To ultimately prime their companies for the next step, this article will identify some useful key measures and focus on how companies can reduce risk, improve profitability, and maximize growth opportunities in the following areas: diversification, revenue stream predictability, standard work and labor development, annuity agreements, intellectual property, growth capacity and infrastructure, and profitability.

**Diversification**

Since a business valuation is predicated on the company’s future performance, diversification reduces risk for the buyer. Consider:

- How diversified are the services you are performing (e.g., the type of work, type of customer, or location of the work)?
- Do you track revenues and the number of customers by type of work, industry segment, and geography?

Many contractors have increased their focus on service work to complement their project work. For example, if a large segment of your business is with health care organizations, then consider exploring manufacturing, government, or education.

Geography is often more difficult to diversify, since location of labor is a prerequisite; but even seeking business within 100 miles can make a difference. If you do track revenues by these types, check how your portfolio is balanced. Focus on achieving some balance of work instead of a perfect level of diversification.
The key considerations are knowing how to approach an active market and recognizing that such a market does not have staying power. Establish a plan for how to downsize, and set aside those profits for reinvestment or development when those market opportunities fade.

Key measures:

- Revenue and number of customers by work type or classification
- Revenue and number of customers by industry segment
- Revenue and number of customers by geography or regional market

**Category: REDUCE RISK**

**Revenue Stream Predictability**

Contractors typically don’t clearly outline sales and marketing processes or measure the performance of their short- and long-term pipelines. They may know what they are bidding on and use a spreadsheet that tracks open and in-process bids. But what about long-term sales metrics?

- What relationships with GCs, developers, architects, bankers, lawyers, property owners, and property managers are important for long-term viability?
- Who do you need to stay connected with, how often do you need to meet with them, and what tracking measures are in place so you have a pulse on the health of your business referral network?

Let’s start with marketing. Too often, marketing is allocated to advertising, sponsorships, entertainment, and trade shows without any regard for who your ideal prospects are, what they need, and why your company is uniquely qualified to help them.

Once this is determined, focus your marketing efforts on where these customers exist and what you need to communicate to them. Your company’s marketing measures should focus on contacts made with ideal prospects, their understanding of what your company does, and ultimately, the leads that your company is best suited to deliver.

Also, consider the sales process, including bidding:

- How do you track potential projects?
- How can you influence these potential projects to increase your chance to win?

- What processes are in place to nurture these longer-term opportunities, and do you have visibility related to the actions taken by your staff?
- What type of bids do you win?
- What analysis is performed on projects won and lost so you know what to look for in a project?

When it comes to sales analysis and processes, the attention to detail in engineering, finance, contracting, labor negotiations, etc., seems to be lost.

As a result, contractors may not have a clearly defined reason why some bids were won and others were lost. They might know what’s in the pipeline for the next few months, but beyond that depends on factors outside of their control. If you were a prospective buyer, would this company be appealing to you?

Key measures:

- Contact nurture pipeline: Funnel of ideal prospect profiles and their knowledge of your organization
- Potential project pipeline: Funnel of various projects in the works that may be a good fit for your organization
- Active pipeline: Funnel of projects that are in process or on which you have bid
- Perform win/loss analysis

**Category: MAXIMIZE GROWTH OPPORTUNITIES**

**Standard Work & Labor Development**

As contractors have quickly gone from trying to find work to trying to find workers, the movement of labor resources for a better pay rate or a better work experience is prevalent in every aspect of the industry, from engineering and project management to field labor. The market’s peaks and valleys and corresponding labor challenge are nothing new. Consider:

- What is your organization doing to establish defined processes and related internal training?
- What is the labor development plan, what is your staff’s role in the plan, and how are you investing in the skills needed to advance employees’ capabilities?

Companies that can bring in junior employees, train them on how the company performs standard work, and set the right level of supervision can have better control over the labor shortage risk. Since it’s extremely important to develop and retain skilled estimators and PMs, let’s consider project management:
• Do you have a standard methodology for managing projects, or does each PM have his or her own unique style?
• Does your company have a development program for a junior PM to graduate from basic competencies to proficient and advanced skills?
• How do you validate and test their capabilities?
• What internal training programs and external training resources are core to your staff development?

Consider becoming active in local universities or technical colleges to understand their construction management programs, and reaching out to specific professors to discuss their curriculum.

Another example of standard work is prefabrication. Many contractors, especially larger ones, have a commitment to prefabrication. The benefits include leveraging lower-cost labor for the prefabrication work and utilizing less high-wage labor on site, since installation is performed faster. Standardization also promotes repeatability, which creates the opportunity to leverage junior resources.

Project management and prefabrication are just two examples. Every contractor can define standard work for every phase of project delivery as well as for sales, estimating, purchasing, billing, scheduling, etc. The measurement focus should be on the “maturity” of the standard work.

Below is a sample method of measuring standard work based on the terminology and scale from Six Sigma practices:
• Level 0 – Person-Dependent: No documentation of the process and the sequence; timing and results may vary
• Level 1 – Documented Process: Documented, but activity performed is not following the documented process
• Level 2 – Partial Deployment: Documented, but inconsistency in deployment
• Level 3 – Full Deployment: Activity documented and deployed consistently
• Level 4 – Measured and Automated: Goals established on the process and measurements are taken to monitor to the goals; the process is supported by technology
• Level 5 – Continuously Improving: Measurements to goals are evaluated and improvements are continuously made

Taking ownership of standard work and labor development can protect your company from the labor shortage. A savvy buyer will know that to achieve future revenue potential, the organization must have the ability to deliver, and delivery requires people to get the work done.

Key measures:
• Maturity of standard work processes
• Learning and development plans with all staff plotted on the scale (from basic to proficient to advanced)

Category: IMPROVE PROFITABILITY

Annuity Agreements

During the most recent economic downturn, contractors focused their attention on service projects to offset the loss in project work. While the addition of service work to your portfolio was previously discussed as a diversification strategy, the emphasis here is on establishing work agreements.

If more future work is built into an annuity agreement or contract, then the company’s future revenue stream becomes more predictable. Some examples include preventative maintenance or service contracts, while other contracts could exist for engineering, project management, and even accounting/finance.

It’s critical to organize this work into an agreement that can be renewed annually based on meeting performance expectations. To the buyer, a healthy annuity portfolio provides the highest level of comfort on future earnings potential.

From a measurement standpoint, consider the questions below; the greater the percentage of annuity work to overall revenue, the higher the value the business will obtain:
• How many annuity agreements do you have, and what is the revenue amount for them?
• Are you growing this portfolio year over year?
• Are you expanding the type of services you can offer in an annual agreement?
• Are you evaluating delivery methods for the work performed to achieve a greater profitability on this work?
• Are you tracking customer satisfaction on the work performed to have greater confidence in your renewals?

Key measures:
• Annual revenue of annuity agreement
• Projected revenue of annuity agreement
• Year-over-year growth in annuity revenue
• Benchmark and year-over-year growth in customer satisfaction on annuity work
**Categories: MAXIMIZE GROWTH OPPORTUNITIES & REDUCE RISK**

**Intellectual Property**

Significant legal documentation exists for protecting intellectual property in the construction industry. The focus of this legal documentation is primarily on the architectural designs and the relationship of the architect and building owner. For purposes of this article, however, “intellectual property” is intended to reference unique methods/processes that are recognized in the market and have distinct value.

A patent can be obtained for intellectual property of a process or invention. As an example, Thomas Edison received a patent for the Process of Constructing a Concrete Building. Edison’s objective was to protect his invention while creating a market value. While a contractor doesn’t need a patent to leverage a unique process for value, to an outside buyer, some form of legal protection would help preserve the value.

Is your company working toward a method or process that can be leveraged in the future and that the marketplace would value? From the buyer’s perspective, something unique in the marketplace that has legal protection mitigates a risk and establishes a growth opportunity.

Key measures:
- Unique designs or processes developed by your organization
- Number of trademarks, patents, service marks, or other intellectual property designations

**Categories: MAXIMIZE GROWTH OPPORTUNITIES & REDUCE RISK**

**Growth Capacity & Infrastructure**

Looking forward to the company’s growth potential is a factor in its valuation. This growth potential is predicated on the previously discussed factors, but also includes the organizational infrastructure. Is the company currently struggling to complete jobs? Will another project break down the entire organizational system? If so, the valuation of the company will be adjusted to reflect the additional investments necessary to obtain future revenue goals.

So, how does your company consider its growth capacity? Let’s take a look at a $5 million contractor seeking to become a $20 million contractor over the next five years. Sample questions might include:

- What does our sales organization need to look like for us to achieve $20 million?
- How much time is currently dedicated to achieving $5 million?
- At what point do we need dedicated sales management vs. reporting directly to the CEO or president?
- At what point do we add additional crews, and how do we do that?

Think about each segment of your organization: sales, finance, operations, HR, the field, etc. People need to report to others, so you’ll have to consider leadership and management for your organization to take shape.

Be aware of additional hiring challenges; you generally need to hire people full time and earlier than when they’re fully needed. Having a staffing plan that outlines and supports your growth capacity demonstrates to a buyer that your company understands the needed infrastructure to meet its goals.

Key measures:
- Annual staffing plan that highlights timing of hires by position related to revenue plan
- Market share, backlog, and geographical growth estimates
- Succession plan for all departments – advancement of key employees and finding their replacements

**Category: MAXIMIZE GROWTH OPPORTUNITIES**

**Profitability**

It goes without saying that a lack of profitability can reduce the value of any business. Rather than citing a number of profitability or financial measures, focus on making annual improvements to these measures. Set targets for various ratios such as current ratio, return on equity, equity to overhead, gross profit margin, debt to equity, fixed asset ratio, return on assets, and backlog to working capital.

Key measures:
- Benchmark and goal targets for various financial metrics
- Compare measures to industry data (such as CFMA’s Financial Benchmarker)

**Category: IMPROVE PROFITABILITY**
Summary

Owners often put off the needed investments in their businesses until they are looking to sell. Understanding what measures a potential buyer will evaluate is the first step; tracking the measures as outlined is the next one.

Making the commitment and investing in the changes is hard work. But having measurement targets will help an organization focus its efforts so that when it’s time to sell the business, you’ll be able to demonstrate a purposeful, proactive organization that is primed for continued success.

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