Strive to Exceed Breakeven: Part 1

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Understanding your numbers is the key to profitability – period. Over the next couple of months, we are going to explore the wonderful world of what happens when the company exceeds its breakeven point.

This month we are going to create the foundation for profitable growth by determining what makes up a company's hourly rate. We will discuss the differences in fixed overhead and variable overhead, and we will discuss projected "billed" hours to the customer.

Part 2 will be an eye-opener. It will clearly show the huge increase in profitability that occurs once the company's breakeven is exceeded. The goal of every company should be to exceed its breakeven point each month. That means setting conservative goals and then exceeding those goals. Once you understand your costs of doing business and how to determine your breakeven rate, the light bulb will go on in terms of understanding profitability AFTER the breakeven point is reached.

The third and final article will discuss a couple of simple, but effective, bonus systems for your technicians in the service department as well as the installation department.

Let's begin by discussing the definitions of fixed and variable overhead.

Fixed Overhead – Fixed overhead costs are expenses that remain basically the same no matter how much work you do or don't do. Fixed overhead costs are things like rent, utilities, telephone, most insurances and loan payments. Each of these items will remain pretty much the same if you doubled sales, tripled sales or didn't sell anything at all. These fixed expenses are just that, fixed. They continue no matter how much work you do.

Variable Overhead Costs – Variable overhead, by definition, is directly tied to productivity. Variable costs go up when you do more work and go down when you do less work. In theory, they actually go away if the company did no work at all. There are relatively few variable overhead costs, at least in relationship to fixed costs. Examples of variable overhead costs would be things like gasoline, maintenance on your vehicles, Visa/Master Card charges and miscellaneous supplies used on jobs. Each of these expenses traditionally goes up when work increases and goes down when work decreases.

Why did we separate costs into fixed and variable? When the company bills out as many hours as they projected to bill for the year, the fixed overhead is fully covered. Any additional work will not have "fixed overhead" attached to it, making the hours billed over and above the budgeted amount, very profitable. The variable overhead costs, however, continue no matter how much work you do because they are tied to productivity.

Another key to our breakeven discussion deals with the hours actually billed the customer. As we all know, we pay the installers and service techs from the time they clock in until they clock out at the end of the day. The question is, "How many hours can actually be billed to the customer?" We could do a whole article on billable versus non-billable time, but let's keep it simple for now.

Service Techs Billed Hours – When talking about billed hours in the area of service, we are talking about the hours the tech can actually charge the customer each day. Non-billable times include shop time, travel time between jobs, sick, vacation, holidays, company meetings, callbacks, warranty work and customer no-shows. When looking at an entire year, most service techs average about 50% non-billable time and 50% billable time. In other words, a full-time service tech usually bills about 4 hours a day to the customer. If they work a 40-hour week, that means an average of 20 hours a week or roughly 1,000 hours a year. That is our goal.

Installers Billed Hours – When talking about billed hours for an installer, the numbers are a lot higher. Let's use an example: Take a very simple job that will take one installer two days to complete. The installer may sit around in the office for 20 minutes both days, or may have to go the shop or distributor a few times to pick up parts. But, if the installer completes the job in two days (16 hours), all their time is considered billable because that is the amount of time the job was bid for. Therefore non-billable time for an installer is traditionally low. Non-billable time for an installer normally includes sick, vacation and holiday time plus perhaps 2-3 hours a week that cannot be charged directly to the job. That means a full-time installer can average billing 35 hours a week to the customer, depending on how much sick, vacation and holiday time the company pays for.

To be able to play with the numbers, we need to create a Sample Company. Let's say our Sample Company has one service tech and two installers. That means the company has roughly 1,000 hours a year it can bill in service, and approximately 3,600 billed hours in the installation department. Now that our hours are set, we need to go back to our fixed and variable overhead costs.

Keep in mind overhead includes more than the typical rent, utilities, office supplies, insurances, etc. Our overhead also includes the two largest (but often overlooked) costs of doing business.

The number one cost of doing business is non-billable time. Our Sample Company has one service tech with approximately 1,000 non-billable hours a year. We are going to pay our service tech $18/hour, so the Sample Company's cost of non-billable time for our service tech is $18,000/year (yes, the company has matching taxes, but let's just keep it simple). Our two installers are making $16/hour, and each has five non-billable hours a week. That means our cost of non-billable time for our two installers is $8,320/year (5 hours/week x 52 weeks x $16 per hour x 2 installers).

The second highest cost of doing business is equipment replacement costs (replaces depreciation from a cash flow perspective). Our service tech is driving a 2010 van that is estimated to last another three years; it will cost the company $30,000 to replace it in three years. That means our cost of equipment replacement for our service department is $10,000 per year ($30,000/3 years = $10,000/year).

Our install team is driving a 2011 vehicle that is estimated to last six more years, and will again cost the company $30,000 to replace. That means the cost of equipment replacement for our install department will be $5,000/year ($30,000/6 years = $5,000/year.

The costs of non-billable time and equipment replacement costs were specifically mentioned since these are the top two highest costs of doing business in the entire company. These two huge costs of doing business are often totally overlooked when most companies are calculating their hourly rates.

Now we could do an entire series of articles on how to create profitable hourly rates for our service and installation departments. However, let's assume we have done our homework and the finalized hourly rates for each department are as follows:

Average Hourly Rate Paid the Techs	Service	Installation
Fixed Overhead Rate per Hour	$18.00	$16.00
Fixed Overhead Rate per Hour	$64.23	$21.87
Variable Overhead Rate per Hour	$16.23	$12.85
Net Profit per Hour	$17.37	$ 5.63
Hourly Rate =	**$115.83**	**$56.35**

Now for two quick questions as we wrap things up on Part 1 of this series.

Q: If we bill out less than 1,000 hours in service and/or 3,600 hours in the installation department, will the company cover all of its fixed overhead costs?

A: No, each department needs to bill out all of their budgeted hours if they are going to cover all of their fixed overhead.

Q: What drops out of our hourly rate once the 1,000 hours in service and the 3,600 hours in installation are billed out?

A: Once our budgeted hours are billed out, ALL of our fixed overhead is covered meaning the fixed overhead costs of $64.23 in service, and $21.87 in installation, will drop out of our hourly rate.

Guess what happens when all of our budgeted hours are billed to the customer? Right again, profit skyrockets! Yes, that will be the subject of next month's article.

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