25 SURE WAYS TO IMPROVE PROFITABILITY

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25 Sure Ways to Improve Profitability

• In order to achieve profitability, you must PLAN for it

• Once the strategy is laid out:
  ✔ you need to compel events to conform to the plan,
  ✔ measure and analyze results,
  ✔ take corrective action when necessary and finally,
  ✔ tighten the plan for continuous improvement - and profit
1. Get Rid of Bad Deals

- Major source of lost profits

- Establish a minimum gross profit target
  - Don’t believe you will make it up with options and upgrades
  - Gross profit typically deteriorates through the construction process

- Don’t use allowances
  - Establish a base specification
  - Price the difference between base & selection
1. Get Rid of Bad Deals

• Gross Profit is your first line of defense
  ✓ Can’t make good net profits without good gross profits

• Conduct gross profit analysis
  ✓ By community
  ✓ By model
  ✓ By house
2. Don’t Give Things Away:

- Analyze Standard Specifications

- Develop practice of “ZERO” base specifications
  - Strip standard specifications to basics
  - Conduct cost / benefit analysis
  - Add back items that give adequate returns
  - 80/20 Rule
  - Create options and upgrades
2. Don’t Give Things Away:

• **DO NOT** overdo a standard feature
  - ✔ Diminishing value
  - ✔ Can be sold as a design option

• If you don’t demonstrate
  - ✔ You gave it away
2. Don’t Give Things Away:

- Focus on a couple of key areas of the home
  - Entry
  - Kitchen (The Living Triangle)
  - Master bedroom/bath
3. Fall Out of Love With Your Houses

• Design the Product for Your Customer – Not Yourself!

• Develop a value mission statement and strategy

• How do you compete?
  ✓ Price
  ✓ Quality
  ✓ Service

• Who is your customer?
  ✓ Understand how your customer defines value
  ✓ Understand your customers’ perceived value
  ✓ Define customer value
3. Fall Out of Love With Your Houses

• How do you plan to deliver superior customer value
  ✓ How do you add value
  ✓ Create a strategy to deliver superior value to a well-defined target market

• Information about customer needs, preferences and buying patterns is **MOST IMPORTANT** input to all business decisions
4. Eliminate Waste & Excess Material Usage

- Trash pile
  - Only the tip of the iceberg

- Diverted materials

- Inventory material deliveries
  - Make sure you get everything you ordered
  - Nothing damaged during delivery
  - No culled material

- Wasteful construction techniques
  - Change framing procedures
  - Question engineers
  - Value engineer materials, usage, & design
4. Eliminate Waste & Excess Material Usage

• Excess material being installed
  ✓ Ladder “T’s”
  ✓ California Corners
  ✓ Non-loadbearing headers

• Return unused or damaged material
  ✓ Return Policy
  ✓ Document to purchasing & accounting
  ✓ Take the credit
5. Develop Scopes of Work and Quality Checklists

- Trade specific scopes of work
  - Atlanta HBA “The Partnering Guide”

- Implement checklists
  - Assure work is complete and accurate
    - Before trade leaves job site

- Train the trades on the scopes of work

- Train superintendents on the scopes of work
6. Have Accurate & Detailed Working Drawings

• Develop a scope of work for architectural drawings,
  ✔ To insure their uniformity

• Input from superintendents, suppliers, & trade contractors
  ✔ Eliminate guess work

• Plan review checklist

• Working drawings should include:
  ✔ All necessary construction details
  ✔ All material assemblage techniques
7. Value Engineer Houses

• Analyze for construction efficiencies
  ✓ Dimensions
  ✓ Construction Techniques
  ✓ Material Usage

• Question engineers
  ✓ Alternate assemblages
  ✓ Alternate materials

• Question Trades & Suppliers
  ✓ Reduce Costs
  ✓ Increase Efficiencies
7. Value Engineer Houses

• Consider pre-assemble techniques
  ✓ Trusses
  ✓ Panels
  ✓ Modules

• Consider new & alternative materials

• Implement material and labor saving techniques
  ✓ Placement & handling of materials
  ✓ Reduced number of trips
  ✓ Same trade contractor doing multiple tasks
  ✓ Improved efficiency
8. Gain Control of Construction Cost Slippage

• Document fill-in orders and extra work
  ✓ Variance Purchase Orders
  ✓ Reason Codes

• Conduct variance analysis
  ✓ Variance review meeting
  ✓ Analyze by reason code

• Develop a strategy to reduce variances
  ✓ No more than 1% of Direct Cost
  ✓ Add + & - variances together
  ✓ Review meeting
  ✓ Eradicate
8. Gain Control of Construction Cost Slippage

• Eradicate Variances
  ✔ Attack large variance categories
  ✔ Attack repetitive variances
9. Improve Estimating

- Prepare in-house detailed quantity survey estimates
  - Detail and accuracy is critical

- Determine quantity of material and labor
  - Bill of Materials
  - Intelligence for negotiations

- Produce reliable house-specific construction cost budgets
  - Reduce variances
  - Reduce fill-in orders
  - Reduce excess materials
9. Improve Estimating

• Coordinate with:
  - Purchasing,
  - Scheduling
  - Job cost accounting
10. Improve Purchasing

• Unit pricing vs. bid management
  ✓ Unit pricing is easier to manage
  ✓ Can price customer change orders

• Qualify trades and suppliers
  ✓ Have trade/vendor application
    ❏ Put on website

• Negotiate with trades and suppliers
  ✓ There is a lot more than just bid price to negotiate
10. Improve Purchasing

• Document the agreements
  ✓ Vendor agreements
  ✓ Trade contractor agreements

• Implement a formal purchase order system
  ✓ Legal binding agreement
  ✓ Preferably released prior to start
    ❑ Staged releases
  ✓ pre-printed invoices
    ❑ Don’t accept invoices
    ❑ Pay purchase order
10. Improve Purchasing

• Use variance purchase orders
  ✓ Release prior to work being done

• Join **Builder Partnerships**
  ✓ Negotiates manufacturer rebates
  ✓ Quarterly submissions
    ❐ Very simple
    ❐ Can be a lot of money
11. Maintain Construction Schedules

• Develop a master schedule
  ✔ Everyone needs to use the schedule
  ✔ Needs to be reliable & consistent

• Consistency before speed
  ✔ Once consistent you can analyze for efficiency

• Continually work to reduce time
  ✔ Look at each component independently
  ✔ Concurrent vs. lineal sequencing
11. Maintain Construction Schedules

• Centralize Notifications
  ✓ Someone needs to manage the schedule
  ✓ Everyone in company needs information

• Use Technology
  ✓ Handhelds
  ✓ Tablets

• Track Schedule Variances
  ✓ By Reason Codes
  ✓ By Trade
  ✓ By Community
11. Maintain Construction Schedules

• Establish a Strategy to Reduce Schedule Variances
  ✓ Same process as for job cost variances
  ✓ Focus on major reasons
  ✓ Purpose to eradicate variance

• Superintendents can adequately supervise only a given number of houses
  ✓ Per cycle

• Schedules impact production yield & quality
12. Develop Quality Standards

- Have scopes of work for each trade
  - Certifications of completions/Job complete checklists

- Set quality standards for each trade
  - Establish a quality manual
  - Picture book
    - The Good
    - The Bad
    - The Ugly
12. Develop Quality Standards

• Develop Quality Checklist
  ✓ 3 – 5 critical inspection points
    □ Foundation
    □ Framing
    □ Final internal quality assurance

• Train the superintendents AND the trades
  ✓ Your Quality Standard

• Consistent quality delivered to your home buyer
13. Standardize Procedures

- Policies, Procedures & Rules
- Trade & Vendor Contracts
- Clear Scopes of Work
  - Checklists
- Organized Job Sites
- Job Site Work Rules
  - Clarifies the Working Environment
- No Ramrod mentality
13. Standardize Procedures

- Be consistent and reliable
- Efficient and effective
- Establish a culture of discipline
14. Develop Quantifiable Objectives

- Measure & track critical performance indicators
  - Analyze financial information using ratio analysis
    - Develop your own target ratios
    - Don’t just review raw numbers
      - Compare to budget
      - Use percentages
  - Chart financial information
    - Construction people are visual
    - Easier to see relationships
14. Develop Quantifiable Objectives

• Conduct comparative analysis
  ✓ Compare actual to target
  ✓ Compare to standard plans
  ✓ Compare projects
  ✓ Compare superintendents

• Conduct trend analysis
  ✓ Critical measurements over time
  ✓ Actual financial ratio trends to targets
15. Watch Staffing Levels

- Maintain balance with sales volume
  - Easy to Hire
  - Hard to Fire
  - Review systems & processes first

- Watch superintendent loading
  - Optimum Capacity
  - Maximum Capacity
  - Minimum Capacity
16. Train Employees & Trade Contractors

- Develop a formal training program for new employees
- Develop on-going training programs for existing employees
  - Cross-training
  - Establish a career path
  - Part of the annual review
16. Train Employees & Trade Contractors

- Develop on-going training programs for trades
- Consider establishing a trade council
  - Doesn’t have to be formal
  - Great for two way communication
- Become the “Employer of Choice”
17. Maintain Adequate Sales Velocity

- Set target velocities for your communities
- The market sets the price
- Builder modifies only marginally
  - Impacts sales velocity
- **DO NOT** discount houses to buy velocity
  - 100% profit
  - How many additional house do you have to sell
    - To make up for discounting
17. Maintain Adequate Sales Velocity

- The typical pricing method is cost-based
  - Accumulate bids
  - Market up costs
  - Final sales price

- **DO NOT** treat profits as a residual
  - Determine market sales price
  - Deduct your target profit FIRST
  - Deduct land costs
  - Deduct operating expense allocations
  - Deduct historical slippage rate
17. Maintain Adequate Sales Velocity

• **DO NOT** treat profits as a residual (con’t.)
  - Deduct average warranty expense
  - Remainder available for direct construction costs

• Develop target budget for direct construction costs
  - Design, specify and estimate toward the target
  - Protect your profits
  - Trade off direct cost, **NOT** profits
18. **Balance Number of Models with Available Lots**

- Make sure models have good gross profits
  - ✔ You will sell more modeled homes

- Decorate to sell, not to win awards
  - ✔ Decorate for your target customer
  - ✔ Decorate to demonstrate
19. Monitor Advertising & Promotion

- Target advertising to your customers
- Establish a public relations program
  - More effective than advertising, and less costly
  - Editorial more effective & less costly
- Be creative with program
- Website
  - Transactional
- Social media
20. Develop a Viable Referral Program

• Set specific objectives for referrals
  ✓ What percentage of your sales will be referrals

• Identify contact points to ask for referrals

• Train your staff to ask for referrals
21. Watch Amount of Unsold Inventory

• Balance the levels with sales velocity
  ✔ For Company
  ✔ For each Community

• Have a strategy to release inventory houses to construction, based on your market conditions

• Set a strategy to liquidate old inventory
22. Monitor Interim Financing Fees & Rates

• Track interim financing fees and interest rates

• Secure a revolving construction line

• Watch unsold inventory
  ✓ Balance the level of specs with sales velocity

• Maintain construction schedules
  ✓ How much does it cost for each day
23. Monitor Points & Closing Cost Offered Buyers

• Mortgage interest rate increase could cause this to get out of control

• Can be a problem for first time home buyer builders.
24. **Analyze Management Systems**

- Look at the information systems
  - Integrate your information systems
  - Improve your management reports
    - Two minute reports
    - Key metrics

- Chart the approval process, workload and number of hand-offs
  - Invoice approval
  - Contract approval
  - Purchasing procedures
  - Change order processing
24. Analyze Management Systems

• Make sure you do not become top heavy
  ✓ Invest in systems before hiring more staff
  ✓ It is easier to hire than it is to fire

• **Do NOT** over-departmentalize
  ✓ Hinders communication
  ✓ Tends to cause more bottlenecks
  ✓ Staffing tends to increase
25. Build House Right the First Time

• Clear Instructions
  ✓ Have them repeat in their words

• Plenty of Advanced Notice
  ✓ Adequate Lead Times
  ✓ Confirmations

• Construction Meeting

• Web Portals
25. Build the House Right the First Time

• You are not in the remodeling business

• Change orders during construction

• Semi-custom vs. mass customization
  ✓ Pre-planned, pre-priced structural options
  ✓ Package selections
    ❑ Eliminate allowances
  ✓ Establish a standard set of specifications
  ✓ Price the difference
How much Profit Can You Make?

- Very inefficient industry
- Average home builder net profitability is historically 3 - 5%
- Average should be 10 - 12%
- Superior profitability should be 20% +
Target Ratios for Homebuilders

• Cost of Sales 70%
  ✓ Land 20%
  ✓ Direct Construction Cost 50%
  (Hard cost)

• Gross Profit 30%
  ✓ Operating Expenses 18%
  ✓ Net Profits 12%
Target Ratios - continued

- Operating Expenses 18%

- Indirect Construction Cost 3.5%
  - Supervisory salaries 1.5%
  - Warranty 0.6%
  - Other 1.4%

- Financing Expenses 4.0%
  - Interim interest 2.0%
  - Points, closing costs, fees 2.0%
<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
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<tbody>
<tr>
<td><strong>Sales and Marketing Expenses</strong></td>
<td>6.0%</td>
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<tr>
<td>Sales commissions – internal</td>
<td>1.5%</td>
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<tr>
<td>Brokerage commissions</td>
<td>2.0%</td>
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<tr>
<td>Advertising</td>
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<tr>
<td>Model homes</td>
<td>1.0%</td>
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<tr>
<td>Other</td>
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</tr>
<tr>
<td><strong>General &amp; Administrative Expenses</strong></td>
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</tr>
<tr>
<td>Administrative salaries</td>
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</tr>
<tr>
<td>Accounting and computers</td>
<td>0.5%</td>
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<tr>
<td>Other (rent, insurance, etc)</td>
<td>2.0%</td>
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### Target Ratios for Custom Home Builders

**CUSTOM HOME BUILDERS:**  
(Under $5 Million in Sales on Customer’s Land)

**Targets**

<table>
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<tr>
<th>Category</th>
<th>Target (%)</th>
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<td>Sales</td>
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<tr>
<td>Cost of Sales</td>
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<td>Gross Margin</td>
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<tr>
<td>Indirect Construction Costs</td>
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<td>Financing Expense</td>
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<td>Marketing Expenses</td>
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<td>General Administrative Expenses</td>
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<tr>
<td>Owners’ Compensation</td>
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<tr>
<td>Net Profit</td>
<td><strong>10.0</strong></td>
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</tbody>
</table>

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Questions and Comments

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The Best Most Reputable Manufacturers in the Industry

A sampling of the manufacturers we have in the Builder Partnerships program

Contact us to participate
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Phone: 303.972.7666
Fax: 303.972.7667
www.builderpartnerships.com
Builder Partnerships awarded the first **Builder Of Choice Award** in 2015 to recognize builders who have demonstrated leadership in their management of relationships with trade contractors and vendors in their local markets.

The Builder of Choice Award (BOC) was created to provide builders with third-party validation and certification from a credible source to demonstrate their commitment to excellence in working with suppliers, trade contractors and other organizations that support the home building process. Recipients received recognition at the 2015 IBS.

This award does more than offer recognition to quality builders; it provides builders with an economical and reliable third-party verification of their commitment to excellence in working within their local market. As a time when labor is becoming more and more scarce, this is something every builder can use.

*Application Deadline: November 1, 2015.*
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- Judged by the Trade Partners & Suppliers
- 10 Categories
- 68 Questions
Five companies were named Builder of Choice™ award winners, recognizing the strength and quality of their trade and supplier relationships.

- Bedrock Builders, Noblesville, Ind.
- Dan-Ric Homes, LaGrange, Ga.
- Wayne Homes, Uniontown, Ohio
- Woodland Homes, Huntsville, Ala.
• Our team covers all areas of the builder organization. Featured areas of expertise include:

  – Assistance with Value Engineering and Material Take-offs
  – Quick, reasonable land valuation / project forecasts
  – In-house customized training programs
  – Specific market research / intelligence
  – Evaluation of key performance ratios
  – Advisory on how to cut costs, sell houses, and pay loans

• Virtual Advisory Board (hourly coaching-consultation) to help cut costs, sell houses, and develop, monitor and conform to strong financial plans

Contact Emma Shinn at eshinn@theshinngroup.com to discuss service options.