

HOW CONTRACTORS CAN NAVIGATE BACK TO PROFITABILITY

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"Uncertainty is the only certainty there is, and knowing how to live with insecurity is the only security."
– *A Mathematician Plays the Stock Market*, by John Allen Paulos

Every contractor is aware of the uncertainty of the construction industry going in, but the challenges facing contractors today are unprecedented. As a construction company owner, you may feel as if you're attempting to cross a wide, rushing river, and you have no idea how you're going to get to the other side – or how long the journey might take.

Do You Have a Map?

Success is rarely an accident. Imagine that you're standing on the bank of that river, peering across, wishing with all your might that you were safe on the other side. But do you truly know what lies ahead – where the best landing spot is and what hazards are between you and your destination?

A successful adventurer starts out with a clear idea of where he wants to go and a map that shows the best route to get there. Like a physical map that helps you navigate around sand bars and rapids to reach a geographic destination, a strategic plan lays out the path to achieve your business goal.

What's the Terrain?

Many contractors are following a plan that was mapped out by the company's founder – the adventurer who saw an opportunity and risked everything he had to exploit it. Whether or not the founder is still running the business, today's terrain looks quite different than it did 20 or 30 years ago.

To survive and thrive in today's extraordinarily uncertain environment, contractors must have a clear vision of what they want to achieve. How will you take advantage of opportunities and navigate around pitfalls on your journey? Following are just a few examples of today's opportunities and challenges:

- The **collapse of the housing market in most major U.S. markets** created a flood of residential contractors shifting into the commercial channel, increasing competition and driving down margins.
- An **aging population** is creating greater demand for hospitals, nursing homes and other health care facilities.
- People aren't the only ones getting older. **Aging infrastructure** means that road-builders and utility contractors continue to be in high demand.

While strategic planning might seem like a luxury a small business owner can't afford, the time spent assessing the environment and your organization's strengths may actually be the highest yielding investment you can make. In a 2002 Clemson University study of more than 150 general contractors, **the average annual return on investment for those with strategic plans was more than one-third higher than that of companies that did not have a strategic plan.**ⁱ

For contractors who take the time to evaluate where they want to go and how to get there, the rewards are many – not the least of which is the hope it can provide contractors and their employees by giving them a sense of control over their destiny. But what does strategic planning actually entail?

What Is a Strategic Plan?

Strategic planning does not need to be onerous. In fact, according to a study of top-performing contractors by Clemson University researcher Dr. Dennis Bausman, the best performers actually have a relatively unstructured planning process, focusing more on the outcomes than on the process itself.ⁱⁱ

A strategic plan also is not a quick fix, nor is it a one-time event. An effective strategy is one that the owners and key employees live and execute every day, and it's one that is constantly revisited and evaluated.

The strategic planning process involves taking a critical look at the company. It requires you and your employees to ask and answer some very tough questions. For example: Are you better than your competitors? If not, what do they do better than you, and how can you improve?

Leadership is about being able to see the organization clearly and honestly and creating a vision of what it could become.

A strategic plan essentially addresses four primary areas:

- **Service mix.** What are you in business to do? Are you purely a plumbing contractor, or is it time to add to your bag of tricks? Be sure to address the services you *don't* provide. If you have historically focused on commercial work, should you consider expanding into the residential or utilities markets? Or are the skills sets required for those sectors too far outside your comfort zone?
- **Markets.** Who do you serve – and not serve? Perhaps most of your experience is with retail stores, but you get an opportunity to bid on a hotel project. Do you make the bid? This is one of the hardest decisions to make. When you're hungry for work, you don't feel like you're in a position to turn down a job that could keep your workers on the payroll. But taking a job in an unfamiliar market can lead to costly mistakes that could turn a thin profit margin into a loss. By focusing on just a few markets, you (and the property owner) benefit from the efficiencies that come from experience. You also become known as "the" contractor to call for that type of work, allowing you to demand a premium for your work. It's no surprise that the most successful contractors focus on a limited number of market niches, constantly honing their expertise in each one, and that they're able to compete on value rather than on price.ⁱⁱⁱ
- **Competitive advantages.** What makes you better than your competitors? What makes your competitors better than you? We've already discussed one potential advantage – "been there, done that" experience. If you are "the" electrical contractor for hotels, then you know just how to run wires so they're hidden from the guests but accessible for future maintenance work. Or maybe your competitive advantage is that you have the capability to operate as either a general contractor or a construction manager, depending on the needs and preferences of the property owner.
- **Capabilities.** What skills and resources do you have – or what do you need to obtain – to support those competitive advantages? If you're marketing your firm as "the" electrical contractor for hotels in your metro area, then you'd better make sure you have all the proper electrical permits, as well as strong relationships with individuals in the county offices responsible for awarding building permits. And if you're promoting your ability to act as a CM, then do you or another one of your employees have experience operating in this capacity?

It's not easy to make a decision to walk away from certain types of opportunities. Making these decisions requires an understanding of industry and market trends, as well as a clear understanding of the economics of your business.

Many contractors don't even know the true costs involved in deploying a worker to a job for one hour. It's true that this number is a moving target, given the fluctuating cost of gasoline, materials, equipment and even parking. But the **key to matching your resources to your opportunities is having a clear view of your cost structure**. If you don't know how to calculate your direct and indirect costs, ask your accountant for help. Your CPA also should be able to design a spreadsheet that allows you to plug in current costs, giving you real-time feedback on the relative profitability of your various services and niche markets.

Chart Your Own Course to Hit Pay Dirt

Taking the time to determine which of your services and niches is most profitable, as well as which ones have the most potential for growth, allows you to actively steer your business toward those golden opportunities.

Charting a course based on facts and data, rather than assumptions and gut instincts, also helps your company in many other ways.

- *You have a greater chance of discovering pitfalls (and bridges) before you're on top of them.*

Taking a step back to survey the lay of the land gives you a much better chance of predicting what obstacles might be in your way, as well as the natural bridges and ladders that can accelerate your journey. For example, in some markets owners are embracing the construction manager model rather than the general contractor model. This shift took many general contractors by surprise, and these slower movers lost opportunities to contractors who embraced the CM model early and marketed themselves appropriately. Or, say you've researched the hospitality industry and discovered that your city has passed new zoning rules that will make it harder for hotels to get permits in the suburbs. Armed with that information, you can approach your clients with a plan for expansion within city limits.

- *A strong strategy allows you to compete based on value rather than on price.*

As we discussed above, a company that is recognized for its expertise in a certain niche market **demand a premium price** compared to contractors who have not differentiated themselves. Think about your own buying habits. Are there certain brands that you buy exclusively, even though they're more expensive? While you might think that brand-name contractors would be the larger companies, even a smaller shop can carve out a niche and build positive name recognition.

- *You're more likely to evaluate decisions objectively, rather than respond to situations emotionally.*

Say you've just been awarded a contract at \$6.5 million, and then the architect comes back to you and asks if you could do the job for \$6.3 million. Your backlog is nonexistent, and you were counting on this project to keep you going for the next several months. Without it, you're facing the prospect of layoffs. In this situation, and thinking about your employees and their families, you might be tempted to agree to the concession. But what if you knew your exact break-even point on the job, and you knew that \$200,000 concession would erase the small margin you were banking on? Would you have more courage to walk away from that job if you had a clear plan for pursuing the type of work that would generate greater profit and give you and your workers a more stable source of income?

- *A map gets everyone marching in the same direction.*

Chances are, some of your team members feel somewhat lost right now. They might wonder where the company is headed, and if it's the right path for them. Just knowing that you have a plan for the future can give them a boost of confidence. And communicating that strategy to all levels of the organization gives them the opportunity to pull in the same direction, increasing your chances of reaching your goals.

You're Not Alone

At this point, you might be thinking, "Of course it would be great to have a strategic plan, but I don't have time to do it. I'm already working 10- and 12-hour days just keeping the business going."

If you find yourself in this position, then you have all the more reason to establish a strategic plan. As a business owner, you must work *on* the business, not just *in* the business. Part of your strategic plan must include ways to better leverage your team so that you can pull out of the day-to-day fray and truly lead the organization.

The design and implementation of the strategic plan also should be a group effort. There are several groups of stakeholders you should tap into as you map out your strategy.

Strategic planning team: Your entire leadership team should be involved in the strategic planning process, including the CFO, business development professionals, key field supervisors and estimators. The team should ideally be comprised of five to eight individuals and should be engaged throughout the process.

Advisory board: Many successful companies assemble an advisory board – an informal group of three to five individuals that might meet two to three times a year to provide feedback on viable strategies to achieve your company's goals. Seek individuals with no financial interest in your firm, but who have a genuine interest in helping your business succeed. For example, you might ask the president of the local chapter of your trade association, or a retired construction business owner from another market.

Underwriters: Your lender and bonding agent also are valuable resources. Not only can they provide input on the best strategy for your company, but also just knowing that your company has a workable plan tends to put underwriters' minds at ease and loosen your credit line. Having the lender and surety on your side takes a good bit of uncertainty out of the equation and opens up new possibilities for growth.

Strategic planning advisor: You might also want to invest in hiring a knowledgeable business advisor who can help you objectively evaluate your opportunities and strengths. This strategic planning advisor should be able to demonstrate:

- Specific knowledge of the construction sector and the metrics that indicate success
- A strategic focus
- Business acumen and financial expertise
- Ability to solicit input and buy-in from key employees

Is It Time to Draw a New Map?

If you and your leadership team can't answer the following questions consistently, then you should strongly consider developing a new strategic plan:

- How are we different from our competitors?
- What three things are we going to change to be more profitable and competitive in the future?
- Who is responsible for implementing these changes?

Now that you understand what strategic planning is and who should be involved, let's talk about what the process might look like.

Drawing Your Map

You've probably never studied cartography, but if you know the terrain, you can draw a map that will help someone get from Point A to Point B. And you don't have to be an expert in strategic planning to create a plan that will get you from where you are to where you want to be. You just need to develop an understanding of your environment, as well as a clear vision and goals for the company; then, choose some strategies that you believe will move you down that path. And, be diligent about staying the course.

While most of our clients take a relatively informal approach to planning, their process does tend to follow a certain structure:

1. **Fact Finding.** Tapping into as many sources as possible – such as employees, project owners, subcontractors, architects, engineers, consultants and other delivery partners – find out as much as you can about the environment you're operating in and your company's performance within that arena. How are each of your operational units or client segments performing relative to one another? What are current and forecast economic trends for your geographic market, and specifically your targeted industries? Getting involved in local trade and business associations is a great way to stay abreast of these trends. (See the appendix, for a list of suggested organizations.) What regulation is coming down the pike that might affect your clients? What client needs are you not currently serving? This phase of the process can take as long as you decide to make it – from a couple of weeks to several months. Just remember that your entire plan will be built on the foundation of knowledge you bring to the strategy meeting, so don't shortchange yourself.
2. **Strategy Meeting.** Bring together your strategic planning team at an offsite location with minimal distractions. Consider using an outside facilitator, who can help you stay on track and bring a fresh perspective to the planning process. During this session – which usually lasts a day or two – you'll review the information uncovered in the fact-finding phase, agree on your company's mission and vision, establish your goals and identify strategies to achieve those goals.
3. **Plan Development.** We're not talking about a 50-page volume here. In fact, brevity and clarity are key. You're shooting for a concise document that addresses the four areas summarized above (See "What Is A Strategic Plan") and spells out specific goals and strategies. The plan should also detail specific metrics that indicate progress toward those goals, as well who within the organization is responsible for implementing strategies and monitoring progress.
4. **Communication and Implementation.** Once you've drawn the map, you need to make sure every member of your team has a copy. Bausman reports that the best performing contractors communicate openly and often about the strategic plan and progress toward strategic goals, because "they believe that informed employees make better decisions."^{iv}
5. **Measurement and Evaluation.** The process never ends. In each and every business meeting, decisions should be measured against your strategic goals, and on a quarterly or bi-annual basis, company leadership should revisit those objectives to make sure they still make sense. You might also want to put your firm's money where its mouth is. In fact, the best-performing contractors link

performance to strategy by asking senior managers to establish personal goals that support the company's strategic goals.^v

Reach Your Destination

There is some comfort in the fact that construction is a cyclical business. At some point, demand will catch back up to supply. In the meantime, margins will continue to be tight and leave very little room for error in bidding. Just remember that the low-bidders won't win in the long run. The contractors who chart a unique path based on their own competitive advantages will survive the downturn and thrive in the recovery.

ⁱ *The Relationship Between Strategic Planning and Financial Performance*, Dennis C. Bausman, 2002

^{ii-v} *Strategic Planning Best Practices*, Bausman, 2003

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ABOUT THE AUTHOR



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Chris leads the firm's construction client service team, offering valuable insight and expert recommendations into issues from financing to operations to employee benefit plans. He is adept at not only helping his clients strengthen their bottom line but also understand the strategies that make such success possible.

In his 13 years at Barnes Dennig, Chris has worked closely with a number of clients to identify accounting improvements and streamline their processes and systems. He has a particular expertise in information technology, helping clients utilize their accounting software to its fullest capability. He also manages an engagement team for employee benefit plan audits.

In every role, Chris's goal is to educate his clients along the way, helping them gain a deeper understanding of the accounting requirements they face and the many ways it can impact a company.

He is a member of the editorial advisory board of *ProfitCrew*, which provides regular and insightful content for the construction industry. He also serves on Barnes Dennig's Accounting and Auditing Quality Control Committee. In this role, he helps the firm deliver the highest quality assurance services, which in turn provides clients with increased peace of mind.

Chris graduated from Miami University with a double major in accounting and finance. He is a Certified Public Accountant (CPA) licensed in Ohio and is a member of the Ohio Society of Certified Public Accountants (OSCPA) and the American Institute of Certified Public Accountants (AICPA).

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