

Does Every Project Achieve Your Planned Profit?



BY GARRETT J. SULLIVAN

For many years, people wondered what made Big Macs™ taste so good. The McDonald's Corporation refused to reveal its secret sauce, fearing competitors would copy the recipe. Recently, a chemist reverse engineered the secret sauce recipe and revealed to the world that it's nothing more than everyday spices and oils.

What does this have to do with your business making a profit? Everything. Your business—and every other business out there—follows a certain “recipe” in the way it behaves. This is your own secret sauce. How do you select and bid new projects? How well do you handle day-to-day workflow? Are your employees motivated? Each facet of your business is an ingredient. Just like McDonald's, your success comes with the right blend of ingredients—and delivering that same, reliable product every single time.

Savvy contractors have followed the construction industry's secret recipe to make a profit on every job.

Surprisingly, it is very similar to the Big Mac™ recipe—it's so simple that it can get overlooked.

There are only seven ingredients: four are lagging indicators and the rest are leading indicators. Lagging indicators are financial, historical results (e.g., last month's job costs, schedule results, billings, etc.). By the time these are reviewed, the owner and project manager (PM) usually have little or no control over the results. Leading indicators can be financial or operational (e.g., over/under billings, total cost to completion, projected cash flow, etc.) and can be projected while the owner and PM still have significant control over the results.

Combined, the most important leading and lagging indicators of a project are key performance indicators (KPIs) and should be forecasted, monitored and published by the individual who has the most influence over them, usually the PM.

The secret sauce recipe's four lagging indicators:

- Actual cost versus baseline costs. Your job costs need to be updated weekly and should be 100 percent accurate. This includes any change order work you may be proceeding with but, have yet to be approved.
- Actual schedule milestones accomplished. It is critically important that a job remains on schedule. This is a major area where profits can fade. Constantly strive to get back on schedule if you fall behind.
- Productivity to date. Do each and every one of your field workers know the amount of production required of them each day? If not, they should. Otherwise, how do you expect them to know if they're causing the job to fall behind?
- Cash flow to date. The project schedule, in combination with the budget, produces a cash flow projection. Monitor this carefully to ensure positive cash flow with a focus on profit throughout the job.

The secret sauce recipe's three leading indicators:

- Projected total cost to completion. This number helps keep the focus on where the job is going and should be an early warning sign to allow the PM to adjust as necessary.
- Projected completion date. All jobs need to finish on or before the completion date. It is very rare that a job that finishes early does not make at least the planned profit or more.
- Projected cash flow. Owners need to emphasize to PMs the importance of making sure invoices are timely and that there are zero obstacles to being paid promptly.

As with any good recipe, it is very important that you follow the directions carefully each and every time. Measurement is extremely important; what gets measured in construction gets performed. The above “ingredients” should be reported to senior management by the PM each month with a forecast for the next month. This should become a standardized process in the company, allowing you to continually monitor the profitability of each job.

How accurate are your measuring devices these days? Now is the time to recalibrate them to keep your profit margins predictable and to remain competitive well into the future. **BI**

For more reading on this subject, please visit www.SullivanHi.com. Garrett Sullivan is the president of Sullivan & Associates Inc., a management consultancy focusing on the construction industry in Hawaii. Connect with him at GSullivan@SullivanHi.com, www.SullivanHi.com or (808) 478-2564.