

# Do The Math!



## The Magic Number

By Jay Goltz

Many people who do production framing have a particular number that represents the minimum amount of gross profit that they will use when they calculate the price of a job. Out of this gross profit comes rent, management salaries, sales expenses, and other overhead costs. If you are putting through millions of dollars of orders and your overhead costs are fairly low, you could stand to make a lot of money if your volume is high enough.

There is a point, though, that you could reach where your fixed costs will start to rise because you have reached capacity. Rent is one of them. Let's compare two framing operations that have decided that a 30 percent gross profit will cover fixed expenses and leave a nice profit.

Both gross \$3 million. They both pay \$8 per square foot for rent annually. The first guy is framing pictures with a very sophisticated moulding, linen mats, and specialty glass. The average unit bills out at \$150. He's framing 20,000 a year, or 80 a day. The second guy is framing inexpensive posters. He's charging \$50 a piece. He's framing 60,000 a year, or 240 a day. As stated, the labor and material in both cases is 70 percent.

Here's the difference: the space the first guy is working out of is 7,500 square feet (at \$8 a square foot, that equals \$60,000 or 2 percent of sales). The second guy is framing three times the amount of pictures, but that doesn't necessarily mean that he needs three times the space. He might, in fact, need twice the space - there are more employees, a bigger break room, more inventory, more space for finished goods. That means that he will need a 15,000 square foot space. He's paying \$120,000 in rent or 4 percent of sales. Considering that the bottom line of these operations might only be 6 percent, this could be a third of the bottom line up in smoke - or rent in this case. All other things being equal, if the first guy made a 6 percent bottom line then the second guy made a 4 percent bottom line.

The point is that most people focus on variable expenses. But you also need to understand how your fixed expenses affect pricing. The biggest fallacy is when people think, "If I get this job, it's all incremental revenue; all of the gross profit will fall to the bottom line." What that means is that the fixed costs are not going to go up at all. Maybe yes, maybe no. It's

### Impact of Fixed Costs

	Company A	Company B
Total Sales	\$3 million	\$3 million
Pieces Framed per year	20,000/year	60,000/year
Average Unit Price	\$150	\$50
Square Footage	7,500 sq. ft.	15,000 sq. ft.
Rent	\$60,000	\$120,000
Rent as % of Sales	2%	4%
Margin after Rent	6%	4%
Net Profit per year	\$180,000	\$120,000

very difficult to figure out what triggers the need for another employee, another saw, or more space. In addition, it's difficult to know what effect taking a big job will have on your existing business. Will you lose three more jobs because you are consumed by that job? Will an employee get hurt because you're working on that job? Will the saw break down because you're working on that job?

What's the Do the Math lesson? The gross profit percentage that you use to calculate your price with should take into consideration whether the materials and processes are more expensive or not. As you can see, simply adding two percent to the gross profit on an inexpensive job would compensate for the higher overhead costs associated with it. ■