PRINT MANAGEMENT ALERT

Managing Your ROP:

Return on People

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Managing Your ROP: Return on People

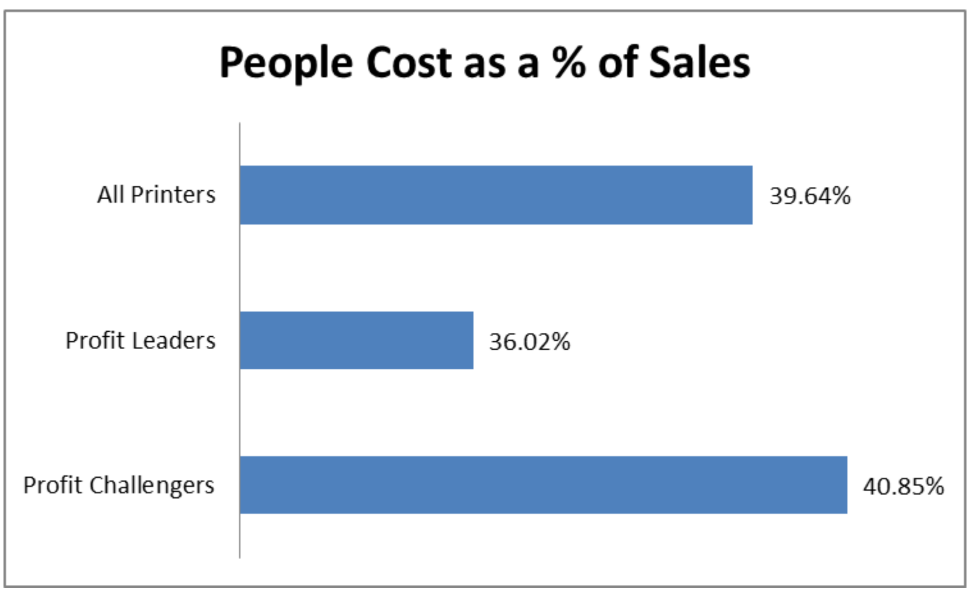
ROI (return on investment) is a common performance metric in business. ROI is important because it measures the return from capital invested in the business. However, while capital in the form of buildings, machinery, equipment, and owner's equity is essential to doing business, it may not be the most valuable asset to a typical printer. Ask a number of printers (or any business) to name their number one asset, and many, if not most, will likely say it is their people. So, how about measuring and managing ROP—return on people.

In this *Management Alert* we examine the concept of ROP for printers by discussing:

- Why ROP is an important performance measurement
- How to measure ROP
- Managing by ROP

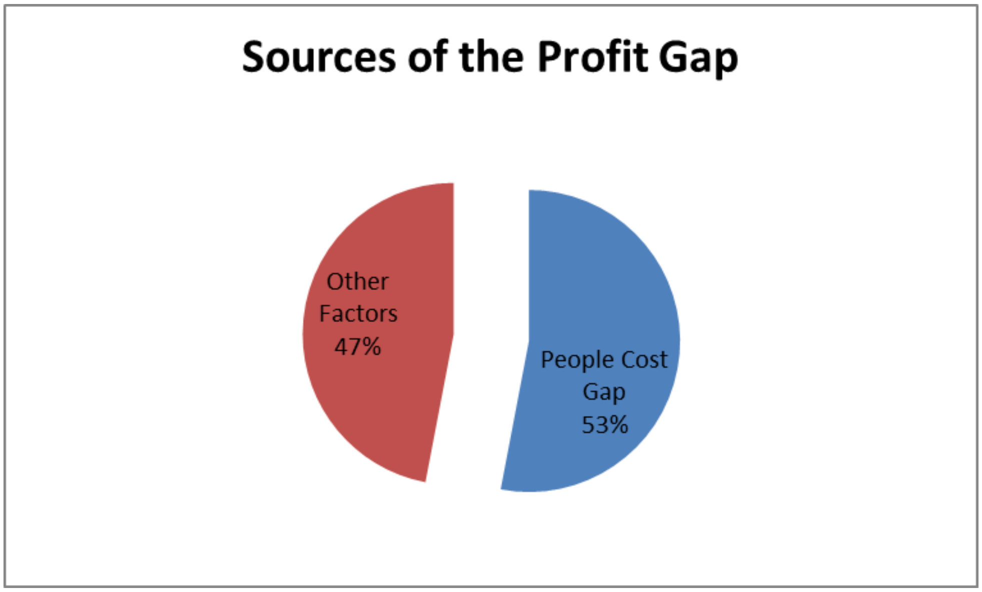
Why ROP?

ROP is important because people are incredibly important to the success of a business. People costs—wages, salaries, benefits, and payroll taxes—comprise about 40 percent of sales for a typical printer. People costs are by far the biggest single line item for most printers. Not surprisingly, profit leaders (printers in the top 25 percent of profitability) score significantly better metrics in this area than all printers and profit challengers (printers in the bottom 75 percent of profitability).

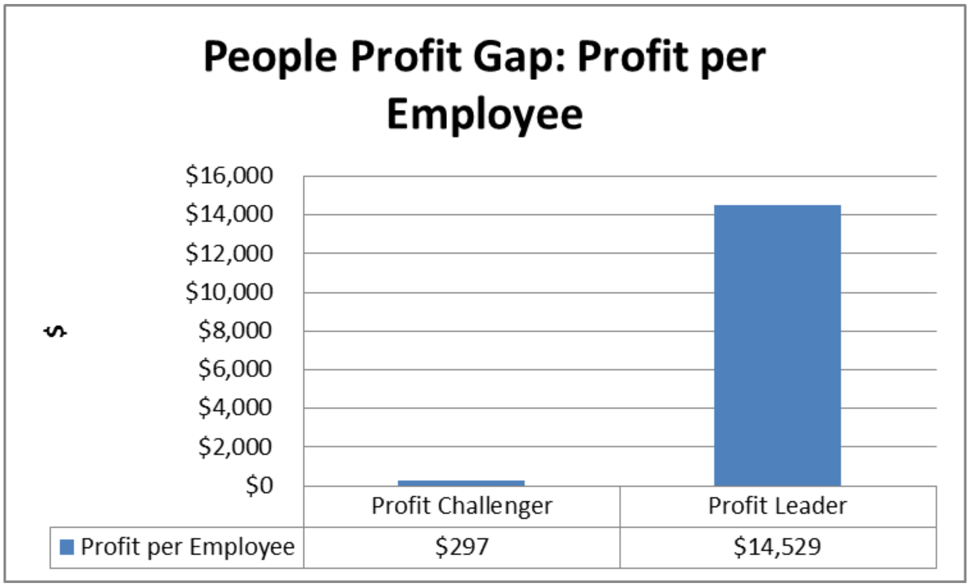


Our research has determined that the advantage that profit leaders have in managing their people accounts for over half of the gap in profitability between profit leaders and profit challengers.

With a typical profit-margin-on-sales gap of around 10 percent between profit challengers and profit leaders, this amounts to over 5 percent of sales.



In terms of profits per employee, the gap is even more dramatic. Profit leaders typically earn over $14,500 per full-time equivalent employee while profit challengers earn less than $300 in profit per employee.



These metrics demonstrate the importance of managing "people productivity" in the printing industry and the need for a performance metric focused on people for your management dashboard—a measure of ROP.

Measuring ROP

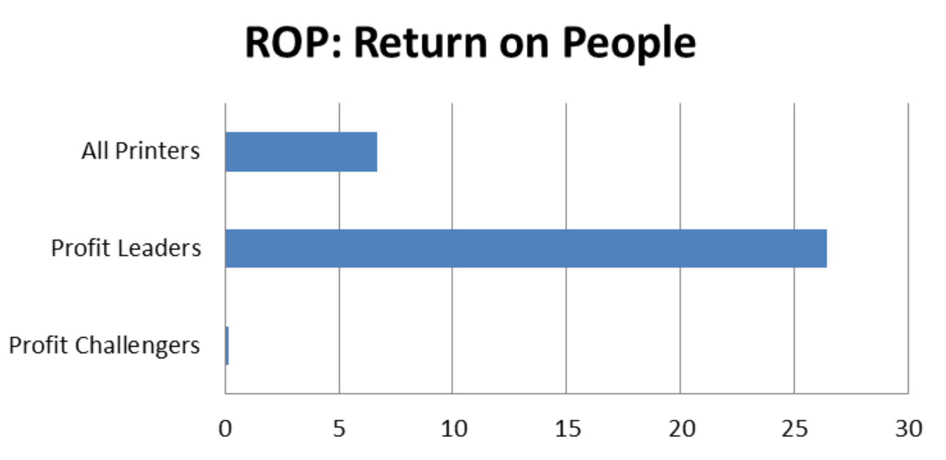
So, what is the best overall calculation of ROP? The most basic measurement of ROP, we believe, is a calculation of profits before taxes as a percent of total people costs (wages, salaries, benefits, and payroll taxes). You can calculate your firm's ROP in two ways:

$$\textbf{\textit{ROP}} = \frac{\textit{Before-Tax Profit Margin on Sales \%}}{\textit{Total Wages, Salaries, Benefits, Payroll Taxes as a \% of Sales}}$$

OR:

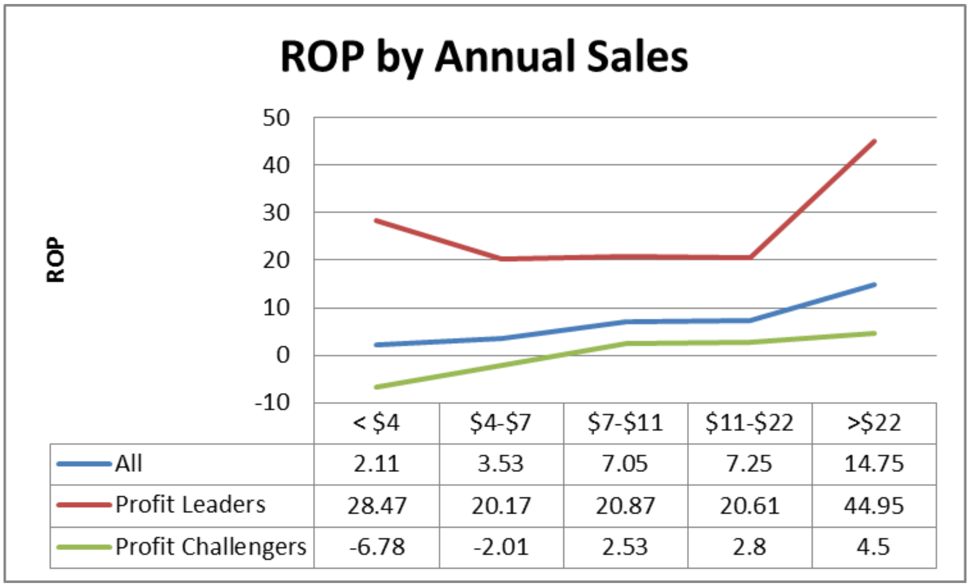
$$\textbf{\textit{ROP}} = \frac{\textit{Before-Tax Dollar Profits}}{\textit{Total Dollar Costs of Wages, Salaries, Benefits, and Payroll Taxes}}$$

Either method will provide the same results. The most recent data demonstrate that printing industry profit leaders significantly outperform profit challengers in ROP. All printers earn 6.7 percent ROP. Profit challengers barely break even, earning just .15 percent. In contrast, industry profit leaders earn over 26 percent ROP demonstrating they are capitalizing on their people.



	Profit Challengers	Profit Leaders	All Printers
ROP	0.15	26.4	6.71

ROP performance by annual sales volumes shows a similar trend.



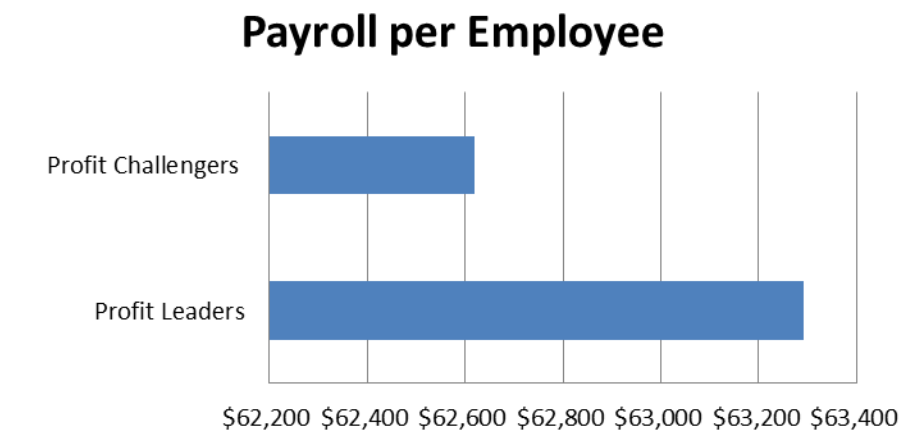
	< $4	$4-$7	$7-$11	$11-$22	>$22
All	2.11	3.53	7.05	7.25	14.75
Profit Leaders	28.47	20.17	20.87	20.61	44.95
Profit Challengers	-6.78	-2.01	2.53	2.8	4.5

Other People-Performance Metrics

There are many other people-centered performance metrics that printers can use to check their management of human resources. A couple common key metrics related to ROP are:

- *Employees per million dollars in annual sales*. Profit leaders have, on average, about 14 percent fewer employees per million dollars in sales.
- *Direct wages as a percent of factory payroll*. Profit leaders have about a two-percentage-point advantage over profit challengers in terms of direct wages as a percent of factory payroll.

Interestingly, while profit leaders spend less on their people costs relative to sales, they actually spend more per employee by paying higher average compensation. Profit leaders also pay their employees more—on average about 1.1 percent higher wages (including benefits and payroll taxes).



	Profit Leaders	Profit Challengers
Payroll per Employee	$63,292	$62,620

Managing by ROP

So how can you use ROP as a management tool? And, what can you do to increase your ROP?

First, remember that there are many key performance metrics you can track and use as a compass in management. The primary issue is not what key performance metrics you use but that you use one (or more) in guiding your management decisions. Before you can manage something you have to track it.

If you decide to use ROP as a key performance measure as a start, you need to calculate your ROP and track it on an on-going basis—perhaps every quarter.

Next, focus on increasing your ROP. To increase ROP you either need to increase the numerator (profit margin) or decrease the denominator (people costs as a percentage of sales).

We have discussed tactics for increasing the profit margin on sales in previous reports. These include ways to increase sales, increase profits, increase utilization, and control costs.

Tactics for decreasing the denominator in the ROP metric (total compensation costs as a percent of sales) include:

- *Evaluate your headcounts.* Conduct a headcount audit. List all of your current positons and evaluate:
  - Are these full-time positions or could they be combined with other positions?
  - Can these positions be eliminated by automation or software?
  - Are these positons crucial to your core products and services?

- Remember, based on profit leaders' performance, it is better to have higher rates of pay for fewer people. Thus, in combining or re-doing positions, you may have to pay more, but as long as your total payroll as a percent of sales declines, you are better-off.
- In today's extremely tight labor markets it is likely you will lose employees as they search for higher wages, so be proactive and look for ways to combine positions and develop employees who can multitask.
- Also, be creative in compensation spending. Many employees may prefer non-taxable benefits to salary increases. Also, benefits like flex-time, four-day weeks, and education and training are highly desirable by employees.

Additionally, think outside of the ROP equation. Remember, these two areas of investment do not show up directly in the ROP formula but still have significant impacts:

- *Investment in machinery, equipment, and software*. This can both reduce people costs (by substituting capital for labor) and increase sales per employee by making each employee more productive.
- *Investment in education and training*. Our research demonstrates profit leaders spend more on training and education than profit challengers. Educated and trained employees are more productive.

With these steps the implementation of an ROP management system could provide a needed focus to your operations, increase your profits, and add to the value of your printing company.

Note on PIA's Center for Print Economics and Management publications: As you may be aware, we recently added another on-going publication to our portfolio—The *Management Alert*. What is the difference between the *Flash Report* and the *Management Alert*? The *Flash Report* is focused on macro trends and developments ***outside the printing plant***—the overall economy and the printing industry including analysis of past trends and forecast of coming trends. The *Management Alert* is focused on developments ***inside the printing plant***—key performance metrics and business strategies and operations to improve performance.