BUSINESS COACHING

Can I afford to Hire More People? (Part II)

“ARE YOU MISSING OPPORTUNITIES BECAUSE OF DOUBTS?”

CAN I AFFORD TO HIRE MORE PEOPLE? (PART II)

As I began to type this article, I was interrupted by a call from a new client with a question (really).

A man had just applied for a job unsolicited. He has years of experience in my client's narrow specialty, knows all the major players in the industry, seems to fit with the company culture, and most important, he would unleash my client to concentrate on growing his business.

As my client put it: "If I had him, we could really take off, But," he continued, "I'm worried about the cost of his salary until he gets up to speed."

So what was my client's question?

"Can I afford to hire him?"

As it just so happens, understanding how to answer that question is the topic of this week's article.

INTRODUCING THE LABOR PRODUCTIVITY KPI

In my last article, titled "Can I Afford to Hire More People?' (Part I), we saw how to establish a salary cap for our businesses. The salary cap is a planning number, a Key Performance Indicator (KPI), that gives us a budget number we can use to hit a profit goal. I said that because what gets measured gets better, we also need a way to track labor productivity throughout the year. To be useful, such a number should inform our hiring decisions and provide an objective measure of the results at least monthly.

We are going to use another suggestion from author Gregg Crabtree's book Simple Numbers, Straight Talk, Big Profits, to create a labor productivity KPI **that shows how many dollars of gross profit we earn for every dollar we spend on people.** A KPI, for example, that tells us "you earned $2.00 of gross profit for every $1.00 you spent on people last month."

Does that sound interesting?

CALCULATING THE LABOR PRODUCTIVITY KPI

Coming up with the number for our businesses requires some math, but it's not too hard, and all the information we need is on our income statement.

I understand that you may not love this stuff as much as I do. If that's the case, just read the text beyond the calculations then give this article to your bookkeeper or accountant. Have him or her come up with the number for you. It's worth the effort because this is a really powerful tool.

STEP 1:

The first step is to get a copy of our Income Statement which should look something like this:

Sales		+1,000,000
CoGS:		
CoGS People costs	**200,000**	
Material	400,000	
Total CoGS		- 600,000
Gross Profit		**=400,000**

Overhead:

O.H. People costs	**100,000**	
All other O.H.	200,000	
Total O.H		- 300,000
Net Profit		= $100,000

STEP 2:

The second step is to add back our Cost of Goods Sold people costs to Gross Profit to get an adjusted gross profit total, like this:

Gross profit	+ 400,000
CoGS Labor (People)	+ 200,000
Adjusted Gross profit	= $600,000

STEP 3:

The next step is to add up all of our people costs from both Cost of Goods Sold and Overhead. Our example is simple, but the real number for our companies should include all people-related costs including wages, salaries, payroll taxes, health insurance, workmans comp - the works.

People costs from CoGS	$ 200,000
People costs from O.H.	100,000
Total people costs	$ 300,000

STEP 4:

The last step is to divide the **adjusted gross profit** by the **total people costs**:

$600,000 / 300,000 = $2.00

UNDERSTANDING OUR NUMBER

The $2.00 result means that we earned $2,00 of gross profit for every dollar we spent on people. That two for one return on people costs earned us a $100,000 net profit from $1 millions of sales.

If we are happy with that, then we need to keep the number at $2.00 (or more). We might even be tempted to add more people, because, hey, two dollars in for one dollar out seems like a pretty good deal. Maybe, maybe not.

WHEN THE KPI DROPS

The problem is that when we add people we always add to our people cost, but not necessarily to gross profit. When that happens, the KPI will drop below $2.00. That's to be expected because, as my client anticipated, it takes awhile for most new hires to get up to speed and to contribute to an increase in gross profits.

That's where the KPI becomes really useful.

Let's suppose that after adding two employees, our KPI drops to $1.75.

We're now only getting $1.75 in return for each dollar we spend on people. That doesn't mean hiring them was a mistake, but it does clearly the effects of hiring two people. We might establish a rule of thumb that says we won't hire any more employees until our KPI is back to $2.00, When it does return to $2.00, we will be making more money because we will be earning a two for one return on 2 more people.

HOW ABOUT YOU?

The labor productivity KPI works in every type of business. It is a good example of how to create and use KPIs to make informed decisions and more money.

It is a disciplined, as opposed to impulsive, approach to the question of "Can I afford to hire more people?"

Have you ever wondered if you could afford to hire more people? How do you decide now? Are you missing opportunities because of doubt?

If you have any further questions, please don't hesitate to mail me at Martin@annealbc.com or visit www.annealbc.com

Martin Holland

Martin Holland is the son of a successful entrepreneur. He grew up hearing about margins and markets, R&D and sales, risk and return on investment. He learned to love the language and rigors of business and grew to believe that business is both the most human of all endeavors and the highest calling. After selling a company in 2011, Martin became a coach in order to help other owners build profitable businesses that do not require their day-to-day involvement.

A native of Norman, Martin earned a B.A. degree from Hastings College in Hastings, Nebraska and a Masters in Business Administration degree from the University of Oklahoma. Over the past 7 years he has written business plans that have raised over $52.4 million in bank and investor financing. He has helped 157 (and counting) business owners reduce stress and increase performance through clarity of purpose, better marriages, more money, and more free time away from the business.