



# Business Mentors

## Five Steps to Improving Your Profitability

Topic: Business Opportunities

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Date/Pages Sep 2003 pp. 30-33

Two of the most valuable commodities in business are time and money. They usually are interchangeable and often come at the expense of the other. The problem in any business is when you begin to trade time for grief instead of profits. Many restoration company owners mistake the purpose of their business. In business school 101, you learn that the purpose of any business is to generate profits.

As restorers, we sometimes forget that our primary product is profit rather than restored homes and buildings. The restoration process is simply a means to the end result. If you do not believe this, then it may make sense for you to go to the IRS and change your tax classification to "not for profit." I am certain that the insurance companies would be more than happy to support your business concept. However, this article is for the rest of you who are interested in making money. It is important to understand what an achievable and acceptable profit level is in this industry and then learning the steps to get there.

The first step to creating a profitable business is to begin by managing your company as a business rather than a restoration company. The measures of a successful business are a healthy cash flow, balance sheet and income statement, rather than the traditional restoration measures such as the number of air movers, employees and vehicles or the size of your warehouse. The most successful companies realize that these measurements simply feed the ego rather than a personal bank account.

- **Step 1 — begin with the end in mind.**

When you analyze your business concept you should establish your end goal and then put the pieces in place to ensure that it happens. According to Linda Case in her book *Making and Managing Money*, successful remodeling companies should be making 10 percent net profits every year. Additionally, the owners should be receiving 10 percent of gross sales in total compensation. This also has been established as an appropriate benchmark for the restoration industry, yet unfortunately, few companies have figured out how to achieve this result. This total compensation should include your vehicle and all other owner privileges.

If you agree with these assumptions, then you need to build your financials off of these numbers. Many full service restoration companies that are able to achieve this 10 percent goal are averaging around 40 percent gross profit margins and have an overhead of around 30 percent. All financials are built a little bit differently and some job items cost more than others. Remember



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that the goal is to build your financials backwards with the end result of a desired net profit. If your gross profit averages 35 percent, then your overhead needs to be maintained near 25 percent and so on.

- **Step 2—understand the largest and most controllable portion of your company—the direct cost of your service.**

The restoration industry has very little price elasticity. That means that there is very little difference between your prices and those of your competition. If you raise your prices, your clients are likely to find a lower cost provider. While I understand that a premium will be paid for quality service, there are still limits to the prices you can effectively charge for your restoration services. It is important to develop a cost structure that supports your pricing.

Establish a budget for all of your work and then put a plan together to achieve your goal. For example, if you have a construction project, you should set a budget for the cost of the project. There are many ways to figure the budget, but at the very least it should cover the direct cost of the materials, labor, labor burden and subcontractors. Some contractors include vehicles, cell phones, uniforms, liability insurance, project management costs and many other indirect costs for the job. It is not important which you include, only that you are consistent. However, the more you include in the direct cost of the job, the lower your profit expectation for the project. If you are only including direct labor and materials, then you will have higher profit expectations because the other items will be shown in your general and administrative costs.

For argument's sake, let's establish a budget for your project of 40 percent gross profit. You should plan in advance how you will achieve this profit. Take each individual line entry and separate labor and materials. Sixty percent of the allowance for labor and materials should be figured for your cost and the rest is your budgeted 40 percent profit.

When figuring your labor costs, it is very important to add in the entire labor burden, which should at least include payroll taxes, workers compensation and health insurance, holidays, bonuses and vacations. Some companies will also include the cost of training, vehicles, cell phones and uniforms. This number is the true cost of your labor - not simply the hourly wage that you are paying.

It is very important that you fully understand the cost of your labor. When you understand this number, you can then make an educated decision whether or not to use in-house employees or subcontractors, and can appropriately set the expectations for your field staff. Take the total cost of the labor and divide this by the hourly cost for your workers. This will give you the budgeted labor hours to complete the project or task. When you do this, you can ensure that your profit margins will be achieved.



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Many contractors choose to use subcontracted labor for their projects. This allows you to have more control over the costs on the job. When you determine the budget for the project, you can hire the subcontractors and have them provide all labor and materials for the budgeted amount. Some contractors make a mistake of hiring subcontractors and paying them by the hour. This is usually a big mistake because it simply provides an open checkbook for the subcontractor. Take advantage of the ability to set your costs in advance in order to meet your budget.

I would be remiss if I left the conversation of gross profits without stating the obvious?your gross profit margins should be much higher on cleaning, mold remediation and water damage restoration projects. You should also understand that the overhead costs of providing these services is also much higher - consisting of warehouse and office space, liability concerns, additional staff labor, higher training costs, more vehicles and other related items.

- **Step 3—measure the results.**

Your accounting program should be designed to measure the costs for every job. If your accounting program cannot track this information, then you will have to manually track the job costs. Measurement of results is the assurance that you will achieve your project budget. The job costs should be reviewed for every job at least every week and ideally, every day. The accumulation of your job costs over a given period of time will comprise the cost of sales that show up on your financials. Planning and managing the job costs is one of the biggest items in creating your financial plan and ensuring your net profits at the end of the year.

- **Step 4—make a projection for your revenue.**

This should be the result of an analysis of the previous year's sales, as well as awareness of competition and market trends. When planning your revenue, it is essential that you use a very achievable and realistic number because you are going to build your company on this number. Break down your revenue forecast by work type and then further by insurance company or referring source. This will allow you to see more clearly if your revenue numbers make sense.

At this point, you have the projected revenue for the company and expected gross profit margins from which you can determine the total gross profit. The other piece of the puzzle is the net profit. When you multiply the total revenue by your expected net profit percentage, then you have the net profit dollars that you should expect to achieve. After you determine the gross and net profit expectations, than figure out your total budget for General and Administrative costs. (Example: \$2,000,000 revenue \* 40% gross profit = \$800,000. \$2,000,000 revenue \* 10% net profit = \$200,000. \$800,000 gross profit - \$200,000 net profit = \$600,000 general and administrative budget.)

From this point you can start to fill in the rest of the picture. Allocate the \$600,000 to each of your administrative costs. There are things that you know such as rent, liability insurance, expected personal compensation—start with these and then move to the discretionary accounts.



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Also, don't forget to budget depreciation, as it is a real cost and can throw off all of your expectations. As you perform this exercise, you may find that you have to make some difficult personnel and capital decisions. However, ignoring the problem is not a solution. Changing the revenue expectations will also influence your overhead allocation, but it is important that you are very realistic in your sales assumptions. Your income and the net profit of your company are at stake.

- **Step 5—chart your progress.**

When you have your corporate budget, you should measure your progress on a monthly basis. This measurement process will allow you to adapt your budget and make changes immediately due to new information. My experience has shown that the process of creating a business financial plan and then routinely measuring the progress will result in the achievement of the desired outcome.

Application of the above procedures will allow you to create a financially successful company. Here are some tips to simplify the road to financial success.

- **Achievement of revenue projections.** Break down the annual expectations and then set a monthly sales goal that is in excess of the annual revenue projection. You can further break sales down into weekly and daily amounts. Measure sales by counting the signed contracts, approved supplements, change orders and completed emergency service. The total of these numbers is not the same as the revenue on your financials because it actually has to be produced to show up on the profit and loss statement. However, this sales goal will proactively allow you to achieve your revenue expectations. If you are behind for the week or the month, then it can act as a motivating factor for marketing activities. Make sure that you measure this number for each estimator in the company.
- **Increase the professionalism of the office.** If you are to convince yourself and your staff that you are a business professional, then look the part. Dress like a professional and demand that your office staff does as well. Have an office cleaning plan to make sure that the physical space is organized and professional. Hire qualified staff members who reflect the culture and attitude of the company that you want to create.
- **Financial measurement.** Utilize a professional accounting program and run monthly financial reports. If you cannot measure it, you cannot manage it. Spend the time and money that it takes to properly measure the financial performance of your company.
- **Pay for performance.** If you want to ensure that you will achieve your project budgets, then put programs in place that reward achievement of your gross profit expectations. A properly developed, performance-based pay program should be self-funding. The bonus



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payments should be utilized to beat the profit expectations, not simply meet them. The baseline for payment of any bonus program is your minimum profit expectation and should escalate from there.

Remember that you are a business professional. Start treating your restoration company as a business. When you show up at the next convention you can laugh when you hear others bragging about their 200 airmovers and 50 employees because you are making at least 10 percent to the bottom line, and you and your family are able to enjoy the financial success of your business, rather than being tied to debt and frustration.

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