



PHCC NEWS

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Plumbing-Heating-Cooling Contractors - National Association (www.phccweb.org)

Understanding labor pricing, Part 1

BY JOHN ZINK

When a new contracting company starts up, how does the business owner know what to charge for its work? The simple answer is "Enough to cover all expenses and earn a profit." The tricky part is properly determining what those expenses are. Remember, no amount of optimism can change the simple fact that if you don't charge for *all* your expenses, you will go out of business!

Let's take a walk through one business owner's process for determining his company's pricing model. Tom, our business owner, is starting up a new service company. He is fortunate to be well known and liked in his community and already has a network of customers ready to use his services. He plans to spend his days in the office, running the business and securing additional work for the four technicians he has found to employ for his new company. Tom has also found a receptionist/office manager who will field calls and handle most of the office paperwork.

For Tom to determine his cost of doing business, he needs to calculate his expenses for materials, labor, overhead and profit. Materials pricing is available from the supply house, so we will focus completely on the three other areas.

Labor costs

Labor costs are more than just technician salaries. To attract his quality techs, Tom put together an attractive benefits package that includes health and disability insurance, a 401(k) plan and other perks. Payroll taxes and other insurance costs also must be covered. After talking with his accountant and other advisers, Tom calculates that his employees' benefits, insurance and payroll taxes will equal 30% of base salaries. These numbers may be higher or lower in your company and must be measured to obtain an accurate final price per hour to charge to customers.

Tom also has to consider his techs' productive time. In a service company, a technician does not spend every minute of his time doing work that the company is being paid for. There are also holidays, sick days, vacation days, training days, time driving from one job to the next and a host of other important but non-billable activities to consider. Tom adds up the time lost to each of these activities and determines that only 65% of each technician's time will be spent doing billable activities. He realizes that he will need to track how warranty work and call-backs affect this productivity rate over the next year.

Tom plans to have each of his techs work 40 hours a week. He combines this information with their salaries and the percentages above to develop a simple worksheet to determine his hourly labor costs.

Tom now knows that he needs to charge his customers \$38.46 per hour just to pay for his technicians and nothing else. Next he has to account for his salary and all the other company expenses that fall into the overhead category. To do this, Tom will need to create a detailed analysis of all his known and expected expenses for the coming year. As a new business owner, Tom must do some thinking and planning ahead to determine what these costs might be. In next month's issue, we will examine Tom's overhead calculations and their effect on his pricing.

Direct labor costs

| | Salary | Benefits, Insurance & Taxes at 30% of Base Salary | Annual Work Hours Per Tech* | Per Tech Billable Hours at 65% of Work Hours |
|--|----------|--|--|---|
| Technician #1 | \$45,000 | \$13,500 | 2080 | 1352 |
| Technician #2 | \$45,000 | \$13,500 | 2080 | 1352 |
| Technician #3 | \$35,000 | \$10,500 | 2080 | 1352 |
| Technician #4 | \$35,000 | \$10,500 | 2080 | 1352 |
| Total Tech Salaries, Benefits & Taxes | | \$208,000 | Total Tech Billable Field Hours | 5,408 |
| Total Technician Labor Expenses | | | | \$38.46 |
| Divided by Total Billable Hours Equals Company Labor Cost Per Billable Hour | | | | |

*A 40-hour work week equals 2080 hours per year

** Sample worksheet provided for illustration only; consult with your accountant for guidance specific to your company.

Understanding labor costs, overhead and proper pricing is a crucial piece in the puzzle of creating a successful company, especially for new business owners. The worksheet above is simply a starting point and just one part of a more complete overhead education tool that will be available from the PHCC Educational Foundation in early 2007. If you would like to practice calculating overhead and pricing with some sample worksheets, visit the Foundation's Contractor Resource Center at www.foundation.phccweb.org. From there, you can download Excel spreadsheets and plug in different numbers to see their effect on the company.

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Want to learn more?

A seminar on "Understanding Overhead: Your Key to Profitability" will be offered Sept. 29 during Network '06 and ISH North America in Chicago. Led by Kirk Alter, the session will explain how to calculate and understand what your real overhead is, and how to use those calculations to make better business decisions and increase your profitability.

Many other educational seminars and networking opportunities also will be available during the week. Come to Network '06 to learn how to save money, be more profitable and grow your business. For more information, visit www.network06.org.