

Jeff Metzger's August 2002 Business Tip

A Critical Benchmark: 25% Fixed Obligation Threshold

I use margin benchmarks to help me manage my business. Margins are revenue or expense items compared to the gross revenue and are expressed as a percentage. Benchmarks are reference points.

The first margin I focus on is-no surprises here-the largest expense category in our industry which is payroll. The next one, and the one I want to talk about here, is what I call Fixed obligation. Fixed obligation is the sum of (1) Rent, including RE taxes, CAM's, etc., and (2) all other debt (lease or other short term obligations on equipment, furniture, copiers, computers, etc.), compared to your Gross Revenue. If your business 'grosses' \$100,000/year and your rent is \$15,000/year and your other debt is \$5,000/year, your fixed obligation margin is 20% ($15k+5k=20k \div 100k=20\%$).

I consider the absolute upper number for fixed obligation to be 25%. A club having a fixed obligation of 25% may be able to stay in business; however, it will very likely have a difficult time with cash flow and is probably not reaping any profit and maybe is in a loss situation.

My club, Kids First, currently has a fixed obligation of 18%. In 1997 (in our previous facility) we were at 11%-very low! However, the day we moved into the new Kids First facility in 1998 we jumped to 31%-very high! The decision to take on such a high fixed obligation was a conscious, strategic decision, as I was fully aware that that 31% was unsustainable. By using benchmarks and simple math, I was able to determine exactly how much revenue I needed to gain in order to get to 25% fixed obligation and that failure would ultimately mean bankruptcy.

In what financial condition would Kids First be had that 31% drifted down to 25% and then stuck there? In a word, profitless. We probably could have scraped by and stayed in business but I am very happy (and relieved) with 18%. However, I am looking forward to the day our short-term startup debt is fully retired which will further reduce our fixed obligation, assuming level revenue. And with continued revenue growth, our business will again see 11%, when, for the 6th time since 1975, we will be ready to move into a larger facility (that's a joke, Penny, just a joke)!

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