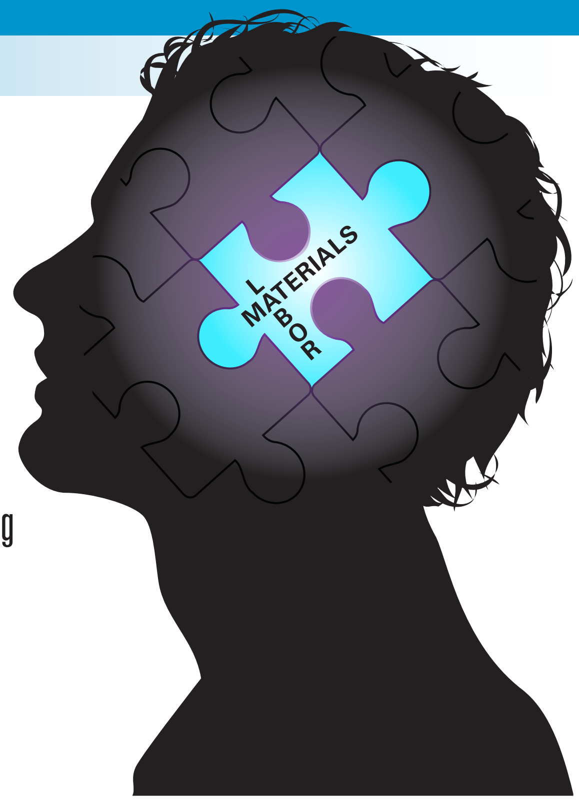
[STRATEGIC SOLUTIONS]

Go direct

Better understanding direct costs can mean more money from existing and new business.

BY **JAYME BROUDY**



SOON AFTER THE recession hit, I received a flood of questions about how to survive the recession. My advice was: Since you can't control the revenue, work on becoming more competitive by implementing better systems and business processes. Some owners took my advice and some didn't.

Now, as things are stabilizing a bit, guess who's winning the battle for new business and returning to profitability soonest? There are certainly areas where bidding wars are raging and profitability is suffering, but the efficient businesses can price lower, burn less cash, and will eventually wear down the competition and emerge victorious.

So what's this got to do with building revenue? Revenue alone doesn't feed the bulldog; business is about profitability, not revenue alone, and since you have more control over your internal costs than you do over the market's gyrations, it makes sense to pay serious attention to your internal costs.

For every point of cost you can take out (and a "point" means going from 35% to 36% of revenue) it's a point you can use to either increase profit in your pocket or reduce your prices and still maintain income.

The place to push hard is in direct costs, meaning the materials and labor used directly in producing your products or services. Reducing these costs means you'll make more money from both your existing revenue stream and all the new revenue that'll come in as things improve. A two point increase in gross margin percentage for a $500,000 business will create $50,000 in your pocket over five years — not too shabby. A $1 million business will see an extra $100,000 — even less shabby. And there are plenty of businesses that are leaving five points of gross margin or more on the table, but they won't for very long if they're still around at all.

How can you make this happen? Look at projects that will improve operating efficiencies, like:

- Better labor scheduling to reduce overtime or travel times.
- Detailed procedures that let people produce better results and less waste/fewer callbacks, etc.
- Tougher purchasing arrangements (your suppliers are in the same boat as you are; they need business.)

I like to attack direct costs first because of the leverage involved, but that doesn't mean indirect costs shouldn't be examined as well. A mistake that gets made here, though, is mistaking investments for expenses and throwing the baby out with the bath water. Systems development costs that produce ongoing returns, marketing efforts to maintain and increase revenue, and other things with payoffs are not expenses; they're investments (and in the case of systems/standalone work are actually going to end up improving margins, so they're doubly important). Don't lump these things together with office supplies and truck washes.

Does this mean you should stop chasing revenue? Absolutely not. Aggressive marketing is more important than ever (and marketing firms are becoming far more results-oriented than ever before, meaning they're more willing to be compensated based on whether their activities actually bring more business in the door). And when business is flat, it's especially important to maintain and increase your visibility, so think hard before reducing marketing spending.

It seems the worst is over (or at least it's not getting much worse), and now's the time to grab the business that's starting to re-emerge. We're seeing a buyer who's very conscious that you need his business more than he needs you, so being able to produce the highest possible quality at lowest price is more important than ever. LM

$ GROWTH GOALS 1. Improve labor scheduling to reduce overtime and travel time. **2. Set up systems to eliminate waste and produce better results.** 3. Review purchasing agreements and vendor relationships to ensure the best deals.

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