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OVERHEAD IN BUSINESS

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**HEATING AND PIPING CONTRACTORS
NATIONAL ASSOCIATION**



**HEATING AND PIPING CONTRACTORS
NATIONAL ASSOCIATION**

**50 UNION SQUARE—EAST
NEW YORK CITY**

1921

Overhead in Business

One wonders why, at this particular time we should again bring up the subject of Overhead in Business, particularly when the price of everything is coming down, and the public and the legislatures are so active in their condemnation of everything that bears even the remotest semblance to collusion. It is for these very reasons that I have undertaken to bring before the hearing contractors the seriousness of this question.

In the first place high prices and high costs have created a fictitious volume, or at least a fictitious value, of business done, so that the man, who formerly did \$100,000 of business in a year and had \$16,000 included in this amount to cover his overhead or expense of doing business and now finds that he is doing a \$200,000 business in which he has \$32,000 to take care of his overhead, feels greatly elated. He has a small surplus in the bank at the end of the year.

What has happened?

Has his overhead decreased?

Instead of it costing him 17% or 18% to do business he imagines that it has only cost him 12% or 14%. He has not analyzed his business! He really doesn't know what has happened! He has forgotten to increase his own salary, let us say, and either he has lived differently or drawn money from some other sources to live as he was accustomed to, or the volume of his business as represented by dollars has appeared too great to be covered by the same number of employees and he has added others to his force, and then has gone out and done the very thing he should not have done, taken work cheaper with less overhead on in order to keep his larger force employed (finding at the end of the year no surplus in the bank). In short he has done every thing but the right thing which of course was to analyze his business in the light of changing conditions.

Our businesses have been absolutely disorganized by seemingly high prices, shortage of labor and a fictitious dollar but now that we are coming back gradually to a normal dollar, and a scarcity of work it is essential that a very careful study and review of the items that make up overhead should be made and understood, or in the trying times ahead of us we will drift back to the unbusinesslike methods of five or six years ago when the newspapers frequently contained notices of the failure of one or more members of our fraternity.

The other point I have mentioned, which may affect our attitude towards overhead, is the activity of the public and the legislative bodies in connection with the various housing investigations. This may seem a far cry from the overhead in our business, but the psychology of the thing is peculiar, and just because the public says we are getting too much or charging too much, we have a tendency to cut our prices irrespective of whether or not we are making any profit in our business.

Speaking of the New York investigation which has been going on so actively, I can say that those who have conducted this investigation are not quarreling with your cost of doing business. As business men themselves, they are interested, for the public good, that we should run our business in a businesslike manner, and with a thorough knowledge of what it costs us to do that business. Their objection has been to the collusive fixing of prices, the getting together of men with the idea of allotting work, and eliminating competition. I know that if a business is properly run and the cost of doing business thoroughly understood, there must be far less urge towards combinations and collusion.

For a number of years, various departments of the government, trade bureaus, Chambers of Commerce, and associations, have conducted an intensive educational campaign with the idea of instilling into our minds that it costs money to do business; that unless we realize this, and call this as much a cost as

labor and material, we are not going to make any money; in fact, most failures are due to the lack of knowledge of this most important subject; and every failure of a legitimate firm, with a good knowledge of business, reacts unfavorably on the public, who in the long run pay for these failures.

A thorough knowledge of the cost of doing one's particular work, covering a period of years, consistently adhered to, is one of the best sales talks in any man's business. For many years, I have had the overhead cost of my business so well formulated that I have been able to obtain work at a higher percentage than others could get, who were less conversant with the cost of operating their business. My knowledge of the true cost seemed so logical to the owner or purchaser that he was willing to accept my analysis and felt that a better job would be obtained from one thoroughly familiar with his own business.

I insert in this article a list of items that have been published off and on for the last six or seven years in the Official Bulletin of this Association. It is well for each of you to review these items and see how many of them you have forgotten, miscalculated, or purposely omitted, with the idea of beating a competitor:

Overhead Expense Items in Steam Fitting Business

SALARIES

Employers' Salaries or Executive Officers' Salaries (such amounts as are drawn from the business for employers' own services).

Superintendents.

Estimators.

Draftsmen.

Bookkeepers.

Stenographers.

Clerks.

Office Collectors.

Office Boys.

Other Office Help.

Stockkeepers.

Porters.

Other Non-productive Labor.

RENT OR ESTABLISHMENT MAINTENANCE

(If buildings in which you carry on your business are owned by you, 10 per cent. of their value should be charged off yearly as rental.)

Store Rent.

Shop Rent.

Water Rent.

Gas and Electric Bills.

Power for Shop.

Heating.

Depreciation of Office Equipment, 10 per cent. (it is recommended that 10 per cent. of the cost value of such equipment should be written off each fiscal year).

Shop Repairs.

Depreciation on Shop Equipment, 10 per cent.

Tools lost, strayed or stolen.

Depreciation and Repairs to Tools, 20 per cent.

Replacement and Repairs:

To Tool House	} 20 per cent.
To Tool Chests	
To Time Clock	

Maintenance of Real Estate.

Cleaning Show Room and Establishment.

Watchman.

Soap—Matches—Waste.

Oil—Belting—Dressings—Charcoal.

DELIVERIES

Include the following items except where used for deliveries charged on estimate sheet:

Garage or Barn Rent.

Automobile Maintenance.

Auto Truck Maintenance.

Depreciation on same.

Gasoline and Oils.

Cartage, Freight and Expressage not chargeable.

ASSESSMENTS, DUES AND DONATIONS

Association Dues and Fines:

Heating and Piping Contractors Association, National, State and Local.

Building Trades Employers' Association.

Credit Association.

Other Organizations.

Donations—Tickets.

SUNDRY BUSINESS EXPENSES

Insurance:

- Liability for Office Force.
- Liability on Labor not chargeable.
- Plate Glass Insurance.
- Business Life Insurance.
- Fire Insurance on Stock.
- Fire Insurance on Buildings.

Interest:

- On Capital 5 per cent on amount invested.
- On Notes Payable and Receivable.
- On Certified Checks while out.
- On Overdue Accounts.
- On Loans to and from.

Taxes:

- United States Government.
- State.
- County.
- City.
- Corporation.

Legal Expense:

- Attorney's Fees.
- Notary Public.

License to work in other States.

Entertainment:

- General.
- Individual Expense.
- Stationery and Printing.
- Postage.
- Office Supplies.
- Telephones.
- Telegrams.
- Bullinger's Guide, Time Tables, etc.
- Text Books.
- Blueprints and Drawing Materials.
- Wrapping Paper, Twine, Packing Boxes, Barrels, etc.
- "First Aid Medical Kit."
- Dodge or other Building Reports.
- Dun's, Bradstreet's or other Mercantile Reports.
- Buying Directories.
- Trade Magazines.
- City Directories.
- Signs.
- Photographs of Buildings, etc.
- Collection Charges (Attorney's Bills).
- Traveling Expenses.
- Attending Conventions Expenses.
- Carfares.
- Auditing Books.
- Patents.

Bid Bonds (this item means your outlay for all bonds you must obtain to accompany bids, for work which you do not get, even though you have placed the cost of bid bonds on your estimate sheets).

Safe Deposit.

Drinking Water and Ice.

Laundry—Towels.

Gifts for Christmas, Special Commissions, etc.

Depreciation on Stock and Materials on hand, 10 per cent.

Depreciation on Equipment, 10 per cent.

Allowances or Rebates on Settlements.

Lost Accounts.

Lost Shop Time.

Lost Time of Mechanics paid but not chargeable.

Deadhead Repairs or "Come-Backs."

Typewriter and Adding Machine Repairs.

Removing Rubbish and Ashes.

Incidentals and all other items you pay for which you do not sell, except equipment.

These items are very interesting to analyze in the light of changing conditions and I want to show what may happen with some of these items. Let us take salaries first. These always come down slowly and practically never to the point they started from. Let us say, and this is true in my own case; that executive salaries equal $\frac{1}{4}$ of the gross overhead. Superintendence, estimating, drafting, etc., equal $\frac{1}{4}$ of the gross overhead. Say that the gross overhead equals 20% of the cost of labor and material. Then Executive salaries equal 5% and other help equals 5%. You have been doing \$240,000 of business. Executive costs are \$10,000; other help \$10,000. If you are lucky you will be able to reduce the amounts to \$8,000 and \$8,000. In the meantime the cost of labor and material drops 25% and your business falls off 20%. On the basis of decreased costs your business would fall to a cost of \$160,000 or on the basis of less business to \$120,000 on which you put 20%, or \$24,000, making a total of \$144,000 and you have a salary roll of \$16,000 leaving only \$8,000 for all other expenses.

You probably renewed your lease during the last five years at an increased rental and can not change that for several years. Your gas bills have gone up and coal bill is double or more and wont come down for years. You have bought office equipment at high prices and must adjust it to the new prevailing prices. That also applies to repairs, depreciation, tools, etc., and so on down the list.

Can you find a single item on the whole list that looks as though it would be smaller in proportion to your business than it formerly was?

It is my honest opinion that the next year or two is going to show the highest overhead percentage that we have ever experienced.

WHAT IS THE ANSWER? THE OBVIOUS ANSWER IS THAT YOU MUST INCREASE THE PERCENTAGE OF OVERHEAD THAT YOU ADD TO YOUR COST OF LABOR AND MATERIAL AT THIS TIME RATHER THAN DECREASE THE PERCENTAGE.

After all, how many of you can show an increase in the real value of your business or a larger bank account? How many of you have had to charge off losses in government bonds, that you bought as a patriotic duty; and against what have you charged these losses? Against what have you charged depreciation in inventory values of your stocks, and materials, items which have nearly put out of business some of the largest concerns in the country? In any trade or business, there is a pretty good average overhead cost, and you cannot get away from the fact; you might as well recognize it and not try to imagine that you are cleverer than the other fellow, and thus able to eliminate from your business what years of experience has taught is an inherent part of every business.

Having carefully analyzed your overhead, it makes no difference how you add it to the cost of your labor and material. The controversy as to whether it should be a factor of your selling price or your cost is purely a quibble. 25% of the selling price, or 33% of the cost, are one and the same thing, and is purely discretionary. It is of no importance, so long as you realize the totals that must be added for the proper operation of your own business.

There are a great many variations and methods of adding overhead—I heard only lately of a contractor who added a different overhead for each size job he figured. Theoretically, this is the proper way to handle one's work, because the smaller jobs cost proportionately more; but practically, it is better to add a definite percentage to all the work, based on an overhead worked out from a strict cost accounting covering a number of years. No business can determine its policies or should change its policy because of a year's surplusage.

There has also been a great deal of discussion as to the propriety of figuring overhead on the basis of labor cost only, the advocates of this method claiming that this being the greatest variable in a business should determine the gross overhead added to each job.

To me the fallacy of this reasoning is obvious; your material prices are more than likely to be a fixed and definite quantity; in most heating jobs they amount to 80% or 90% of the whole cost and they divide themselves into 10 or 12 items of which maybe one may be wrong. Even a 50% error in that one item would only entail a 1% error in the gross profit added, whereas adding say 200% to labor and having only a 10% error in labor, which we make at least three-quarters of the time, entails a 2% error in the gross profit added.

Actually we are more likely to make a 20% error in our labor calculations than we are to make a 25% error in any item of material, and a 20% error in labor would on this basis make a 4% difference in the gross profit while a 25% error in material item would make only a $\frac{1}{2}$ of 1% error in the gross profit.

In the past few years, there has been much controversy as to whether labor and material had gone up faster than the cost of doing business. It is difficult to answer that question categorically, because overhead is not a question of a year or two. In some years, the answer might be "yes"—in others "no"—but over a period of years, the proportion does not vary very much. I have said that over a period of years the overhead of a business does not vary very much and I believe that the overheads of concerns in the same line of

business whether they are large or small concerns do not vary to half the extent that some of the large concerns would lead us to believe. If in some years the profits of these larger concerns on the same overhead basis as the smaller concerns might appear proportionately larger, in the bad years their loss would be proportionately greater. Therefore a given period, say a seven year period, which covers the usual cycle of fat and lean years, to remain solvent and stable they would require within narrow limits the same percentage of overhead as the smaller concerns. These larger concerns should ponder over this proposition and the smaller concerns should conduct their business on the basis of their own true overhead and should not be deceived by the assumed and untrue overhead of the larger concerns reaching for too much business.

Before I close, I want to tell of an interesting analysis I made of my own business, which covers four different lines, each having a very different gross overhead cost. These lines are growing differently, and it is necessary to add to the overhead expense as the possibilities of expansion arise, and to charge this increased cost against different lines of our business. In analyzing my entire business, I found that salaries, including very fair salaries for officers, just about equalled all other overhead expenses. Then I figured that if our profits were to equal the overhead of the business, in figuring what a man was worth to the business, his salary had to be multiplied by four to get the gross profit (that is, the overhead and profit), that he had to earn for the business. Assuming that we decided that 25% of our selling price was a fair gross profit, then each man's salary would be one-sixteenth of the total volume of business he must add to the gross sales to justify our putting him on our payroll. Of course, the extra business calculated could be cut in half before the extra man would show as a dead loss; but it is at least a measure of what each man should be valued at. A concrete example could be as follows: Suppose a concern is doing \$400,000 worth of business a year, and to increase that business, decides to

put on a \$5,000 man; how much business should he bring in to justify his salary? We say \$80,000 but \$40,000 would actually balance his cost. Of course, you realize that besides his salary this increased business means another \$5,000 at least in the cost of doing that business.

If in what I have said, I bring to you a realization that now of all times is the time to sit up and analyze your business, to realize that in the trying days to come only the real business men are going to survive, I shall feel that I have been well justified in harping this long on an old theme.

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