THE DR. IS IN

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THINK GLOBALLY, ACT LOCALLY

It's wise to rethink the meaning of "break even."

While I was teaching a class at CEDIA EXPO last month, I introduced the topic of breaking even. I mentioned that the last article in my column in *CustomRetailer* was about breaking even. One attendee (let's call him Bob*) turned to me and said, "Yeah, I know all about breakeven! I just finished one of those really horrible jobs, but I was lucky because after all was said and done, I broke even!"

When I asked Bob to elaborate, he went on to explain that even though he didn't make any profit on the job, he was able to invoice the client enough to cover all the job costs. Therefore, he thought he broke even. But did he?

Let's look at some numbers. Let's say you have an average job of $50,000 that you are able to sell with enough markup to achieve a 35 percent gross margin. (A 35 percent to 40 percent gross margin is often quoted as a standard for this industry. But be careful—do not confuse markup with margin, see *CustomRetailer*, June 2009). And since you also keep a tight reign on your overhead costs, you are able to achieve a 5 percent net profit. Sounds good, right? If you only did one job, this is what your Income Statement would look like:

	One Good Job	
Job Income	$50,000	100.0%
COGS	32,500	65.0%
Gross Profit	17,500	35.0%
Overhead	15,000	30.0%
Net Profit	$2,500	5.0%

If you duplicate this process, and produce five jobs this way, you'd make a gross profit of $87,500 and a net profit of $12,500. But then, what happens when you have one of those nightmare jobs—the one where nothing goes right, you can't please the client, and you are trying as hard as you can just to finish the job and run away as fast and as far possible. This is the job that Bob described. But then, he said that he felt lucky because he was able to recover all his job costs, and break even! So, in this example, if the job cost $50,000 and he was able to receive $50,000 from the client, you might agree with Bob that he dodged the bullet.

	One Good Job		Five Good Jobs	One Bad Job	Total of Six Jobs	
Job Income	50,000.00	100.0%	250,000.00	50,000.00	300,000.00	125.0%
COGS	32,500.00	65.0%	162,500.00	50,000.00	212,500.00	88.5%
Gross Profit	17,500.00	35.0%	87,500.00	0.00	87,500.00	36.5%
Overhead	15,000.00	30.0%	75,000.00	15,000.00	90,000.00	37.5%
Net Profit	2,500.00	5.0%	12,500.00	(15,000.00)	(2,500.00)	-1.0%

But the problem with this thinking is that Bob wasn't looking at the big picture. He is looking at each individual job, not his company as a whole. He didn't realize that this one bad job has literally wiped out the profit the he has earned from the five previous jobs. See chart above.

Notice that since he only covered his Cost of Goods Sold (COGS), there was nothing left to pay for the overhead. And surely, he was continuing to spend money on overhead while he was running this bad job.

Keep Track, Know the Impact

So consider your own financials. Realize that if you have one of those losing jobs, you might need to complete at least five more good jobs just to make up for that one bad job.

What's the solution? It's certainly a good goal to avoid the bad job, but it's unrealistic to think that that is possible. Creating a process to produce good jobs efficiently, communicate with the client, and keep on budget can go a long way to preventing the losing job, or at least mitigating your loss. But let's face it; sooner or later you will encounter that client who makes your life miserable—that job where nothing goes right.

Therefore, the best solution is to not only keep on track of each individual job (act locally) but to be aware of the overall impact of all your jobs (think globally). Don't pull all your profit out of the company each year. Keep cash reserves on hand so you can cover your overhead and continue to stay in business to find and produce those good jobs—the profitable ones.

And DO NOT, under any circumstances, reduce your "overhead" markup just to get more work. As the old saying goes: "What I lose in profit, I can make up in volume." No, you can't!

Look at your financials over the last few years. Review your overhead costs on a year-to-year basis. Divide last year's overhead costs by 250—there are 250 work days in a year. That is the dollar amount that it costs you each day you stay in business. If your jobs are not producing enough revenue to cover your overhead, then you will not be in business for long. I'm hoping "Bob" learned from our discussion, and I have the opportunity to see him surviving and thriving at CEDIA EXPO next year! CR

**The names have been changed to protect the innocent.*

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