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*Thank you for requesting this informational report. We hope you will find it to be both interesting and useful.*

## **Business Success By Knowing Your Numbers**

Want to know one of the quickest ways to put yourself out of business? Not knowing your numbers. Your financials tell the story of the true state of your business. They reveal the areas of your business that are excelling, but they also indicate where your business is doing poorly.

Right now, many of you are saying, "Who has time for numbers?" I understand you are very busy, but please keep in mind that these figures are easy to find — they're right on your profit and loss statement and your balance sheet — and with a few clicks of your computer's mouse, they can be retrieved in no time at all. Best of all, if you spend just 20 minutes each week reviewing your financials, you can get a realistic sense of your business status and thus begin to see your business and profit grow.

The first group of numbers to look at can be found on your profit and loss statement (P&L). Your P&L is the most recognized and most easily understood of the two financial statements. It is a picture of your business over time. The figures it contains, particularly the ones discussed below, tell you exactly how your business is doing, and the more often you look at them, the quicker you will be able to spot potential problems and opportunities.

- Sales: This figure tends to be the number most everyone looks at because sales are the lifeblood of a company. As an owner, you should be looking at this number frequently to make sure you are hitting your predetermined sales objectives. Knowing this figure will allow you to properly plan for future growth and manage your marketing, pricing, overhead, and workforce accordingly. But, please keep in mind that although your sales may be strong, it does not mean you are making money. This is why monitoring the following numbers is so important.
- Gross Profit Margin (GPM): This is the most important number to watch. As a contractor, you should be achieving a 30 to 40% GPM. This margin should allow for sufficient enough funds (cash flow) to cover overhead and still achieve a 5 to 10% net profit, assuming your overhead is in line with the industry average of 20 to 25% of sales. If your current GPM is within or greater than this range, then you are doing a great job running your business. If not, then you need to take a closer look at your estimating. You may be undercharging for your work (setting too low a mark-up) and/or under-calculating your labor hours and/or your material

and subcontractor costs. You might also want to take a closer look at your workers' productivity, as you may have an issue there as well.

- **Job Costing:** This should be monitored along with your GPM, and regularly too. Job costing allows you to drill down per project and compare actual results versus estimated results. With each job, you can clearly see what went right and what went wrong (in terms of labor hours and materials and subcontractor costs). This information gives you the ammunition to more accurately bid future projects as well as understand what projects to stay away from (because of their low GPM.) Job costing is an ongoing reality check.
- **Overhead:** These are your fixed costs — sales and marketing expenses and general and administrative costs — and they should be looked at monthly. As I said earlier, your overhead (indirect costs) should be 20 to 25% of your sales. If it is currently at or below this range, then you are doing a good job of managing your overhead. If it is higher than this range, then you should begin looking at ways to decrease it. Overhead creep can easily cash-strap your business in good times and quickly put you out of business if the economy slows.
- **Net Income:** This is your bottom line — the money that is left over once all your direct and indirect expenses are paid. This number should be monitored monthly, and as I mentioned earlier, your goal should be to achieve a 5 to 10% net profit. If you are achieving that, you are doing a great job of managing your company — keep it up. If not, you need to look at ways to increase sales, improve your GPM and reduce your overhead.

The next group of numbers you want to review regularly — your checking account balance, accounts receivable (A/R), accounts payable (A/P) and your break-even amount. These numbers can be found on your balance sheet or derived from figures on both your income statement and balance sheet.

Your balance sheet shows the financial state of your company on any given day — what your company owns (assets), how much it owes (liabilities) and how much equity you have in the business.

- **Checking Account:** The first asset you should constantly look at on your balance sheet is your checking account balance. You should always know exactly how much cash you have on hand, as it will allow you to make sound cash-related decisions both now and in the future.
- **A/R:** The other asset to keep your eye on is your Accounts Receivable. Your A/R is the amount of money that is owed to you. As a contractor, these accounts should never include residential customers who are over 30 days due. If they do, you need to contact these customers immediately and collect on these overdue accounts. As for your commercial customers, you should do your best to keep them within 30–45 days.
- **A/P:** On the liability side, you should regularly look at your Accounts Payable. Your goal is to pay your bills within 30 days. If cash flow allows, make your

payments early to receive early payment discounts. However, please keep in mind that — in general — your payables should be in step with your receivables. If you are receiving payments in 30 days, then you should be paying your bills in 30 days. This balanced approach will prevent a cash crunch.

- Break-even: Your break-even point is the amount of sales you need to make in order to pay all your bills and leave your company in the black (although without profit). Your break-even can be calculated weekly, monthly or yearly.

To determine your break-even amount, divide your overhead dollars by your gross profit margin. For example, if your monthly overhead is \$21,000 (be sure to include any owner's draws as well as vehicle and loan payments) and your gross margin is 30%, then your monthly break-even revenue is \$70,000 - \$840,000 for the year. If your gross profit margin were to drop to 28%, you would then need to produce \$75,000 in monthly volume to break-even, \$900,000 in yearly volume.

Please keep in mind that no profit can be made until your break-even point is met. And, if gross margin erodes even a few percentage points, it can really hurt your company's profitability.

The final group of numbers you want to review regularly — your cash flow and financial ratios. These numbers can be derived from figures found on both your income statement and balance sheet.

- Cash Flow: With small businesses, thorough cash management is essential. Cash flow projection will help you make short-term as well as daily decisions about where to spend your cash. It should represent a period of time up to 12 weeks ahead and it is a rolling projection – as one week drops off, you add a week at the future end to replace it.

A simple cash flow projector can be created in Excel. It consists of two segments – income and expenses. In the income section, you enter the name of each income source (jobs you have signed) and then insert the dollar amount into the week you expect to collect. You do the same for your direct and overhead expenses in the expenses section below it. You enter the names of the vendors you have to pay, how much you have to pay them and when. At the top of each column, you input the beginning cash balance in your checking account. At the bottom of the column, insert the ending balance. This negative or positive number then goes to the top of the next weekly column as negative or positive cash.

By updating your cash flow projection weekly, you can collect your money when it is due instead of a week or two later when it shows up on your aging report. If you see no income projected for a certain week, start making those sales calls. Cash flow projection also shows you when to save your cash, because you'll know when you will need it later on. It gives you the control you need over the critical cash flow part of your business.

Because cash flow maximization is so critical to your business' growth and overall success, I will share with you my top ten cash flow improvement tips.

1. Always state that your draws become due at the start of a phase rather than at its completion — for example, at the start of finish trim rather than the completion of drywall. This will free up two to four weeks worth of cash.
2. Have your customers pay for their change orders in advance – before the work is started – not at the end of the job. This will improve cash management as well as reduce the customer's final bill shock.
3. Split your final draw into two smaller draws, the first due at substantial completion and the second upon the completion of punch list items. This will help lower end-of-job stress for both you and the client.
4. Hand-deliver invoices and personally pick-up checks. This will make a major difference in your cash flow.
5. Make bill collecting a customer relations effort. Phone, talk with and meet the customer to clear up any confusion, answer questions and resolve problems quickly. This will boost customer satisfaction.
6. When you have bills offering early payment discounts, always pay by the due date for the discount. A two-percent discount will do wonders to overall company net profitability.
7. Pay all non-discounted bills on the last date that will maintain your company's good credit. This will provide you with the cash to pay discounted bills on time.
8. Subcontract rather than employ whenever possible. Subcontractors are paid much less frequently than your own employees and hiring them tends to reduce labor and materials overruns.
9. Consider a bi-weekly payroll. You will increase your cash flow as well as cut your payroll costs in half.
10. Open a line of credit with your local contractor-friendly bank. This can be used to smooth out cash flow bumps. Think of your line of credit as a short-term bridge loan – not a way to get out of financial trouble. The rule of thumb is to clean up your line of credit once a year.

So, there you have my top ten cash flow maximization tips. If you follow these simple guidelines, you will see a dramatic improvement in your company's cash flow, growth will be steadier and much easier to manage, and your level of stress will progressively decline.

- Ratio Analysis: Ratio analysis is another important success factor to monitor. Like cash flow, maintaining solvency (the ability of a business to pay its bills) is crucial for every business. The ratios you should be looking at are net working

capital, current ratio, quick ratio and debt-to-equity ratio. All these ratios can be derived from your balance sheet.

*Net Working Capital:* Total current assets less total current liabilities equals the net working capital of the business. Generally speaking, a positive number should be present for most businesses.

*Current Ratio:* Total current assets divided by total current liabilities equals a company's current ratio. Your current ratio helps you determine if you have enough working capital to meet your short-term financial obligations. A general rule of thumb is to have a ratio of 1.3 to 2.0.

*Quick Ratio:* Cash plus receivables divided by current liabilities equals your business' quick ratio. Also known as the "Acid Test," your quick ratio helps you gauge your immediate ability to pay your financial obligations. Ratios of 1:1 to 1.2:1 are generally considered acceptable.

*Debt to Equity Ratio:* The total debt divided by the total equity of the company equals the debt-to-equity ratio. Also called the leverage ratio, this is used to describe how much debt is used to finance the business. A ratio of .9:1 is a sign of a well-capitalized company.

To successfully run and grow your trades business, you need to thoroughly understand your numbers. This three-part series, "Business Success by the Numbers," should aid you. If you have a question about any of the topics I wrote about in this series, please feel free to contact me.

If you are serious about achieving outstanding business results, we suggest that you contact us to discuss how we can help you quickly and easily realize the success you deserve – we offer a free one hour telephone consultation. Please call (508) 480-0010 or email [klister@ParadigmStrategies.com](mailto:klister@ParadigmStrategies.com) to discuss our services in more detail.

I hope this report has given you some "food for thought". I appreciate your interest in our work and wish you much success in your future business endeavors.

Best Regards,

*Kevin Lister*

### **About The Author**



Founder and president, Kevin Lister, is a leader in the field of business performance improvement. He possesses nearly 20 years experience in business management and consulting, effectively operating his own ventures and assisting others with realizing business success. He spent two of those years working as a performance improvement consultant to Eastern European companies making the transition to a market economy.

With an entrepreneurial spirit and CEO's point of view, Kevin brings hands-on expertise to helping building contractors, sub-contractors, and other trades businesses. Kevin has deep knowledge and understanding of the trades, based on 14 years in the construction industry, a family history of owning trades businesses, and a genuine interest and enjoyment in helping blue collar enterprises.

Kevin possesses a Masters of Business Administration (MBA) from Olin Graduate School of Business at Babson College and a Bachelor of Science in marketing from Bentley College. He teaches management and marketing for the University of Phoenix Online.

Kevin is a member of several professional and business organizations, including the Institute of Management Consultants (IMC), the Associated Subcontractors of Massachusetts (ASM), the Builders' Association of Greater Boston (BAGB) and the Boston Chapter of the National Association of the Remodeling Industry (NARI).

Kevin has been awarded the Certified Remodeler Associate (CRA) designation from NARI. He has also been named to the board of directors of the Eastern Massachusetts Chapter of NARI.

### **About Paradigm Strategies**

Paradigm Strategies is one of the country's leading business consulting firms to the construction, automotive and motorcycle industries. Our clients include contractors, sub-contractors, auto repair shops, small auto dealerships, motorcycle repair shops, and motorcycle dealerships, as well as suppliers to these trades.

We are dedicated to helping small to mid-sized companies become more successful by improving sales, cash flow, profitability, productivity and competitiveness. With an understanding that each business is unique, we take an individualized approach when counseling our clients.

To every client relationship, we bring new ways of thinking, new ideas and a straight forward approach that ensure and consistently deliver positive changes and significant results. Based on your needs, business goals and an internal assessment of the issues that are inhibiting growth and success, we develop a customized, strategic program plan that provides you with focus and momentum, and enables you to create the future you envision for your company.