

HOW DO I MAKE A PROFIT SELLING SIGNS

By Bob Glenister

Money, hence profit, is the root of all evil. No! money is merely a tool, give a hammer to a carpenter and they will make the most beautiful wooden item, give it to a fool and they will smash everything in their path. The same applies to money, learn the trade and you will make beautiful things.

Adam Smith, the father of modern economics, concluded that in selfishly seeking to maximise their profits the businessperson unwittingly is also maximising the benefits to society as a whole from the efficient utilisation of the resources under his control.

Remember this always, the more honest profit you make, the greater the benefit to society as a whole and drink a toast to all who make honest profits.

First we need to define profit. I was hoping to find a clear definition but the more I investigated the term the more I discovered that there is much dispute over what is considered profit. The opening rhyme defines this argument clearly, there are many things in life which cannot be directly measured and it is important that what I teach you, is balanced with a level of compassion and integrity in your dealings with your fellow man.

The definition therefore that I finally have found acceptable is the following:

"A company's profit is the maximum value which a company can distribute during a period, and still expect to be as well-off at the end of the period as at the beginning".

By using standard accounting and the tools I give you today, you can therefore measure the money part of the profit. Secondly you can make a judgement based on what is important to you on whether the quality of your life and those around you, has improved in regards to the things you value.

For my personal views on this please go to

www.rolanddg.co.za/my_business_philosophy.htm

The Accounting definition of profit: Profit value is the difference between the selling price of a product or service and the **total cost** of the resources consumed to develop, produce and sell the product or service.

The key words here are **total cost**.

Most people still use material based costing to determine selling price.

Example:

A small truck needs two door signs and some lettering at the back..

Outside life 3 years

Simple text no Logos.

Total Vinyl required 1 sq metre

Cost of Vinyl R25.00 Ex Vat

Selling price R50.00 for Vinyl and add something for

labour, R30 its only Jannie who is applying and he

only costs me R1500 a month.

Quote to the client R80.00 plus Vat.

Will this company make a profit?

We cannot answer the question without looking at the cost structures of the company and the relative efficiencies in the company and for that matter nor can the owner of the company, until the end of the month when it might be too late.

What we need in any company is the ability to know with certainty, that the prices we are charging our customers are making us wealthier, everyday!

So we must design our accounting systems not around the Receiver of Revenue for Vat returns, nor for the Bankers who want to determine if our overdraft is too large, but around us, the owners of the company.

The system must let us know on a daily basis that we are on the track for buying that new house or overseas holiday or whatever it is that makes us tick. A major purpose of an accounting information system is to provide information to insure that the most value is obtained from scarce resources.

The system must be easy to use and must be user friendly to anyone in the company who needs to quote a customer, and as long as the required work is not out of the ordinary, (i.e. requiring research on specialised materials etc) it should take no longer

than ten minutes to be able to quote.

It is not difficult at all, because if we know our total costs per minute we know what our selling price needs to be almost instantly.

How then do we determine our total costs per minute?

First we need to understand three key concepts:

1. Fixed Costs: These are those costs that we have to pay even if we do not make a single sign. For examples rent, leases, salaries etc.

Please do not make the mistake of not charging yourself rent if you work from home, you are only fooling yourself and if one day you need to move out due to a divorce or your company getting bigger where is the money going to come from, your alimony settlement? I do not think so.

2. Variable Costs: These are costs you only spend on the particular job i.e. vinyl, Perspex, Abs, temporary labour used for this particular job.

3. Multi-use Variable costs: These are products and services you use only once you start trading and vary according to the level of trading you do. These include:

- Methol Alcohol (Blue train, Methylated Spirits)
- Protective clothing (Gloves, Overalls, Masks etc.)
- Multi-Use items bought in Bulk (Bolts, Nuts, Rivets, etc)
- Bank charges (These only result from trading)
- Bad debts (You cannot have a bad debt unless you have sold something)
- Interest
- Communication (Telephone, Internet, Cell Phone)
- Transport (Delivery, Collection, Postage, Freight)

I have given you a broad outline. What you need to do with your accounts is simply run through each one and ask the following questions.

Does this account increase if I do more work?

No -> Fixed Cost

Yes-> Is it specifically used on one job ?

Yes -> Variable cost.

No -> Do I have any left over, that could be used over many jobs? ->

Yes -> Multi Use Variable cost.

Now I know what you are saying; Bob! Bad debts, bank charges and interest do not quite fit the simplistic approach listed and by your definitions would fit into variable costs.

Yes! Bank charges and interest should be a variable cost. The banks, very cleverly, make it so complicated to work out your exact bank charge on every transaction that your salespeople would have to carry a complex set of tables around with them just to be able to calculate exactly what the potential charge will be. I therefore put into Multi-use so that I know it will be recovered from the customer.

Bad Debt. Well you cannot recover a bad debt from the guy who has gone bad, so yes by definition it's a variable cost but you need to get all your customers to pick up a portion of this cost so we put it into Multi Use. This is not an excuse to run a loose credit department, all you will do by not controlling your credit to the customer is push your prices up to a point where your customers will go elsewhere.

Boring, boring, boring Bob.

Ok, now the good stuff starts:

1. Please try and use 3 to 6 months of figures and average them. (If we add up all six months figures then divide by six we will have a six months average, the same applies for 3 months just divide by three) this will greatly assist your accuracy.

2. We have gone through all our costs and by example have the following results. Please plug in your own figures.

Fixed Costs: Average R25 000 per month
 Multi-use Variable Costs Average R 5 000 per month
 Variable costs should only relate to particular jobs and should be recovered in the invoice price, what we are trying to see is, are we recovering the rest of our costs.

3. As a quick check on your companies performance do the following.

Variable costs Average	R 10 000 per month.
Monthly Sales Average	R30 000
Profitability ratio	R30 000 divided by all costs R40 000 (25000FC + 5000 MUVC + 10000 VC)

0.75 (as soon as we see a zero in front we know that we are in trouble and we need to look for the cause of the problem.)

This trouble could be that we are losing money or it could be hiding other things.

It cannot hide in fixed costs, because we know we pay fixed costs even if we do not make one sign. It can however hide in Multi-use, if for example you bought five years (not a wise move as this will impact on your cash flow) of nuts and bolts at an auction you will need to subtract the remaining value from your multi-use costs. Secondly it can hide in unfinished work that you have not yet invoiced but taken the costs into account. So be careful to match costs with invoiced amounts.

We do not want to find this out at the end of the month it's too late to fix.

We therefore use the same figures to derive a daily check on our profitability.

This is a quick check formula that lets us know daily and weekly that we can go to sleep without a care in the world or that tomorrow is a day we need to start looking at our company systems very seriously.

Using the figures above we divide them all by 22 (average number of working days in a month).

Fixed Costs	R1363 average per day
Multi-Variable costs	R 227 average per day
Variable costs	R 454 average per day

Total costs average R 2044 per day

Invoiced Today R5000 (today)

Profitability Ratio 2.45 (good profits for today)

Some purists among you will argue that the variable costs used during the day should be exactly what was used and not an average. I cannot argue with that. Other than to say that what we are trying to achieve, is a very simple tool that assists us daily in focussing our company and unless the turnover from day to day varies by more than 30%, averages will quickly highlight that you have a problem or not. If it's simple in your company to get the variable costs for all the jobs done today, it will greatly assist the accuracy of your calculation if you use these figures.

Having said this please do not try this on Multi-Use items, and try add up percentage of gloves, or number

of pencils used, etc. This will only frustrate you and prevent you from being successful.

This is all very well but how much do I quote for a job?

We have to have a good understanding of our costs, workflow and the competitive position of the market for us to correctly quote on any given job.

We now know what our costs are, let's see if we can understand how to apply costs to work flow.

Starting from a one man band /one woman band with no automatic equipment (this is just to illustrate our point).

Workflow One Person band:

The customer comes in, spends 15 minutes shooting the breeze and drinking tea. He then discusses the job for a further fifteen minutes and leaves. The signmaker now prepares a quote and faxes it to the client (30 minutes). The client approves the work with some minor changes (5 minutes). The signmaker now designs the work and cuts the vinyl by hand (2 hours). The phone rings while doing the sign and it's the mother and they talk for six minutes. The phone rings again and it's a new customer and they talk for two minutes. The signmaker then weeds the work (5 minutes), applies application tape (2 minutes) and applies it to the ABS substrate (20 minutes). Client comes in and approves the job (15 minutes). He then pays for the job and leaves.

If the signmakers' Fixed Costs are R15 000 per month on average and the Multi-Use Variable costs are R500 per month average and the variable costs for this job are R 75. How much must the signmaker charge for the sign?

**Part 2 will follow in the next issue.
 Thanks to Bob Glenister of Telpro for
 contributing this information.
 (011) 466 1551**

*Silver is precious,
 Gold is too.
 I am precious,
 And so are you.*

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Last Month we looked at defining costs and defining profits, we now move on to apply these on a day to day basis in our business.

We closed last months' session with a puzzle, for those who missed it I have repeated it here with one change. Last month's puzzle was gender neutral, to make things more interesting I have named the first Signmaker Jane, the reasons will become clearer as we progress through the article.

Work Flow One Person band:

The customer comes in, spends 15 minutes shooting the breeze and drinking tea. Discusses the job for a further fifteen minutes and leaves. Jane now prepares a quote and faxes it to the client (30 minutes) The client approves the work with some minor changes (5 minutes). Jane now designs the work and cuts the vinyl by hand (2 hours). The phone rings, while doing the sign and its her mother, and they talk for six minutes. The phone rings again and it's a new customer and they talk for two minutes. Jane now weeds the work(5 minutes), Applies application tape (2 minutes) and applies it to the ABS substrate (20 minutes.) Client comes in and approves the job (15 minutes.) Pays for the job and leaves.

If the Jane's Fixed Costs are R15 000 per month average and her Multi Use Variable costs are R500 per month average and the variable costs for this job are R 75. How much must Jane charge for the sign?

Shooting the breeze	15 Minutes
Discuss Job	15 Minutes
Quote	30 Minutes
Approval	5 Minutes
Design and Execute	120 Minutes
Talk to Mom	6 Minutes
Charm New Customer	2 Minutes
Weeding	5 Minutes
Application Tape	2 Minutes
Apply to substrate	20 Minutes
Convince customer they are getting a good deal and to come back again with further jobs.	15 Minutes
Total	235 Minutes

Jane's Fixed Costs per minute; R15 000 per Month: - Which equates to R681.81 a day (R15000 divided by 22 working days in a month) ; - Again dividing by 8 gives us the cost per hour = R681.81 divide by 8 = R85.22 ; - Now dividing by sixty gives us a cost per minute = R 85.22 divide by 60 = R1.43 per minute.

(A quick number(for the purists, derived factor) is $22 * 8 *$

$60 = 10560$, so, when ever you have a monthly figure and you want to know, "What is the cost of this per minute?" divide it, by 10560)

Jane's Multi-use Variable cost per minute;

is then, using our quick number, R500 divided by 10560 = 0.047 which rounds up to R0.05 per minute (Never round down costs, otherwise you will always under recover them, rather over recover and pay yourself a bonus!)

So total cost to manufacture the sign is. (There is an exception, we will discuss furtherdown)

Fixed cost 235 minutes at R1.43 per minute	R336.05
Multi Use Variable costs 235 at R0.05 per minute	R 11.75
Variable Costs	R 75.00
Total Cost	R422.80

Remembering our definition of profit:-

"A company's profit is the maximum value which a company can distribute during a period, and still expect to be as well-off at the end of the period as at the beginning"

If Jane now charges R422.80 for the sign, will she make a profit? No, she will be exactly in the same position she was before she made the sign. No better and at least no worse, this in accounting parlance is called "Break Even"

So some portion has to be added to make a profit, what this is, is determined primarily, by competitive forces. These I will discuss a little later.

What if Jane is not busy?

The other problem with the above over simplification is that we have presumed that Jane will use all of the eight hours in a day to make other signs. What if, this is the only sign she makes in a day and on average she is only busy for 235 minutes out of 480 minutes (8 hours times 60) on any given day?

She would then have to charge at least, to break even;

Fixed cost 480 minutes at R1.43 per minute	R686.40
Multi Use Variable costs 480 at R0.05 per minute	R 24.00
Variable Costs	R75
Total Cost	R785.40

Again, for the purists among you, some over recovery has taken place and can be called profit by our definition;-

R15000 divided by 22 = R681.81 and R500 divided by 22 = R22.72 plus variable costs of R75 gives us a grand total of R779.53. Subtract this from R785.40 gives us a over recovery of R5.86 per day, or R128.98 per month.

This has resulted purely because we rounded up our cost factors. I prefer to leave this error in place as it favours you, the owner, and makes your life easier, in that you do not have to work with cumbersome figures. Remember always, after reading all of this, our objective is to achieve an easy method of quoting, not something that requires a BSc or BCom degree.

Presuming that our heroine Jane, has enough work to keep her busy, we use the first result and add a profit percentage of 50% on cost (33% Gross Margin, I will discuss the difference between Gross Profit Markup and Gross Margin , below)

Cost of Sign	Mark-up/Profit	Selling Price
R422.80	R211.40	R634.20

So our Gross Profit markup on costs is R422.80 plus (50% of R422.80) = R211.40. On the other hand our Gross Margin on Sales is R211.40 divided by R634.20 = 33.33%. So if we mark-up all our jobs by 50% then our total profits at the end of the month are 33% of our Total sales figure.

Jane would be doing very well at these prices and would probably make a good R10 000 profit per month and R100 000 a year. This before the tax-man decided that some of it belonged to him and that some fat politician needed a new plane, and that Jane would not mind giving up some of her sweat and tears in sponsoring him. (ha-ha)

Tarzan strikes back!

Now Tarzan, another Signmaker suddenly starts stealing Jane's customers, this, because his prices are a lot less. Is he simply trying to push Jane out of business, or playing a marketing game to establish himself in the market. "He can not keep this up, his overheads are higher than mine, he works from an office, I work from home. He has two staff members, I have none. He will go out of business and then I will have to rebuild my customer relationships" Jane laments.

Will he go out of business?

Lets look at Tarzan's cost structure.

Fixed Costs R28 000 a month
Multi-Use Variable Costs R 1 500 a month

So based on pure costs Jane has a point.

The key is, understand your costs, understand who your customer is, understand what your customers needs are.

If you understand all this, and you are sure that you are recovering your costs and are making some profits, you will continue to go from strength to strength and will in the medium to long term achieve your dreams.

To Summarise.

- 1 Take your fixed costs for a number of periods.
- 2 Average them and divide by the same number of periods.
- 3 Divide this by 22 then by 8 then by 60 and get fixed cost per minute for your business.
- 4 Do the same with multi-variable costs.
- 5 Estimate how much time the job will take to complete.
- 6 Multiply the Estimated time by the fixed costs per minute.
- 7 Multiply the estimated time by the multi-use variable costs per minute.
- 8 If you practise parallel processing, divide this figure by the quantity of channels you will use on the job, be aware of bottlenecks.
- 9 Add to this to the Variable cost for the job.
- 10 Now add your profit.
- 11 Quote the customer.
- 12 If the quote is rejected find out why, and if it's a pricing issue, determine who you are competing with and decide if you want to try and meet their price or if its even worth your while trying to compete, never to go

below your costs, you will go out of business.

- 13 If you are being rejected constantly on price, look at improving your cost structures or finding more discerning customers.
- 14 Most of all love what you are doing, I have never met a person who loved what they were doing, who was not making money doing it.
- 15 Remember: Effectiveness is the ability of a company to provide goods and services demanded by customers. Efficiency, on the other hand, is the ability of a company to provide goods and services at low costs relative to their selling price, so do not discount for the sake of discounting.

Conclusions

Errors in thinking

If I work from home, I have to be cheaper than a guy who has an office and staff

If I work from home, I have to be cheaper than a guy who has an office and staff. We have proved above, this is not true, but it presumes that the owner of the office-based company knows what to spend his or her money on. If the owner spends money on fancy cars, fancy location, fancy finishes, and employs staff to make his office look pretty instead of productive. Then yes, you will beat them on price, the simple truth is that productive assets are where you should spend your money, these include people and machines, not carpets or jacuzzis'.

Material costs are everything:

Beat up the suppliers on price, use cheaper and nastier vinyl, this is the road to profits. Again we have proved materials are an insignificant factor in your costs, time is your biggest cost. Using cheaper material normally adds cost. More difficult to weed, more costs. Earlier failure, more costs. When competition threatens your pricing, look to efficiency first, not materials. How can I get the job out faster, which automatically means cheaper. Going cheaper on materials is normally a knee jerk reaction and costs you in the long run.

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