



NAHB Building Business Briefs

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Managing Overhead to Maximize Profits

Michael Payne, president of Payne & Payne Builders in Chardon, Ohio, always knows how much money he needs to make each year to break even. And if he hits a major downturn, he knows how to adjust his business accordingly. Here's his method for managing overhead and maximizing profits:

First, determine your business's absolute bottom-line fixed costs (the minimum you have to spend to keep your business alive). Then, using your gross margin percentage, calculate the gross sales you need to break even:

$$\text{Break-even dollar volume} = \frac{\text{Fixed Costs}}{\text{Gross Margin \%}} \quad \text{e.g. } \frac{\$508,000}{18\%} = \$2,822,222$$

Of course, you want to do more than break even. To boost your profits, take a hard look at your current actual overhead. Is each cost and additional dollar worth the sales you must generate to support it? What could you cut if sales failed to meet expectations? Here are some pointers:

- **Business-related travel.** "I serve on both my local association and NAHB's boards of directors," says Payne. "These are gifts I'm giving back to the industry, but they're not necessary for business survival. If things got really bad, I'd probably cut back on traveling to some of the meetings."
- **Office supplies.** Despite the proliferation of computers and back-office software, you're always going to need things like pens, paper, file folders, paper clips, etc. But do you need so much of them? You may lose a volume discount if you don't buy items in bulk, but if you tie your spending to actual need and buy less, but you'll spend less money on smaller packages.
- **Subscriptions.** It's good to read a variety of business and industry publications to stay informed, but not if subscribing to them eats into your profits. "This is nickel-and-dime stuff, but the pennies really add up," says Payne. Try reading some publications at the library or on the Web—provided there's no online subscription fee.
- **Phone lines.** Do you really need six of them? Could you get by with two or three phone lines instead? Probably.
- **Cell phones.** "These tend to get wasted," says Payne. "There's no reason why people can't make calls before they leave the office and after they return from the jobsite." Cut cell phones out of your overhead and you'll save a couple hundred dollars a month.

- **Marketing expenses.** If you run large ads, consider reducing the size and/or the frequency with which they appear. Similarly, cut down on the frequency of mailbox stuffers or direct-mail pieces.

“This goes against what the industry says about doing more marketing in a down market, but I say you can’t get blood from a stone when the market is bad,” says Payne. “You can be in the best location with the best product at the best price, but sometimes nobody buys.”

- **Office space.** If things get really bad and you’re thinking about getting rid of your office and working out of your home’s garage or your bedroom, consider working out of one your models instead. It’s a better way to separate your personal life from your business, and besides, you’re already maintaining the model and paying for its utilities.

After you’ve figuratively cut the fat out of your overhead, determine what your break-even dollar volume would be if you had fewer fixed costs. The difference between that and your current break-even dollar volume tells you the range of fixed costs you have to play with.

Get familiar with your overhead by examining it regularly. That’s what Payne does when he receives his income statement and balance sheet each month. It’s a lot smarter and easier to let your sales drive your fixed costs, not the other way around. Builders have more control over overhead than sales volume. Sales often depend on many factors beyond your control.

Payne’s “bucket theory” is another way of looking at it. “Every business is a bucket,” says the builder. “Whatever’s in the bucket is your assets. The spigot is your sales, and the holes are your overhead. How many holes can you plug?”

Read the PRO Builder Business Plan Guide for some more guidance on managing overhead and maximizing profits. The publication includes an electronic spreadsheet for calculating fixed costs and developing the financial section of your business plan. The price is \$22.46 for NAHB members and \$24.95 for non-members. Call 800-223-2665 or go to www.builderbooks.com to order.

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