



HOW-TO

Prepare for next year

BY KEVIN KEHOE

Painfully aware that any prognostication or prediction might be off base, it's safe to say the 2013 forecast depends on the presidential election this November. At the same time, any change in the national office can't alter the reality that a global economic slowdown will pressure the commercial real estate market, which will affect growth aspirations, profits and access to capital. So, make a business plan that addresses accurate market conditions, your profit and your cash needs.

The following story is a slightly disguised version of a company's experience planning and executing that plan in 2012. We'll call it Company X, and I'll use \$1 million as a fictitious revenue number. The company is larger, but \$1 million makes it easier to understand the financial relationships among the numbers. Although the year hasn't ended, the company is on track. I hope this example serves as a lesson that might inform your decision making and planning processes for 2013. The plan included, but wasn't limited to, the assumption that:

LABOR COSTS WOULD RISE—based on the mishandling of the H-2B program, increased labor department rules and regulations, a dysfunctional unemployment policy and the health care uncertainties that remain.

UNIT PRICING FOR LABOR WOULD REMAIN FLAT—based on conversations with customers who suggested they were rejecting lowest prices more often (this wasn't true from 2008 to 2010) and were less tolerant of lower quality. (They were calling vendors about their strategy of fewer hours applied to the job to reduce contract prices.)

INTEREST RATES WOULD REMAIN LOW AND GAS PRICES WOULD REMAIN FLAT—based on our faith in Ben Bernanke to continue his easy money policies. These conditions would make equipment purchases less expensive. At the same time, the crashing euro would result in dollar-denominated oil prices being less inflationary.

IMPROVED INFORMATION SYSTEMS WOULD ALLOW REVENUE GROWTH WITHOUT OVERHEAD STAFFING GROWTH—based on a stubborn refusal to add staff, by benchmarking the return-

on-overhead-dollars-expensed ratio with high-profit companies and the purchase of new software the year before. We had good people, and with proper information, motivation and a clear plan, they could perform small productivity miracles.

Here's how we planned for these assumptions. You can see the results in the tables below.

➤ The first assumption called for a labor cost increase. We increased wages for several key foremen to retain their services. As a result, the average wage rate increased 5 percent, from \$13.33 to \$14 per hour. To offset the cost increase, we planned for a productivity improvement of 6 percent in the return on labor dollar paid from \$2.13 to \$2.25. Given that the high-performance benchmark for this ratio was \$2.40, it suggested we still had room for improvement. Also, the operations people committed to reduce hours through lean management practices across the board. Work could be done more efficiently, saving 6 percent of hours.

➤ The second assumption called for flat unit pricing to the customer. In many cases, we believed we could raise prices on some jobs through the renewal process and still meet the 90 percent retention goal, which we did. We also made salespeople breathe easier when we kept pricing tight on new work. At the same time, we expected them to do a better job qualifying prospects so they wouldn't waste time bidding work where the customer gave us little chance of success and by managing the job specification (occurrences and frequencies) tighter to reduce total hours needed to do the work on a new sale. This would

pressure production to be more efficient and manage the schedule more in tune with the weather (we prayed for a hot, dry summer) and the customers' feedback through account managers. As a result, the adjusted revenue per hour would increase 11 percent, from \$28.33 to \$31.50 per hour.



QUICK TIP

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› The third assumption called on stable gas prices and minimal equipment purchases based on tighter route management to reduce drive time and better emphasize minimizing equipment abuse. As a result, our overhead spending for this expense increased 13 percent (\$225,000 from \$200,000). This change was reasonable and in line with the 15 percent revenue increase. We believed we could improve these expenses but erred on the side of caution.

› The fourth assumption called for no additional overhead spending for staff. The 15 percent sales growth was based on an increase of the return on overhead dollars by only 6 percent. This number was well within reasonable, high-profit benchmark performance and no more unnecessary overhead spending. We kept salaries flat and installed a bonus system based on gross profit dollar performance at year's end, when the staff could earn much more than a standard 3 percent raise. At the same time, we barely raised the new sales goal for the salesman from \$250,000 in 2011 to \$252,750 for 2012. The salesman felt it could be accomplished with the more focused approach

and pricing model outlined in the table.

The tables below tell the story of Company X's planning process, from where we started in 2011 to where we wanted to end in 2012. Given tight access to capital, we had to show a near-10 percent profit to drive cash flow. This was the ultimate goal of the planning. Everyone understood how critical it was to achieve this.

The key to making the plan was based on sweating the numbers, involving managers and getting buy-in to the strategy and ownership of the result.

The same type of planning can be used this year when you lay out your goals for growth and profit for 2013. Keep in mind there's no such thing as the perfect plan. General Patton famously said, "No plan survives contact with the enemy." He also said, "An average plan aggressively executed is far better than a perfect plan never completed." Therefore, focus your plan, and see if you don't have a prosperous 2013. *LM*

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TABLE 1: COMPANY X

BEFORE

ACTUAL RESULTS: PROFIT AND LOSS 2011

Revenue	\$1,000,000	
Labor	\$400,000	40%
Material	\$150,000	15%
Gross profit	\$450,000	45%
Overhead	\$400,000	40%
Net profit	\$50,000	5%

OVERHEAD

Supervisory	\$50,000	5%
Fleet/equipment	\$200,000	20%
Rent/office	\$40,000	4%
Marketing	\$20,000	2%
Insurance	\$75,000	7.5%
Computer	\$15,000	1.5%

TOTAL	\$400,000	40%
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Paid production labor hours	\$30,000
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RATIOS 2012

Sales growth	11%
Contract revenue retention	85%
New sales made	\$250,000
Average wage rate/hour	\$13.33
Adjusted revenue earned/hour	\$28.33
Return on labor dollar paid	\$2.13
Return on overhead dollars expensed	\$2.50

TABLE 2: COMPANY X

AFTER

BUDGET/PLAN: PROFIT AND LOSS 2012

Revenue	\$1,152,750	
Labor	\$435,483	37.8%
Material	\$172,913	15%
Gross profit	\$544,354	47.2%
Overhead	\$435,000	37.7%
Net profit	\$109,354	9.5%

OVERHEAD

Supervisory	\$55,000	4.8%
Fleet/equipment	\$225,000	19.5%
Rent/office	\$40,000	3.5%
Marketing	\$20,000	1.7%
Insurance	\$80,000	6.9%
Computer	\$15,000	1.3%

TOTAL	\$435,000	37.7%
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Paid production labor hours	\$31,106
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PLANNING RATIOS 2013

Sales growth	15%
Contract revenue retention	90%
New sales made	\$252,750
Average wage rate/hour	\$14.00
Adjusted revenue earned/hour	\$31.50
Return on labor dollar paid	\$2.25
Return on overhead dollars expensed	\$2.65



Revenue includes contract and extras invoicing. Labor dollars and paid production hours include all payroll expenses (taxes, too) for foremen and crews. Material includes subcontractor costs. Contract retention percentage is based on dollars. The average wage rate equals labor divided by paid production hours. The adjusted revenue earned per hour equals revenue minus materials divided by paid production hours. Return on labor dollar paid equals adjusted revenue earned per hour divided by average wage rate per hour. Return on overhead dollars equals revenue divided by total overhead. The last two ratios are the most consistent ones used to plan and compare companies because they remove regional and local differences in unit labor costs and market unit pricing.