Older gear - needs more repair. Some staff members- engineers versus PA - are variable. And are you taking into account the mark up on the freelancers or the subrental gear as a profit?

Tom: The short answer is, no. Depreciation – in reality, what you are referring to is degradation - does not affect what the house charges to the job. Some purchases are a better return than others. Stuff breaks: fix it or buy new. The charge to the job is based on market rates (eg: the wholesale price), not the cost of ownership.

In regard to the labor part of your question, the markup on labor is indeed profit. I am in favor of it!

Q: How does the cost model hold up with extremely high acquisition cost equipment not yet widely available in the market?

Tom: Good question. The system works at any price point. Let's use LED tiles as an example. They have a high acquisition cost, but not all companies choose to buy. Therefore access is limited in most markets. If you own LED, then you should expect a higher return because you have higher acquisition costs and less competition. Some companies choose to accept a lower margin on LED in order to keep the equipment busy (and cover those monthly lease payments). In our job cost model, we would apply a lower margin when calculating the retail price based on the wholesale cost. This would also affect the minimum gross profit the company will find acceptable.

Likewise, products such as screens tend to dictate a lower retail price compared to wholesale: this simply means that because these products are very common and somewhat low risk, we can't apply the same markup as we can on a projector or a wireless mic.

Q: There is a company in our area that constantly "sub-rents to sub-renter", which I find is eroding my prices. What would you say to that company?

Tom: I'd say, "Thanks for the great prices!" Someone that sub-rents to the sub-renter is a wholesaler. They aren't eroding your prices, you are failing to keep up with the market changes. What you can charge your customer is based on what this company charges you. Now, if they rented to end-users at wholesale prices you would have reason to take issue with them, but the only thing you can do is reinforce your own value proposition.

Q: Alternately, is there a average net income % for the industry?

> Tom: Yes. Purchase my 2012-13 R&S Business Metric Survey. There is a lot of data on direct costs as well.

Q: Does or should equipment cost calculations only include direct equipment related expenses (e.g. replacement, repairs, cap ex, warehouse prep, etc..) or does a proration of fixed costs get included?

> Tom: Actually, I am suggesting that you skip those calculations altogether in determining your cost. The wholesale market already did that for you and set the price. Just mark that up and run with it.
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> Where such calculations matter is in determining whether you purchase the products for yourself or not. If your demand does not warrant the purchase, you should spend your CAPEX on things that will make you more money.

Q: hi tom -- under the four tiers of pricing, can you elaborate on wholesale 'price to the trade'?

> Tom: Think of "the trade" as your peers and competitors. For most of you that would be the Production Rental segment: entities that own inventory and make it available to customers.
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> Meeting Planners and Producers are in the same industry, but their "trade" is event planning and production not rental. Even if they own a piece or two of gear that they "rent" to their clients, that does not mean they are part of your trade group – no more than owning a wrench makes you a mechanic.

Q: What's the best way to start to figure out in-house cost of equipment? I'd like to determine in-house costs and compare them to sub-rental costs.

> Tom: I think you are missing the point, but here goes: Your in-house cost is based on depreciation (over the life of the item, not tax basis), repairs, and maintenance. For some items, the product is viable for only a short time (think: projectors). For other products, the durable life can be years and years (think: screens). If your cost of ownership for a projector lasting four years is $10,000 total, and if you are spending $5,000 a year on sub-rentals for that product (and expect that price to be the same for the next four years), then you would earn a 4:1 return on the purchase. What this does not take into account is how many times you will give that projector away just because "it's sitting on the shelf"!

Q: in order to set a retail price you said to work from the wholesale price. What if we have a lot of different suppliers and sometimes I get really great prices?

> A: That is the right question! In setting your retail price, you need to evaluate RELIABLE sub-rental options. Don't base it on special brother-in-law deals. The wholesale price is the price you can't count on getting even in the busiest month of the year.

Q: I don't understand the "House's Money". Do we calculate that for every product?

> A: House Money is a difficult concept to grasp on your first introduction to the concept. Think of it as an outcome or a byproduct. Owning equipment and having staff are a cost advantage to the house. The difference between the real cost of a staff person for instance, and the replacement cost for a tech (we said it was $400 in our example) that small variance is the house's money. The variance on equipment is much higher. We can't assign that advantage to any one project.

Q: Can you help us with commission structures too?

> A: Thank-you and YES. We can add that to the scope of work, but I recommend that you complete the implementation and spend some time living with it before tampering with (or introducing) commissions. This is something we should talk about if you want to explore this system further.