

HOW-TO

Prevent business failure

BY FRANK ROSS

As consultants, we're constantly asked "What are the reasons companies succeed?" or "What do other companies do to make more money?" Recently, I received an unusual question: "What are the top 10 reasons companies fail?" Typically, consultants are optimists and think about why businesses succeed, so fielding this question is outside the normal response zone, but here goes.

1 Lack of cash flow

Poor cash flow is probably 90 percent of the reason companies fold. Everything makes up the other 10 percent. You can lose money every year you're in business, but as long as you have positive cash flow and can pay the bills, you can live to fight another day. The first day you're unable to pay your bills or meet a payroll, vendors can shut you down and employees will leave.

There are an infinite number of reasons companies don't have adequate cash flow (most of them created by management), but there's one that resonates above all. We don't do a sound job collecting the money we're owed because we don't like asking for it.

Here's a tip—make collections a responsibility of the sales process. Customers are at the highest level of euphoria at the time of the sale. You've created a vision in their minds—it's a beautiful garden or a proposed low price. Either way, at that moment, they're as happy as they'll ever be. This is when you set the terms about how you'll bill the job and how you expect to be paid. Don't expect customers to know how to pay you. Get a commitment from them, and follow that commitment through to the completion of the job.



2 Drive-by estimating systems

I constantly meet folks who'll price a job by driving by a site and rationalize doing so because the job is similar to other ones. This method doesn't always work. There's a reason the Small Business Administration ranks construction as the second most risky business behind restaurants. Every job must have a quantity takeoff and extension, be marked up for overhead and marked up with a profit. For every job, know how much profit you have and how low you can go before you bid. It's a time-consuming process, but one that's focused on eliminating losers.

3 No job tracking

Once you earn a job, track your performance to ensure you're harvesting the margin (overhead and profit) you put on the job when you sold it. If there was a way to verify this statistic, we'd discover fewer than 25 percent of contractors have job-tracking systems that work. If you don't know how a job is performing, you have two problems. One, without a tracking system, you can't spot problems in the job before they manifest. Two, you can't verify that your estimating standards to price work are correct.

4 No financial reporting by profit center

Few of us perform only one type of work. We're normally involved in installation, maintenance, enhancements and retail. Every type of work you perform has different cost and overhead structures. If you don't know performance by profit center, how can you control

costs and accurately price the work?

Have an income statement that separates total company performance into the various profit centers with which you conduct business. Furthermore, break down all financial information by month and compare that performance to the budget.

Without a solid reporting system, you're taking far too much risk by not knowing where you stand financially. This industry is risky, and you make it more so by not having the correct information to guide you.

5 No budgets

Fewer than 10 percent of the businesses in the U.S. prepare a budget, according to *Inc.* magazine. A budget means a working budget—one you think through methodically, starting with how much net profit is needed to support cash flow and identifying how you'll spend money in each overhead account so you know how much gross margin you must generate to support your standard of living. Once the gross margin is established, analyze the backlog to determine the margin you're carrying into the year. Then forecast how much new business you must sell, and at what price, to create gross margin coverage for overhead and profit needs. Every month, track how you're performing against budget, and make adjustments to your plan to reflect actual performance (rolling budget). A budget is the road map for your business needed to make smart decisions.

6 No pricing by profit center

One of the principle reasons to categorize your income statement into profit centers representing various types of work is pricing. It makes no sense to price all types of work the same. Breaking your income statement into profit centers will allow you to create a relationship of the direct costs necessary to perform the work and overhead required to support it. Once done, depending on the type of work,

a relationship between overhead and direct costs can be established such that you can create the appropriate markups to price the work correctly. Without correct pricing, you run the risk of pricing low-risk work too high and not getting it and pricing difficult work too low and not realizing it.

7 No long-range planning

Creating a vision of where you want the company to be in three to five years is a constant in highly successful companies. The three- to five-year plan starts by understanding what you do best then strategizing how you can capitalize on that skill set to maximize the bottom line.

A long-range plan, which isn't a financial plan, comprises a series of definitions of how you see the business in the future. For example:

- › What markets will you serve?
- › What types of work will you perform?
- › Where will you find your labor pool?
- › What facilities and equipment will you require?
- › What will be the capital required to fund those requirements?
- › What organizational growth do you see?
- › What tracking systems do you require?
- › Will you be expanding geographically?

It's brainstorming at its best, but here's the catch—on any one of those issues, we'll likely be spending money to achieve our long-term goals. Be proactive to maximize efficiency and the return on investment.

8 Lack of labor control

We're in the service business, which means we sell labor, but it's amazing how few of us control our labor force. Consider the following:

- › Do you have proven labor standards by which you estimate every job?

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- › Do you prepare a labor budget for every job you bid?
- › Do you measure the hours and tasks completed each day?
- › Does the labor budget include the support activities such as load time, travel, clean-up, maintenance of completed operations and a punch list?
- › Does the crew leader have a definitive understanding of what needs to be accomplished every day along with the hours budget to accomplish those tasks?
- › Do you track weekly billable time against total hours paid?
- › Do you know the composite wage rate of your crews?
- › Do you track the amount of overtime hours paid against total hours paid?

If the answer to any of these questions is “I don’t know,” you can control your labor better. Do that by measuring it. William Edwards Deming, an American statistician, said it best: “If you can’t track it, you can’t control it.”

9 No control of overtime

Is overtime a good thing? As far as your employees are concerned, it’s most appreciated. But is it good

for the company? Do you control it or leave it up to the employees? Many consider it a necessary evil. But overtime is as much a controlled line item in your financials as advertising. Accept that overtime is a management decision, not an employee decision. To control it, appreciate there’s good and bad overtime. Good overtime includes:

- › Setting an annual budget for overtime and because you do, that cost for overtime is embedded in your pricing strategies and is captured over all jobs.
- › Billing the customer at overtime rates when you work overtime.
- › Billing certain skill sets—irrigation and lawn care techs, for example—at a high rate. Whenever the hourly billing rate for an employee is three times his hourly cost, you can work as much overtime as you can bill and you’ll be fine financially.

All other overtime is bad because it’s neither embedded in your pricing nor billed for separately, which means it’s a drain on profitability.

10 No ownership of benchmarks

Most managers assume people under their tutelage know what’s important and will do what they must to achieve excellence. I beg to differ. Employees are willing warriors and will do your bidding. If you don’t set expectations, they’ll interpret what they think you meant to say. Here’s an exercise: List what you believe defines an excellently run company. Do you measure those things? And if you do, have you assigned ownership of those items to someone on your team? Do you:

- › measure leads coming in;
- › know how many leads to chase on average to sign a contract;
- › track job efficiencies and profitability, as well as overtime;
- › know the revenue per hour you earn on every job;
- › know by profit center if you’re hitting sales and margin goals, as well as whether you’re making a profit in each;
- › budget; and
- › reforecast the budget every month following the publication of financial statements?

If you track these items, is each owned by a key employee, and do you hold that person accountable for the performance of each? If not, there’s a huge opportunity for your company. Tracking, creating measurement benchmarks, assigning ownership and holding people accountable at all levels will propel your company to levels of efficiency and profitability never seen before. **LM**

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