Case 2

Superior Electrical Contractors: Residential Services Division

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As Jim Bell, owner of Superior Electrical Contractors, studied monthly sales figures for the last three months, what he feared he would see became clear. Last year, sales declined 37 percent and the year before those sales declined 20 percent. In light of this trend, Jim questioned the survival of his firm. He believed that the firm could survive if the newly created Residential Services Division could bring in the sales lost in the commercial market.

Background

Jim Bell began Superior Electrical Contractors eleven years ago in a medium-sized city in the South. The company's primary service was electrical wiring of commercial buildings. As a secondary line, the firm also sold and serviced residential and commercial heating and air-conditioning units. Since the company's inception, electrical contracting services had accounted for 70 percent of sales with the remaining 30 percent coming from the sales and service of heating and air-conditioning units. Routine maintenance services in the secondary line included Freon checks, filter replacements, and system repairs.

Most commercial electrical contracting work is given to the firm with the lowest bid on the project. Superior Electrical prepared each bid from electrical specifications furnished by the general contractor, or in a few cases, the client/company itself. If Superior submitted the winning bid, it would receive the contract and had to complete all work within the specified time at the bid price. Jim developed his own computer applications to assist in preparing cost estimates that helped him achieve a 98 percent average accuracy on job cost estimates.

Sales History

Superior Electrical Contractors grew from a sales volume of less than $100,000 in the first year to over $900,000 within a period of four years. Years six through nine showed sales figures holding consistent at around $1 million; however, as the state's economy faltered, sales volume declined. Figure C2.1 shows sales figures for the company. Although Superior's market share remained the same, there simply were not enough new jobs to bid. Tables C2.1 and C2.2 show the company's income statements for the past two years and the current balance statement.

Jim realized that he had to do something to reverse the trend in sales volume. The company began this fiscal year with the lowest level of contract work since the firm's first year of operation. He was convinced that the firm had to either expand the geographic area that the company operated in to find additional commercial work or find new sources of revenue in the current geographic area.

The Residential Services Division

Although the company generated some revenue each year from sales and services performed for residential customers, this business

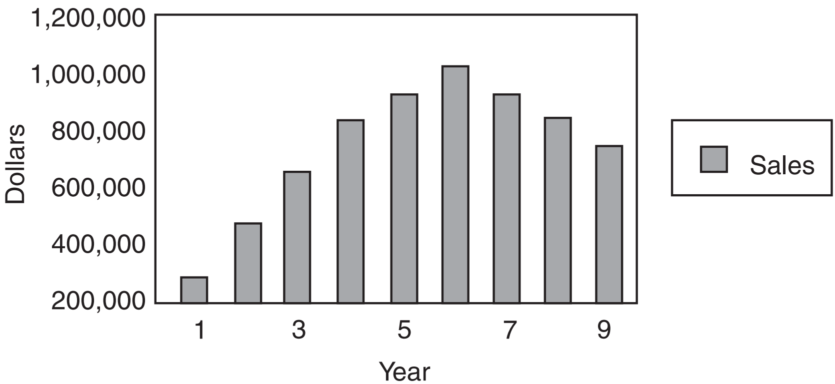

FIGURE C2.1. Superior's Sales by Year

TABLE C2.1. Comparative Statements of Income and Expenses for the Most Recent Years Ended June 30

	Two years ago		**Last year**	
	Percentage	**Dollars**	**Percentage**	**Dollars**
Income				
Contract income	100.00	937,317	100.00	594,624
Direct job costs				
Materials	41.15	385,716	39.42	234,417
Labor	23.24	217,870	25.13	149,404
Payroll taxes	2.64	24,739	2.66	15,795
Truck and travel	2.04	19,117	2.32	13,772
Subcontract	.42	3,950	1.64	9,744
Equipment rental	2.26	21,141	2.06	12,259
Miscellaneous	1.23	11,487	.08	556
Total direct job costs	72.98	684,020	73.31	435,947
Gross profit	27.02	253,297	26.69	158,677
Operating expense	26.88	251,958	37.94	225,591
Income (loss) from operations	.14	1,339	(11.25)	(66,914)
Other income				
Interest income	.18	1,700	.03	168
Gain on sale of fixed assets	.21	1,930	.00	–
Total other income	.39	3,630	.03	168
Income (loss) before taxes	.53	4,969	(11.22)	(66,746)
Federal and state income taxes	.00	0	.00	0
Net income (loss)	.53	4,969	(11.22)	(66,746)

was never aggressively developed or promoted. The firm always viewed this work as a way to keep crews busy between contracted jobs. Many competitors in this market perform a variety of electrical services for home owners, such as (1) light/fan fixture installations, (2) repair/replacement of electrical switches and breakers, as well as (3) sales and service of heating and air-conditioning units.

TABLE C2.2. Balance Sheet, June 30, Last Year

	Value	Totals
Current assets		
Cash in bank	$10,030	
Accounts receivable—employees	216	
Accounts receivable—trade	54,571	
Materials inventory	54,667	
Costs and estimated earnings in excess of billings	14,575	
Prepaid expenses	8,890	
Total current assets		$142,949
Fixed assets, at cost		
Machinery and equipment	63,083	
Accumulated depreciation	(55,936)	
Net fixed assets		7,147
Other assets		
Note receivable—officer	11,072	
Stock, at cost	500	
Refundable deposits	300	
Total other assets		11,872
Total assets		161,968
Current liabilities		
Accounts payable	$23,942	
Payroll taxes payable	3,068	
Accrued interest	2,459	
Accrued insurance	5,517	
Notes payable—bank	103,160	
Billings in excess of cost and estimated earnings	79	
Total current liabilities		$138,225
Long-term liabilities		
Notes payable—bank		82,393
Total liabilities		220,618

	Value	Totals
Stockholders' equity		
Common stock	33,520	
Treasury stock	(3,380)	
Retained earnings	(88,790)	
Total stockholders' equity		(58,650)
Total liabilities and stockholders' equity		161,968
Balance at beginning of year—July 1, two years ago		(22,044)
Add: Net income (loss)		(66,746)
Balance at end of year—June 30, last year		(88,790)

A customer experiencing an electrical problem would usually use the yellow pages to locate an electrical sales/service firm or rely on word-of-mouth recommendations from friends and neighbors. If customers were satisfied with the electrical sales/service firm, they would continue to call the same firm as other needs arose.

The idea for increasing the emphasis on the residential market came about by necessity but also through a conversation with another contractor at a national convention. This contractor explained to Jim that his firm had doubled its sales volume within two years by offering a maintenance contract to home owners. The maintenance contract provided (1) two maintenance calls on each home to check out the central heating and air-conditioning system; (2) add refrigerant, if needed; (3) oil motors; (4) clean or replace filters; and (5) check for leaks and potential problems. The contract specified one filter and two pounds of refrigerant free per year. Customers paid for any additional supplies or parts required to repair a unit, separately upon approval to perform the work. The contractor said that he sold the maintenance contract for $99, which covered the cost of providing the service. However, additional services identified through the maintenance service, in addition to repeat business on other requested electrical services and word-of-mouth advertising, doubled his sales volume. The contractor told Jim that each maintenance contract generated an additional $300 in business and $150 in profits.

Jim asked a team of marketing students at the local university to conduct a survey to determine consumer interest in the idea of a maintenance contract. The results were very encouraging.

Market Survey Results

The survey of 100 area residents screened out non–home owners and home owners with homes valued at less than $75,000 to make sure the information represented higher-income consumers. Jim felt that the higher-income segment was most likely to respond favorably to such an offer. Those respondents who were extremely interested or somewhat interested were higher-income males with at least a college education (see Table C2.3).

Market Area Data

The market area served by Superior Electrical Contractors includes a population of 500,000 people and approximately 112,428 homes. Information from the tax assessor's office on the value of homes is shown in Table C2.4. Jim estimated that twenty percent of these homes were rental properties; however, he was certain that the rental homes were valued under $75,000. Jim believed that this left a large market potential for the maintenance agreement even with the under-$75,000 homes factored out.

Pricing Strategy Options

Jim believed that two alternative pricing strategies were available (see Table C2.5 for consumer price expectations). The first was a low price of under $100. This low price, though, would generate very little, if any, contribution to profit. However, a higher penetration of

TABLE C2.3. Level of Consumer Interest in Maintenance Agreement

Response	Percentage
Extremely interested	11.1
Somewhat interested	50.0
Not at all interested	26.4
Don't know/not sure	12.5

TABLE C2.4. Tax Assessment of Home Values (Current Year)

Home value	Number	Percent
Less than $25,000	3,375	3
$25,000 to $50,000	13,491	12
$50,001 to $75,000	25,857	23
$75,001 to $100,000	30,356	27
$100,001 to $125,000	20,236	18
$125,001 to $150,000	11,243	10
$150,001 to $175,000	4,497	4
$175,001 to $200,000	2,249	2
Over $200,000	1,124	1
	112,428	100

TABLE C2.5. Expected Price for a Maintenance Agreement

Expected annual price	Percentage
$50 or less	21.5
$51 to $75	26.9
$76 to $100	29.3
$101 to $125	16.2
$126 to $150	4.6
over $150	1.5

homes would achieve greater exposure for Superior that might lead to additional revenue from other services.

The other strategy would price the agreement between $120 and $125 per customer generating between $20 and $25 contribution/margin per customer. The trade-off would be lower market penetration and less opportunity to generate additional revenues from maintenance agreement customers.

Time was running out on choosing the right strategy. Jim had to call the printer so the price could be included in the brochure that was to be mailed to past customers. Jim was undecided on how best to promote the service to other home owners. The brochure cost $1,500 for 1,000 copies and represented one-tenth of his advertising budget. In addition to selecting the media and the message, Jim also had to decide on how long to run the promotional campaign.