

Setting Financial Targets to Achieve Business Goals

Written by: George Hedley, Hardhat BIZCOACH, Construction Business Coach and Industry Speaker

The key to building a successful construction business: knowing and managing your numbers. You can't bid projects right unless you know your job costs, production rates, actual overhead, and profit goal. You can't stay on budget unless you know, update, and track your job costs on a regular basis during the performance of building a project. Your company can't make a profit unless you know your annual overhead cost and how much sales at an average markup you need to break even and achieve your profit goals.

When most contractors start their companies, they are excellent at building and doing the work required by their trade or specialty. For example, rough carpenters know how to frame a house or office building, plumbers know how to install plumbing, and project managers know how to award trade contracts and schedule and manage onsite work. Unfortunately, most contractors aren't proficient in setting budgets, managing cash flow, calculating overhead, tracking job costs, and making a profit. Eventually, new contractors might hire an office manager to help them organize their paperwork and handle the bookkeeping – but their new hire may not know construction financial management either. So then you would have a business owner and a semi-bookkeeper who aren't educated in managing the finances for a construction company.

As a construction business coach and consultant, I work with many different types of contractors: new, old, experienced, and hard workers. Most of them do not know their numbers and



therefore struggle with doing enough work at the right price and proper markup to make a generous profit.

DO YOU HAVE A NET PROFIT GOAL?

If you are planning a trip, you start with a destination and then design a route to get to your goal. In business, you start with a goal to make a profit and design a plan to achieve your goal. Do you have an annual net profit goal? Annual net profit is the amount of money left after all your expenses – including job cost, overhead, and the owner's salary – are paid. In other words, it's your company's taxable income. How much money or net profit do you want to make this year in dollars: \$100,000, \$250,000, \$500,000, or more? With a clear goal you can build a plan to achieve it. Without a clear goal, you don't have a

specific destination to move toward, and therefore you can't reach an unknown target.

Do you know, track, and stay updated on your numbers?

- » Sales – Annual sales required at what markup to make the profit you want
- » Breakeven – The amount of annual contract revenue and markup you need to break even
- » Gross profit – Sales income minus job cost
- » Overhead – Your annual overhead fixed general and administrative costs
- » Markup – Your total overhead and net profit markup you can achieve in your marketplace based on the type of work you perform, job size, customers, and competitors
- » Margin – Your gross profit margin (overhead + profit) divided by sales revenue
- » Net profit goal – Your annual net profit goal in dollars and as a percentage of job costs and sales
- » Backlog – The amount of contract work you have left to complete
- » Bid-hit-win ratio – The number of jobs you win versus the number of jobs you bid on
- » Working capital – The available cash you have available to run your business and pay your bills
- » Equity – The net worth of your business
- » Liabilities – The amount of liabilities, loans, and debt you owe
- » Accounts receivable – The amount of receivables billed and currently owed
- » Sales growth – Your company growth goal
- » Average job size – The average job size of all your jobs for the year
- » Job cost tracking – Project job cost budget versus actual cost; crew production hours budget versus actual hours spent; and material and equipment costs versus budgets.

PROFIT STARTS WITH WINNING PROFITABLE WORK

The owner of a construction contracting company in Michigan called me for advice. He complained about his customers always asking for lower prices, and the many cheap competitors he bids against who don't charge enough.

Therefore, his sales were slowing down, his workload didn't allow him to make enough money, and his jobs typically finished over budget. He also complained: "I can't sell enough work at my old markup rates to cover my overhead. So, I lowered prices 5% to try and attract more sales. My lower prices still aren't attracting enough new work or customers. What should I do?"

I asked a few simple questions: "What's the fixed overhead cost of keeping your business open every month and year? What's the break-even annual sales revenue you need at the markup rates you're charging? How much more annual sales will you need if you lower your markup rates? What's your average job size, and how many jobs do you bid versus win every month? Do you know and keep track of how many crew hours it costs to install materials per square foot?"

He had no clue. He didn't know or track his annual overhead cost of doing business, job cost, or crew production rates. He had a part-time office administrator who paid the bills while he took care of the contracting business, including estimating and bidding, contracts, scheduling crews, ordering materials, restocking, dealing with customers, and chasing money. Odds are his administrator didn't know the answers to those questions either, and neither of them had ever seriously discussed overall financial matters. So, I politely asked: "How can I help if you don't have any idea what it costs to keep your business open or do the work?"

I asked him to calculate his annual overhead costs, bid budget crew hours versus completed job crew hours on a few typical jobs, bid markup versus completed job markup, and his bid-hit-win ratio. We then set a time for a follow-up session in two weeks. Guess what? He didn't show up for our scheduled coaching session, and I never heard from him again. I'm sure he still doesn't know his numbers, works too many hours, and isn't making any profit.

DO YOU HAVE A HANDLE ON YOUR NUMBERS?

Business owners must be strong in financial management. Most weren't trained in accounting or finances. There are numerous ways to learn construction finances, including books, courses, webinars, working with a construction business coach, or joining the Construction Financial Management Association

(CFMA) and attending their workshops.

Profitable contractors take personal responsibility to do what they need to do to learn and understand:

- » Income statements
- » Balance sheets
- » Cash flow
- » Over/under billings
- » Markup versus margin
- » Work-in-progress (WIP) schedules
- » Cash versus accrual accounting
- » Labor burden rates
- » Equipment costs

To build a construction business, you must be focused on your bottom line numbers, know the amount of sales and markup you need, know your labor costs per unit of work, and always be sure you're making a profit. You can't rely on someone else to care about your finances as much as you do. Someone else can pay the bills, send out invoices, prepare financial reports, and do the accounting, but the owner must be responsible for knowing the numbers every day, week, and month – not just once a year, when they meet with their accountant and find out they didn't make what they wanted to make.

PROFIT IS THE SCORE CARD OF THE COMPANY OWNER

When I present to conferences, I often ask: "Why are you in business? To make a profit? How much profit do you make?" The typical answer is: "I don't really know."

Could you imagine the CEO of a Fortune 500 company who doesn't know their numbers? No! When asked these important questions, many construction business owners don't know how much money they make. This tells me most owners don't focus on what counts most. Profit is return for business ownership, taking risk and investing capital in your business. Profit is the net amount remaining and available at the end of the year or month to provide a dividend or distribution to the company owners, or to leave in the company for next year's growth. Net profit is the best indicator or score card of your strategic plan, management team effectiveness, written systems, project managers, supervisors, foremen, financial tracking systems, and your company leadership.

Busy construction business owners spend their time trying to win enough work to keep their crews busy, negotiating with trade partners and suppliers, building projects, scheduling, supervising onsite workers, doing paperwork, and then hoping the bottom line numbers work out later. Often, these hardworking, dedicated, multitasking owners don't like to be bothered with the numbers. So, they pass financial matters off to an untrained construction bookkeeper or spouse to handle and manage the money, worry about making payroll, paying the bills and getting paid.

I have been a construction business owner since 1977, and I have hired over 10,000 trade partners, worked with hundreds of contractors as their business coach, and presented over 500 keynote speeches and workshops at construction conventions and company meetings. My experience tells me that fewer than 10 - 15% of all construction business owners actually know or regularly track their numbers. Guess what? These few who know their numbers also make the most money in their market.


AIM AT SOMETHING TO HIT YOUR TARGETS

Profit-driven owners and managers are competitive. They need targets and scoreboards to stay on top of their score. You can't win a basketball game without shooting at a target (the basket), keeping score, and knowing which team is ahead during the game. You can't reach your business goals by trying to work as hard or as fast as possible while not knowing your numbers or how well you're doing.

What financial, profit, and job cost targets does your company aim at? I know I've said it before, but I'm saying it again: Most companies shoot at moving targets by attempting to make "as much money as possible" or "more than they are currently making." More than what? More than a few dollars or as much money as possible? These are not specific targets or goals. Five percent, 10%, or 15% are not clear targets either, as they depend on variable sales or job costs. Do you have specific financial targets to shoot for and track your progress monthly?

NET PROFIT IS THE LIFEBLOOD OF YOUR COMPANY'S SUCCESS

You can't grow your business without making a substantial profit. Without profits, you can't do bigger projects, buy the right equipment, hire better managers or supervisors, get a

line of credit, or increase your bonding capacity. Having no net profit depletes all the cash from your company and leaves you with nothing to invest to grow your business, build a management team, train your employees, develop customer relationships, or improve your service. The more profit you make, the more cash you have to spend on your future, and the faster you can build your company. Without a good net profit margin at year end, your business will struggle, and you won't be able to move toward achieving your long-term goals of building a business that works. 



About the Author

George Hedley is a professional construction business coach, consultant, and popular speaker. He helps contractors to build better businesses; grow, profit, develop management teams; improve field production, and get their companies to work. He is the bestselling author of “Get Your Construction Business To Always Make A Profit!”

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