

Improving Contractor Profitability through Accounting Software

Key trends & patterns...and where to find them

By Kurt Koenig



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Construction accounting software has been around for a long time. Twenty or thirty years ago the emphasis was on automating back office processes (things like payroll, accounts payable, and billing) and keeping track of business activity by producing reports like financial statements, supporting schedules, and job cost reports – essentially retrospective “scorekeeping.”

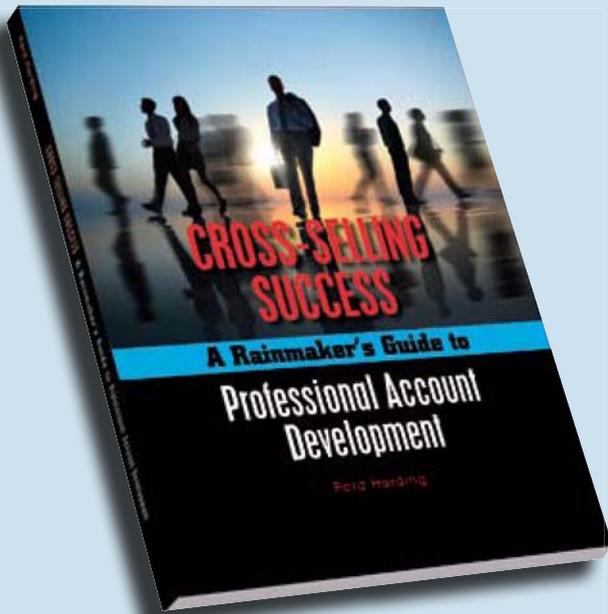
Not to say that retrospective scorekeeping hasn't always retained great value. My family has been in the construction business since the early 1920s, and I have heard stories about the “shoebox” method of accounting: the contractor kept a shoebox on the top shelf of his closet. When a customer paid, he put the money in the shoebox. When he had to pay employees, subs and suppliers, he took money out of the shoebox. If there was money in the shoebox at the end of the year, it was a good year. If the shoebox ran dry, it either meant closing the doors or raiding other sources of funds to keep the lights on. This analogy extended to larger firms – they just substituted a checking account for a shoebox. If this sounds crazy, consider that the practice of including job schedules in standard contractor financial statements, even in very large firms, was not widely adopted until well into the 1960s.

Early computerized construction accounting systems offered the ability to see which jobs made money and which lost money, and which operations within the jobs came in over or under budget. This was a major step forward. Being able to monitor profit and loss separately from cash flow was also very helpful. When the shoebox was running low, it would have been helpful to have payment and collection cycles on our generally-profitable jobs to prevent a temporary crisis, or we'd worry that we were just flat-out losing money. Today we can quickly produce reports that will show our banks, sureties, suppliers and other sources of credit that we're on solid footing.

Measuring profit by job and monitoring cash flow are basic functions that every contractor expects from his accounting software. Terms like “business intelligence” and “analytics” reflect the need to mine the information stored in accounting (and other) systems to identify exceptions, trends, and opportunities to look forward and backward, and use the results to improve performance, profits, customer service, and new sales.

Following are some examples of the types of information today's contractors are using to produce the results they need, and the most effective ways of delivering that information to the people who need it to do their jobs.

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Key Performance Indicators

The specific pieces of information that reveal these exceptions, trends, and opportunities are often referred to as "metrics" or "Key Performance Indicators" (KPIs). Each KPI has attributes that dictate how and when you should look at it. To be reliable, each has certain prerequisites in terms of the information that needs to be kept up to date in the underlying systems. Important attributes include:

- **Volatility:** Some Key Performance Indicators can change day to day and demand immediate action. For example, production on labor-intensive jobs, cash position, open issues, RFIs, etc. Others can be dependent on cycles, like payroll process or accounting closes.
- **Trends:** Changes over time can be very important for certain Key Performance Indicators, less so for others. For example, one contractor we know highlights his jobs with the largest change in projected gross margin as part of their month-end closing process. This is a simple comparison of last month to this month. His highlighting triggers immediate investigation of those jobs. Other data points, like repair work order revenues for a service organization, may warrant analysis over longer periods – months, or even years – and be a factor in longer-term planning.
- **Patterns:** Analyzing profitability is a great example of seeking patterns. Which customers, types of work, project managers, geographic regions, etc. are most (or least) profitable? Here, again, this information is valuable input for longer-term decisions about where to focus your business development and bidding efforts.

KPI Examples

The following are a few examples of Key Performance Indicators, grouped by category.

Resources

Cash and Working Capital

- **Cash:** at the most basic level, a readily-accessible picture of which jobs and business units are contributing cash to, or demanding cash from, the company. This can be looked at several ways, all of which may be helpful to summarize by project manager, customer, business unit, etc. to identify best and worst performers.
- **Cash position:** at this point in time, is this job cash positive or cash negative? Show me the jobs (business units, project managers, customers, etc.) with the largest negative cash positions...
- **Payable/Receivable status:** how do open AP and AR balances stand for this job? Too much open AR might spur collection actions, or might be an indication of overbilling (see below).
- **Working Capital:** available cash and overall company operating liquidity. Highlights potential issues with your ability to pay employees, vendors, and creditors in the short term. Often calculated as follows: Cash + Available Line Of Credit + Current Assets – Current Liabilities.

Manpower

- A comparison of projected labor requirements (remaining hours on all labor activities, possibly adding in anticipated labor for jobs in the bidding stage) with available headcounts by employee type.

Equipment

- A comparison of projected equipment requirements (remaining hours, days, etc. on all equipment activities, again possibly adding in anticipated equipment use for jobs in the bidding stage) with available pieces by type of equipment.

Project Management

Change Orders

- Analysis of open (unapproved) change orders, with emphasis on risk exposure. For example, show me the change orders not-yet-approved by my customers on which I have spent money or issued commitments in the form of purchase orders or subcontract change orders.

Labor

- Analysis of labor activities or cost codes, also with emphasis on risk exposure. For example, show me the labor codes which have the largest unrealized cost variance (projected variance minus job-to-date variance).

Project Administration

- Contractors are demanding accounting software that also tracks important project documents, such as submittals, requests for information, issues, etc. that might impact cost or revenue, and certainly refer to information in the accounting system like vendors, subs, employees, customers, and jobs. For example; show me all the requests for information where the response is past due. Show all requests for information responses due today/this week/next week; show me all the requests for information that are linked to a potential (or approved) change order.

Service Management

Maintenance Contracts

- Expiring contracts: for contractors with service operations, long-term service agreements or maintenance contracts are an important source of recurring revenue. The ability to quickly see which contracts are due to expire in the near future helps the contractor's sales team focus its efforts on obtaining renewals.

Work Orders

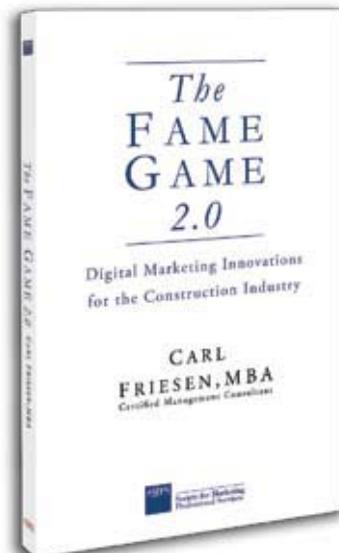
- Unassigned work orders: customer satisfaction is key to retention and repeat business, and timely response on service work orders is key to customer satisfaction. Visibility of unassigned work orders helps dispatchers and service managers make sure nothing is falling through the cracks.
- Unbilled work orders: my contractor father liked to remind me "cash is king!" Shortening the service-to-cash cycle and reducing days to sales outstanding are very important to all contractors. In the service department, highlighting unbilled work orders helps billing personnel and service managers keep the cash flowing.

Workforce Management (Payroll and HR)

Employees

- As construction activity picks up, contractor attention is refocusing on what had been the number one issue in construction before the downturn: personnel. At all levels from the office to the field, the industry is justifiably concerned about attracting and retaining qualified people to support increased volume. Because of the overlap between payroll (typically a component of the accounting system) and HR, contractors expect systems that can maintain and expose an expanding array of employee information. The following are two examples of Key Performance Indicators that bear on employee qualification:

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- **Employee Certifications:** many labor-intensive contractors must keep track of employee licenses, certifications, and security clearances that need to be kept up to date and renewed. Visibility of expiring certifications helps HR managers and personnel follow through to ensure timely renewal. Also, the ability to quickly identify which current and/or formerly active employees possess a given certification helps staff up new jobs.
- **o Training classes:** contractors need to maintain their employees' knowledge and skills across a variety of domains. For example, safety is a huge priority in construction. Safety and HR personnel need to stay on top of which training classes are offered, which employees have attended, what classes are upcoming, and which employees need to attend those classes.

Payroll

- Payroll processing can be a substantial administrative burden for labor-intensive contractors with tangible and intangible penalties for late payment, inaccurate calculations, and other issues. Catching exceptions in payroll speeds the process and reduces rework and other avoidable expenses. Key Performance Indicators like these help payroll personnel identify issues before they become problems:
 - Employees missing timecards
 - Employees with fewer than 40 total hours and some overtime hours
 - Employees with more than 40 regular hours

Delivery and Presentation

The examples we've discussed are a very small subset of the valuable information that may be waiting in your accounting system to be shared with your team. The other paradigm shift that's driving adoption of business intelligence and analytics solutions is the manner in which the information is delivered and presented to its audience .

- **Exception focus:** Reports are great – when you need a report. Given the pace of activity and volume of information in most construction and service operations, your key people don't have time to wade through pages and pages of detail to find the handful of items that most urgently need attention. Users expect and need systems to highlight items needing attention (labor codes with

largest projected overruns, jobs with worst cash position, past-due RFIs, etc.).

- **Graphic presentation:** In many cases, a picture can tell a story faster and with more clarity than data. Your people want to be able to identify the most urgent items at a glance, without having to comb through a table of words and numbers.
- **Direct action:** Once an exception has been identified, it must be as quick and easy as possible for the user to take action: analyze underlying details, review associated documents, change or update information, issue communications.
- **Accessible anytime, anywhere:** Construction is a mobile industry. A few years ago we were talking about how to establish connectivity to the job site and put computers in the trailer so your people didn't have to come back to the office to access information and get work done. Now everyone has a smart phone and/or tablet, and they're used to getting and acting on information from those devices. Now field personnel are saying, "Let me review a plan, take

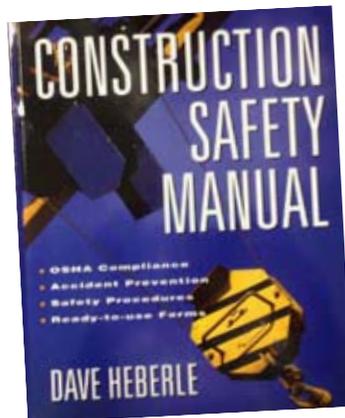
and send a photo, answer a question...from wherever I am on the job site. I don't have time to walk back to the trailer, and I like my iPad better than that PC anyway."

My goal for this article is to expose you to some concepts and examples, and get you thinking about how you and your team can leverage the data in what you used to think of as that boring old accounting system to improve how you do business. I hope I have succeeded. If you have any questions or would like to discuss business intelligence and analytics in construction software in more detail, please feel free to contact the author.

About the author: Kurt Koenig has nearly 30 years of experience in the construction enterprise information systems industry.

Kurt is the co-founder and Vice President of Penta Technologies, a post he has held since 1991. In his tenure at Penta Technologies, Kurt has managed Sales and Marketing, Client Services, Product Development, Product Management, and has had direct involvement in executive-level customer relationships. Contact him at kurt.koenig@penta.com or (262) 780-2402.

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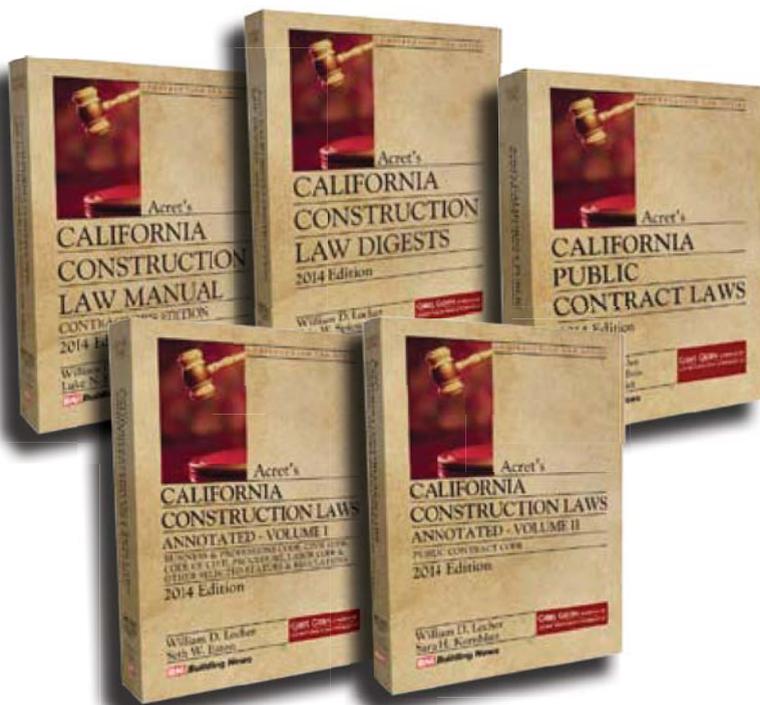
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