

Printing Industries of America



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PRINT MANAGEMENT ALERT

**Impact of Cost on Profitability
in the Printing Industry**

By Dr. Ronnie H. Davis

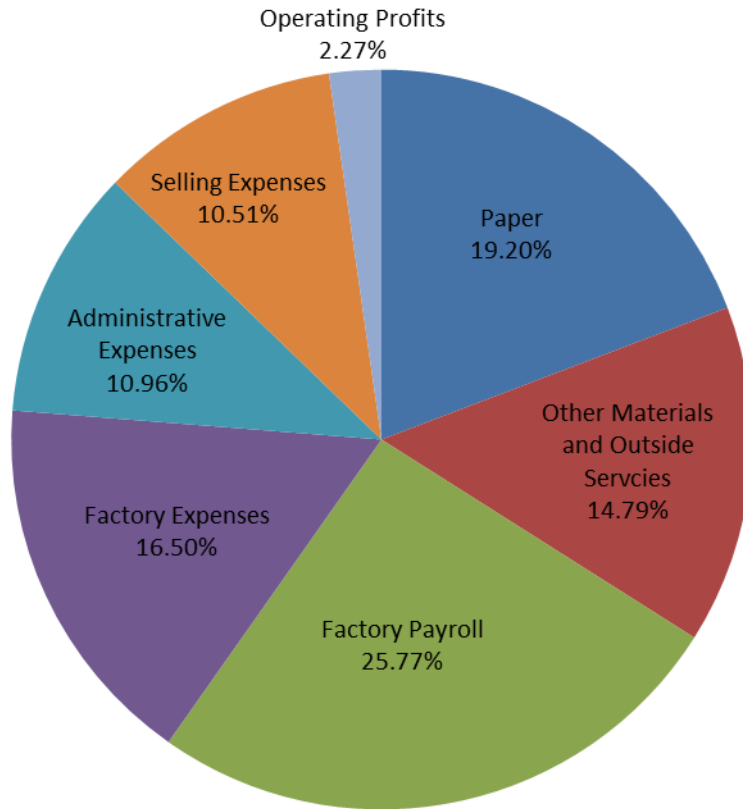
Senior Vice President and Chief Economist

The Impact of Cost on Profitability in the Printing Industry
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Pinpointing how costs impact profitability in the printing industry is critical for printers to understand and leverage in their businesses. The key factors that can help them to lower costs and increase profitability are presented here using industry data¹ for sheetfed commercial printers covering primarily commercial and advertising, direct mail, and packaging.

The underlying drivers of printer profitability are sales or total revenues, the prices they charge, and their cost structure. In general, increased sales, higher prices, and lower costs all add to the bottom line and the profitability of companies. Last year, a typical sheetfed printer's costs comprised just under 98 percent of total sales, leaving only two-percent profits across the industry. Often in today's print market, there is a "street price" for the product, above which the printer cannot increase their pricing unless there are additional value-added services. Printers can increase profitability by analyzing their sales and operations, making business changes that increase sales volumes, and or lowering their manufacturing costs.

The complex recipe for print production results in over 100 separate cost-expense items for a typical printer's chart of accounts. However, these can be grouped into the main categories¹



shown in

Figure 1. In this data, for an average sheetfed printer the manufacturing costs cover the majority of the costs at 76 percent. This is made up from the factory payroll (all factory employees, benefits, etc.), factory expenses (rent, insurance, power, etc.) paper, materials, and outside services. Admin and selling costs account for 22 percent, leaving just over two-percent average profitability. Clearly, reducing the costs indicated above will impact companies' profitability.

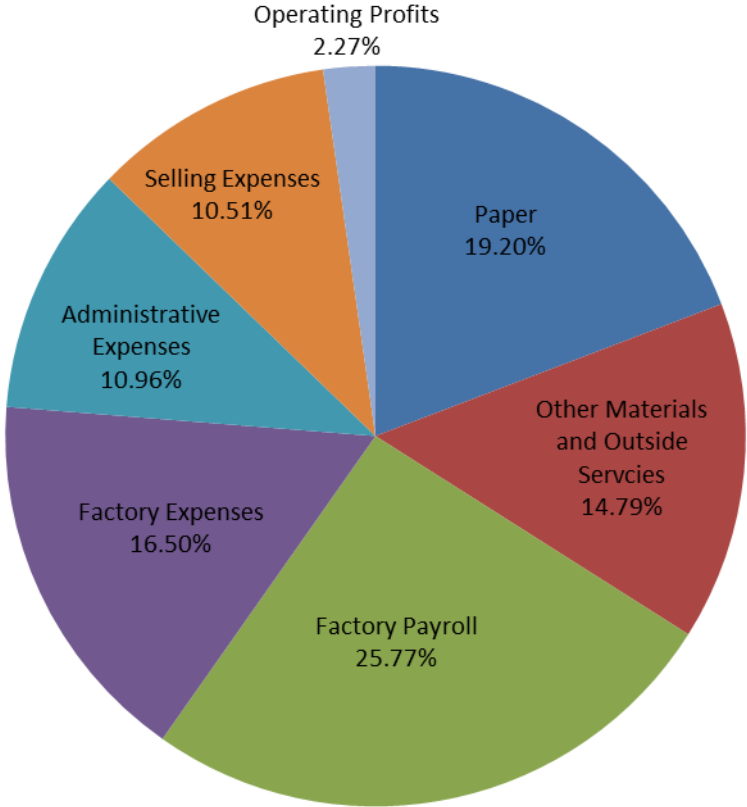


Figure 1: Sheetfed Printer Costs

So what happens to profits as companies reduce costs? As profit margins are typically slim, profits increase disproportionately to a given percentage-cost decrease. For example, a one-percent decrease in manufacturing costs (factory expenses and payroll, paper and other materials/outside services) translates to a 34-percent increase in profits, other things remaining equal. Therefore, achieving a three-percent reduction in the manufacturing costs doubles profits! A one-percent decrease in overall total costs translates to a 43-percent jump in profits. By leveraging manufacturing efficiency, printers can turbocharge their profitability.

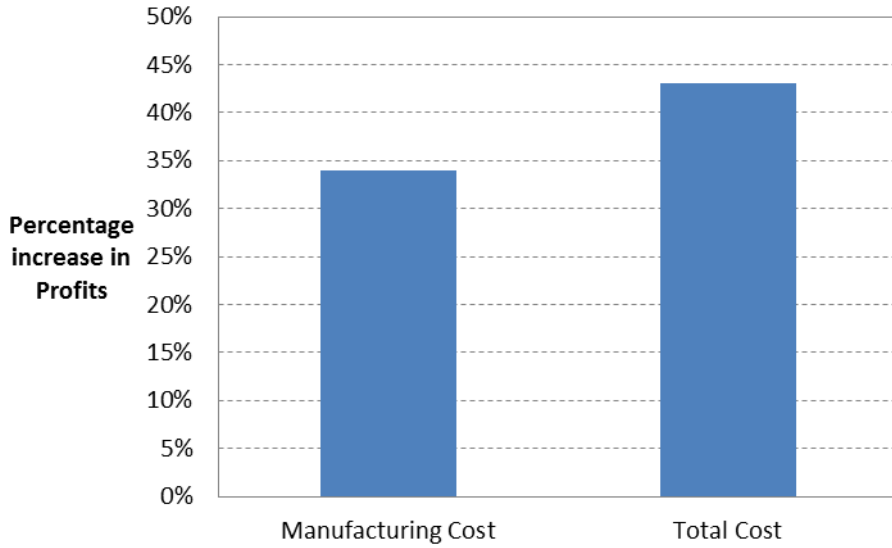


Figure 2: Effect of One Percent Reduction in Costs on Companies' Profitability

How does this relate to the printers' profitability as defined by the *PIA Dynamic Ratios*¹ studies? Profit-leading printers (printers at the top quartile of profitability) have significantly lower cost structures than those with profit potential (printers at the bottom quartile) with a differential of approximately \$13.00 on every \$100 of sales to the profit challengers (Figure 3). This shows that controlling manufacturing costs is a primary driver in increasing profitability. This reduction in the comparative cost of production has two benefits to the profit leaders. Not only are they making increased profit on their equipment, they also have the flexibility to adjust pricing to increase their conversion rate with estimates, therefore also increasing total sales.

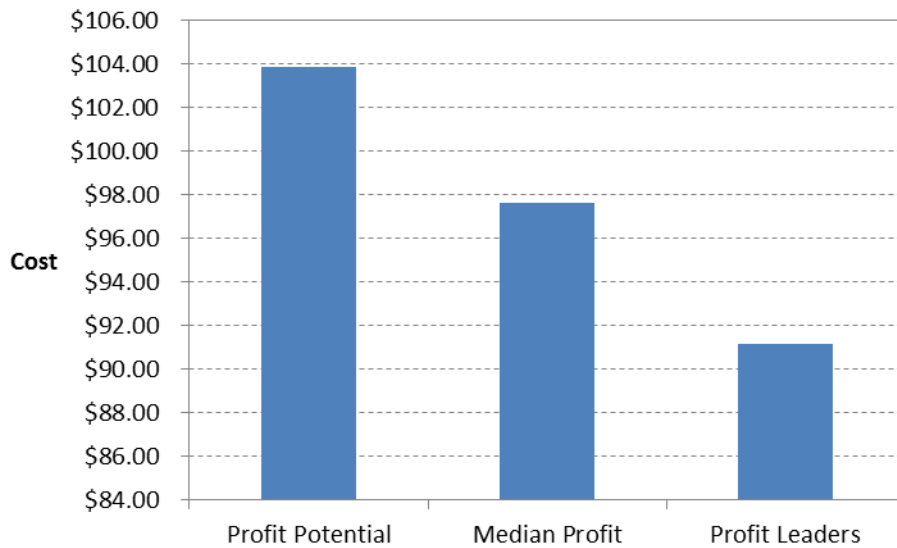


Figure 3: Comparative Cost for Every \$100 Job

Investigating the data in more detail identifies the secret of achieving this low-cost advantage. A big part is the classic practice of substituting capital for labor and increasing productivity. The profit leaders have almost double the investment per factory employee compared to those with profit potential. This is due to continual performance improvements in equipment, which lead to higher productivity and lower staffing levels. All of this translates into the number of employees in a company, where the profit leaders save more than two employees per million dollars in sales compared to those with profit potential.

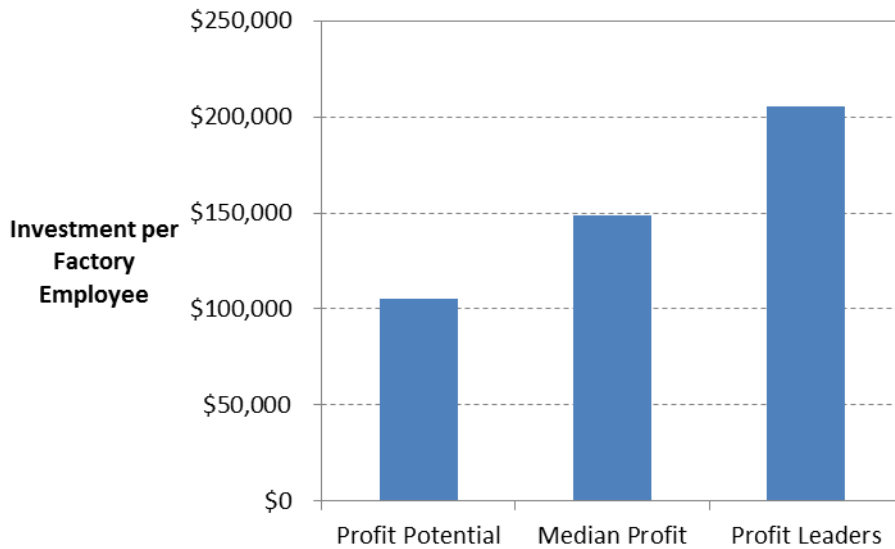


Figure 4: Investment in Machinery per Factory Employee

This savings in labor results in a dramatic impact in terms of profits per employee. The profit-leading printers earned almost \$8,700 per employee last year compared to a loss of over \$600 for those with profit potential (Figure 5). Analyzing your own performance will allow you to know where you are and what types of changes are needed to further maximize your profitability.

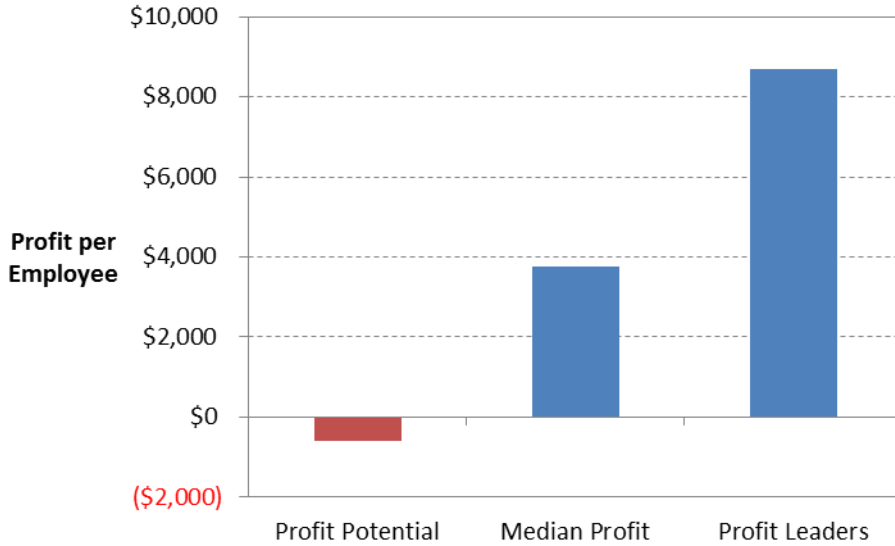


Figure 5: Profit per Employee

In conclusion, a primary path to higher profitability for printing companies is lowering cost. This will also, by definition, increase the sales conversion rate and therefore also increase total sales. There are two key drivers for lower costs:

- More equipment, specifically newer and more productive equipment, for manufacturing
- Fewer but more productive and higher-paid people

These two factors working in tandem are the crucial determinants of the profit gap between industry profit leaders (sheetfed printers in the top quartile of profitability) and the rest of the industry (the other 75 percent of the industry) where over the last 10 years there has been, on average, a 10-percent profit differential between these groups (Figure).

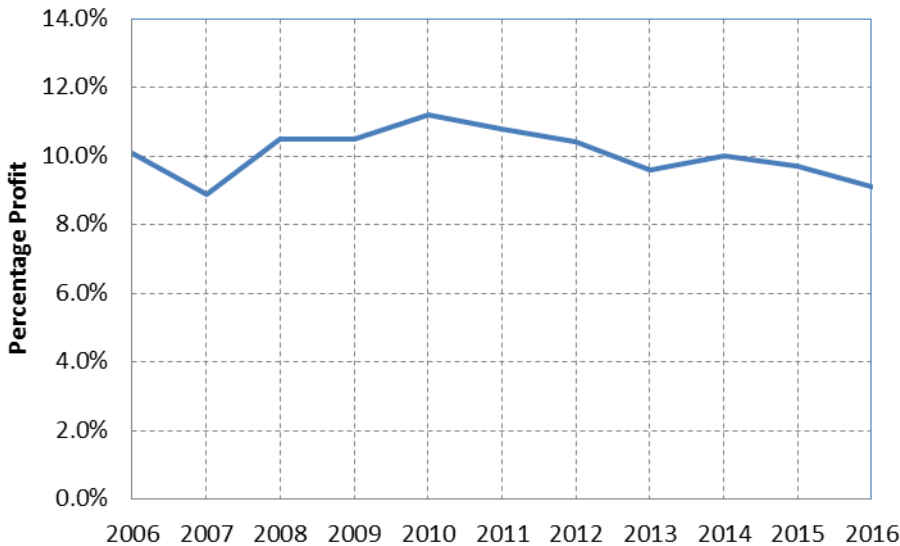


Figure 6: Profit Gap Between Profit Leaders and Rest of the Industry

References

1. Printing Industries of America's *Dynamic Ratios* for printers that are primarily general commercial sheetfed printers but also use other processes such as digital and inkjet.