Managing Your Key Financial Numbers

To improve your results!

An article by Alan Sparkman

Most contractors like numbers – dimensions, elevations, even unit costs – but many don't spend enough time with the critically important numbers on their financial statements. Successful contractors need to be able to read their financial statements as well as they can read a blueprint.

Continue >

The goal of this article is not to transform you from contractor to accountant but to point out a few of the key financial numbers and concepts related to your Income Statement (also called your Profit and Loss Statement) that you need to understand to better manage the business side of your company.

Some of you are saying, “The only number I have to worry about is the bottom line!” Fine. Would that bottom line be gross profit, operating profit, earnings before taxes or earnings after taxes? And are you referring to just your current job or all the jobs you do in a year or a quarter? Let’s take a quick look at these important profit milestones, and introduce two types of costs that every business has to handle in order to really produce a bottom line profit. First, let’s define our terms since different accountants often refer to these items by different names.

Most contractors don’t spend enough time with the critically important numbers on their financial statements.

Income Statement Terminology

Revenue – all income from all sources for your business. For contractors this typically comes in the form of payments or draws from your customers as you complete work on a specific job. You may also have income from other sources such as equipment rental or perhaps management fees. Sometimes you have income from the sale of equipment or property and your accountant may classify this as Other Income instead of lumping it in with your revenues from normal business operations in order to give a clearer picture of where your income is being generated.

Using these terms, we can construct a simple Income Statement that applies to nearly all businesses, including contractors.

Variable Costs - the costs that apply only to a specific job and that you don't pay until you do that job. For contractors, examples would include the cost of materials, labor, subs, equipment rental, supplies and so forth that are used on a specific job. Manufacturing businesses may refer to this as the Cost of Goods Sold, and most businesses do a pretty good job of putting these items into their prices.

Fixed Costs – The costs that you have to pay whether you do one job, twenty jobs or no jobs. These are the costs that often get overlooked when pricing a job but that doesn't mean you don't have to pay them!

- Some Fixed Costs apply mostly to one particular job - supervisor salary, jobsite utilities, etc. These are often called Direct Fixed Costs, or you might refer to them as Project Overhead.
- Some Fixed Costs apply to all your jobs – office manager salary, insurance, office phone, bad debts, office rent, marketing – and these are often termed General and Administrative Fixed Costs, or perhaps just General Overhead.

Gross Profit – What is left after the customer pays you and you pay Variable Costs. This is often referred to as Margin or perhaps Spread. We will refer to this as Margin for the rest of the article.

Operating Profit – What is left from Margin after you pay Direct Fixed Costs

Earnings Before Taxes – What's left from Operating Profit after you pay General and administrative Fixed Costs

Earnings After Taxes – What's left from pre-tax Earnings (or Earnings Before Tax) after you pay Uncle Sam, Uncle State (fill in the name of your Governor here) and maybe your local Uncles. For most businesses, this will be about 40% of your Earnings before taxes, but it might even be higher. This is the real Bottom Line.

Having more detailed lines in your income statement will begin to reveal much more clearly where your money is going and where you may need to direct your attention to increase your bottom line.

Using these terms, we can construct a simple Income Statement that applies to nearly all businesses, including contractors. Your Income Statement will have more lines of detail, but you should be able to classify all the lines on your Income Statement into the basic categories we have described. *This is important because it will begin to reveal much more clearly where your money is going and where you may need to direct your attention to increase your bottom line.*

Here is a sample Income Statement based on $100 in Revenue along with a percent of revenue column for each line item. The percentage information is very useful as you compare one project to another, or as you compare one time period to another, or for trend analysis of your Income Statement over a period of years. Revenue is the baseline for the percent of sales view so it is listed at 100%. All the other lines are expressed as percentage of sales. By comparing these percentages you begin to get a picture of how your Revenue dollars are being spent and you can easily see when one part of your business changes relative to everything else.

Sherpa Concrete	2004		2005	
Revenue-(Monthly, quarterly, annual.)	$100	100%	$100	100%
Variable Costs	($70)	70%	($69)	69%
Margin (this is NOT the 'Bottom Line')	$30	30%	$29	29%
Direct Fixed Costs (or Project Overhead)	($10)	10%	($10)	10%
Operating Profit	$20	20%	$20	20%
General & Administrative (or Gen. Overhead)	($10)	10%	($10)	10%
Earnings before Taxes	$10	10%	$10	10%
Taxes (Assumed to be 40%, will vary)	$4	4%	$4	4%
Profit after Taxes (the famous "Bottom Line")	$6	6%	$6	6%
(Red numbers=negative)				

Keeping the sample Income Statement in mind, here are some tips for how you could use this information to better manage your business and increase your Bottom Line:

We have defined Gross Profit or Margin as the difference between Revenue and Variable Costs. **If you could only look at one line on your Income Statement, this is the line I would recommend.** Without a sufficient margin, you won't have enough money to cover your Fixed Costs and you won't make any money. Probably the biggest reason that businesses fail is that they confuse Margin with Bottom Line Profit. At the Margin line there are still a lot of bills to pay – including your own salary as manager of your business! Besides that very important item, you still have to pay rent on your office, your accountant, insurance on your equipment, utilities, truck payments – and this is not even close to being a complete list.

The real question at the Margin line is how big it needs to be to cover all those remaining costs and leave something for the Bottom Line. That's where the percentage view of the Income Statement pays off. If you analyze your income statements for several years you should be able to see how your Margin is changing and you can begin to establish the minimum Margin you need to cover your Fixed Cost and produce a positive Bottom Line. If your present income statements (you do have something besides just tax returns – right?) aren't providing this kind of information that should be your first action item.

Another important tip about Margin. There are really only two ways to make Margin increase. One is to increase your Revenue (that means you may need to charge more for your work) and the other is to reduce your Variable Costs. Too many businesses focus on reducing Variable Costs without paying any attention to the Revenue side of the equation. Once you know what kind of Margin you need, that should become your primary filter for what jobs you want to pursue. If you know it will take a bid that produces less than your desired Margin to get a job you need to take a close look at whether or not you really want to pursue that project. Knowing in advance what Margin you need prevents you from wasting resources pursuing jobs that will end up not being profitable at the Bottom Line.

Probably the biggest reason that businesses fail is that they confuse Margin with Bottom Line Profit.

Once you get your margin goal established, you can spend more time studying the other line items on your Income Statement. You should be tracking the percentages of both Direct Fixed Costs (project overhead) and your General Overhead items to see if they are going up or going down as a percent of sales. Those items that are increasing need some management attention to see if you can reduce them. Any reductions you can make in Overhead items will increase your Bottom Line so this is time well spent.

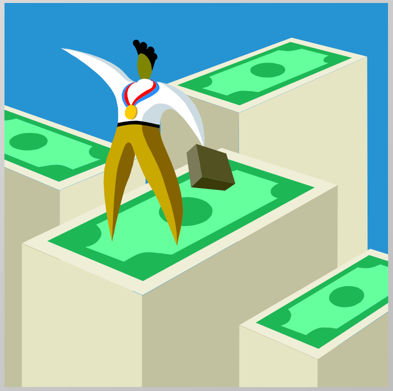
Sometimes you won't have much control over lowering an Overhead item. Insurance costs might be one example. However, if you see that your insurance percentage is beginning to creep up that should be strong signal that you need to increase your revenue enough to make up for the extra insurance costs. Remember, if your Fixed Costs are going up while your Margin is staying the same, your Bottom Line is shrinking. Many times the only way to address this problem is to increase bid prices.

Remember, if your Fixed Costs are going up while your Margin is staying the same, your Bottom Line is shrinking.

There's a lot more your Income Statement can tell you about how to better manage your business – make it a point to sit down with your accountant and discuss how you can wring more information out of your financial statements. If possible, try to set up an income statement for each individual job so you can compare your line items not only from time period to time period but from job to job. This should help you identify the types of jobs that produce a bigger Bottom Line.

And finally, use your newly discovered Income Statement knowledge to answer a very important question. First, think about the kind of return you want when considering an investment of your money. It is generally accepted that an individual can put money in stock investments and reasonably expect an average return of 10 – 12% if the investment is kept at least five years. Most of us would be unwilling to invest in any venture that didn't offer at least that rate of return.

Now look at your income statement and find out what kind of return your business is generating at the Earning before Income Taxes line. Is your business delivering a return that at the very least equals what you would demand from your other investments? If the answer is 'No' you need to begin applying your new-found knowledge right away to make your next Income Statement produce a return that changes the answer to 'YES'!



Sherpa info

HOW YOU CAN USE THIS DOCUMENT

You have unlimited right to print, distribute, and use this guide. E-mail it to a friend, put it on your website, or any other ideas you see fit. You can print it and post it on a job, at your favorite coffee shop, in your office, or get creative and engrave it in concrete. Please share freely, the only things you may not do is alter it or charge for it.

COPYRIGHT INFORMATION

DOWNLOAD GUIDE

This guide is available on line at http://www.concretesherpa.com/finances.

EMAIL TO A FRIEND

Click here to pass the guide along to someone cool.
http://www.ConcreteSherpa.com/email/finances.

SUBSCRIBE

Learn about the latest Sherpa Guides and other concrete information available in the Concrete Network's Newsletter. http://www.ConcreteNetwork.com/newsletter.htm

Sherpa info

SUMMIT DATE

This document reached the summit (was created) on June 7, 2005 and is based on the best information available to the Sherpa at that time. To check for updates please click here http://www.ConcreteSherpa.com/finances.

NAVIGATION & USER TIPS

You can move around this guide by using your mouse or keyboard arrows. Left mouse button goes to the next page, right mouse button goes to previous page. Click on the right arrow (→) for the next page and the left arrow (←) to go the previous page.

KEYBOARD SHORT CUTS	PC	MAC
Zoom in (Larger)	[Ctrl] [+]	[⌘] [+]
Zoom out	[Ctrl] [-]	[⌘] [-]
Full screen/normal screen view	[Ctrl] [L]	[⌘] [L]

ABOUT THE CONCRETE SHERPA

The Concrete Sherpa is a team of people that represent the experience, teaching and learning of our team members and other industry leaders *on a mission to make life better for the concrete contractor*. We are an idea center striving to deliver thought provoking ideas based on “Concrete Advice for Business and Life” to stimulate you to reach new heights. As a user, you should remember to consider all information you receive, here at the Concrete Sherpa or elsewhere, not as a *cast in concrete* recommendation, but rather as an idea for you to consider and ponder.

Sherpa info

THE JOURNEY LEADING TO THE CONCRETE SHERPA PROJECT

The Concrete Sherpa Project (A Sherpa is a “guide”) was born at The Concrete Network in mid 2004. Here is how it happened:

The biggest surprise, or gift, since starting The Concrete Network in 1999 has been the concrete contractor friends from around the country we’ve made and witnessing the passion they have for what they do. These people include Dave Pettigrew, up in the San Francisco Bay Area, or the Verlennich brothers in Minnesota, or Bob Harris in Georgia, the list goes on and on. It’s quite inspiring.

We were once asked, “How are you so excited every day about concrete?” Well the answer is simple, it is impossible to not be excited about concrete when you have the job we do- interacting with hundreds of concrete contractors from every state in the country.

The thing we’ve learned about concrete contractors is that most are passionate *craftsmen*- they are often less passionate and experienced in the “office stuff”. Human nature channels us to do what we are most comfortable with; learning how to use a new saw-cutting tool is comfortable; learning and implementing a new estimating strategy, or job management tool, is not so comfortable.

Sherpa info

THE JOURNEY CONTINUES…

So Sherpa was born to provide FREE and easy to use information on topics many contractors are not too comfortable with.

- Concrete Sherpa is here to provide help to contractors who are often ‘Lone Rangers’ and don’t have anyone to get solid business advice from.
- Concrete Sherpa is here to provide help for contractors who have to work too hard and too many hours in their business, and one day realize they need to work *on their business, not in their business.*
- Have fun with Concrete Sherpa and go faster towards reaching success than you might have on your own.
- To skeptics who think something free can’t be valuable, or there must be a trick- visit Concrete Sherpa and decide for yourself.

We hope you make great use of the Concrete Sherpa and it helps you to become an awesome success for yourself, your family, your church, and your community.

VISIT THE CONCRETE SHERPA

To visit the Concrete Sherpa click here http://www.ConcreteSherpa.com.