



THE BENCHMARK

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What the gross margin benchmark means to your business

What kind of gross margins can I expect this year? I get asked this question every week. The easy answer is "lower," as pricing becomes even more aggressive. This price decline is a simple fact of life in every segment of the Green Industry thanks to the current oversupply of contractors relative to the shrinking stock of work. The tougher question is how to react to this market condition.

Table 1 shows the year-over-year impact the economy is having on gross margins in two seg-

ments: design/build and grounds management. Because pricing in the bid/build segment is so aggressive, it is difficult to pinpoint a benchmark. But I have observed gross margins as low as 19% in this segment.

The best strategy is to focus on gross profit dollars in your pricing and estimating instead of target fixating on gross margin percentage. After all, percentages don't pay for overhead, dollars do. The example below outlines a "before and after" picture of the financial impact of a lower gross margin.

Keeping in mind the primary objective of achieving the same gross profit dollars to pay for our overhead, the strategy combines a decrease in the hourly labor price and a production hours efficiency gain in exchange for an average wage increase (because of increased overtime). This strategy requires no additional equipment and minimizes increases in overhead costs.

In our example, we reduce the price of labor by 10%, from \$32.71 to \$29.35. A more competitive price should result in increased sales. As a result, labor hours would necessarily increase by 9,000 hours to produce the new work. But by budgeting for 5.5 hours of overtime per man per week (increasing the average wage from \$12.50 to \$13.26) in exchange for a 5% efficiency gain on the current work (equivalent to two hours per week per employee), we can cover all those hours without adding people or equipment.

If lower gross margins are a constraint and fact of life, you will have no other choice but to respond creatively to lean out your pricing and your production to maintain your gross profit dollars.

As for the old gross margin percentages, forget about them for now. They are an old benchmark that represents the way it was. We all have to deal in the now.

TABLE 1: GROSS MARGIN DECLINES

Year	Design/build	Grounds Mgmt/Contract work
2009	48%	47%
2008	54%	55%

TABLE 2: BEFORE AND AFTER

Factor	Before	After
Revenue	\$1,709,091	\$2,000,000
Labor (payroll and taxes)	\$546,909 [32%]	\$700,000 [35%]
Material expense	\$170,909 [10%]	\$240,000 [12%]
Subcontractor expense	\$51,273 [3%]	\$120,000 [6%]
Total cost	\$769,091 [45%]	\$1,060,000 [53%]
Gross profit	\$940,000 [55%]	\$940,000 [47%]
Average wage rate	\$12.50	\$13.26
Production hours	43,753	52,808
Markup on materials/subs	25%	25%
Hourly labor price	\$32.71	\$29.35