quoins2pixels

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Inflation Opportunity

The rapid return of significant inflation together with the major disruption in the paper supply chain with its attendant sharp price increases is both a challenge and an opportunity. In the recent years of low inflation and plentiful paper, we and our customers became used to the idea that printing not only didn't increase in price, but actually got cheaper. This was helped by the introduction of new and more productive technology which the competitive market passed along to our customers.

In the last few months everything changed. Inflation came roaring back (how much are you paying for gas now?) and paper suddenly became hard to get. These two realities are challenging but also beneficial as they have created customer expectance of significant price increases. Their resistance to increases has been blown away by current circumstances.

Your response should be to acknowledge this reality and fully reflect it in your quotes. Your mission as always is to get as much as the customer will pay, but also get the order. Your pricing policy should reflect what the customer now expects to pay rather than what they would have just months ago.

The Enemy -- BHRs

Just after the turn of the century (1900), Printer's Cost Conferences spread across the country selling the idea that printers shouldn't sell below cost and that cost was defined by Budget Hour Rates (BHRs) that assigned a portion of all the costs of running a business to individual hours of a machine or hand operation through a necessarily arbitrary process of allocation and unitization (division by the number of expected hours to be sold).

More than a hundred years later, BHRs are still engrained in in our industry's thinking. Their presence blinds management to the reality that the "cost" to produce a job is just the amount actually spent to do it (materials, production wages, commission). If we do another job, the overhead (rent, equipment depreciation or rental, front office) doesn't increase.

As a result, management fails to see the power of full utilization of their plant—the powerful impact of running at least two full shifts with significant overtime to accommodate with variation in demand. Achieving this goal, requires the refocusing of the pricing process on the customer relationship and away from the "cost" defined by BHRs.

Why Should I Use BHRs?

As readers of *Q2P* have probably inferred, the authors are not proponents of Budgeted Hourly Rates (BHRs). Yet, it's not that BHRs don't have value. They are an effective cost accounting tool when used in a traditional manufacturing environment (think building autos; refrigerators, widgets, etc.). They can also provide differential value to our operation -- hand bindery should not bill out at the same rate of our

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multi-million dollar printing press. The challenge of management in our industry is to understand what BHRs are -- and what they are not.

They are necessary to drive our MIS/Estimating systems. Each cost center, through some process, has been assigned a value (BHR). That value is then used along with estimating standards (how long a process will take to accomplish) to provide a value which represents costs. Thus, using BHRs are necessary for our estimating system to function. Yet, ask any printer when was the last time they reviewed their BHRs and standards AND updated both to what their accountant said they should be, and more than likely the answer will be "Are you crazy, I can't use those numbers. I'd never sell anything." Therein lies the base fallacy of using BHRs. If we understand they are a tool to help us derive a value which is a starting point of our discussion of value with the customer, they're a good tool. If we think they represent actual costs, therein lies our doom.

It's Picking My Pocket

In the days when sheetfed litho dominated our industry, a printer in Chicago routinely generated a 15% pre-tax profit in his $8 million sheet-fed offset business. Was this the result of having the latest and greatest equipment? Was this the result of a breakthrough in order entry and handling? Was this the result of charging all buyers higher prices? None of these elements had a role in his extraordinary success.

The 15% pre-tax profit flowed from his realization that every hour the equipment on his floor wasn't running, it was picking his pocket. Having realized this he became focused on a three-shift, 24/5 and if possible, a 24/6 operation. He saw that he had the equipment and with time he could build the workforce, but the key was building volume.

He knew that at average pricing levels he would spend about 60% of the revenue dollars on materials, buy-outs and commissions. He also knew that a lot more work was available at lower prices. There were also situations where customer would pay higher prices if only asked.

Realizing this, he established five levels of pricing. A few jobs brought in a 45% contribution to overhead with price increases, but many more new ones came into the shop at 30%, 20% or even 10% contribution to overhead, but together they brought a vast increase in dollars to pay for the overhead. Since the rent, equipment and front office didn't become more expensive, the result was a 15% pre-tax profit.

"Our Payroll is Too High"

That's not an uncommon perception in the face of slow growth and tough competition. There's no question that you have to achieve and maintain positive cash flow, or the business will fail and no one will have a job. In the course of trying to address this challenge, we've heard draconian solutions like eliminating paid holidays and vacations, or across the board wage cuts which will likely lead to the loss of the best people. Usually, the best solution is to layoff one or more people.

A useful preliminary step is to see how much overtime is being worked. Because printing has an unpredictable short term demand curve, overtime is the best way to handle day-to-day peaks. Most firms find that an average of 10% overtime is a good target (that's about 200 hours per year per employee). If the actual amount of overtime is well below this, the workforce can be safely reduced thereby effecting needed savings and making the remaining jobs better.