# Business

## Make More By Controlling Your Growth

by Joe Stoddard

When I was a young builder in the early '80s, there was an old-timer in town who worked with a couple of his sons, a small crew, and a handful of good local subcontractors. Despite never advertising, these guys took job after job away from me (and other competitors), selling them for prices much higher than I could have imagined anyone getting at the time. Their workmanship was good but nothing extraordinary, and — in my opinion — their building science was stuck at 1955. Still, there was something about them that kept them working for the best clients, doing high-visibility projects at the highest possible selling prices and, I'm guessing, the highest profit margins. Thankfully, they usually worked on only one job at a time, so once they were booked up they'd be out of our hair for a few months.

At the time, I often wondered: What did that old-timer know that I didn't?

### The Reality of Supply and Demand

If you revisit my February column on "lean" principles, you'll remember that "value" is whatever consumers are willing to pay for the goods and services offered to them. What motivates someone to purchase from you — rather than from another company — is the perceived value your company brings to the project. And the best way to create that perceived value is to consistently deliver a superior job and then let word of mouth — along with the occasional nudge from you for more referrals — work to your favor.

As long as you're providing more perceived value than your competition, you'll generate increasing demand for your services. But here's where many builders and remodelers make a fatal error: Instead of using their break-even project budget to establish challenging but achievable sales goals (as discussed in my August 2010 column), they go into "make hay while the sun

**Scenario A: Increasing Demand, No Change in Selling Price**

| Quarter | Qualified Leads | Jobs Sold | Closing Ratio 1 in: | Average Selling Price | Direct Costs Per Job | Indirect Costs and Overhead Per Job | Average Net Profit $ | Net Profit % | Total Net Profit $ |
|---|---|---|---|---|---|---|---|---|---|
| Oct–Dec | 10 | 2 | 5.00 | Sold jobs are completed in the following quarter | | | | | |
| Jan–Mar | 13 | 3 | 4.33 | $100,000.00 | $75,000.00 | $15,000.00 | $10,000.00 | 10.00% | $20,000.00 |
| Apr–Jun | 17 | 4 | 4.25 | $100,000.00 | $77,500.00 | $15,478.00 | $7,022.00 | 7.02% | $21,066.00 |
| Jul–Sep | 23 | 5 | 4.60 | $100,000.00 | $78,250.00 | $16,101.00 | $5,649.00 | 5.65% | $22,596.00 |
| | | | | $100,000.00 | $79,672.00 | $16,372.00 | $3,956.00 | 3.96% | $19,780.00 |
| | | | | | | | | | $83,442.00 |

**Scenario B: Increasing Demand, Increasing Selling Price**

| Quarter | Qualified Leads | Jobs Sold | Closing Ratio 1 in: | Average Selling Price | Direct Costs Per Job | Indirect Costs and Overhead Per Job | Average Net Profit $ | Net Profit % | Total Net Profit $ |
|---|---|---|---|---|---|---|---|---|---|
| Oct–Dec | 10 | 2 | 5.00 | Sold jobs are completed in the following quarter | | | | | |
| Jan–Mar | 13 | 2 | 6.50 | $100,000.00 | $75,000.00 | $15,000.00 | $10,000.00 | 10.00% | $20,000.00 |
| Apr–Jun | 15 | 2 | 7.50 | $105,000.00 | $75,000.00 | $15,000.00 | $15,000.00 | 14.29% | $30,000.00 |
| Jul–Sep | 17 | 3 | 5.67 | $107,500.00 | $75,000.00 | $15,000.00 | $17,500.00 | 16.28% | $35,000.00 |
| | | | | $108,000.00 | $75,000.00 | $15,000.00 | $18,000.00 | 16.67% | $54,000.00 |
| | | | | | | | | | $139,000.00 |

These spreadsheet scenarios illustrate two different responses a remodeling company could make to an increasing demand for its services (as tracked in the Qualified Leads column). In Scenario A, the owner chooses to take on more jobs than the two per quarter he had budgeted — but at the same average selling price and using the same crew. As a result, the pace of work becomes more hectic and costs rise as, for example, the company has to hire out work that it previously kept in-house in order to meet the schedule. Even a modest rise in direct and indirect costs has a noticeable effect on profit percentage. In Scenario B, the owner decides instead to raise the selling price, then selects the best clients from among a more slowly increasing pool of leads. By focusing on efficiency and organization, the company is able to produce an additional job in the fourth quarter, and profits for the year increase substantially.

shines" mode and start booking every sale that comes in the door, thinking that now they are "growing" their company.

Most of you know the ending to that story, probably from personal experience. Eventually these businesses will sell more than they can produce, their quality of service will slip, and — as they try to ramp up — both their overhead and their direct costs will rise. The end result will be that they'll work harder and deal with more projects, people, and inspectors in order to make less money than if they'd stayed with their original sales plan (assuming they had one). Many contractors describe this phase of their existence as the period when the company was running them — which is exactly what was happening.

Take a look at Scenario A in the graphic on the previous page. Business is hopping, with qualified leads increasing each quarter. The company produced a steady 10 percent net profit in the first quarter of production. Three quarters later, though, it's cranking out 2.5 times as many jobs but making less than half as much per job (3.96 percent versus 10 percent). This business will have no problem keeping its doors open — the net earnings are on target at roughly $20,000 per quarter — but what's the point of working harder to make the same or less? And when things cool back down, which they will, the company's still going to have 2.5 times as many customers as it can efficiently handle, all demanding warranty service and few likely to be raving fans.

The truth is, in this business it's very difficult to grow profitably at a rate much higher than 15 percent to 20 percent per year. If you completed 10 good jobs last year, budgeting a dozen or so of the same-size projects this year would be a reasonable expectation.

It's not just dollar volume you have to think about, either. Taking on projects that are radically different in size and scope than what you're accustomed to can also get you into big trouble. Two million dollars' worth of simple room additions is nothing like a single two-million-dollar custom home, and being able to do one does not necessarily equip you to do the other.

## The Smart Way to Grow

Hopefully you're tracking the number and quality of your sales leads. At the point at which you can identify a trend of increasing demand — say, six to eight weeks of steadily increasing numbers — start raising your prices (and your profit margins). A couple of things will happen. Demand will moderate, but the quality of your leads will increase because your reputation for being "more expensive but worth it" will discourage the low-price shoppers. You may find that your sales closing ratio gets better, since your prospects will already have a pretty good idea of what they're getting into when they hire you. Most important, you can become more selective about which jobs you actually take, which will help you stay focused on the projects that make the best use of your company's talents and are the best fit with your mission statement.

Scenario B in the same graphic illustrates this perfectly. The company increased prices by a couple of percentage points each quarter — nothing drastic, but enough to moderate demand slightly. It concentrated on closing the best prospects and meeting (not exceeding) its budgeted sales of two projects per quarter. The closing ratio climbed for few months from 1 in 5 to around 1 in 7 leads, then fell again in the fourth quarter, indicating less sales resistance as the quality of the leads improved. The owner decided to grow a little that last quarter and took on three jobs instead of the budgeted two, for a very controlled annual growth of around 12 percent (nine jobs rather than the budgeted eight).

Look what happened to the company's profits as a result: They went through the roof! Because there was no massive ramp-up required in staffing, equipment, or other overhead, both direct costs and overhead stayed on budget for the entire period. And because the gradual price increase went straight to the bottom line, net profit percentage increased from the budgeted 10 percent to a little under 17 percent. Net profit dollars skyrocketed from the budgeted $80,000 for the year to $139,000. That's an extra $59,000 of pure profit over and above what was budgeted that can be used to improve the business or put in the bank for the next downturn.

As we've discussed in past columns, another option would have been to have lowered the sales budget and done fewer projects, or to have worked up to — but not beyond — production capacity and banked or invested the extra profit. The point is that options do exist, and by taking advantage of them, you stay in control of your operation instead of letting it control you.

## Old-Time Wisdom

So there's the old-timer's secret: Slow and steady wins the race. Of course some buyers will be lured in by lower prices or the notion that "They're really busy — they must be good," but few make that mistake twice. An experienced buyer of contracting services recognizes value in a company that is careful not to take on more work than it can efficiently produce.

In other words, you have to earn the privilege of charging more. If you establish a reputation for creating extra value for your customers, budgeting carefully, working efficiently, maintaining a tight schedule, minimizing callbacks, and watching your dollars like a hawk, you will be rewarded with a backlog of buyers who are willing to pay a premium for your services.

JLC *contributing editor* ***Joe Stoddard*** *moderates the Business Technology forum at jlconline.com.*