WHAT TO DO IN TODAY'S ECONOMY TO RETURN TO PROFITABILITY!

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The last several years have been particularly difficult for printers' profitability. The 2008/09 recession has significantly reduced sales as printers' customers have reduced their marketing budgets. Furthermore, printers' customers have moved some of their shrinking budgets to the web. To add insult to injury, energy costs and medical benefit costs have increased many time the rate of inflation. The good news is that most printers experienced a stabilization of revenue in the third quarter of 2009. Over the first quarter of 2010, printers will see if their customers have restored marketing budgets or just maintained 2009 funding. In either case, there is no guarantee that 2007 revenue level will ever return and it is time for printers to manage their firms based on the realities of today.

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Today's situation is difficult but not as daunting as many printers view it. In fact, the current situation has many positive attributes.

In addition to the market stabilization, printers should take comfort in that there is no study supporting that you have to be big to make good profits. There are many known attributes of successful firms – being big is not one of them

WHAT TO DO?

There is a proven three step approach to returning a printer to profitability after a downturn in sales:

First, bring cost in line with current sales levels; **Two**, review your pricing strategies and insure that your best customers are supported and defended from competition and that your least profitable customers are identified and corrected, and **Three**, focus and manage your sales force so it is achieving profitable growth.

The first step is most important to complete as a successful cost management program will provide the cash and time to complete steps two and three which may cost money and will certainly take time.

RETURN TO PROFITABILITY

1. Match costs to current sales
2. Modify pricing strategies based on customer profitability
3. Manage sales force to achieve profitable growth.

Today we will focus on Step 1 to match costs to current sales levels. In future articles we will further explain the importance and the "How to" for steps 2 and 3.

Over the years, I have seen many tools for matching cost to current sales levels. I have seen gifted leaders who by walking around identify most actions needed to resize. Such talent is a requirement in today's environment but because of the dramatic downturn in sales, usually not adequate to identify all actions needed. Today I will review a metric that can help any printer match cost with sales and more importantly assist the entire workforce in maintaining the proper relationship between costs and sales.

The metric is Value Added per Payroll Dollar (VA / Payroll $) and is calculated by dividing Value Added by Payroll Dollar when each is computed as follows:

VALUE ADDED

- Net Sales, less
- All Material Cost and Supplies, less
- All Outside Services

PAYROLL DOLLAR

- All Payroll including Commissions, plus
- All Employee Benefits, plus
- All Employer Payroll Taxes, plus
- All Temporary Labor

VA / Payroll $ has several unique characteristics that make it a superior metric for assisting printers. First, it is highly predictive of profits and has an R^2 of .9 (see exhibit 1). In another words, it accounts for 90% of what drives profits when profit is measured as EBITDA as a percent of sales). Accordingly, concentrating on this metric is likely to drive improved results. Second, it predicts profits over multiple periods of time for the same printing firm (see exhibit 2). Third, it predicts profits across all segments of the industry (see exhibit 3). Fourth, it is easily understood by all employees.

HOW TO USE VA / PAYROLL $?

Here's how to use it (in five easy steps):

1. Begin the process with a mind set that all labor costs are variable, including executive salaries. Remember there is no study in support of the premise that you need to be big to be profitable. Family owned business must also identify any salary that is attributable to ownership and only include in the following analyzes market salaries for actual work performed.
2. Compute VA / Payroll $ for each of the last several years including the most recent years when your firm's profit was acceptable (see exhibit 4).
3. Compute VA / Payroll $ by department (or in what ever manner you analyze labor costs) for each of the last several years including the upcoming budget year.
4. By examining VA / Payroll $ in those years when your firm's profit was acceptable develop VA / Payroll $ objectives for the upcoming year by department (or in what ever manner you analyze labor costs).
5. Compare VA / Payroll $ objectives (step 3) to upcoming budget (step 2) and identify areas in need of improvement.

Now the difficult work begins. If your current VA / Payroll $ is below 1.5 it is unlikely that you are making any money (see exhibit 5). Obviously exceeding this level is mandatory. Examine staffing levels, pay rates, machine speeds for the periods above on an absolute basis and on a per VA $ basis.

Make the difficult decisions. For instance if sales have dropped by 20%, 5 customer service reps now needs to be 4. If sales reps are not covering their draw — reduce the draw or fire the rep and transfer the fired rep's customers to the house or performing reps. Today most employees are happy to have a job. Although unthinkable two to three years ago, many firms have successfully reduced salaries across the board without a significant reduction in employee morale. You may need to rethink how you staff shifts and rethink your attitude about sending people home when you don't have work.

The bottom line that for a printer, profits can only be achieved when your labor cost are in line with you Value Added.

Most printers have seen pressure on their Value Added margins. For example, if your value added has dropped from 55% of sales to 52% or 5.5%, your labor has to also improve by 5.5%. Work with your employees to increase line speeds, reduce waste or improve set up times to offset the contraction in Value Added margins.

In summary matching your costs, particularly labor costs, to your lower sales is the first step to returning your printing firm to profitability. This is difficult work and must begin with the attitude that many firms make good profits and your current sales levels and you can do the same.

My advice is think smaller, match cost and look forward to great profits when sales return to higher levels. For example if you were a $20 million printer and now can reasonable expect sales to be at the $15 million level — match your cost to a $13 million sales level and enjoy great profits if you achieve $15 million in sales.