

The Economics of Trading Up

Why paying more for quality equipment will pay off

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Contributor

Now removal contractors are encountering margin compression and budgetary constraints at practically every turn. Their challenge: determine where to cut costs to preserve the bottom line. While capital expenditures on equipment are the obvious temptation, a recent study proved that paying more for quality equipment will prove a worthwhile investment in the long-term. Given the downtime, maintenance and repair costs, and the reduced useful lifespan that results from the purchase of lower quality equipment and products, contractors stand to gain economically by investing in quality equipment and extending the replacement cycle to survive during tough times.

Throughout the 2009-2010 winter season, snow removal contractors faced more than their share of challenges. Increased competition and pricing pressure resulting from last year's economic roller coaster, credit tightening for new equipment purchases, and of course, the usual climactic uncertainties all contributed to the mounting financial pressure on contractors.

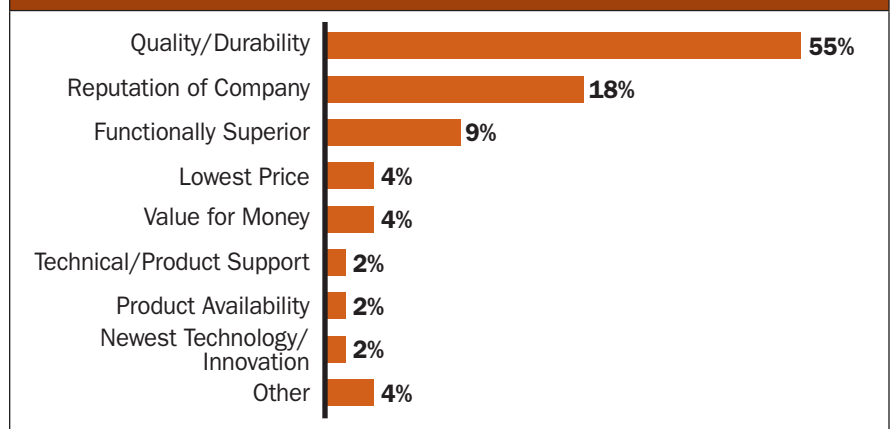
Tightening their belts

The confluence of cyclical and secular trends has resulted in a "perfect storm" for contractors. They have been forced to become more aware of how they are investing in their businesses and more discerning about where these expenditures will generate a meaningful return. Not surprisingly, sizeable cash-depleting investments—such as heavy equipment—have become natural targets for cost-cutting.

Commercial snow removal con-

Total Cost of Ownership	Regular replacement cycle (7 years)	Extended replacement cycle (9 years)
Regular purchase price	\$4,480	\$3,480
Reduced purchase price	\$4,700	n/a

Equipment Purchasing Criteria among Snow Removal Contractors



tractors yield an average of \$125,000 per plow operated in a given season. Because margins can vary from 25% to 65%, investments of up to \$40,000 in equipment are not only difficult to justify, but also have the potential to force a business into the red. With the downward pressure on margins that contractors are facing, this type of scenario has become a daunting reality across the country.

As a result, contractors have been forced to re-evaluate their buying criteria and consider whether the additional costs for reliability, durability, quality and brand name (traditionally upheld as the critical features for snow removal equipment purchases) are still the right factors on which to base a decision. The recent entry of low-cost brands and the release of "personal-use grade" products by reputable manufacturers have intensified

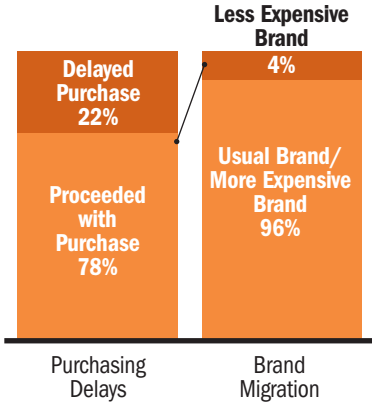
the temptation for contractors to take a chance on such products.

Often, a contractor's decision comes down to either making do with cheaper equipment to get through the short-term, or investing in a higher-quality product—in the hope that it will pay off long-term. While the purchase of expensive equipment may appear to be an obvious area to shave off expenses, improve cash flows and increase profitability, research has shown that gambling on quality can sometimes result in the opposite, increasing the cost of ownership over the long-term.

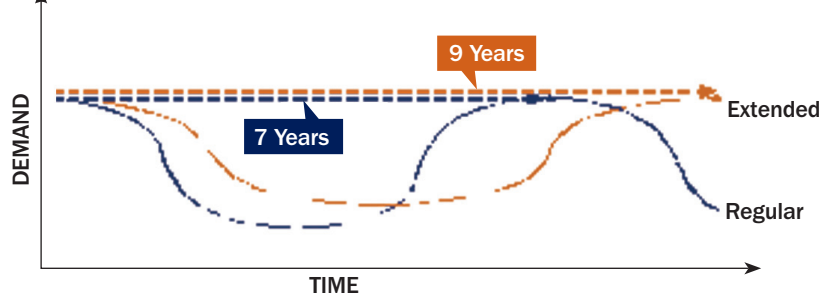
Quality vs. price

For most contractors, the quality of equipment continues to be the top criterion for plow purchases. In fact, price has actually remained a minimal factor over time, with only 4% of contractors

Purchasing behavior among equipment purchasers from 2006-2009



Replacement cycle for snow removal equipment



basing their plow purchase primarily on price.

Even given the economic conditions of 2009, most contractors did not give in to the temptation to trade down to cheaper plows, with less than 5% of purchasers switching to a cheaper brand. Ultimately, opting for the less expensive model left some contractors regretful once the costs of downtime, breakages and a lack of support became apparent.

According to Stax's recent study, the findings unmistakably proved that it is substantially more profitable for contractors to delay plow purchases rather than switch to less costly brands. Given the difference in the equipment replacement cycle alone, the total cost of ownership is 25% less for average-priced plows (\$4,500) vs. their less expensive counterparts. Savings are achieved from an average of three years gained in useful life for higher-quality plows, even excluding the opportunity cost related to downtime, which is often incurred from cheaply constructed plows.

The predominant reaction to the down economy among contractors was to capitalize on these dynamics by taking advantage of the well-made equipment they owned and delaying the purchase of new equipment. Consequentially, the regular seven-year replacement cycle for equipment experienced an approximate two-year extension.

Are price hikes coming?

Will the resultant pent-up demand cause price increases once this large group of

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contractors must replace old equipment during the next cycle? Possibly. Equipment prices have been on the rise for

Historical/Projected Price Trends	
2001	\$3,001
2002-2003	\$3,907
2003-2004	\$3,982
2004-2005	\$3,560
2005-2006	\$4,052
2006-2007	\$4,082
2007-2008	\$4,191
2008-2009	\$4,480
2009-2010E	\$4,600
Compound annual growth rate	5.90%

the past 10 years, and with an impending demand bubble in the market, the heavy discounting and pricing wars between dealers that have recently driven down costs are not apt to continue.

Nevertheless, it is undeniable that the benefits of quality snow removal equipment will continue to outweigh the costs and risks associated with purchasing cheaply manufactured products. In this industry, high prices still equate to significant value, which is sure to pay off for contractors in the end. **SB**

Anna Long is a manager with Stax, Inc., a strategic consulting firm based in Boston. She led an initiative analyzing the economic impact on the snow removal equipment market in the U.S. and Canada. This project was based on 200 distributor interviews, a survey completed by 400 snow contractors, and analysis of available market data. Visit www.stax.com.