Keep What You Earn: How "Cost Triggers" Protect Profit
by Garrett J. Sullivan

Full, unedited article

It feels like a dirty trick — you increased your company's sales volume for the year, but made less profit. Your crews worked harder than ever, but your bottom line actually shrunk. Sound familiar? If so, you're not alone. If you'd like to keep more of what you earn, consider using the following three precepts. They're simple, yet profound:

I. Plan Your Profit: It sounds basic, but it's not. Many of us fixate on gross income to the exclusion of the bottom line. It is only at year end that we "discover" what our profits were. Try turning this model upside down. Shift your focus to the net income by establishing a specific dollar amount as your "Annual Planned Profit". By clearly defining this to your management, you can collectively track your progress toward the final goal.

II. Try Adaptive Budgeting: In times past, a single budget was sufficient, but in today's tough economy, with contractors moving in and out of geographical areas, the more savvy contractors are preparing numerous budgets. Can your budget accommodate sudden, real-life situations such as a bad or cancelled job, a labor strike, material shortages, and/or unanticipated material cost escalations? When you face something like this — and we all have — you'll be too busy dealing with the situation to take notice of your budget. That's where the bleeding usually begins. In contrast, if you pre-determine appropriate cost-cutting measures (e.g., "cost triggers"), your likelihood of achieving your Annual Planned Profit goes up exponentially.

III. Establish Cost Triggers: This is the crux of adaptive budgeting. A cost trigger is a preset cost reduction from your annual budget that is implemented when the actual profit to date is not on target. There are two types: senior management cost triggers, which may or may not have employee buy-in; and employee cost triggers, which are democratic and almost always have employee buy-in.

Senior management cost triggers are reductions that can be immediately deployed without approval. These include wage or hiring freezes, reduced vacation, or reductions to expenses such as advertising, company vehicles, charitable donations, or office supplies.

Employee-agreed triggers are established through a series of meetings between senior management and staff. Employees brainstorm a list of cost-saving measures and vote upon the order in which they will be implemented. Options can include reductions to the 401K match, reduced employee training or tuition reimbursements, or cutting bottled water delivery etc.

When the staff agrees on the triggers beforehand, it lets them make their personal plans in a more orderly and less stressful environment. Additionally, it creates a sense of “Ownership Thinking” because they are actually participating in the tough decisions — and are personally vested in the company’s outcome.

Here’s an example: A contractor’s Annual Planned Profit is $1.2 million. At the end of the first quarter, the actual profit to date is $200,000 instead of $300,000. At this point, the company launches its senior management triggers. If these don’t bridge the $100,000 gap, the company initiates the employee-agreed triggers until the shortfall is covered. Depending on the size of the company, the cost triggers can be relaxed as the Planned Profit returns to target.

As one of 12 members in a nationwide construction industry peer group, I’ve observed some significant anecdotal evidence to validate this approach. Within the group, 10 companies regularly use cost triggers. Every one of them reached their target since adopting these approaches. Many CEOs in the peer group also believe that with democratic, employee-approved cost reductions in place — and the staff’s attention on reaching the Planned Profit – a certain “magic” helps to avoid the triggers from going into effect. One company in the group had great financial challenges last year and was forced to employ all of its cost triggers. The following year, the CEO was able to give everything back that the employee sacrificed.

In my observation, utilizing cost triggers has created outstanding results. It does require a new level of transparency. A company must adopt a certain amount of open book management. One alternative to hard dollars is to track the Planned Profit by percentages. Some owners are more comfortable than others on this subject, and each company needs to decide what works best within its corporate culture.

Is it time for you to update your annual budget? To download a free budget template or sample cost trigger document, go to www.sullivanonline.com. You just might surprise yourself at how well you can control your company’s bottom line, despite the turbulent environment around you.

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