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Give new customers a pricing incentive

There are some signs that prices are stabilizing, but until the real estate cycle turns up, commercial inventories are worked through and vacancies are filled, pricing is not going to return to 2007 levels anytime soon. Given this, it pays to use incremental pricing to compete effectively for new business.

1 START. Using your 2010 P&L statement, determine your monthly contract billings, which for our example is $140,000. Calculate the contract portfolio earn rate (divide total revenues by total labor hours to do the work: $25.75). Then, calculate the enhancement percentage (enhancement revenues divided by contract revenues: 19%), and determine the enhancement gross margin percentage (45% in our example).

2 STRATEGY. In our example, we assume an 85% renewal rate — and this adjusts monthly contract billings to project renewal revenue and gross profit. Because we are still earning $25.75 per hour, with an average wage rate of $12.50 for the hours worked, we will earn 51.5% on this book of business.

Next, we model incremental new contract revenue of $500,000. These we anticipate will sell at an average discount of 10% less than the $25.75 to which we are accustomed. As a result, we will earn less on this new work: only $23.18 per hour. In reality, of course, it is likely we will sell some jobs for higher than this rate and some lower to achieve this average. As a result, we plan to accept a lower gross margin of 46.1%.

We are not happy about this, but we risk selling far less at higher rates. That would create an even greater problem: not covering overhead.

Finally, we estimate enhancement revenue. In this example, we are conservative in projecting the same 19% of contract revenue at a 45% gross margin. In addition, we make an assumption of an allowable overhead growth of 10%. This will be required to fund the additional equipment costs that come with adding new contracts.

WEB EXTRA For a chart showing more on pricing new work competitively, visit www.landscapemanagement.net/kehoechart1.

3 RESULT. The effects of the strategy: 85% renewal, new revenue of $500,000 at 10% less price and enhancements holding steady at 2010 levels, gives us a P&L projection of $140,366 and 6.1% in net profit. Therefore, despite the gross margin declining from 50% to 49.2%, we make more money.

The key to lower incremental pricing is — and must be, in my experience — to grow your overhead at less than 50% of your sales growth. In this case, we accomplish that mission — as well as making it more likely that we will be competitive in pricing new work.

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ILLUSTRATION BY: ISTOCK INTERNATIONAL INC.