

Remodeling's Deadliest Sins

Nine common business mistakes and how to avoid them

by Tom Swartz

By my reckoning, more than half of all remodelers lack the knowledge needed for success in business. They either don't understand basic numbers like overhead and gross margin, or they don't use those numbers in their decision-making. Time after time, they base major decisions on opinion or gut feelings — not on good systems and objective measurements.

My conclusion comes partly from my own experience and partly from in-depth conversations with hundreds of remodelers. I have taught more than 100 certification courses and countless short seminars, where I've listened to attendees talk about their struggles to make a profit. Some of my 35 employees have been self-employed in the past, and they've told me about their uphill battles to stay in business. Everyone tells the same stories.

I've drawn on those stories and experiences in compiling the following list of the remodeling industry's nine most common business sins. All are potentially deadly, with consequences ranging from personal burnout to business failure. If they don't kill a company, they will certainly keep it from growing. Even experienced contractors make these mistakes. I know I do — even though I've been in the business for more than three decades and manage a \$4.5 million company.

So think of the items in this list as red flags. If any of them pertain to your company, address them immediately.

1. Pricing competitively
2. Using a poor payment schedule
3. Saying, "I'll make it up on the next job"
4. Saying, "I've got \$20,000 in the bank — some of it has to be mine"
5. Operating without a growth plan
6. Biting off more than you can chew
7. Not having clear job descriptions
8. Refusing to delegate
9. Clinging to misplaced loyalties

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Pricing competitively

It may sound counterintuitive, but if you price jobs based on what you think the competition would charge, you're playing a no-win game.

To charge enough, you need to know your job costs, overhead, and labor burden. Your labor burden consists of any production expenses you cannot charge directly to a job, including employee benefits, bonuses, truck expenses, and tools.

Once you understand your costs, you need to know how much to mark them up.

Yes, you have to stay competitive to stay in business, but competitiveness is more than just price. You have to learn to sell yourself, your company, and then the project, in that order. A truly competitive company is one that customers hire for its reputation for quality, reliability, and integrity.

2

Using a poor payment schedule

More than any other business blunder, poor payment schedules are what give remodelers a bad name. Typically, the remodeler runs out of money before finishing a job; then he starts a new job to get a down payment and maintain cash flow. Too often, the result is what customers call a 98 percent company — one that makes a strong start on jobs but has a tough time finishing that last 2 percent. Earning a reputation for leaving jobs unfinished is the deadliest sin of all.

We fell into this trap on a job we did in the mid '90s. At the end of the project, the customer owed us \$17,000, but the only outstanding items were a faucet and a special-order panel. I sent my head sales guy over to tell the customer that she could hold back \$1,700 but had to pay the rest. He came back looking like a whipped puppy. The customer had told him in a very nice but firm tone that if she couldn't get us to finish the job owing \$17,000, she'd never get us to finish owing only \$1,700.

That experience taught us the importance of having clear payment schedules for all jobs. Say

we're doing a \$30,000 room addition. We get \$5,000 at the contract signing plus any money needed for special material orders. We get another \$10,000 when we start work, \$10,000 when we start the dry-wall, and the final \$5,000 at completion.

The payoff is that we are never called a 98 percent company.

3

Saying, "I'll make it up on the next job"

Remodelers often take work at discounted prices to keep their crews busy, or they do extra work without charging the customer. The rationale in both situations is that the company will make up the money later. That almost never happens.

My company doesn't like to lay people off, so in the past when times were slow, we took jobs at cost — or at cost plus 10 percent — just to keep everyone busy. The last time we made this mistake was in 2001, when we reached out to past customers and offered to do some larger projects for them at a "deep discount." We did three such jobs and lost over \$100,000 combined. In each case, we thought we would make up the loss on the next job, but we never did.

How do we handle slowdowns today? If work is slow, we might need to cut everyone's working hours by 10 percent to 20 percent or go to our trade contractors to get job-cost concessions. But we take jobs on our terms or not at all.

4

Saying, "I've got \$20,000 in the bank — some of it has to be mine"

It's easy to rationalize using business funds for personal expenses. But a business owner who monitors job costs and expenses — and manages his company according to numbers rather than hunches — is much less likely to indulge in this

kind of flawed thinking. It's most common among small contractors who see money in the bank for the first time, but owners of more established companies are also vulnerable.

I'm no exception. At the beginning of 2001, my company had some cash reserves in the bank. We hadn't touched it for a while, and I was feeling burned out, so I decided to use some of it to travel with my wife. After all, we "deserved" it. I took a good chunk of the money and went on an extended vacation. During that time, interest rates rose and sales fell. Had I not touched the money, my company could have used it for operating expenses; instead we ended up having to borrow money at a relatively high interest rate.

I was lucky. I know one contractor who used \$15,000 of the \$20,000 in his business account to buy a hot tub and make a down payment on a new car. Despite working 60 to 70 hours per week, he went out of business a year later, and now works for me as a salesman.

The solution? Have a written business plan and a written budget with a minimum cash reserve, and stick to it.

5 Operating without a growth plan

A good business plan details, in writing, how much you want to grow and how you will get there. I knew a remodeler who wanted to increase his annual volume from \$300,000 to \$450,000 but had no plan for how to make that jump. He simply sold the extra work and put on his toolbelt. He had no systems in place to manage the extra volume, and before long he found himself in trouble with back taxes. A year later he was out of business.

This is typical. If you want to grow, you need to decide how much you want to make, the sales volume you need in order to reach that level, and how you will get those sales. Just as important, you need to think through how you will manage the extra work, set benchmarks to gauge your progress, and find someone to hold you account-

able. (I recommend joining a peer group or hiring a business coach.)

The greater your volume, the more important it is to have documented systems and processes. I tell people who want to grow their business to rethink their 10 most important processes — how they answer the phone, for instance, or how they get clients; their sales process; their payment schedules; their billing systems; and so on. I also advise them to identify all their expenses, including the owner's salary; to decide how much profit they want to make; and to determine how much markup they need to pay for it all.

Make sure you have a plan. And — I can't emphasize this enough — make sure it's based on data, not opinion.

6 Biting off more than you can chew

Remodelers sometimes base their decisions to take jobs on fear or uninformed optimism, rather than on their business plan. They usually choke on the result.

For instance, my company's forte is room additions, kitchen remodels, and fire restorations — but in 2002 we took on a whole-house remodel with a room addition because we were worried about the future and had decided we needed more sales. We figured the project's \$400,000 budget was high enough to guarantee a profit.

We couldn't have been more wrong. We lost control of the job, going so far as to let the customer hire our subs direct to keep costs down. We still had to schedule and manage the subs, but since we weren't able to mark up their costs, we didn't get paid for doing so. We knew this ahead of time, but the job had so many potential dollars attached to it, we couldn't let it go.

Although it should have taken only six months or so, the job dragged on for a year. In addition to costing us more than we charged the customer, it put our staff under unnecessary stress for months.

Stick to your business plan.

7

Not having clear job descriptions

As they grow and take on more employees, many remodelers fail to clearly define each employee's responsibility. For example, until about 10 years ago we didn't spell out whether the production manager or the lead carpenter was responsible for closing out a job. We assigned this responsibility on a job-by-job basis — again, managing by opinion rather than by system. As a result, we were finishing jobs late and antagonizing customers.

Today we know exactly who is responsible for what. Our production manager doesn't go out into the field and doesn't interact with customers. He gives our lead carpenters the support and manpower they need and helps them solve problems, but the lead on each job is totally responsible for getting the work done.

Our lead carpenters line up subs, order materials, manage the schedule, collect payments, and keep the job within budget. And they don't get paid their bonuses until the customer signs a certificate of completion.

We no longer have unfinished jobs.

8

Refusing to delegate

Growing means learning how to delegate. We've all heard how important this is, but even experienced contractors can fall back into the trap of doing everything.

I went through a period a few years ago when I insisted on doing all of my company's hiring. During the course of a few months I hired three receptionists, all of whom failed dramatically. Finally I turned the responsibility over to the managers in charge of the office — the people who would actually work with this person. They hired a receptionist who's been with us for three years now and has, in fact, been promoted. Now I leave the hiring to the head of the team that the new member will join.

It's important to recognize the difference between delegating and dumping. A person who

knows how to successfully delegate gives people everything they need to succeed, from training to follow-up. That means checking in with them periodically and giving them benchmarks to gauge their progress.

In our company, the hiring process includes a 17-question interview process plus drug and criminal background checks. For management hires, we use a 210-question test by Caliper (www.caliper.com). It determines whether a candidate is a good match for the job and the company, and I've found its results to be quite accurate. This kind of support prepares the hiring team for success rather than setting them up for failure.

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Clinging to misplaced loyalties

Breaking up is hard to do, but sometimes it's necessary. I learned that 20 years ago, when I had a production manager I really liked whose salary was more than I could afford. When interest rates spiked and we were looking for ways to cut costs, I realized I had to let him go.

After he left, I found out he had a history of shooting down ideas employees had offered to improve business. As a result, they had stopped taking initiative. That changed when he left, and the other employees stepped up to the plate and got us through the hard times.

As the owner, you need to ask yourself if you have the hard edge it takes to make your business successful. Having this edge means being willing to make tough — even painful — decisions to keep your company in business and profitable. Most likely, you'll face such a decision when you have to eliminate a key person on your team. You have to resist the feeling that you owe your employees something, and take personalities out of the equation.

In short, you need to run your business as a business.

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