

9 Numbers you need to keep your business profitable

→ When I ask a construction business owner or manager: "Why are you in business?"

→ He usually answers: "To make a profit."

→ Then I ask: "How much profit do you make?" Most of them don't really know.

A majority of construction business owners and managers don't focus on what counts most: their numbers. Business owners and managers spend their time getting jobs built and then hope the bottom-line numbers work out. Often, these hard working people don't like to be bothered with the numbers and pass them off to a bookkeeper or spouse to handle, manage and worry about. I have been a general contractor since 1977, worked with hundreds of subcontractors and presented keynote speeches and seminars to tens of thousands of construction business owners and managers. The sad truth is only one out of twenty business owners will ever become financially independent. And even worse, one out of eight construction businesses fail every year. Why? The top three reasons for business failure include not enough profit, too little equity and slow collections. See the pattern?

Only One Out of Five Will Thrive!

You don't want a business that struggles, doesn't make enough money or fails. I'm sure your goal isn't just to stay busy and create enough revenue to pay your bills. But this is the norm in the construction business, as owners focus on the wrong things everyday. If you watch 95 out of 100 general contractors, builders or subcontractors and follow their progress for ten to twenty years, you'll hear the same story over and over:

- They work too hard for their effort and risk.
- They never make big money.
- They never have any money leftover to invest.
- They never get out of debt.
- They can't stop working because they need money to live on.

Out of every 100 construction business owners at age sixty-five:

- Only one will be independently wealthy.
- Four will be financially secure.
- Twenty-four will still be working out of necessity.
- Thirty-one will be dead.
- Forty will be broke and need social security to make ends meet.

It seems as if business owners hope their efforts will eventually make them wealthy or give them financial freedom. But the odds that they hit a jackpot, win the lottery or inherit a fortune to create wealth are better than creating wealth by continuing to do business the way they currently do. Construction business owners deserve better. But it takes a plan and focus on the necessary numbers to keep you headed in the right direction. The following is a list of nine necessary financial numbers you must know, track and review on an ongoing weekly and monthly basis-even if you hate numbers!

Profit is NOT a dirty word

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1. Know your construction profit margin numbers.

Are you hitting your profit goals? Do you even know what your profit target is or should be? How do you determine your net profit markup? I conducted a survey of over 2,500 construction business owners and managers and discovered less than 40 percent of all companies had specific written net profit targets. According to the Construction Financial Management Association (www.cfma.org), the average pre-tax net profit for general contractors is between 1.4 and 2.4 percent and for subcontractors between 2.2 to 3.5 percent. This is not enough profit to compensate the risk contractors take. Contractors and subcontractors get in a rut of providing the same services as their competition to the same customers, year-after-year. Contractors generally offer the minimum per plans and specifications and do the same scope of work as their competitors. They are then forced to compete on price against other competent contractors and thus diminish their opportunity to make a good or above average profit margin. How often do you offer extra services or provide added value to your customer or project, which increases your net profit margin by 50 percent? What is your game plan for maximizing your bottom line and getting more than the average competitive markup? Every year, sit down with your management team and decide how much gross and net profit you want to make. To determine the number you want to hit, look at your equity or net worth in your company. Look at your projected overhead for the upcoming year. Look at the risk you take to operate your business. Then determine how much net profit you want to make in total dollars, and track your progress monthly.

2. Know your equity numbers.

Equity or net worth is the actual value of your company, not including the intrinsic value. It's the sum of your total assets minus your total liabilities. It's found on the bottom of your balance sheet or financial statement. One of every construction business owner's top priorities is to grow the net worth of their company. If the company doesn't grow in value, the company can't do more work, increase their bonding capacity or grow in size. Over 80 percent of all construction business owners don't know what their company is worth. Only after you know what the investment in your company is, can you then determine your return on investment goals for net profit. I recommend construction companies shoot for a minimum net profit of at least 15 percent return on total equity or investment. Additionally I recommend companies aim at a 25 percent return on equity as an excellent profit target. To determine your net profit goal:

Company Equity	\$400,000
Net Profit Goal @ 25% =	\$100,000

3. Know your overhead numbers.

Making a net profit starts with knowing how much money you need to earn and collect to cover your fixed cost of doing business, also known as overhead. In my survey, I also discovered that only 30% of contractors actually know their overhead budget for the year. It is unacceptable for business owners not to know or care what it takes to keep their company open. At the start of every year, calculate the annual overhead expenses you anticipate spending to keep your company open and running. This number is a must know. Then track it every month to make sure your actual expenses do not exceed your overhead budget. Another profit target I recommend contractors aim for is return on total annual overhead. At the beginning of each year, determine your annual overhead expenses. Overhead expenses are an investment in your future in hopes of getting a return. Subcontractors should shoot for a pre-tax net profit return on their annual overhead expenses of 20 to 40 percent and general contractors should shoot for 25 to 50 percent. For example to determine your return on overhead expenses goal:

Annual Projected Overhead	\$500,000
Net Profit Goal @ 40 percent	\$200,000

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4. Know your sales numbers.

True or false? Only 23 % of construction company owners know or track their annual sales or volume goals. (The answer is true.) Do you know your sales numbers or targets? How often do you track them, and what do you do every month to keep them on target? In the financial examples above, the company owner knows he must make a minimum of \$500,000 to recover his overhead expenses, plus shoot for \$100,000 to \$200,000 net profit. This is the gross profit (overhead and profit) goal. From these numbers, he can then determine how much work the company needs to perform at the markup and gross profit rate that they can set in their marketplace to hit the numbers they want to achieve. Divide your total gross profit goal by the gross profit percentage you can achieve in the marketplace in which you compete to determine the volume needed to hit your numbers. (Note: Gross profit and markup are not the same number.) How to calculate the sales you need at the gross profit you can achieve:

Overhead	\$500,000
Net Profit Goal @ 40%	\$200,000
Gross Profit (OH & P) Goal	\$700,000
Average OH & P Markup	25%
Average Gross Profit	20%
Total Sales Volume Needed	\$3,500,000



Now you know how much total sales you need at an attainable markup rate to achieve your numbers. Next, track your sales numbers monthly to make sure you are on target to hit your annual sales, overhead and profit goals. Unfortunately, only the top 19% of contractors and subcontractors set specific overhead, profit and sales targets for the year and then track their progress monthly. As a result, only the top contractors can make necessary adjustments to their estimating and bidding strategy, customer selection, project management and field operations as the need arises.

5. Know your job cost numbers.

Before you can bid for a job, you've got to know exactly what it will cost to build. The purpose of every estimate is to create an accurate budget of what the job will cost. Eighty-one% of all contractors do not know exactly what their accurate labour & burden rate or fringes cost for each of their field employees. This creates inaccurate bids and estimates for the biggest part of any job: labour. In addition, most don't really know what their equipment costs them annually to own or how much they should charge per hour when equipment is used on the job. Stop everything, and sit down with your accounting manager to get an accurate account of what every employee and piece of equipment you own costs annually. For your labour cost, include all taxes, insurance, workers' compensation costs, health insurance, vacation, union dues, overtime, small tools, training, pension, profit sharing and any other benefits you provide. For your equipment cost, for each piece of equipment include the purchase cost, finance and interest, payments, insurance, maintenance, tires, gas and repairs. Now you really know what it costs for labour and equipment. Next, you must have an accounting system and software to track your actual job costs. It should create accurate reports of what each part of your field operation and work performed costs to install by cost code or work task. From these printouts, you can verify that the numbers you use for estimating new projects are accurate. If you don't know what it costs to build, it is almost impossible to ever make any money!

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6. Know your contract numbers.

Top construction business owners know their contract numbers. These include closed jobs and current jobs in progress. They review how well they did on past jobs and how well they're doing on current jobs. You should have a monthly report of all your completed and current projects, see the example below:

Completed Contracts Report

Job Name	ABC Project
Start Date	June 1
Project Manager	Dave
Superintendent	Bill
Foreman	Sam
Contract Amount	\$1,000,000
Bid Gross Profit Markup	\$ 200,000
Actual Gross Profit	\$ 150,000

Job Name	XYZ Project
Contract Amount	\$2,000,000
Bid Gross Profit	\$ 300,000
Estimated Final Cost	\$1,650,000
Estimated Final Gross Profit	\$ 350,000
Variance	\$ 50,000

Costs to Date	\$ 825,000
Percent Complete	50%
Profit to Date	\$ 175,000
Amount Earned to Date	\$1,000,000
Amount Billed	\$ 900,000
Estimate Cost to Complete	\$ 825,000
Contract Balance	\$1,100,00



7. Know your receivable numbers.

You can't make any money unless you collect what you're owed. Doing work is fun, but putting money in the bank is even more fun. I know it isn't your favourite job to call deadbeat customers and ask for money. Stay focused on collecting what's owed by getting an updated weekly account receivable aging report every Monday to review.

Weekly Account Receivable Aging Report

Accounts	Total Due	30 Days	60 Days	Retention
Project #1	\$ 70,000	\$35,000		\$15,000
Project #2	\$ 45,000	\$50,000		\$25,000
Project #3	\$ 65,000			\$55,000
Total Due	\$180,000	\$85,000	\$0	\$95,000



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8. Know your liability numbers.

To keep your eye on the ball, you've got to know what your liabilities and debt include. Create a report listing out all of your debts, liabilities and large balloon or one-time payments due in the near future.

Liability & Debt Report	Amount	Payment	Terms	Due Date
Line of credit				
Line of credit drawn				
Other credit loans				
Equipment loans				
Future tax payments				
Real estate loans				

9. Know your cash numbers!

Cash is king and the life blood of your business. You need to know what you've got to work with to make good decisions. Get a report of your cash position every week and include the following items:

- Weekly Cash Report
- Bank Deposits
- Cash In Bank
- Checking
- Payroll Account
- Savings
- Weekly Payroll Cost
- Weekly Equipment Cost
- Weekly Overhead Cost
- Investments
- Liquid
- Long Term

Know Your Nine Numbers!
 Doing great work doesn't really matter unless you make it your priority to always make a profit. Don't delegate or ignore the most important part of your business. Follow these nine necessary numbers, and stay on track toward becoming one of the top contractors in your market. Every week take at least one hour to review these financial figures with your key management team & accounting manager. This small investment of time will give you a much better return than going out to the jobsite one more time to remind your foreman what to do.

By George Hedley.

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Our tip

Discuss with your bookkeeper and/or accountant and reap the rewards.