The Competitive Edge in Business
- A Contractor’s Toolkit for Financial Success

OSSF Edition

Home Study Course
By
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This course is authorized by the TCEQ for eight (8) hours of continuing education in the following categories . . .

- Re-certification of Installer I, Installer II, Site Evaluator and Designated representative

The course is also authorized by the Texas Department of Health for eight (8) hours of continuing education for re-certification of Professional Sanitarian.
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This manual is prepared for contractors and professionals who work with contractors in the OSSF industry.

The record is dismal with high failure rates for new contractors . . . and it gets worse. Some of the contractors who seem to beat the odds find they don’t have adequate capital for equipment replacement when it’s needed. Others just don’t realize their full potential. The cause is often lack of adequate business skills. Some don’t spend adequate time planning and developing competitive strategies. Others have not set up a book keeping system that allows them to accurately identify and recover all business expenses in their bidding strategy. Many do not have a professional marketing strategy or planned sales approach.

There are a few contractors however who do very well. They have developed a set of skills in planning, business finance, bidding, estimating, strategic marketing and sales. They know where their bottom line is and how much profit they need from every project. They know how to attract the right kind of customers, and how to sell quality at a fair profit . . . They have learned and developed the proper tools to build financial success.

Yes! I said they have learned and developed business tools. They were not born knowing how to run a successful business. Contrary to the popular cliché here are no born sales people. These are all learned skills. Contractors who have these skills learned and practiced them over time. Some had a mentor or partner to learn from. Some took business courses and seminars. Most have been to the school of hard knocks, which is the most expensive way to learn. But all successful contractors have learned and developed skills in planning, business finance, bidding, estimating, strategic marketing and sales.

If you are a contractor this manual is your toolbox for financial success . . . Skills to learn . . . Tools to sharpen your competitive edge.

If you work with contractors it will give you a better appreciation of this side of the industry . . . and an appreciation that it takes more than technical skills to be successful in the business of installing an on-site sewage facility.

It provides quality continuing education for professionals who are licensed as Installer I, Installer II, Designated Representatives, Site Evaluators and those registered as Professional Sanitarians in Texas.
Chapter 1
The Competitive Edge

Overview

In this chapter we will discuss a professional response to increasing competition, increasing sophistication of customers and the dynamic market.

Learning Points

It is more important now than ever for contractors to keep an eye on the big picture. Change is ever present and constant in the information age. A revolution in technology is driving change that is at times dramatic.

Competition is increasing from several sources in Texas causing price erosion and market saturation in both the irrigation industry and OSSF industry.

Customers are becoming more sophisticated with higher expectations and better negotiating skills.

In this climate where business failure rates for contractors are as high as 85 percent in the first five years of business . . . Absolute professionalism is not an option, it’s a must.

A planned, professional and calculated business approach will turn this challenge into an excellent opportunity for success and awesome profits.
Introduction

Take a look at what is happening all around you. The world is changing. It has changed dramatically in just the past twenty years. People are changing and a generation of Baby Boomers is now shaping markets, with Generation X not far behind. We are now also fully into the information age where change is ever present and constant. The information age is driving change at multiple levels . . . with expanding technology causing changes that at times occur suddenly. In addition to all of this there are other underlying trends and business cycles that are causing gradual changes.

The result is changing markets, changing customers, and increasing competition. The most successful on-site contractors will be those who watch the trends, recognize the paradigm shifts as they occur and plan for change. The competitive advantage lies with those who work out strategies to position their company competitively in the world that is coming.

Technology is driving constant change in the OSSF market. Just consider how Class I Aerobic Treatment Systems have changed the market place in the past 20 years. What was once just an idea has now become an accepted industry standard for on-site wastewater treatment. That is just one example. Look at how control systems are changing. We now have high tech control systems with environmental sensors, solid-state circuitry and computer logic controllers. That is just a sampling. There are still many technological challenges facing our industry. What will the next 20 years bring? More importantly, will you see it coming and how will you respond?

Technology is also driving change in the market place at other levels. The Wal-Mart marketing phenomenon has changed market distribution and pricing systems. It is now possible for homeowners to buy building materials at discount prices. In fact it is often cheaper for contractors to buy materials at Handy Dan, Lowe's, and other superstores than it is to buy at wholesale plumbing supply houses. In addition the superstores are selling the idea that homeowners can build and maintain their own home improvements without any need for a professional contractor. Where will this trend lead and how will it affect professional contractors?

Competition comes from other sources also. Some would say that there's contractor around every corner, and they are right! We have never seen competition in such an overwhelming magnitude. Thousands of registered On-site sewage installers work in Texas. A high level of saturation is common
throughout Texas. In addition, in some areas of Texas licensed installers have to compete with unlicensed individuals who undercut the licensed professionals. Where does this put the professional? It takes thousands of dollars of business from them and undermines the need for professionalism in the industry . . . These trends are causing price erosion and market saturation.

While the market is changing and the intensity of the competition is unquestionable . . . The customer is also changing. With television and the internet bringing the world into their living rooms, customers are more educated, informed, and more demanding than ever before. A bottom of the line system will not sell like it once did. Quality and longevity of systems are becoming more important issues. In some parts of Texas environmental issues are becoming much more important and our customers are more aware of the issues. The potential to sell additional benefits with an OSSF system is increasing because of more discriminating and more educated customers. At the same time, the challenge of doing so is becoming more difficult as our customers become more sophisticated.

These more sophisticated customers have better negotiating skills. They often want a first-class system. Unfortunately they often want to negotiate a second-class price . . . and as a professional, you know they cannot have both. So our job then, as professional contractors is to sell them on why they should be willing to pay more for the type of system they really need and for the level of quality they want. That is a challenge in itself, since they often don’t completely understand OSSF technology or how to distinguish differences in quality between contractors . . . but the often think they do. Successful sales and marketing then becomes the multifaceted challenge of gaining credibility with them, then helping them understand what they really need, why they need it, and how to distinguish the different levels of work quality between contractors. Once you have done that, you must show them that is exactly what they're getting. And in order to do all of this, absolute professionalism is not an option . . . it's a necessity. If you are going to succeed in the long-term, you must develop professional skills and a professional image.

In addition we work in a highly regulated industry. Laws passed by the Legislature and the manner that these laws are interpreted by state and local regulators not only directly affect installers . . . They work to shape the marketplace. Contractors need to recognize the regulatory trends and what is behind them in order to determine positive and negative effects on their individual business and on the industry as a whole.

On an industry level they need to support their state association to help develop and support group strategies to shape the trends. On an individual level installers need to recognize the trends they cannot change and spend time working out strategies for the most competitive response possible.
The vital skill that you as a contractor need to develop is the ability to look at the big picture to see the trends driving regulation in our industry. You can then support the positive trends and recognize what might be changeable about the negatives or at least develop a competitive strategy to deal with the negative trends that may be difficult or impossible to change.

For example the rules requiring licensing are driven by the widely accepted belief that it promotes professionalism and thereby results in a more consistent, reliable installation that meets established quality standards and proper protection of water resources. The overall trend here is the widely accepted belief that the use of regulation to promote professionalism will benefit all segments of these industries as well as the general public. With this trend in place it is very unlikely that there would be dramatic changes in licensing regulations. Change in this area is more likely to be the gradual fine-tuning of a widely accepted concept.

Other trends are much more complex with less agreement among industry players. An example would be the trends in regulation of Class I Aerobic Treatment Units. Current regulations attempt to standardize quality through an equipment approval process that approves what is, in effect “an unchangeable treatment package.” This creates the consistency needed by regulators as well as big financial incentives for all manufacturers and some installers . . . So, it would be difficult to change.

There are however many negatives that create the potential to drive dramatic change in this area. The negative side is that manufactures control who can maintain and repair their Class I aerobic plants. This is in spite of the fact that all Class I aerobic plants are very similar in design . . . as a result many installers have the skills and capability to maintain any type of Class I system without the need for over-site and control by manufacturers. Many installers also have the ability to make brand and model substitution of parts, (aerators for example) during system maintenance by consulting manufacturer’s specifications. State and N.S.F. regulations do not allow them to do so. Other negatives include the fact that consumers sometimes have no choice about which licensed installer they can choose to repair and maintain their system. Some manufacturers limit which installers they will certify to maintain their systems. This in effect creates State supported monopolistic practices resulting in higher costs for consumers. (Much like if you bought a Ford pickup and laws prohibited you from having service and repairs performed by any one but the Ford dealer in your town) . . . These negatives all create the potential for dramatic regulatory change in this area. Indeed, It could happen in one legislative session.

The questions every contractor must ask are . . . “What are the major trends in the marketplace that are driving change?” . . . “What are the positives and what are the negatives?” . . . “How will I respond next year?” . . . “How will I respond in the next five years?” Current business failure rates for contractors are higher than 85 percent in the first five years of starting business . . . and the figure would be
even higher if it included those who stay in business, but do not turn a respectable profit. This is not to say that you shouldn't respond, but that your response should be planned, professional, and calculated.

Those who respond in this way will thrive and profit greatly by viewing today's marketplace as an excellent opportunity. Through careful planning and attention to your business you can make awesome profits. The key is to evaluate every aspect of your life and your business, and to constantly make improvements. The process of never-ending improvement, is a concept that all successful businesses in the world today base their business philosophy upon. We should do no less in our industry.

So take a good look at your company inside and out and work to transform your company, one step at a time into a marketing and sales powerhouse. Be one of the elite group of contractors at the top of next year's market . . . It has been said that the difference between mediocrity and excellence is about 10 percent. Aim for a 10 percent improvement in your business practices and beat them all at the game!
Chapter 2
Planning & Strategy

Overview

This chapter highlights the importance of strategic planning. It gives a detailed outline and discussion on how to develop a business plan.

Learning Points

Business plans are essential for the long-term success in any business. They serve as a sales tool, a financing tool, a training tool and a road map to success for the company.

Business plans contain specific information about the business that helps loan officers; potential buyers and new employees understand what is both special and important about the business in a very short period of time.

All business plans are based a standard format with specific information about the business, details on technical areas, marketing strategies and financial strategies.

Strategy development is a skill that can be learned.

Strategy development is the process of working through a series of dichotomies.

Success of any business depends upon being skilled in strategy development.
Planning and strategy development are two of the most important skills a contractor can develop. Experience shows however that they are the two most neglected and least practiced of the essential skills needed for success of a contracting business.

We already said that over 85 percent of all contractor businesses failed within the first five years. The fact is that most experts agree a lack of planning and direction is the cause. The message should be clear. If you want to be around to collect the profits to be made in any contracting business, be it OSSF contracting or OSSF site evaluation and design, you had better spend some time planning.

Why is it that so few contractors participate in this vital step? Why would you not sit down and chart a course for your future? The reason most give is that they're too busy. The truth usually is that they are too busy putting out fires and do not have much time left over to plan ways to manage and tend those fires. Another reason is that some contractor’s egos get in the way and they assume they are just too good at what they do to have to spend much time planning. Others just don't make a connection between the time spent planning and increases in profits. Really there is no good reason. It has been said that a failure to plan is a plan for failure.

There is of course a select group of contractors with the foresight and the vision to plan. They're open to new ideas and have found a connection between planning and profits. They realize that a business plan is essential. They know that the time they spent planning will pay them back many times over in creating a better competitive position for their business, and increased profits. They understand how information from a well thought out business plan can be used to see a more complete picture of the internal and external business environment. They have developed skill in using this information to develop business strategies at multiple levels that allow them to capitalize on both the internal and external environment. They have identified the best, most profitable opportunities in their area and have developed marketing strategies for each market segment identified in their business plan. They have strategic business plans that make their businesses highly competitive. They have a plan for profit and a strategy to work the plan.

Business plans are essential for long-term success in any business. A properly executed plan will do the following for you.

- It will define exactly what business you are in.
- It will state your mission and the reason you are in business.
- It will establish concrete goals for projects, and goals for profits.
- It can define agreements between partners.
- It will provide a format for your banker to fall in love with your business at loan application time.
- It will increase credit lines with your distributor.
• It can assign tasks to personnel and departments. It will support the monthly business review and course correction planning session.
• It will help you prioritize your efforts toward specific and measurable results.
• It will help you set milestones and deadlines for special projects.
• It will help orient new employees to what your company is all about.
• It will help you increase your management control over more jobs.
• It can be a tool you use to present your business as a significant, sellable asset when you decide to retire.

Many business plan outlines are available in business textbooks, from the small business administration, and from business planning computer software. Most have many of the common elements that are included in the following pages. You should customize your plan for the future of your business. Make it something that you are comfortable with. The key is not to make it too formal or extremely long. Keep your reader in mind. Concentrate on accurately providing a blueprint of your business and make it practical so that you can carry it out.

The following pages give you a sample format with explanations that you can use as you begin to build the plan for your company. Don't be confined by the outline . . . get creative. No two businesses are exactly alike . . . no two business plans should be exactly the same. Follow the guide, but the plan is yours to create just as you have created your business.
Business Plan Outline Summary

I. Cover sheet
II. Executive Summary
   A. Mission Statement
   B. Objectives
   C. Core Competencies
      1. Technical
      2. Marketing
      3. Finance
   D. Purpose
III. The Business
   A. Legal Structure
   B. History
   C. Facilities
   D. Operations
      1. Organizational structure
      2. Qualifications
      3. Equipment
IV. Technical
   A. Background
   B. Technical Description
   C. Comparison
   D. Trends
V. Marketing
   A. Target Market
   B. Competition
   C. Advertising
   D. Sales Techniques
VI. Finance
   A. Structure
   B. Statements
      1. Balance Sheets
      2. Income Statement
   C. Projections
VII. Supporting Data
VIII. Conclusion
Business Plan Outline Detail

I. Cover sheet

Include the following
- Name of your Company
- Company Logo
- Dates Your Plan Was Issued
- Name of the Preparer of the Plan
- Name and Title of Owners
- Company address, phone number, and fax number,

The cover sheet should be very professional looking and pleasing to the eye. First impressions do count, especially with bankers and potential business buyers.

Spend time creating a professional image. Come up with a respectable and attractive business logo. One that reflects your company and what you stand for. Obtain professional help if you need it from marketing and graphics experts. Once you develop an attractive logo, use it, on stationery, sales literature, advertisements in newspapers and the yellow pages. Remember, first impressions really do count . . . in marketing image is everything.

II. Executive Summary

The executive summary of the business plan serves to draw the reader’s interest to the rest of the plan. Each element requires careful thought and attention. Try to keep this section brief yet powerful.

A. Mission Statement
B. Objectives
C. Core Competencies
   1. Technical
   2. Marketing
   3. Finance
D. Purpose

THE MISSION STATEMENT

Form a common mission for your company's goals and philosophies. Your mission statement describes the purpose of the company. The whole idea here is to form a common vision for your company's goals and philosophies. Get all of your employees involved in the formation of the statement. This will create a synergy in the organization that everyone can rally behind.
All highly successful companies have developed a common vision of what the company is, what it does, and what it stands for. The vision then radiates throughout the company . . . employees feel it and customers see it and respond to it.

Our forefathers had a mission in mind when they drafted the United States Constitution . . . the “plan” for our county. You could say that the mission statement of the United States is the preamble to our constitution . . . where in a brief paragraph they laid out the framework of who we are as a people, were the power in our democracy rests, what we stand for and what we will try to accomplish. It is in effect the “mission statement” of the United States.

As you develop your mission statement attempt to capture in a few words the kind of feeling that the framers of the Constitution inspired with the preamble, “We, The People of the United States, in order to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense and promote the general welfare for ourselves and our posterity, do ordain and establish this Constitution of the United States of America.”

Include the following -

- The reason your company exists.
- Areas of expertise for specialization.
- Geographic territory and clientele targeted.
- The positive environmental impact of your industry.
- Your commitment and your company's commitment to professionalism and quality.

An example of the Mission statement is Environmental Training Systems’ Mission Statement.

We plan to exceed our customer’s expectations for environmental education with relevant, timely, and well-told information that will help them meet their objectives in life and increase their bottom-line in a fun and meaningful way.
A typical Mission statement for an on-site sewage contractor might read as follows:

“Clear-Flow On-Site Systems is dedicated to providing cost effective residential on-site sewage treatment and recycling systems to customers of the Austin area through a well-trained staff focused on safety, health and environmental protection.”

Creating a concise, meaningful mission statement takes time and creative thought. In order to get the creative process started, you must start by expanding on ideas in each of the areas that should be included in your mission statement. Put your thoughts in writing as you expand on what is important and relevant to your business in each of the areas.

After you have completed the process of expanding on your thoughts, take several days to fine tune and focus your thoughts on what is really most important. Then condense all of your thoughts into a brief but powerful statement that describes what your company is all about and what it stands for.

Use the following worksheet to begin creating your mission statement. Make notes in each category of each element that should be in your company’s mission statement.

1. The reason your company exists.

2. Areas of expertise for specialization.

3. Geographic territory and clientele targeted.

4. The positive environmental impact of your industry.

5. Your commitment and your company’s commitment to professionalism and quality
OBJECTIVES

Objectives Are Simply Business Goals. Developing a set of long-term, intermediate, and short-term goals is the basis of any business plan. Don't underestimate the power of well-defined goals. Goals should radiate through every level of your company and be tied to each other, working toward common long-range objectives.

Can you imagine playing soccer without a goal or baseball without a home plate? Almost unimaginable isn't it. Businesses are no different. You have to have definite goals, definite targets to shoot for, or you will wander aimlessly.

Youth baseball or youth soccer programs are more than fun and games. We use them to develop our children into responsible adults by building appropriate social skills, team skills, and ability to focus and achieve results, physical skills, and self-confidence. All of this does not just happen. It takes a common vision by all who are involved in the programs. It takes planning and goal setting in each of the areas that are important to developing the desired results. It takes goals at multiple levels that are interconnected to support and build the final results we want to achieve.

Businesses are no different. You have to have a common vision of what your business is all about and what you are trying to achieve. Then you must develop goals at multiple levels that are interconnected to support and build the final results you want to achieve.

Create Several Goals in Each of the Following Areas:

- Daily goals
- Problem solving goals
- Innovative goals
- Development goals
- Sales level goals
- Profit level goals
- Market share goals
- Any other areas that are important to the success of your business.
For example, successful contractors will make goals in the area of quality installation, (a daily work goal.) They will have goals for inventory tracking and goals for accounting practices, (problem solving goals.) They will have goals for employee training, (a development goal.) These are just a few examples. As you read the description of the various types of goals that follow . . . Write down possible goals for your company.

**Daily Work Goals** - These are the most important for your supervisor and work crew. Take time with your crews to develop these goals as a team. If your employees feel they have a part in establishing company objectives, they will be much more likely work toward them. You should strive for improvement in the areas of operating more efficiently, improving quality of work, and increasing productivity. You might set a goal for filling out a quality checklist after finishing a job, or completing a progress report before leaving every job site.

**Problem Solving Goals** - Take the time to get rid of problems at every level in your organization. Talk with your employees about what problems they face. You may be surprised! Problems could range from billing and receivables collection to frequent loss of tools by work crews. Target on your key problem areas and do what you have to for arriving at a solution.

**Innovative Goals** - These goals include researching new technology to incorporate new products and techniques into your business. Successful companies must constantly take measures to stay ahead of the competition and be different. Innovative goals must constantly be examined to avoid becoming obsolete. Work with your product supplier to keep up with the latest trends in the industry. Innovative goals are extremely important to keep your business competitive.

**Development Goals** - Training and development are essential for the future of your company. If you're going to maximize the success of your organization, every employee should have a plan for continued growth and development of both personal and work skills. Improving work skills includes training on installation techniques and practicing basic technical skills for your front line employees. It also includes continuing education for the business owner in the areas of planning, sales and marketing to increase your bottom-line and ensure success. Improving personal skills includes reading and training in subjects such as “Seven Habits of Highly Effective People” by William Covey.

**All of the above goals which relate to sales level, profit level, and market share will prove extremely important in dealing with marketing and sales.**

You should include goals for different time periods - One-year goals, Three-year goals, and Five-year goals. Figure out exactly what you want to achieve. When setting these goals, look at past sales and profit levels while you look at prevailing
trends. Again involving your employees in goal setting can be a determining factor on whether you achieve your goals.

**Keep in mind that goals are intended to get results . . . base your goals on the following principles if you want to achieve the results you expect.**

**Specificity**
Write your goals with the end result in mind. Be specific and leave no room for the question . . . Did we achieve the goal? Everyone should have no problem measuring results.

**Accountability**
Be sure to assign goals to specific crew leaders or work crews. You don't want employees who don't want to be accountable . . . Or who don't take pride in what they accomplish.

**Quantitative**
Put numbers on your goals. General words like we want to be the best, most improved, just won't work. Nail down the numbers. Be exact and be very clear.

**Deadlines**
Put a date on every goal you set to achieve. Deadlines put a push on things to get them done.

**Support**
Don't leave major long-range goals hanging. Break them down into workable sub-goals with actions you can take to achieve the long-range objectives. Weekly and monthly evaluation should look at factual progress on your goals.

**Tracking Goals**
Make sure your goal can be tracked. If you can track it, you can improve it.

The long-range goals that you come up with should be included in your executive summary. State your goals right upfront and your reader will know that you're a proactive professional with an eye for the future . . . You will make the valuable first impression that loan officers look for . . . You will make a valuable first impression on new employees.

**CORE COMPETENCIES**

The specific areas that make your company special or better than your competitors are your core competencies.

In this section, briefly describe what your company does best in the following areas:
• Technically
  o In the technical area describe the technical competence of your company and the special attention that you pay to quality.

• In Your Marketing Strategy
  o Layout your marketing strategy in detail. Describe your target market and how you will successfully reach the market.

• In Your Financial Position
  o Show your financial stability and your ability and dedication to maintaining accurate accounting records and financial control systems.

Use the following work sheet to brainstorm and list the core competencies of your company or the company you work for.

Technical
  1.
  2.
  3.
  4.

Marketing Strategy
  1.
  2.
  3.
  4.

Financial Position
  1.
  2.
  3.
  4.
PURPOSE

Direct this section to the reader.

If this version of your business plan is for a banker or investor –
- Describe the loan or investment you're looking for.
- Describe why you need it.
- How much you need.
- How and when you'll repay it, etc.

If you're preparing the plan for potential buyer of your company –
- Discuss the terms of sale.
- Discuss total dollar value of your company
- Describe major assets.
- Point out any unique value your company may have.

When tailoring the plan for new employee –
- State the importance of learning every aspect of the business
- Discuss why they should become a true team player.

This is the last section of the executive summary in your business plan. It should be brief yet powerful. After reading the executive summary the reader should be anxious to learn more about your company.

Remember, the executive summary, as a whole is a brief yet powerful introduction to the rest of your plan.

III. The Business

A. Legal Structure
B. History
C. Facilities
D. Operations
   1. Organizational structure
   2. Qualifications
   3. Equipment

The Business section brings the reader up to speed on the type and structure of company you run. The reader of your plan may have no clue about the industry or your business. Assume nothing.
Legal Structure

The legal structure, or the ownership, of a business has its own shape and peculiarities. Is the business a sole proprietorship, partnership, or corporation? You should define exactly who owns the company.

History

You should give a brief history of the industry you are in and a brief history of your business. When you describe the industry, describe the history of your organization as it fits into the big picture.

Show that you are technologically advanced and have entered the computer age with computer generated professional sales presentations. If you are in the irrigation industry, show how you use central control systems and computer aided design software. If you are in the OSSF industry describe any logic control systems built into the systems you can install.

Questions you should answer include the following -

- Who started your company?
- Why was it started?
- How old is your organization?
- Exactly what type of business do you run?
- Is it exclusively OSSF installation, or do you service maintenance contracts?
- Is it irrigation alone, or a mixture of irrigation and landscaping?
- Do you occupy slow months with a second business like Christmas or seasonal lighting, swimming pool service or tree trimming?

Fully describe the type of business you run and be specific. Talk about why you have been successful or what makes you one of the best in your market. Be sure to include professional organizations. Wrap this section up by describing the trends in your market and how your business will respond to be profitable in the future.

Facilities

Describe the facilities that your company has but only if it is one of your strong points. If not, be brief and move on. Always include the actual location, the number of years you have occupied the premises, anything that is the special or attractive about the facilities you have. Include the square footage of the building plus any lease or mortgage arrangements.

Operations

The operations section enables you to describe your people . . . the heart and soul of your business. Start by drawing a chart of your organizational structure. Include job descriptions for every position shown in your
organizational structure. You may want to back up a chart with qualifications and resumes of every employee. State their technical expertise, number of years in the field, marketing or financial aptitude and any other special characteristics that add value to your company. If you have a small company you may want to include future job positions along with job descriptions to show how your company will grow.

Be sure to assign specific job tasks and duties in each job description as you describe the organizational structure. Leave no questions about who is accountable for special projects and clarify the role of each employee.

The last step in describing the organization is to list the major equipment that allows you to get jobs done. How many trucks do you own? What kind of trencher or backhoe do you have? Include all of the specialized equipment that will distinguish your company and add value to your service. Describe also any types of equipment that you rent or subcontract for.

IV. Technical
A. Background
B. Technical Description
C. Comparison
D. Trends

Describe the kind of system that you install and include technical detail. Show your product knowledge and your industry sophistication. Show what makes your company better than the rest. Make a positive impression on the reader by confidently working in the features of the type of system that you install. Keep in mind that your reader may know nothing about the industry. Consider providing some background information before jumping into technical details.

Describe the design and installation techniques used in your business with a technical description of the typical installation. In the OSSF industry elaborate on the type of treatment systems (Brands & models of Class I Aerobic systems, valves, spray and rotary heads you use and how they are both different and better than your competitor. Describe the attention that you pay to quality in every step of the process. Wrap up this section by comparing the system that you install with that of your competitors. Do you use a better product? Most importantly, answer the question: how do you distinguish yourself from the competition?

V. Marketing
A. Target Market
B. Competition
C. Advertising
D. Sales Techniques
Your profit goals depend on marketing and sales techniques. Describe your marketing and sales strategy and be sure to include your sales objectives. Describe your strategy for achieving those objectives.

Many good irrigation or OSSF installers go out of business just because they don't know how to sell. Very rarely do those who are good at marketing and sales see their businesses fail.

You should identify your target market. If you have done your homework, include the demographics of your target market, including age, income, geographic location or type of business. Do you rely on residential, commercial, municipal, resorts, or a combination of several? Be sure to emphasize that you don't sell strictly on price. Describe how you will reach the target market by selling quality, dependability, and performance.

Chapter VII, “Sales and Marketing Through Strategic Influence” contains information on the latest research on major market segments in the United States. Stanford Research Institutes Values and Lifestyles Survey is used by major marketing firms to identify and target these market segments. Incorporate this information into your marketing strategy.

As we said earlier, there's tremendous competition in today's marketplace. Describe your competition. Describe their relative market share as compared to yours. Describe your marketing strategy and marketing objectives. Be very clear on how your company is both superior to and different from the competition.

How do you advertise? What is your main source of exposure? Do you use the Yellow Pages, direct mail, door hangers, or rely on word-of-mouth. What portion of your total budget goes to advertising? Remember, word-of-mouth is your best advertising method. Chapter VII outlines a six step strategic marketing approach you can use to develop and pursue the same kind of quality sales leads and customers that you can generate through word of mouth advertising.

You must use different sales techniques than your competition. Describe your sales strategy. How do you distinguish yourself and sell a difference in your product rather than compete on price alone? How you create credibility for your company? How you beat the infamous low bidder? Be sure to describe your unique selling position and pricing strategy.
VI. Finance

A. Structure
B. Statements
   1. Balance Sheets
   2. Income Statement
C. Projections

This is where you show that your company has the proper financial structure and that you and your team are financially responsible. Project the idea that you have a well-established system of accounting and financial statements. Be sure to show hands-on involvement of your management team.

The financial structure of your company is composed of bookkeeping records and financial statements. You'll want to describe who does your accounting, how often, and what statements you regularly prepare. Be sure to include whether you use manual accounting systems or automated computer software. If you are applying for a loan . . . be sure to discuss that fact . . . show how you will use the money . . . and how you will pay it back.

Include some of your financial statements, with a description of each. Have at a minimum, a balance sheet and income statement. **The balance sheet** describes your company at a specific point in time. Attach past balance sheets and the most current one. **Income statements** show the financial activity of your business over a period of time. Be sure to attach the latest income statement and statements from previous years. Attach a sheet with each statement discussing the highlights of your company's growth, profitability, or the need for capital. Obtaining a loan may require as many as three years of financial statements.

Include a section with projections to develop some assumptions about the future. Draw from past statements and market research you have done. Include in your projections future income, cash flow budgets, and breakeven analysis charts. The income projection statement is a forecast of future revenues that should carry out over at least two years. The cash flow budget projects how much and when cash must flow in and out of your business. Include a breakeven analysis for future sales levels.

The financial section will take some time and effort. You'll need to work with your accountant or bookkeeper. Stay positive and remember accounting is very important to a stable business and significant profits.
VII. Supporting Data

This section allows you to attach helpful information so the reader can get a better picture of your business. A positive credit report can be a huge selling point for your business. If it's good show it off. If your credit report is not good, work on improving it. This can be a great selling advantage. Include some graphics in this section. Photographs and drawings are a great way to bring closure to the plan.

VIII. Conclusion

Restate the main points in the executive summary. Be brief but highlight the strong areas of your business. Focus on the audience, whether it is a loan officer, a new employee, a potential buyer of the company, or any other entity. The conclusion should be a call to action based on the strengths of your company.
Developing Strategy

Information from your business plan can be used to look at the elements in the internal and external environment that can have an impact on your business. The information can then be used to develop a way, or strategy to capitalize on those elements. The goal is to gain a competitive advantage and make a profit. It is vitally important to succeed in strategy development if your company is to succeed and stay in business. The question is how . . . And that question is increasingly difficult to answer in the changing markets and speedy communication that have become the norm as we enter the 21st century.

So, what is strategy?

The American Heritage Dictionary defines strategy as "the science and art of military command as applied to the overall planning and conduct of large-scale combat operations." The military connection should not be overlooked. In many markets, it's all-out war among competitors. Some textbooks define strategic management "as the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives."

You can see in both definitions that strategy development is a high stakes endeavor. With military strategy development we are determining the fate of nations and if a people will live in freedom or under tyranny. With business strategy development we are determining the success or failure of our company, and consequently our financial future, the lifestyle we can enjoy, leisure activities we can afford and the time we will have available to enjoy it.

You can also see an emphasis in both definitions on planning or a plan. In this changing world, the emphasis should also bear a warning . . . that while some businesses may find success through a planned or intended strategy, just as many success stories have come from an unanticipated change in course or emergent strategy. As you move forward with your plans and implement strategy . . . stay flexible. Be open to new trends, emergent technology and changes in the business environment. Adjust your plans to take advantage of new opportunity.

SWOT

Before you can begin to develop business strategies you must first gather information about your company, the competition, and the external business environment. You should start with a look at all strengths, weaknesses, opportunities and threats inside and out of your company. You must perform what is called a SWOT Analysis.

You should examine your business plan in light of the local market and what your competition’s business plan would look like.

You should pick out SWOT.
The first two components (Strengths and Weaknesses) generally deal with elements found within the company, and the last two (Opportunities and Threats) examine the environment outside the company including your competition. SWOT profiles, along with a company’s mission and major goals, make up the tools you'll need to develop and form strategies. These game plans reflect in broad terms how, where and why your company should compete as well as against whom.

**Importance of mission, core competencies and time in strategy development**

As you gather supporting data from the SWOT analysis and before you begin creating strategy remember that there are other important aspects of your business that should be incorporated into the strategy. Decisions on strategies to pursue should be anchored by the mission . . . they should be based on your core competencies . . . and time frames should be considered.

Without some framework of what your company stands for and hopes to achieve, how can it court potential customers? The mission defines the unique purpose that makes the company different from other contracting businesses. It should be an integral part of your company strategy.

Decisions on strategies to pursue should also be anchored in your core competencies. You should base all strategies on areas that you have competence in. Just because a SWOT analysis identifies what looks like a good opportunity, it does not necessarily mean you should develop strategies to pursue it. Make sure you pursue only strategies in areas that your business has the competence to succeed in.

Time frame is also an important consideration. Traditionally, the top-level strategies were aimed five years into the future, and the time span of sub-strategies or tactics were shorter. Now, some businesspeople question the wisdom of trying to project from today's world what the company will look like in five years. The world may be changing too quickly for such long-term vistas, particularly in rapidly developing industries, services with changing markets, or in areas in which government regulation is being added or removed.

Would you trust yourself to develop a strategy for Microsoft Inc. today that you believe would be valid five years from now? With deregulation in Texas, can you see the dilemma electric utilities (traditionally a monopoly) face as private businesses enter their markets and force them into becoming competitive? Can you be certain of regulatory changes we will face with increasing population pressures on the environment and on water supplies in Texas?

Some businesspeople believe the focus should be on short-term strategies with the long-term strategy being more general in nature.
All agree that managers should stay flexible and be ready to adapt strategies to a rapidly changing world. After a strategy is selected and implementation begins, competitors may react, and your company may have to evaluate its strategy in terms of a new “playing field.” Remember, this is a dynamic system. The strategic decisions were made at a fixed point in time, but their implementation occurs in real time, in an uncertain future.

Creating Strategy

Once you have gathered all of the information needed such as the SWOT analysis, mission statement and detailed description of core competencies, you can begin to create strategies for your company. Strategy development is a matter of working with a series of dichotomies . . . or a series of choices to make connections between two concepts that seem to be at odds with each on the surface but are really irreversibly connected.

One example of this type of dichotomy is price and quality. On the surface they seem to be opposing values. You can’t have high quality and low price at the same time. It may also seem that you can separate them . . . to just quote a price on a job for example. But in reality they are inseparable. Any time you discuss price, a level of quality is implied. Any time you discuss quality, pricing levels are implied.

The challenge and the pay off in strategy development is to build your strategies around these dichotomies . . . to make the connections in your strategies and help your customers make the connection in their minds. For example, the first question most customers ask a contractor is “How much will it cost me?” That is an incomplete thought since there is no reference to quality. In addition it shows a lack of understanding on your customer’s part that not all contractors do the same quality of work. It also shows some false assumptions by the customer that they already know what they actually need . . . which is often not the case.

So the challenge then, is to develop strategies that allow you to educate your customers and make the connection between price and quality in their minds before, or at the same time you quote a price. Sell yourself to gain credibility. Do your homework to determine what they really need, and sell what has value to them . . . before you sell them on the price.

Selling on price alone is a no-win strategy. There will always be someone behind you waiting to beat your price by $100. They are usually the contractors who lack the business skills to know their bottom line or how much return they need to provide consistent quality and grow their business. They are also the contractors who don’t know how to sell quality because they have not developed skills in marketing and sales. Often in cases like this the customer gets a lower quality because the contractor finds he doesn't have enough money in the bid to do a good job.

The winning and most profitable strategies revolve around educating your customer to see that not all contractors are equal, not all resulting systems are equal and therefore not all bids are equal. Chapter VII outlines some of the skills to use to help you make this happen.
You should also recognize that some potential customers have mental rules that will make it very difficult and sometimes impossible for you to sell to them at the level of profit you need. Give it your best shot but don’t be reluctant to let your competition have the customers who can’t see the quality you are selling. Build your strategies around the most profitable customers . . . Develop sales and marketing skills that allow you to focus on the most profitable top half of the market.

You should build separate strategies for each market segment you want to penetrate and each major business goal you want to achieve. Build your strategies around the following dichotomies, focusing on what makes your company different, and staying within the areas your company has the skill and competence to succeed.

<table>
<thead>
<tr>
<th>What makes you different?</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Quality and Price . . . or . . Low Quality and Price</td>
</tr>
<tr>
<td>Narrow Product Line . . . or . . Broad Product Line</td>
</tr>
<tr>
<td>High-Tech Products . . . or . . Low-Tech Products</td>
</tr>
<tr>
<td>Trendy Products . . . or . . Conservative Products</td>
</tr>
<tr>
<td>Brand-Name Products . . . or . . Generic Products</td>
</tr>
<tr>
<td>Customized Products . . . or . . Standard Products</td>
</tr>
<tr>
<td>Niche Market . . . or . . General Market</td>
</tr>
<tr>
<td>High Service . . . or . . Low Service</td>
</tr>
</tbody>
</table>

While there are many approaches to strategy, here are some of the most common. Many contractors include several of these elements in the strategy they develop for their company.
Price and Quality: As already discussed, price and quality are the most common strategic elements. The strategy may be to produce a superior quality product or service and charge appropriate price, or to produce a lower cost item and charge a lower price.

- Simply aiming to be the low bidder is not a strategy. Positioning yourself in the low end of the market and going after work for a mobile home sales company at a defined minimum quality level would be a low-cost strategy. By the same token positioning yourself to go after the high-end housing market, selling quality and only bidding on work above a certain price range would also be a strategy.

State-of-the-art products: offering the most technically advanced products can form a powerful strategy if you have developed that capability. This strategy can get you a premium price in some market segments if your competition has gone low-tech. In other market segments, low tech, and reliability can be a winning strategy.

- O.S.S.F. contractors making a decision to market Hoot brand Class-I aerobic treatment units and promoting the high-tech advantages of that system - or - deciding to offer advanced control systems with off-site monitoring and control capability, both would be examples of this strategy.
- The opposite strategy would be selling the advantage of low-tech systems by stressing proven reliability.

Trendy products: The current trend toward fashionable products can earn you a premium price.

- Examples would be controller or aerator covers that are designed to look like features of the landscape. A fiberglass, weatherproof cover that is designed to look like a landscaping boulder for example.

Brand name products: Some manufacturers do a considerable amount of consumer marketing and have developed wide brand name recognition. Certain market segments respond positively to recognized brand names.

- Deciding to feature these brand names at a premium price could be a strategy. Deciding to sell generic or less recognized brands at a lower cost could also be a strategy.

Customized products: Making your products different and focusing on a smaller segment of the market can be a strategy.
A common strategy of smaller firms is to offer a high degree of customization, allowing them to specialize and focus more on their identified market segment than would be allowed from the typically more standard offerings of larger firms.

**Niche market:** Offering unique products or services that service obscure niche markets is another common strategy for smaller companies. Typically the smaller volume increases operating costs but there's less competition that usually allows a higher markup.

- Specializing in systems that treat high strength waste would be an example for O.S.S.F. contractors.

**Service:** Including a high degree of service is often used to differentiate a business from the competition that offers minimal or very little service.

- **Making broad statements like** "our goal is to please all of our customers" is not a strategy. Setting definite service standards with time frames and follow-up then incorporating them into company policy is a service strategy.

**IMPORTANT NOTE:** Incorporate what your customers value the most when working out your strategies. Refer to the Stanford Research Institute’s Values and Lifestyles Survey in chapter VII for information on what the most common market segments value most.
Real World Criticisms of Formal Planning Systems

While developing a detailed business plan is considered vital to developing a company’s financial resources and full operational potential . . . Not everyone agrees on one best form of the strategic planning. The model to fit a company's abilities to the demands of the environment, using SWOT, was developed at the Harvard Business School during the 1960s. Research into the usefulness of formal planning has found mixed results, and history has shown major missteps by companies that acted on extensive strategic planning, but read the crystal ball of the future wrong.

Tom Peters and Robert Waterman, authors of “In Search of Excellence”, question the value of formal planning in strategic decision-making.

Henry Mintzberg of McGill University proposes that emergent strategies may be as successful as intended strategies.

C.K. Prahalad of the University of Michigan and Gary Hamel of London Business School say that traditional strategic planning focuses too much on current resources and environment and not enough on future opportunities. They prefer a strategic intent model, the setting of ambitious goals that force a company to stretch beyond its current abilities, with a focus on finding ways to develop the capability to achieve those goals. Their model is still hinged, however, on information gathered while developing a business plan . . . on the mission statement, and the SWOT analysis of the strategic planning model.

No magic bullet has been found that will produce successful strategies every time. However the development of a business plan and performing a SWOT analysis will help you focus on what’s most important and cause you to gather information needed to formulate a business strategy that has the best chance of success.
Chapter 3

Budgeting, Accounting and Finance with Profits in Mind

Overview

The goal of this chapter is to build the foundation of knowledge necessary for you to use budgeting and accounting as a management tool.

Learning Points

Contractors need to understand the basic concepts in accounting and apply them to their business.

An accounting system consists of journals and ledgers that are kept to record every financial transaction made by a company.

Budgeting is used to identify how much work a company must complete to earn the profit that is needed for successful operation.
Basic Accounting

Whether you have a full-time bookkeeper, an outside consultant, or in-house capability with a computerized software package, you need to understand the basic concepts in accounting. Basic accounting consists of keeping accurate records of your financial transactions in a consistent and reliable way. This is done by establishing a set of consistent categories to track income and expenditures and then keeping the entries current at regular intervals. The set of consistent categories is called a Chart of Accounts.

A basic accounting system also uses two basic financial accounting reports to compare, analyze and track the data . . . Balance sheet and Income statement.

Each of the three elements of a basic accounting system is explained in the following sections.

Chart of Accounts

A Chart of Accounts is simply a set of records tracking every expenditure and income item by category. The Chart of Accounts is the name given to the list of individual account categories that you assign to each type of expense or income. The income and expense categories are usually determined based on income tax reporting requirements or areas the business owner needs to monitor or analyze. General categories such as “Direct Job Costs” or General & Administrative Overhead” are usually broken down into subcategories such as “Direct labor” and “Job Material” or Advertising” and “Equipment Parts and Repair”.

Expenses and income can then be tracked and recorded on the Chart of Accounts using either the Cash Method or Accrual Method.

Cash accounting is simply recording expenses and income as cash is received or dispersed. Cash accounting is usually preferred by smaller businesses because it is a simple method to use and it is most familiar . . . It is basically a running total like a check book balance which is organized into items by category.

Accrual accounting is simply a method of recording changes in income or expenses as they are incurred, regardless of whether on not the actual cash has been received or dispersed. Larger businesses usually prefer accrual accounting because it reflects changes when they actually occur. Companies operating on credit or with large accounts receivables have a more up-to-date, accurate picture of their financial position with an accrual accounting system.

There are several very good computer accounting software systems that can be used to set up your Chart of Accounts. Many of these programs integrate into other tax and accounting programs that can simplify not only your accounting but also allow you to
directly interface with your bank on-line and download directly into electronic Federal Income Tax Forms. I highly recommend the use of these computer tools to simplify your accounting and reporting needs.

I use a program called “Quick Books Pro” which both interfaces with my bank account on-line and downloads my Chart of Accounts directly into the appropriate slots on electronic Federal Income Tax Forms in a program called “TurboTax”. The program costs were minimal . . . less than $300 for “Quick Books Pro” and about $60 for the Small Business Version of “TurboTax”. This combination works very well for me, but there are several other good programs to choose. Find a combination that works for your business.

**Balance Sheets**

A balance sheet provides a snapshot record, at a specific point in time, of everything your business owns (its assets) and all it owes (its liabilities) and the owner's equity. Assets include cash, inventory, accounts receivable and fixed assets such as property, equipment and vehicles. Liabilities include accounts payable, mortgages, leases, loans, and taxes owed. On the balance sheet total assets equal the total liabilities plus the owner's equity.

A projected balance sheet is a prediction of your business’ net worth at a specific time in the future. Potential lenders or investors will want to see a projected balance sheet covering one to three years into the future.

**The Anatomy of a Balance Sheet**

The typical balance sheet displays the businesses assets on the left side of the page and liabilities and net worth on the right side of the page. Some times the format places assets at the top of the page and liabilities on the bottom.

**BALANCE SHEET**

\[
\text{ASSETS} = \text{LIABILITIES} + \text{NET WORTH}
\]

Assets are normally broken down into two main categories: Current Assets and Fixed Assets. The current assets usually mean anything that can be converted to cash within one year. Fixed assets are more permanent things like buildings or major equipment.
Liabilities are divided in a similar manner. They are normally shown as current liabilities (that which is owed within one year) and long-term debt. Current liabilities include bills for items such as inventory, salaries, rent, etc. Long-term debt is normally those items that by agreement do not need to be paid back quickly, such as a mortgage or long-term note.

The difference between assets and liabilities equals net worth. That is, after all bills and notes are paid, anything left is net worth. Another definition is that net worth is what is due the owner of the business once all liabilities have been paid.

\[
\text{ASSETS} - \text{LIABILITIES} = \text{NET WORTH} \\
\text{OR} \\
\text{ASSETS} = \text{LIABILITIES} + \text{NET WORTH}
\]

**Why It Is Called a Balance Sheet**

The keyword here is balance. Because both the total assets and liabilities and net worth totals are the same, they balance. That is true even if liabilities exceed the assets. In that case, net worth becomes negative and it must be subtracted from the liabilities, instead of being added.

**How a Balance Sheet Is Prepared**

A balance sheet is a document that uses the principal of double entry accounting. It is called double entry, because each business action affects two or more accounts. For example a sale will increase Cash or Accounts Receivable but decrease Inventory. An Account can be Cash, Inventory, money you owe (Accounts Payable), or owed to you (Accounts Receivable) etc. Accounts are organized in categories called Current or Fixed Assets on one side of the sheet, and Current or Long-term Liabilities on the other. Assets and liabilities (plus net worth) must always balance, hence the name balance sheet.

For example, let’s suppose that a new business started with the owner's savings of $100,000. The beginning balance sheet would look something like this:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>CURRENT ASSETS</td>
<td>NET WORTH</td>
</tr>
<tr>
<td>Cash $100,000</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

The owner then decides to purchase supplies or inventory for their contracting business. For example Hydro-Action runs a onetime special sale to dealers on aerobic
treatment units, but only if they take delivery within the next 30 days. So, the business owner decides to stock up and purchases $50,000 of merchandise (inventory), but pays only $25,000 in cash (this will reduce cash by $25,000) and promises to pay the other $25,000 in 30 days, (this creates a new account called Accounts Payable) placed under the category of Current Liabilities.

The balance sheet would now look like this:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>CURRENT ASSETS</td>
<td>CURRENT LIABILITIES</td>
</tr>
<tr>
<td>Cash</td>
<td>Accounts Payable $25,000</td>
</tr>
<tr>
<td>$75,000</td>
<td></td>
</tr>
<tr>
<td>Inventory $50,000</td>
<td>NET WORTH $100,000</td>
</tr>
<tr>
<td>TOTAL $125,000</td>
<td>TOTAL $125,000</td>
</tr>
</tbody>
</table>

The balance sheet is in balance with the addition of $25,000 that is owed to the vendor. It is placed under current liabilities because it is due to be paid back in a specified period of time that is less than one year. Current Assets are those items that can be converted into cash within a year.
Now let's suppose that the owner buys a building for $100,000. He puts $25,000 down and obtains a $75,000 mortgage for the remainder.

The balance sheet would now look like this:

<table>
<thead>
<tr>
<th>BALANCE SHEET</th>
</tr>
</thead>
<tbody>
<tr>
<td>CURRENT ASSETS</td>
</tr>
<tr>
<td>Cash $50,000</td>
</tr>
<tr>
<td>Inventory $50,000</td>
</tr>
<tr>
<td>TOTAL CURRENT ASSETS $100,000</td>
</tr>
<tr>
<td>FIXED ASSETS</td>
</tr>
<tr>
<td>Building $100,000</td>
</tr>
<tr>
<td>TOTAL FIXED ASSETS $100,000</td>
</tr>
<tr>
<td>TOTAL $200,000</td>
</tr>
</tbody>
</table>

(Note the addition of two new accounts, one called long-term debt, because it is to be paid over a period longer than a year; and the second account called fixed assets that includes land, buildings, and equipment.)
When sales are made, inventory will decrease and cash will increase. If some sales are made on credit, a new account called Accounts Receivable will need to be added under Current Assets. But suppose that $20,000 of the inventory is sold for $25,000, ($15,000 is received cash and $10,000 is on credit).

The balance sheet would look like this:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
<td><strong>CURRENT LIABILITIES</strong></td>
</tr>
<tr>
<td>Cash $65,000</td>
<td>Accounts Payable $25,000</td>
</tr>
<tr>
<td>Accounts Receivable $10,000</td>
<td></td>
</tr>
<tr>
<td>Inventory $30,000</td>
<td>TOTAL CURRENT LIABILITIES $25,000</td>
</tr>
<tr>
<td><strong>TOTAL CURRENT ASSETS</strong></td>
<td></td>
</tr>
<tr>
<td>$105,000</td>
<td></td>
</tr>
<tr>
<td><strong>FIXED ASSETS</strong></td>
<td><strong>LONG TERM DEBT</strong></td>
</tr>
<tr>
<td>Building $100,000</td>
<td>Mortgage $75,000</td>
</tr>
<tr>
<td><strong>TOTAL FIXED ASSETS</strong></td>
<td>TOTAL LONG TERM DEBT $75,000</td>
</tr>
<tr>
<td>$100,000</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>TOTAL</strong></td>
</tr>
<tr>
<td>$205,000</td>
<td>$205,000</td>
</tr>
</tbody>
</table>

(*profit from example sale)

Note that this business action affected three accounts that are on the assets side of the balance sheet, one account (inventory) lowered, while the cash account increased and a new account called Accounts Receivable was added, so that the total did not change.

To complete the balance sheet the company name and address has been added along with the date of preparation. The balance sheet is a snapshot of how a business stands at any given point in time.

Now let's take a look at how an income statement is prepared.
**Income Statements (sometimes called Profit & Loss Statement)**

An income statement presents your actual business revenues and expenses. The difference between these is your company's net profit (or loss) over a specified period of time. The income statement or profit and loss statement shows the total actions of a business over a period of a month, a quarter or a year.

**The Anatomy of an Income Statement (profit and loss statement)**

Let’s take an example and construct an income statement for a contracting company for the period of a year. The income statement begins when a sale is made. So the first entry or account would be Sales. For example, if your company’s sales for the year totaled $355,000, this is how it would look on a profit and loss statement.

<table>
<thead>
<tr>
<th>Sales</th>
<th>$355,000</th>
</tr>
</thead>
</table>

The next entry would be the direct job costs. Let’s say that the direct job costs for the year was as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct labor</td>
<td>$67,450</td>
</tr>
<tr>
<td>Direct labor payroll taxes</td>
<td>6,800</td>
</tr>
<tr>
<td>Job material</td>
<td>99,400</td>
</tr>
<tr>
<td>Subcontractors</td>
<td>11,000</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>3,300</td>
</tr>
<tr>
<td>Other direct job costs</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Total Direct Job Costs</strong></td>
<td><strong>$189,950</strong></td>
</tr>
</tbody>
</table>

The next step is to subtract total direct job costs from net sales. The added entries would appear on the profit and loss statement as shown below:
### Net Sales

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct labor</td>
<td>$67,450</td>
</tr>
<tr>
<td>Direct labor payroll taxes</td>
<td>6,800</td>
</tr>
<tr>
<td>Job material</td>
<td>99,400</td>
</tr>
<tr>
<td>Subcontractors</td>
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</tr>
<tr>
<td>Fuel oil</td>
<td>3,300</td>
</tr>
<tr>
<td>Other direct job costs</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Total Direct Job Costs</strong></td>
<td><strong>$189,950</strong></td>
</tr>
</tbody>
</table>

### Gross Profit

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit</td>
<td>$165,050</td>
</tr>
</tbody>
</table>

The next entries that go on a profit and loss statement are the expenses connected with running a business. In the example on the next page we call this category of expenses General and Administrative Overhead. Expenses are either cash or accrued.

The profit and loss statement now looks like the example on the next page: (Note that it now has a heading that covers a period of time, in this case one year.)
PROFIT AND LOSS STATEMENT
EZ CONTRACTING COMPANY
JANUARY 1, 2001 THROUGH DECEMBER 31, 2001

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales</strong></td>
<td>$355,000</td>
</tr>
<tr>
<td><strong>Direct Job Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Direct labor</td>
<td>67,450</td>
</tr>
<tr>
<td>Direct labor payroll taxes</td>
<td>6,800</td>
</tr>
<tr>
<td>Job material</td>
<td>99,400</td>
</tr>
<tr>
<td>Subcontractors</td>
<td>11,000</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>3,300</td>
</tr>
<tr>
<td>Other direct job costs</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Total Direct Job Costs</strong></td>
<td>$189,950</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>$165,050</td>
</tr>
<tr>
<td><strong>General &amp; Administrative Overhead</strong></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>5,000</td>
</tr>
<tr>
<td>Equipment parts and repairs</td>
<td>3,400</td>
</tr>
<tr>
<td>Equipment rentals/lease</td>
<td>1,700</td>
</tr>
<tr>
<td>Equipment/vehicles insurance</td>
<td>2,500</td>
</tr>
<tr>
<td>Insurance/hospital and life</td>
<td>4,200</td>
</tr>
<tr>
<td>Insurance/liability</td>
<td>2,250</td>
</tr>
<tr>
<td>Insurance/workers comp.</td>
<td>4,200</td>
</tr>
<tr>
<td>Office expenses</td>
<td>2,800</td>
</tr>
<tr>
<td>Payroll taxes</td>
<td>5,700</td>
</tr>
<tr>
<td>Rent/facilities</td>
<td>8,300</td>
</tr>
<tr>
<td>Salaries/officer</td>
<td>50,000</td>
</tr>
<tr>
<td>Salaries/office managers</td>
<td>15,700</td>
</tr>
<tr>
<td>Small tools and supplies</td>
<td>2,300</td>
</tr>
<tr>
<td>Telephone, radio, fax</td>
<td>3,250</td>
</tr>
<tr>
<td>Training</td>
<td>3,600</td>
</tr>
<tr>
<td>Travel and entertainment</td>
<td>850</td>
</tr>
<tr>
<td>Utilities</td>
<td>1,400</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>1,400</td>
</tr>
<tr>
<td><strong>Total G. &amp; A. Overhead</strong></td>
<td>$118,550</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>$308,500</td>
</tr>
<tr>
<td>Operating profit</td>
<td>46,500</td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,200</td>
</tr>
<tr>
<td>Interest expense</td>
<td>1,500</td>
</tr>
<tr>
<td><strong>Profit Before Taxes</strong></td>
<td>$42,800</td>
</tr>
</tbody>
</table>
Budgeting

A budget is defined in the Merriam-Webster’s Dictionary as a plan for the coordination of resources and expenditures. As such it is a plan for the future of your business based on the assumptions you make about future income and expenses. In real world business terms, Budgeting is used to identify how much work your company must complete to earn the profit that you need. Profit is not a luxury. It is a very necessary part of the business financial picture. Budgeting also helps you control overhead expenses, and helps determine if there are enough resources to do the work; or if the resources are being maximized for efficiency and helps insure that you never run out of cash needed to operate.

Segments of the Complete Contractor’s Budget

1. Income Forecasting
2. Expense Budgets
3. Cash Flow Projections
4. Profit Projections

A complete budget or set of projections for the future of your business should include all of the above segments. All are related. Preparing a realistic budget is quite a task. It involves working and re-working the budget sheets until you come up with a plan that is realistic and meets all of you business’s needs for both cash flow and profit. It is worth the effort however since it is possible to control the future of your business to the extent that income, costs, expenses, and cash flow are predictable.

Use the attached Sample Budget Sheets and the following guidelines to develop your company’s forecast for the future.
**Income Forecasting:**

Estimating future revenues is not difficult if you base your projections on historical revenue for your company. To that you can factor in the amount of growth you expect based on experience and resources you have gained over the past year as well as strategies you have developed for your company. Analyze closely and be certain that you have enough resources in the form of skill, labor and equipment to do that amount of work involved in the revenue forecast. If you don't have enough resources you need to reevaluate. If you're not maximizing your resources then look at how much more work you can do to become the most efficient with the amount of resources that you have.

---

**INCOME FORECAST SHEET**

COMPANY: _________________
TIME PERIOD: _______________

**SALES**

<table>
<thead>
<tr>
<th>Service</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installation of new systems</td>
<td></td>
</tr>
<tr>
<td>Repair work</td>
<td></td>
</tr>
<tr>
<td>Maintenance Contracts</td>
<td></td>
</tr>
<tr>
<td>Parts Sales</td>
<td></td>
</tr>
<tr>
<td>Seasonal Work</td>
<td></td>
</tr>
<tr>
<td>Equipment Work</td>
<td></td>
</tr>
<tr>
<td>Other (specify)</td>
<td></td>
</tr>
<tr>
<td>Other (specify)</td>
<td></td>
</tr>
<tr>
<td>Other (specify)</td>
<td></td>
</tr>
</tbody>
</table>

**TOTAL PROJECTED SALES**

<table>
<thead>
<tr>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>
Expense Budgets:

Identify and define all expense items that occur because you're in business. Project expenditures in all categories. Itemize line by line. Look at past history to help be realistic, reasonable and accurate. Be certain you're defining necessities and not just things you want. Identify equipment costs, maintenance and projected use for the year. Determine expected costs for materials, sales tax, the number of man-hours to install work, expected equipment usage and how much will be spent on subcontractors.

Be sure to increase projections of direct job costs to reflect all increases in work projected in your Income Forecasting.

Don’t forget to factor in increases in overhead expense that would be incurred if your future plans require additional office space, office supplies, training or other overhead expenses.

See the EXPENSE BUDGET PROJECTION SHEET on the next page.
## EXPENSE BUDGET PROJECTION SHEET

**COMPANY:**

**TIME PERIOD:**

### OVERHEAD EXPENSE

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td></td>
</tr>
<tr>
<td>Bad Debt.</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
</tr>
<tr>
<td>Licenses</td>
<td></td>
</tr>
<tr>
<td>Training/Seminars</td>
<td></td>
</tr>
<tr>
<td>Insurance/liability</td>
<td></td>
</tr>
<tr>
<td>Med. Insurance</td>
<td></td>
</tr>
<tr>
<td>Owner Salary</td>
<td></td>
</tr>
<tr>
<td>Office Salary</td>
<td></td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td></td>
</tr>
<tr>
<td>Legal</td>
<td></td>
</tr>
<tr>
<td>Accounting</td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td></td>
</tr>
<tr>
<td>Office Expenses</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
</tr>
<tr>
<td>Tools</td>
<td></td>
</tr>
<tr>
<td>Travel</td>
<td></td>
</tr>
<tr>
<td>Misc.</td>
<td></td>
</tr>
<tr>
<td>Unapplied Labor</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td></td>
</tr>
<tr>
<td>Repairs &amp; Fuel</td>
<td></td>
</tr>
</tbody>
</table>

**TOTAL OVERHEAD**

---

### COST OF SALES

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials</td>
<td></td>
</tr>
<tr>
<td>Sales Taxes</td>
<td></td>
</tr>
<tr>
<td>Labor</td>
<td></td>
</tr>
<tr>
<td>Labor Burden</td>
<td></td>
</tr>
<tr>
<td>Sub Contractors</td>
<td></td>
</tr>
<tr>
<td>Rented Equipment</td>
<td></td>
</tr>
</tbody>
</table>

**DIRECT COST OF SALES**

**TOTAL PROJECTED EXPENSE**

100%

(Total Overhead + Direct Cost of Sales = Total Projected Expense)
Cash Flow Projections: (Sometimes called Cash Position Charting)
This is one of the most frequently ignored aspects of budgeting, but one of the most important. Profits are not the only objective in operating the company from year to year. Cash must also be available. Several factors can adversely affect cash flow, including a growing level of accounts receivable, excessive investment in fixed assets, or too high a level of debt with associated monthly payments of principal and interest. Use the attached example Cash Flow Worksheet to create cash flow projections for each month of the coming year. Start with your cash position in the first month of the cycle then add monthly projected sales and all other projected sources of cash to be brought in to the business. Subtract all projected cash uses such as the cost of good sold and operating expenses and taxes. The result is Ending Cash for the Month.

<table>
<thead>
<tr>
<th>CASH FLOW PROJECTION SHEET</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPANY: __________________</td>
</tr>
</tbody>
</table>
| TIME PERIOD: _______________

<table>
<thead>
<tr>
<th></th>
<th>January</th>
<th>February</th>
<th>March</th>
</tr>
</thead>
<tbody>
<tr>
<td>STARTING CASH</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>CASH SOURCES</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>Receivables</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>Total Cash Sources</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>CASH USES</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>Cost of Goods</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>Taxes</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>Total Cash Uses</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>NET CHANGE IN CASH</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
<tr>
<td>ENDING CASH</td>
<td>______</td>
<td>______</td>
<td>______</td>
</tr>
</tbody>
</table>

TABLE FORMULAS
Starting Cash = Ending Cash carried over from the previous month
Net Change in Cash = Total Cash Sources – Total Cash Uses
Ending Cash = Starting Cash + Net Change in Cash

Profit Projections:
Identify and define how much profit is needed to make the business worthwhile. Define the profit needed for the following.

- **Profit needed to retire debt.**
- **Profit needed to purchase new equipment.**
- **Profit needed for growth.**
- **Profit needed to warrant the risk involved.**
- **Profit needed to reward employees.**
- **Profit needed to pay taxes.**

Your Profit Projection is the total Income Forecast minus the total Expense Budget. Make certain that the strategy you choose results in sufficient profit to cover all of the above profit needs. If you come up short in your projections, reevaluate your plans.

**PROFIT PROJECTION SHEET**

COMPANY: ____________________
TIME PERIOD: ________________

**PROFIT**

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Justify Risk</td>
<td>______</td>
</tr>
<tr>
<td>Reward Employees</td>
<td>______</td>
</tr>
<tr>
<td>Retire Debt. (1 yr)</td>
<td>______</td>
</tr>
<tr>
<td>New Equip. (1 yr)</td>
<td>______</td>
</tr>
<tr>
<td>Growth</td>
<td>______</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>______</td>
</tr>
</tbody>
</table>

**TOTAL PROFIT REQUIRED**  

**Note:** Total Projected Sales – Total Projected Expenses should be greater than or equal to Total Profit Required. If it is not, go back, re-examine your strategy and rework your Budget Projections. (Expense Budget Projection and Income Forecast Work Sheets)

**Basic Definitions:**

- **Assets** -- Items of worth owned by the company. Cash, accounts receivable, inventory, machinery, trucks, and equipment, are examples.
Breakeven point -- The sales level where all fixed expenses are covered and profit making can begin.

**Budget** -- A plan for the coordination of resources and expenditures.

**Cost of goods sold** -- Your direct cost of providing a good or service to the customer. Materials, labor, equipment, and subcontracting; or the major items that contribute to cost of sales.

**Current assets** -- Cash or items that can be quickly turned into cash. Examples include: cash, accounts receivable and inventory.

**Depreciation** -- The decrease in value of assets over their expected life by an accepted accounting method.

**Direct cost** -- The cost that is easily identifiable with the item being sold. Examples are materials and labor.

**Equity** -- The owners claim to capital that they have invested in the business plus any earnings retained by the business.

**Fixed cost** -- The cost that does not vary with the amount of sales. Examples include: rent, insurance, truck payments, and loan payments.

**Fixed assets** -- Valuable items used for conducting business, rather than for resale. Examples are: land, buildings, improvements, equipment, furniture, and trucks.

**Gross profit** -- Total Sales - Cost of Sales = Gross Profit. The profit remaining after all direct costs are deducted, but before operating expenses (indirect costs and overhead) are deducted.

**Indirect cost** -- Costs that cannot be easily associated with a specific job. Examples are advertising expenses, legal service, accounting service, and insurance.

**Liabilities** -- Debts that the business owes. Examples include accounts payable, taxes, and bank loans.

**Markup** -- The difference between the cost of a product or service to a business and what it charges the customer for that product or service.

**Net income** -- Gross Profit - Operating Expenses = Net Income. The bottom line profit after all costs of doing business have been deducted.

**Operating expenses** -- The business expense that is commonly incurred while conducting business. Examples include depreciation, insurance, rent, salaries, and utilities.

**Overhead** -- The collective term including indirect, general and administrative expenses of the business but excluding direct costs like labor and materials.

**Profit** -- Sales - Total Cost = profit. The amount of money retained by the business after all fixed and variable costs have been deducted from total sales.

**Salvage value** -- The lowest dollar value that the asset will reach when it is fully depreciated.

**Variable costs** -- The cost that will fluctuate directly with the level of sales and production. Examples are materials and labor.
Chapter 4

Ratios and Percentages
The Tools of Finance

Overview

This chapter presents two important tools of the financial trade, ratios and percentages.

Learning Points

Ratios and percentages are tools that help you understand and evaluate the financial side of your business.

There is a major difference between cash and profit

Ratios can help you understand when borrowing makes sense, and help you convince your banker that borrowing makes sense for your business.

You will learn where to obtain data that is meaningful to your business

You will learn how to predict the future from past trends

You will learn tools to help get more productivity from your organization’s expenses.
Introduction to Understanding Ratios and Percentages

Ratios are simple financial tools used to help measure liquidity (financial stability), business profitability, and organizational efficiency. The concepts in this chapter may seem complex at first, but will become clearer as you work with ratios and percentages. Be persistent and learn how to use the tools of financial analysis. In doing so, you will gain additional insight into your business operation . . . and you will learn to see your business as your banker or loan officer sees it.

The purpose of all financial analysis is to determine the financial effects on a business based on current, past and possible future managerial business decisions. Ratios and percentages will help you accomplish this. Since all aspects of a business are interrelated, it is essential that accurate measurements be taken of its financial operations to determine future courses of actions in order to make the best possible financial decisions. The most important point is that every business must determine their needs and decide which ratios are most meaningful and most appropriate to use. Not all ratios will be needed. Each business should first have an accurate accounting system to provide accurate financial information. Then decide which ratios will give them the information they need about their operations.

Why Use Ratios Analysis?

You use ratios everyday. They are common. They provide a better understanding of a wide range of situations. For instance, when you compare mpg of gasoline on your automobile, or hear the unemployment rate on TV you are using ratios. The ratios are easier to grasp and are more meaningful to us than the total number of people out of work or the total number of gallons of gas used. Ratios are useful when we look for the best price per ounce for food, or when we compare batting averages of baseball players . . . or even when we measure pressure in pounds per square inch at a sprinkler head.

Ratios are an even more important tool when you want to measure the progress of your business and compare the business to its competition.

How Ratios are Developed

Ratios describe the relative size of two quantities expressed as the quotient of one divided by the other. For example, the ratio of 50 to 100 is written as 50:100 or 50/100.

Simply put, ratios are expressed by placing one number over another number. For example, “50 divided by 100” is a ratio. It means that 50 is to be divided by 100. The answer will be a percentage. In this case 0.50 or 50% because 50 is one-half of 100. The number on top of a formula represents the figure you're comparing to the bottom figure. For instance, if the 50 of the above
ratio represents $50 of sales and 100 represents $100 of fixed assets “such as a piece of equipment”, you are able to compare the amount of sales generated by the fixed assets. In this example, you are comparing the sales amount to one-half of the value of fixed assets, in other words you have a return on fixed assets of 50 percent. Another way to express this is to use proportions. This means that fixed assets to the sales is in the proportion of 2 to 1.

If the numbers were reversed: 100 divided by 50, then sales became $100 and fixed assets became $50. In this case the fixed assets generated 200 percent . . . or two times their value. In the words of your 4th grade teacher, “50 can go into 100 twice”. In the words of your financial advisor, “the proportion of sales to fixed assets is now two to one.” So, you can see that ratios are fairly simple but powerful tools used indicate how your business is doing. They do not make decisions for you . . . However they do provide information you can use to make sound decisions. Several ratios should be examined before any major decision is made. So, let's look further into percentages and ratios.

What Ratios Measure

Ratios measure proportions. In our example of 100 divided by 50, we were able to determine what proportion one figure is of another. Ratios also measure relationships. They do this because they can translate assets, such as tools/inventory; and liabilities such as payables/loans, into dollar figures. By doing this it is easy to see valuable relationships between two seemingly unrelated items. Ratios also allow you to make comparisons between time periods. For example, a ratio lets you measure your net profit from one month to another, or year to year.

Using Ratios Without Fear

You should use ratios without fear. Think of a ratio as a tool when looking at your business . . . just as you think of trucks and trailers as valuable tools to your contracting business. Ratios are simple to calculate, especially with a hand-held calculator, and easy to use. They provide a wealth of information that cannot be gotten anywhere else.

Ratios cannot take the place of experience or replace good management, but they will make good managers better. Ratios can help to point out areas that need more investigating or assist in developing future operating strategy.

Essentially, financial ratios are compiled by taking numbers from the business’ financial statements and converting them into meaningful relationships and indicators of the financial performance of the business. These ratios are expressed as either as a comparison of one to another, or a percentage (%). Calculating financial ratios covering the current and past fiscal years of a business and then comparing them against each other or comparable industry averages for
the same time period will provide an insight into the business’ financial condition and operating performance.
(Industry averages are included in the appendices).

**Basic rules for ratios**

Careful review of the following five basic rules will ease you into the use of ratios.

1. To determine a percentage change . . . suppose your sales increased 25 percent the first month of the year and 37 percent the second month. It would be wrong to state the second month's increase was 12 percent. This is because both were taken from the same base period (in this case 100). Therefore this is a 12-percentage point increase. To determine the actual monthly increase, the 12-point increase of the second month should be divided by the new base period of 125 (the beginning figure plus the first month's increase) for a true monthly increase of 9.5 percent.

2. When comparing a part to a whole such as net profit to sales, the whole is always the denominator of the fraction or the base. For example, net profit/sales.

3. A percentage of something can increase by more than 100 percent, but it cannot decrease by more than 100 percent. Think of it this way - you can double your money, (200%), but you can only lose 100% of your total investment.

4. Ratios lose significant accuracy when they are excessively detailed. This is important because it means that you don't need a lot of detailed data or figures to use ratio analysis. Analysis is very often significant when used in general ways . . . Ballpark figures are often used.

5. Always remember that ratios will assist you in decision-making but will not make the decisions for you.

**Ratios are quick and easy tools they can give you very useful information but be careful . . .**

- **Stay objective.**
  Don't use ratios to support pre-determined conclusions. Use them to help you better understand your business.

- **Use the correct figures.**
  If you are looking at a percentage change between two-dollar figures, such as a raise in price from $10 to $15, the number you want to compare is the difference between the two-dollar
figures that is $5. This difference figure ($5) is then divided by $10 for a percentage raise of 50 percent. Don't divide $10 by $15 or vice versa.

- **Don't compare meaningless numbers.**
  For example you could compare expenses to the fixed assets and this number is easy to calculate but it has no real meeting in the operation of a business.

**Introduction to ratios**

There are several common ratios that can be used to measure and control a business. You won't use all of the ratios presented but you have this book as a reference for when you may need them. By the same token, there is no need to memorize them, because you can always come back to this part of the book for reference.

Financial ratios do have limitations in their application and are not meant to be used as final answers to understand the financial operations of the business. They are simply used to provide additional information to help make financial decisions. Financial ratios also become more useful when calculated and tracked over time to determine trends in the business.

**Business Ratio Analysis**

There are a number of business ratios which potential lenders and investors will use in order to assess the relative health of your business. Ratio analysis is a useful management tool because it helps identify positive and negative trends in your business performance. Descriptions of many useful financial ratios are included in this chapter.

Two financial analysis tools commonly used by lenders and investors are “return on investment” and “working capital.”

**Return on investment:**
Return on investment is considered one of the best criteria for determining a business’ profitability.

\[
\text{Formula: } \frac{\text{Net Profit}}{\text{Equity}} \times 100 = \%\%
\]

**Working Capital:**
While not a true ratio, it is frequently used with ratios in analysis. Working capital represents assets available to protect the ability of the business to repay short-term obligations. This number alone, however, is not useful without knowing how the working capital is being utilized. The other ratios provide this analysis.

\[
\text{Formula: Current assets - Current liabilities = $?}
\]
Financial Ratios are Categorized into Three Groups:

- Liquidity ratios
- Profitability ratios
- Efficiency ratios

The first set of ratios are called liquidity ratios because they measure the amount of cash available to cover expenses, both current and long-term. These ratios are especially important in keeping a business alive. The fastest way to go out of business is not paying your bills on time due to a shortage of cash. *Lending institutions often do not want to loan money when it is actually needed. Make arrangements ahead of time for a line of credit. The best time to do this is when your business liquidity looks very good. Make sure your line of credit agreement is always in writing!*

The second set of ratios is called profitability ratios. These ratios measure and help control income. This is done through higher sales, larger margins, getting more from your expenses, and/or a combination of these methods.

The third set of ratios is called efficiency ratios. Efficiency ratios measure and help control the operation of your business. They add another dimension to help you increase your income by assessing such important transactions as the use of credit, control of inventory, and/or management of assets.

Which Ratios to Use

Some of the ratios are more important and more useful than others. While I have included many types of ratios for your use, your commercial loan officer will be concerned most with the following.

- Current or Quick Ratio
- Debt to Net Worth Ratio
- Net Profit Ratio
- Return on Investment Ratio

Focus on them and you will understand what your commercial loan officer is focusing on to make judgments about your company’s ability to pay him back and the profitability of your company.

As you study each type of ratio remember that the figures given as the “Generally accepted standard” in this chapter are general guidelines. For specific numbers that you can use to compare your business with other contracting businesses just like yours, refer to the appendices for copies of the relevant pages from Ratio Industry Averages Books. They are listed by category. There is no
category for OSSF Contractor. You should look for a category that closely matches your main business function such as “specialty trade contractor” or “plumbing, Heating & air conditioning contractor.” These are the averages that your business will be compared with by financial people such as commercial loan officers.
In the following explanations of ratios, each figure used to develop the ratio will be taken from the Balance Sheet and Profit & Loss Statement attached.

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Notes Payable</td>
</tr>
<tr>
<td>16,540</td>
<td>3,381</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>Accounts Payable</td>
</tr>
<tr>
<td>5,500</td>
<td>2,842</td>
</tr>
<tr>
<td>Inventory</td>
<td>Other Current Liabilities</td>
</tr>
<tr>
<td>3,675</td>
<td>2,132</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>Total Current Liabilities</td>
</tr>
<tr>
<td>1,133</td>
<td>8,355</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td></td>
</tr>
<tr>
<td>26,848</td>
<td></td>
</tr>
<tr>
<td>Land/building</td>
<td>Mortgage</td>
</tr>
<tr>
<td>50,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Equipment/fixtures</td>
<td>Other Long Term Debt</td>
</tr>
<tr>
<td>22,000</td>
<td>4,484</td>
</tr>
<tr>
<td></td>
<td>Total Long-Term Debt</td>
</tr>
<tr>
<td></td>
<td>29,484</td>
</tr>
<tr>
<td></td>
<td>Net Worth</td>
</tr>
<tr>
<td></td>
<td>61,009</td>
</tr>
<tr>
<td>Total Assets</td>
<td>Total Liabilities &amp; Net Worth</td>
</tr>
<tr>
<td>98,848</td>
<td>98,848</td>
</tr>
</tbody>
</table>

**PROFIT AND LOSS STATEMENT**

**EZ CONTRACTING COMPANY**

**JANUARY 1, 2001 THROUGH DECEMBER 31, 2001**

<table>
<thead>
<tr>
<th>Net Sales</th>
<th>$355,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Job Costs</td>
<td></td>
</tr>
<tr>
<td>Direct labor</td>
<td>67,450</td>
</tr>
<tr>
<td>Direct labor payroll taxes</td>
<td>6,800</td>
</tr>
<tr>
<td>Job material</td>
<td>99,400</td>
</tr>
<tr>
<td>Subcontractors</td>
<td>11,000</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>3,300</td>
</tr>
<tr>
<td>Other direct job costs</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Total Direct Job Costs</strong></td>
<td><strong>$189,950</strong></td>
</tr>
</tbody>
</table>

| Gross Profit               | $165,050           |

<table>
<thead>
<tr>
<th>General &amp; Administrative Overhead</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>5,000</td>
</tr>
<tr>
<td>Equipment parts and repairs</td>
<td>3,400</td>
</tr>
<tr>
<td>Equipment rentals/lease</td>
<td>1,700</td>
</tr>
<tr>
<td>Equipment/vehicles insurance</td>
<td>2,500</td>
</tr>
<tr>
<td>Insurance/hospital and life</td>
<td>4,200</td>
</tr>
<tr>
<td>Insurance/liability</td>
<td>2,250</td>
</tr>
<tr>
<td>Insurance/workers comp.</td>
<td>4,200</td>
</tr>
<tr>
<td>Office expenses</td>
<td>2,800</td>
</tr>
<tr>
<td>Payroll taxes</td>
<td>5,700</td>
</tr>
<tr>
<td>Rent/facilities</td>
<td>8,300</td>
</tr>
<tr>
<td>Salaries/officer</td>
<td>50,000</td>
</tr>
<tr>
<td>Salaries/office managers</td>
<td>15,700</td>
</tr>
<tr>
<td>Small tools and supplies</td>
<td>2,300</td>
</tr>
<tr>
<td>Telephone, radio, fax</td>
<td>3,250</td>
</tr>
<tr>
<td>Training</td>
<td>3,600</td>
</tr>
<tr>
<td>Travel and entertainment</td>
<td>850</td>
</tr>
<tr>
<td>Utilities</td>
<td>1,400</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>1,400</td>
</tr>
<tr>
<td><strong>Total G. &amp; A. Overhead</strong></td>
<td><strong>118,550</strong></td>
</tr>
</tbody>
</table>

| Total Operating Expenses       | 308,500            |
| Operating profit               | 46,500             |
| Depreciation                   | 2,200              |
| Interest expense               | 1,500              |
| **Profit Before Taxes**        | **42,800**         |
Ratio Type #1: Liquidity Ratios
Useful liquidity ratios are as follows.

Current Ratio

<table>
<thead>
<tr>
<th>Current Assets</th>
<th>26,848</th>
<th>=</th>
<th>3.21 Times</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Liabilities</td>
<td>8,355</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Measures: The ability to meet short-term obligations. Or the ability of the company to pay its debts.

Generally accepted standard: Current assets should be two times or 200 percent of current liabilities.

Low ratio: A company may not be able to pay off bills as rapidly as it should. It may not be able to take advantage of cash discounts or other favorable terms. It may not be able to keep its suppliers happy and receive eager service. High inventory means high accounts payable.

High ratio: Money that could be working for the business is tied up in government securities, cash savings, or other safe funds.

Remarks: The proper ratio depends on the type of business, time in the business cycle, and the age of the business. You need to know what is proper in your type of business. Industry averages for ratios are included in the appendices.

Quick ratio: this is another variation of the current ratio except it eliminates inventory so that only cash and accounts receivable assets are counted. It is sometimes called the acid test. Some analysts reduce accounts receivable by 25 percent before using this ratio. This depends on how much faith you have in your ability to collect your debts. The ratio looks like this:

<table>
<thead>
<tr>
<th>Cash + accounts receivable</th>
<th>22,040</th>
</tr>
</thead>
<tbody>
<tr>
<td>current liabilities</td>
<td>8,355</td>
</tr>
<tr>
<td></td>
<td>= 2.64 Times</td>
</tr>
</tbody>
</table>

A safe margin would be at least 1.0 times.

Turnover of Cash Ratio
Or Working Capital Ratio

<table>
<thead>
<tr>
<th>Sales</th>
<th>$355,000</th>
<th>=</th>
<th>13.22 Times</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital</td>
<td>$26,848</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

It's often called working capital ratio because it's the amount necessary to operate your business on a daily basis. Working capital is the money you use for
salaries, to pay your bills, etc. The amount of your working capital changes every
time you receive cash, make a cash sale, or write a check.

**Measures:** The turnover of cash or working capital. Maintaining a positive cash
flow or working capital balance will provided an adequate means to finance your
sales without struggling to pay for the material or goods you are buying.

**Generally accepted standard:** Sales should be five or six times of working
capital.

**Low ratio:** You may have funds tied up in short-term low yielding assets. This
means that you make it by on less cash.

**High ratio:** A vulnerability to creditors, such as the inability to pay wages or
utility bills.

**Remarks:** Usually, if the current assets/current liabilities ratio is low, the
turnover of cash ratio will be high. This is due to the small amount of working
capital that is available.

**Debt to Net Worth Ratio**

<table>
<thead>
<tr>
<th>Total Debt</th>
<th>$37,839 ($8,355 + $29,484)</th>
<th>= 0.62</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Worth</td>
<td>$61,009</td>
<td></td>
</tr>
</tbody>
</table>

**Measures:** The total debt coverage expresses the relationship between capital
contributed by the creditors and that contributed by the owner.

**Generally Accepted Standard:** Some analysts feel that current liabilities to net
worth should not exceed 80 percent and long-term debt should not exceed net
worth by 50 percent, or creditors might want as much to say about the operation
of your business as you.

**Low Ratio:** Greater long-term financial safety. This would generally mean you
have greater flexibility to borrow money. An extremely low ratio might mean
that the company’s management is too conservative. This may indicate the
company is not reaching its full profit potential . . . that it is not reaching it’s full
profit potential from leverage, which is realized by borrowing money at a low rate
of interest and obtaining a higher rate of return on sales.

**High Ratio:** Greater risk is being assumed by creditors, therefore, they will have
a greater interest in the way the firm is being managed. Your ability to obtain
money from outside sources will be limited.
Remarks: Again, a lot depends on where the business is in its lifecycle, what the policy of the owners are, the state of the economy, and the particular business cycle. Remember long-term debt is leverage. Leverage can work for you during good times and against you during bad times. This can create decreased earnings if too much money is borrowed.

Ratio Type #2: Profitability Ratios

Profitability is why we are in business. We want better return for money and time than we can get from the bank or other low risk interest paying opportunity. This is one of the most commonly used methods to evaluate whether you are doing well with your business. For example, if savings accounts or money market accounts are paying a higher percentage than you are earning on the money you have invested your business, you'll probably want to consider selling your business and reinvesting your money elsewhere. That is of course unless you like your line of work better than you like making more money. Profitability ratios provide you with the means to measure your earnings in several ways. They measure your profit margin, return on assets, return on investment, and return on sales.

As a general rule, profitability or income comes about from changes in price or volume or both. Therefore, changes of your ratios over time will come about by what you do that affects changes in your price and/or volume. You see this by increases in expenses such as adding salespeople or more advertising; changes that take place as assets are depreciated, or new ones are added; or if borrowing takes place. If you raise or lower your prices, changes will actually be shown by changes in your ratios.

Net Profit Ratio

| Earnings Before Interest and Taxes | $44,300 ($1,500 + $42,800) | 12.4% |
| Net Sales | $355,000 |

Measures: The effectiveness of management. This is a valid comparison between companies in the same industry. This ratio filters out any distortions that may occur because of high debt or other factors that may affect the tax payments or lack of tax payments.

Generally Accepted Standards: This depends on the business and industry. The volume of business is also an important factor as well as the age of the business. Industry averages by size of the business are included in the appendices.

Low Ratio: Perhaps the expenses of doing business are to great; there are inefficiencies; or sales are too low for the costs.
**High Ratio:** There is a high earnings margin or expenses are being held down.

**Remarks:** The measure of what is a good ratio is dependent on the type of business or industry. You should compare this to industry standards like those in the appendices. Earnings before interest in taxes are also called operating income.

**Rate of Return on Sales Ratio**

<table>
<thead>
<tr>
<th>Net Profit</th>
<th>$42,800</th>
<th>= 12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$355,000</td>
<td></td>
</tr>
</tbody>
</table>

**Measures:** How much net profit was derived from every dollar and sales. It indicates how well you have managed operating expenses. It may also indicate whether the business is generating enough sales to cover the fixed costs and still leave an acceptable profit.

**Generally Accepted Standard:** Depends on the business and or the industry. Price and volume are important and play a large role in determining this ratio.

**Low Ratio:** May not be too much in some industries; for instance businesses that have high turnover of inventory or one that uses low margin to attract business such as a grocery store which might show a low ratio, but still be healthy.

**High Ratio:** Usually the higher the ratio the better. However if you are beating last year sales figures in show a steady increase, you're on the right track.

**Remarks:** In analyzing your business, this ratio might be viewed with many facts in mind and used in conjunction with other ratios and analytical tools. Do not use this ratio alone, as you can easily begin comparing apples and oranges. However comparing it with your own results month after month or year after year is valid.

**Return on Investment Ratio**

<table>
<thead>
<tr>
<th>Net Profit</th>
<th>$42,800</th>
<th>= 70.15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Worth</td>
<td>$61,009</td>
<td></td>
</tr>
</tbody>
</table>

**Measures:** Return on the owner’s investment. *Many people use this figure as the final evaluation. It is given a lot of weight by investors.*

**Generally Accepted Standard:** A relationship of at least 14 percent is generally considered necessary to fund future growth.

**Low Ratio:** You may have done better reinvesting your money in savings bonds or some other investment opportunity. This could indicate inefficient
management performance or it could reflect a highly capitalized, conservatively operated business.

**High Ratio:** It could be that creditors are a source of much of the funds, or that management is efficient, or that the firm is undercapitalized.

**Remarks:** This measure is considered one of the best criteria of profitability. It can be a key ratio to compare against other companies or the industry average. It should however be used in conjunction with other ratios. There should be a direct relationship between return on investment and risk. The higher the risk is, the higher the return will be. Remember, net worth is the difference between assets and liabilities. A smaller net worth figure would equate to a higher ratio.

Another measure of return on investment is:

\[
\frac{\text{Earnings Before Interest and Taxes}}{\text{Net Worth}} = \frac{24,000}{143,000} = 16.7\%
\]

**Rate of Return on Assets Ratio**

<table>
<thead>
<tr>
<th>Net Profit</th>
<th>$42,800</th>
<th>= 42.29%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$98,848</td>
<td></td>
</tr>
</tbody>
</table>

**Measures:** The profit that is generated by the use of the assets of the business.

**Generally Accepted Standard:** Varies a lot depending on the industry and the amount of fixed assets that are used, the amount of cash that must be available, etc.

**Low Ratio:** Poor performance, or ineffective employment of the assets by management.

**High Ratio:** Good performance, or effective use of the company’s assets by the owner.

**Remarks:** This ratio can easily be distorted by heavily depreciated equipment, a large amount of intangible assets, or unusual income or expense items. This ratio should be used with other ratios to compare firms in the same industry and of approximately the same size. It is a valid tool if you know the real value of your competitor’s assets (especially fixed assets) and whether they are including outside earnings as a large part of their current assets. If you don’t know, be careful of making conclusions from this ratio alone.

A variation of this ratio would be to split the assets into fixed and current and work a ratio on each of them. Knowing the return on fixed assets could be
important to a business that has to count on a heavy investment in fixed assets such as rolling stock or heavy machinery to generate sales and profits.

**Ratio #3: Efficiency Ratios**

Efficiency ratios measure how well you conduct your business. These ratios provide an indication of how fast you are collecting your money for credit sales and how many times you're turning over your inventory in a given period of time. They measure the amount of sales generated by your assets and return you are earning on your assets.

Efficiency ratios are important tools to keep your business in balance. For instance, if you offer too much easy credit to generate sales, this will show up as an increase in the average number of days it takes to collect your accounts receivable. If you over buy, even with well-meaning intentions of not passing up a real bargain, it will be reflected in a decrease in the turnover of your inventory. If you acquire too many fixed assets without a corresponding increase in sales this ratio will quickly remind you of less sales generated by your assets.

Other ratios will also play a part in maintaining the balance in your business and will aid you in maintaining healthy growth, however the efficiency ratios will usually show problems in your operation sooner.

**Average Collection Period Ratio**

<table>
<thead>
<tr>
<th>Accounts Receivable X 365 Days/year</th>
<th>Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,500 X 365 = 5.65 Days</td>
<td>$355,000</td>
</tr>
</tbody>
</table>

**Measures:** The turnover of receivables. The average period of time it takes to collect your credit sales dollars.

Generally accepted standard: depends on your collection period policy . . . If it is 30 days, than 30 days as the standard.

**High Ratio:** A slow turnover that may be the result of a number of delinquent accounts, or a tax collection policy, or perhaps credit is being used to generate sales.

**Low Ratio:** A fast turnover that could be the result of a stringent collection policy or fast paying customers.

**Remarks:** Generally anything within 10 to 15 days of your collection period is deemed acceptable and considered within the collection period.
Fixed Assets to Net Worth Ratio

| Fixed Assets | $72,000 | = | 118% |
| Net Worth    | $61,009 |

**Measures:** The amount of fixed assets that are part of net worth. This ratio is important because it provides an indication of how much capital is tied up in low liquid assets.

**Generally Accepted Standard:** A rule of thumb for small business is that not more than 75 percent of your net worth should be tied up in fixed assets. If fixed assets are approaching 75 percent of the firm’s net worth, the firm may be hurting for working capital to meet current expenses.

**Low Ratio:** A proportionately smaller investment is fixed assets in relation to net worth, that is, net worth may consist of more liquid type assets. This is a better situation for the creditors.

**High Ratio:** A larger investment in plant and property, which may be hard to liquidate if cash needed, especially if they are not paid for.

**Remarks:** Fixed assets should be carried along the balance sheet as depreciated fixed assets, not original cost. The presence of substantial leased fixed assets (those not shown on balance sheet) may deceptively lower this ratio. The amount of fixed assets depends on the industry: for example the fixed asset requirement for a trucking company or a heavy equipment operating business may be relatively high, they will be low for an average retailer or consultant and not too meaningful.

Investment Turnover Ratio

| Net Sales      | $355,000 | = | 3.59 times |
| Total Assets   | $98,848  |

**Measures:** Ability of the firm to generate sales in relation to assets.

**Generally Accepted Standard:** This will vary greatly depending on the business and the industry; for instance a service business would have limited fixed assets and little if any inventory compared to a manufacturing company. (Industry averages for contractors are included in the appendices.)

**Low Ratio:** The assets may not be fully employed or too many assets may be chasing too few sales. The assets are not pulling their own weight. The firm may be expanding while the business is not growing.
**High Ratio:** More sales may be generated with fewer assets. This may indicate the something good is happening or has happened. Maybe you're getting more sales from the same level of buildings and equipment.

**Remarks:** This ratio should be used only to compare firms within specific industry groups and only used along with other ratios. As with any ratio measuring assets, it can be given a distorted reading if the assets are heavily depreciated or if there are large amounts of intangible assets, such as goodwill. When comparing to other companies or comparing same industry averages, be careful that the asset figures are approximately the same. This ratio does not consider a price increase or decrease, or how well you watch your expenses. This ratio when combined with in the net profit ratio becomes another return on investment ratio.

**Using The Ratios to Perform a Ratio Analysis**

So now that you've learned what ratios are and what they can do for you, we are ready to learn how to organize and use the ratios to analyze the business. A ratio review chart is used for this purpose. Two additional forms are included to help organize ratios and assist you in using the ratio review chart. The first is the data gathering form, which you use to gather necessary figures from the balance sheet and the profit and loss statement. The second form is the comparison chart. It provides place to work your ratios and insert your industry averages. Industry averages are available at public libraries, from your banker, or business associations. Information on industry averages for contractors is included in the appendices.

Not all ratios are equally useful. To determine which ratios to use, you should consider the type of business that you have, the age of your business, point in the business cycle, and what you are looking for. The age of your business is important. If you pass the initial three to five-year startup and have liquidity, you are probably interested in expansion. In this case, the profitability and efficiency ratios will be factors you should closely monitor. This will help to keep your business operation in balance.

OSSF contractors are dependent upon seasonality for income. More sales occur during certain periods of you the year than any other. During each rise and fall of the cycle, ratios can be very different. It is necessary to watch these and anticipate action needed so that your ratios reflect what is needed. For example if you are expecting a big sale but it hasn't come through, or anticipating low sales, you need liquidity to carry you through. If you offer credit, you will need to watch your collection time between the sale and the payment, or you will face a lack of working capital.

And if you're planning for expansion, you should be able to show regular profits, which are in line with your industry. A low debt structure will also help influence lenders to provide the money you need at a favorable interest rate.
<table>
<thead>
<tr>
<th>Items</th>
<th>Dollar Figures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$</td>
</tr>
<tr>
<td>Net Sales</td>
<td>$</td>
</tr>
<tr>
<td>Working Capital</td>
<td>$</td>
</tr>
<tr>
<td>Total Debt</td>
<td>$</td>
</tr>
<tr>
<td>Net Worth</td>
<td>$</td>
</tr>
<tr>
<td>Earnings before Interest in Taxes</td>
<td>$</td>
</tr>
<tr>
<td>Net Profit</td>
<td>$</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>$</td>
</tr>
<tr>
<td>Average Inventory</td>
<td>$</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>$</td>
</tr>
</tbody>
</table>
### Ratio Review Chart

<table>
<thead>
<tr>
<th>Ratio Type</th>
<th>Month or Year</th>
<th>Month or Year</th>
<th>Month or Year</th>
<th>Month or Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working Capital Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt to Net Worth Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Profit Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate of Return on Sales Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Investment Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate of Return on Assets Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average Collection Period Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets to Net Worth Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Turnover Ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This chart gives you a quick look at how your business is doing. You may discover things that you need to take into account because a ratio is low. This review chart is more to help you stimulate your thinking and not necessarily to provide answers. It may be helpful to complete one each month for the ratios that you feel are most important to your business. It may also be helpful to compare several years of ratios.
Using Ratios to Gain Control of Your Business

One of the best ways to gain control of your business is through financial analysis. There are four basic techniques that will help you control your business through the use of ratios and percentages. By gaining control I mean helping you forecast how much money it will take to prepare for a new promotional effort, take on new product line or expand your sales. Control works two ways. First it helps you improve what you are now doing and secondly it helps you prepare for expansion or change without being caught short of cash because you did not have a plan to keep things in balance.

The four control techniques are trend analysis, cash position charting, target statements, and accounts receivable aging schedule.

1. Trend Analysis

Trend analysis is simply a method of keeping track of month-to-month and year-to-year ratios and expenses. It helps you stay on the right path by allowing you see trends in your business and alerting you to adjustments that you need to make to help your business stay successful.

The attached ratio review chart will help you do this. Use the attached chart to help you track your ratios month-to-month and year-to-year. It would also help you to track your expenses both month-to-month and year-to-year.

2. Cash Position Charting (Sometimes called Cash Flow Projections)

In contracting business the lack of cash, even for a short period of time, can cause all of your work and planning to become worthless. Never run out of cash! Never ever! If you can't pay your bills . . . if you can't pay your help and can't pay yourself, you won't be in business very long . . . even if you are showing a profit on paper!

To help you avoid this situation a cash position chart or cash flow projection will be very valuable. It will help you target when cash will be needed to pay bills. It will also help you determine where to obtain cash to support things you need to do in support of expansion . . . such as increasing cash sales or borrowing. A cash position chart deals only with cash. Cash paid out and cash taken it. It helps identify periods when borrowing should be considered and allows you to make arrangements for the cash before you actually need it. It shows professional financial planning and is especially helpful when talking with bankers. We have already covered methodology in the section on budgeting.

4. Target Statements

(This is another approach to budgeting, or projecting income, expenses and profit that was described in the section on budgeting as Income Forecasting, Expense Budgets & Profit Projections)
A target statement is a model (or the ideal) of the balance sheet and profit and loss statement. It's the ideal because it is the one you want to achieve. To make a target statement began by comparing your balance sheet and profit and loss statement percentages with those you wish to achieve. Remember to keep reality in mind when making target statements. Rely on past experience. Experience will probably tell you that you won't be able to achieve a 50 percent increase in sales or reduce expenses by one-half overnight. Steady progress toward your goal is more realistic.

Also take a balanced approach. You can't sacrifice one element of your business very long without causing more problems somewhere else. Use your balance sheets and profit and loss statements help you develop your own target statement. Place a column on both reports, one for your averages and another column for your targets. Then compare the two. Determine the figures that you need to meet your targets for each line item. Use ratios and a cash position chart to help you develop your strategy. You should take into consideration the age of your business, the condition of the economy, your competition, and the nature of your business. Things take time but if you keep your finances straight you will not only survive you'll prosper.

4. Accounts Receivable Aging Schedule

The accounts receivable aging schedule is a simple tool. It is a control technique that can save you both money and headaches. It is simply a record as a reminder of customers who still owe you. It will allow timely follow-up with appropriate overdue notices to delinquent customers, which can head off problems. Experience shows that the longer you wait to collect your accounts receivable, the less likely you are to receive full payment. The following figure shows the collection likelihood for accounts receivable over a period of time. (These are actual statistics from a retail business)

<table>
<thead>
<tr>
<th>Past Due By:</th>
<th>Probability of Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 days</td>
<td>95%</td>
</tr>
<tr>
<td>60 days</td>
<td>82%</td>
</tr>
<tr>
<td>120 days</td>
<td>70%</td>
</tr>
<tr>
<td>6 months</td>
<td>49%</td>
</tr>
</tbody>
</table>
Summary of How to Take Control of Your Business

1. A trend analysis will help you measure the direction that your business is going.

2. A month by month and year by year comparison will accurately develop the trend that your business is taking.

3. Plan to never run out of cash. NEVER EVER. Cash position charting will help you forecast when you will need money and how much money you will need to carry out your business plans.

4. Develop and take aim at a target that you want to hit through the development of a target statement with a target balance sheet and profit and loss statement. (Remember, this is just another approach to the planning & budgeting process discussed in Chapter 3.)

5. An accounts receivable aging schedule is a must if you offer credit. It will help remind you of accounts that are past due which require special attention.
Chapter 5
Bidding and Estimating

Overview

This chapter discusses the process of bidding and estimating. The most common and the best bidding formats will be presented in detail. Individual spreadsheets are formatted in “Microsoft Excel” on computer diskettes that accompany this chapter.

Learning Points

There are several approaches to the bidding process. Some are somewhat risky while others are based on solid planning.

The multiplier bid format is an effective, realistic bid process if it is based on solid planning.

The comprehensive bid format takes into account all costs associated with both the job and with doing business. It is the most accurate method.
Doing good quality work will enhance your reputation and get you some of the best referrals for the best jobs. Sales skills and knowing how close the sale will help you get you work. Both are important skills, however your profit lies in the effort you put into planning and accounting which can lead you to realistic estimates and profitable bids.

There are several approaches to the bidding process. Some are very accurate and profitable. Others are somewhat risky.

**Bidding by the OSSF System Type & Number of Bedrooms - The Educated Guess Format**

There are several quick and dirty methods of bidding such as bidding by the type of system and number of bedrooms. They are fast and easy but fairly risky. They are not recommended unless you have experience with exactly the same type of work you are bidding . . . and not unless you have accurate financial records from these past jobs to know costs and profit levels. Otherwise the tendency with these methods is to bid based on low-cost and not on quality or profitable extras. In most cases it is safer to start with a layout and design that you can do material takeoff on. Without accurate records, anything less is not much more than an educated guess. Do not use this method unless you have previous, profitable experience on exactly the same type of job you are bidding on.

Contractors who make this choice without extensive prior experience on similar jobs that have produced acceptable profit are just pulling some numbers off the top of their heads and hoping their guess keeps them out of the red. They are a professional contractor’s worst nightmare. The good news is that most will eventually go bankrupt. The bad news is the damage they do to professionalism in the industry with unrealistic, low-ball bids and resulting poor quality work because they didn’t figure enough money into their bid to do it right.

The professional’s choice should be one of the following methods.
The Multiplier Bid Format:

Many contractors do a material takeoff and then use what's known as the multiplier method. They come up with the multiplier based on past history to multiply materials or materials and labor by this cofactor such as 2, 2.5 or 3. **Success with this method requires that you have experience in the business, and have kept good records.** The multiplier used depends upon the percentage of materials or materials and labor. The multiplier factor is different for each industry and can be different for commercial vs. residential work within industries. Differences in the multiplier relate to relative percentages of each category. To be successful with this method, you must use a different multiplier for each category of work or type of job. As a general rule; if you are multiplying times materials, the factor you should aim for is 2.25 for onsite installers.

The ratio you ultimately get is dependent upon your sales ability and the market you're in. If you have adequately planned ahead of time, you will know your fixed and variable overhead expenses. You will know the profit level you need to build your business. You will know your true labor costs, including benefits and employment taxes. With this information, you will be confident with the multiplier you develop.

Attached are example bid sheets that can be used with the multiplier method. They require that you know something about your overhead expense and how much profit you’re comfortable with. The following spreadsheets are included on the computer diskette that goes with this manual. There is an example set of spreadsheets for an on-site sewage facility bid. All formulas and sheets within the set are linked. Changes to values will change the resulting bid and profit values.
The Comprehensive Bid Format

Comprehensive bidding takes into account all costs associated with both the job and with doing business. This method takes the bidding process a step farther. It combines a detailed material takeoff for each specific job with projected unit costs for overhead and labor from your budget projections. The budget projections for both overhead and labor are calculated as costs for units of time that can be applied to each specific job.

Attached are bid sheets that you can use with the comprehensive bid. You will need to draw upon your budget projections from the budget sheets and include them into your bid. You should include the following:

- **Overhead expenses**
- **Variable and direct job costs**
- **Labor costs including design fees and subcontract expenses**
- **Profit margin**

The attached spreadsheets require that you know something about your overhead expense and how much profit you're comfortable with. There is an example set of spreadsheets for an irrigation bid and for an on-site sewage facility bid. All formulas and sheets within each set are linked. Changes to values will change the resulting bid and profit values.

Customize them to your operation and use them as tools to give you the competitive edge.

IMPORTANT NOTE: The following worksheets are printouts of computer spreadsheets on “Microsoft Excel”. The attached computer diskette contains spreadsheet files with formulas to link the spreadsheets within each bid file. The example is for a residential OSSF bid. The spreadsheet file is for you to use in your business and customize as needed.
### MATERIAL TAKE OFF LIST - OSSF

Input your quantity of parts and amend costs for parts as needed
(formulas will recalculate values - All sheets linked)

<table>
<thead>
<tr>
<th>Item</th>
<th>Quantity</th>
<th>Cost</th>
<th>Tot. Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class I Aerobic Treatment System (Base System)</td>
<td>1</td>
<td>$2,300.00</td>
<td>$2,300.00</td>
</tr>
<tr>
<td>500 GPD Treatment Plant (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>500 Gal pump tank (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rotary vane aerator (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/2 hp effluent pump (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aerobic control panel (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chlorinator (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 sprinklers (included)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>System Add or Change Items</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Substitute linear air pump</td>
<td>0</td>
<td>$105.00</td>
<td></td>
</tr>
<tr>
<td>Add 24 hour clock timer</td>
<td>0</td>
<td>$75.00</td>
<td></td>
</tr>
<tr>
<td>Substitute 800 gallon pump tank</td>
<td>0</td>
<td>$100.00</td>
<td></td>
</tr>
<tr>
<td>Substitute 1000 gallon pump tank</td>
<td>0</td>
<td>$150.00</td>
<td></td>
</tr>
<tr>
<td>Substitute 1500 gallon pump tank</td>
<td>0</td>
<td>$350.00</td>
<td></td>
</tr>
<tr>
<td>Substitute 750 GPD Treatment Plant</td>
<td>0</td>
<td>$150.00</td>
<td></td>
</tr>
<tr>
<td>Substitute 1000 GPD Treatment Plant</td>
<td>0</td>
<td>$500.00</td>
<td></td>
</tr>
<tr>
<td><strong>Misc. Parts &amp; Fittings</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sand (16 SY load)</td>
<td>3</td>
<td>$60.00</td>
<td>$180.00</td>
</tr>
<tr>
<td>1&quot; Elect. Conduit</td>
<td>100</td>
<td>$0.14</td>
<td>$14.00</td>
</tr>
<tr>
<td>Elect wire 12/2 WG UF (power)</td>
<td>100</td>
<td>$0.20</td>
<td>$20.00</td>
</tr>
<tr>
<td>Elect wire 14 ga. TWW (alarm)</td>
<td>200</td>
<td>$0.08</td>
<td>$16.00</td>
</tr>
<tr>
<td>J-Box</td>
<td>2</td>
<td>$10.54</td>
<td>$21.08</td>
</tr>
<tr>
<td>4&quot; Sched 40 2-way cleanout tee</td>
<td>1</td>
<td>$12.86</td>
<td>$12.86</td>
</tr>
<tr>
<td>4&quot; Sched 40 PVC pipe</td>
<td>60</td>
<td>$1.60</td>
<td>$96.00</td>
</tr>
<tr>
<td>1&quot; Sched 40 PVC pipe</td>
<td>160</td>
<td>$0.20</td>
<td>$32.00</td>
</tr>
<tr>
<td>1&quot; Sched 40 flexible PVC pipe</td>
<td>6</td>
<td>$0.40</td>
<td>$2.40</td>
</tr>
<tr>
<td>PVC glue</td>
<td>1</td>
<td>$7.13</td>
<td>$7.13</td>
</tr>
<tr>
<td>PVC cleaner</td>
<td>1</td>
<td>$5.18</td>
<td>$5.18</td>
</tr>
<tr>
<td>Hydraulic Cement</td>
<td>1</td>
<td>$8.56</td>
<td>$8.56</td>
</tr>
<tr>
<td>Misc. pipe fittings &amp; wire connectors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL PARTS</strong></td>
<td></td>
<td></td>
<td><strong>$2,805.41</strong></td>
</tr>
</tbody>
</table>

Copyright 2001, Environmental Training Systems, All Rights Reserved
<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>PEOPLE</th>
<th>HOURS</th>
<th>MAN HOURS</th>
<th>RATE</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design &amp; Site Evaluation</td>
<td>1</td>
<td></td>
<td>300.00</td>
<td>300.00</td>
<td></td>
</tr>
<tr>
<td>Consulting Fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Day Labor</td>
<td>0</td>
<td>0</td>
<td>5.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crew (Production)</td>
<td>1</td>
<td>12</td>
<td>12</td>
<td>7.00</td>
<td>84.00</td>
</tr>
<tr>
<td>Crew (Supervisor)</td>
<td>1</td>
<td>12</td>
<td>12</td>
<td>10.00</td>
<td>120.00</td>
</tr>
<tr>
<td>Labor Burden (30%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>61.20</td>
</tr>
<tr>
<td><strong>TOTAL LABOR COST</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>565.20</td>
</tr>
</tbody>
</table>
OVERHEAD WORKSHEET - OSSF

THIS WORKSHEET WILL COMPUTE YOUR OVERHEAD PER CREW FOR EACH DAY YOUR CREWS WORK

Put your actual costs into the worksheet.
Change the work days to reflect the actual number worked by your crews.
Change the number of crews to reflect your crew count.
(formulas will recalculate values - All sheets linked)

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>ANNUAL</th>
<th>MONTHLY</th>
<th>WORK DAYS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Rent</td>
<td>$ 500.00</td>
<td>$ 22.73</td>
<td></td>
</tr>
<tr>
<td>Office Utilities</td>
<td>$ 250.00</td>
<td>$ 11.36</td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td>$ 65.00</td>
<td>$ 2.95</td>
<td></td>
</tr>
<tr>
<td>Cell phone</td>
<td>$ 125.00</td>
<td>$ 5.68</td>
<td></td>
</tr>
<tr>
<td>Pager</td>
<td>$ 40.00</td>
<td>$ 1.82</td>
<td></td>
</tr>
<tr>
<td>Yellow Pages</td>
<td>$ 500.00</td>
<td>$ 41.67</td>
<td>$ 1.89</td>
</tr>
<tr>
<td>Vehicle Payment</td>
<td>$ 375.00</td>
<td>$ 17.05</td>
<td></td>
</tr>
<tr>
<td>Vehicle Insurance</td>
<td>$ 225.00</td>
<td>$ 10.23</td>
<td></td>
</tr>
<tr>
<td>Equipment Payment</td>
<td>$ 450.00</td>
<td>$ 20.45</td>
<td></td>
</tr>
<tr>
<td>Equipment Insurance</td>
<td>$ 150.00</td>
<td>$ 6.82</td>
<td></td>
</tr>
<tr>
<td>Office Person</td>
<td>$1,200.00</td>
<td>$ 54.55</td>
<td></td>
</tr>
<tr>
<td>Office labor burden</td>
<td>$ 360.00</td>
<td>$ 16.36</td>
<td></td>
</tr>
<tr>
<td>Training / CEU's</td>
<td>$ 450.00</td>
<td>$ 37.50</td>
<td>$ 1.70</td>
</tr>
<tr>
<td>Fuel &amp; Oil</td>
<td>$ 300.00</td>
<td>$ 13.64</td>
<td></td>
</tr>
</tbody>
</table>

DAILY OVERHEAD        $ 187.23

PRODUCTION CREWS      1 $ 187.23

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# DIRECT JOB COST - OSSF

(formulas will recalculate values - All sheets linked)

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>QUANTITY</th>
<th>UNIT COST</th>
<th>COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment Rental</td>
<td>1</td>
<td>$55.00</td>
<td>$55.00</td>
</tr>
<tr>
<td>Sales Tax</td>
<td>1</td>
<td>$238.46</td>
<td>$238.46</td>
</tr>
<tr>
<td>Road Toll Fees</td>
<td>6</td>
<td>$1.00</td>
<td>$6.00</td>
</tr>
<tr>
<td>Dump Fees</td>
<td>1</td>
<td>$45.00</td>
<td>$45.00</td>
</tr>
<tr>
<td>Blue prints</td>
<td>3</td>
<td>$9.00</td>
<td>$27.00</td>
</tr>
</tbody>
</table>

**TOTAL DIRECT COSTS**

$371.46

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## ON SITE SEWAGE FACILITY BID

(formulas will recalculate values - All sheets linked)

**CLIENT:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>MATERIAL COST</strong></td>
<td>$2,805.41</td>
</tr>
<tr>
<td><strong>OVERHEAD COST (1 1/2 production days)</strong></td>
<td>$280.85</td>
</tr>
<tr>
<td><strong>DIRECT COST</strong></td>
<td>$371.46</td>
</tr>
<tr>
<td><strong>LABOR COST</strong></td>
<td>$565.20</td>
</tr>
<tr>
<td><strong>TOTAL OVERHEAD &amp; LABOR</strong></td>
<td>$1,217.51</td>
</tr>
<tr>
<td><strong>SUB TOTAL (Cost of Goods Sold)</strong></td>
<td>$4,022.92</td>
</tr>
<tr>
<td><strong>PROFIT MARK UP (adjust as desired)</strong></td>
<td>52%</td>
</tr>
<tr>
<td><strong>PROFIT (52% markup gives 34% profit)</strong></td>
<td>$2,091.92</td>
</tr>
<tr>
<td><strong>MAINTENANCE CONTRACT (2 years)</strong></td>
<td>$225.00</td>
</tr>
<tr>
<td><strong>SYSTEM SALES PRICE</strong></td>
<td>$6,339.84</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Percentage</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MATERIAL</td>
<td>44%</td>
</tr>
<tr>
<td>OVERHEAD &amp; LABOR</td>
<td>19%</td>
</tr>
<tr>
<td>PROFIT</td>
<td>33%</td>
</tr>
<tr>
<td>MAINTENANCE CONTRACT</td>
<td>4%</td>
</tr>
</tbody>
</table>

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Chapter 6

The Power of Ethical Business Practices

Overview

In this chapter we will discuss what ethics in business is, the need for ethical business practices, a systematic approach to applying ethical reasoning to business practices, ethics in contractor/client relations, and client education.

Learning Points

There is a difference between ethics and morality

Business ethics is a set of skills that can be learned

There are several practical methods and “rules of thumb” that can be applied to a reasoned, practical approach to business ethics and contractor/client relationships
What is Business Ethics?

Ethics is a branch of moral philosophy that deals with the use of reason to determine what is right and what is wrong. Ethics implies conformance with an elaborated, ideal code of moral principles. Ethics and morality are synonyms yet each has a distinct, connotation. Moral is defined as relating to, dealing with, or capable of making the distinction between, right and wrong in conduct. Moral implies conformity with the generally accepted standard of goodness or rightness in conduct of character.

The question is often asked why try to teach ethics to adults? It's a moral issue. It is something that everyone should learn in church as an adolescent, or something that someone’s parents should have taught them before they left home. This line of reasoning however simplifies a complicated issue and assumes that ethics are moral issues that can be decided has a dichotomy of yes or no . . . right or wrong. This way of thinking confuses ethics with morality.

They are related but distinctly different. Morality is based on faith and decisions are based on issues of faith in what is “right and wrong.” Ethics is based on reason. Ethical decisions are not so easy, not so straightforward, and sometimes there's not a good answer or there may be several answers with varying degrees of “correctness”. Kenneth Blanchard and Norman Vincent Peale noted in their book The Power of Ethical Management “that dealing with such a topic as ethics is like untangling a fishing line. The more you get into it, the more complicated it becomes.”

Definitions of ethical behavior even tend to vary from age to age and from culture to culture. Even with these variations however the general form of ethical behavior, from the very origins of ethical philosophy. . . from the age of the Greek philosopher Plato though the present time, has included the following qualities: honesty, integrity, fairness, loyalty, kindness, courage, generosity, compassion, altruism, and unselfishness. When people display these qualities, they can be said to be behaving ethically.

This description sounds simple and straightforward, but as experience has shown all of us . . . It’s not! William Temple in Men’s Creatrix summarized the paradoxical simplicity in moral choices and the associated complexity in ethical actions with his statement, “There is only one ultimate invariable duty, and its formula is “Thou shalt love the neighbor as thyself.” How to do this is another question, but this is the whole of moral duty.” (emphasis added by the author of this book)
How indeed!!! How do you define the dimensions of ethical behavior in a way that we can all agree on them?

- When did your competition consider what was fair to you?
- Just what is your definition of fair anyway?
- Is it fair to use common sense when the letter of the law seems not always to make sense?
- Is it fair to save your customers some money if you are sure that you can install a system that will work and not cause anyone any problems but doesn’t meet the letter of the law in all respects?
- Who do you owe your loyalty to? Do you owe it to your customers? Do you owe it to state and local regulations? Or, is primary loyalty owed to your bank account?
- What about generosity in the competitive marketplace?

As you can see, our simple task of making the right choices and living ethically quickly becomes a complicated mess in the real business world. The black and white dichotomy of moral choice between good and evil becomes a bit more complicated when we are faced with real world business choices and we encounter questions with several seemingly good but conflicting answers or sometimes, no apparently good answer.

A Practical Approach to Business Ethics

So how do we approach this important but complicated subject in our professional life? 60 percent of the Business and Finance programs at colleges and universities in the U.S. don’t even teach business ethics as a course for college credit! Many argue that ethics are tied to morals and can’t be taught to adults since an individual’s morals are defined and set in place during adolescence . . . or that there are many competing definitions involved in the dimensions of ethical choices and ethics as such, is not a science that belongs in the business world . . . it’s best left to the philosophers.

While critics abound, there are some who believe as I do that business ethics can be taught. Those who take this approach believe in business ethics based on reason, not on morals. The very definition of ethics suggests a reasoned approach. After all, Ethics deals with the use of reason to determine what is right and what is wrong. It is not a moral judgment, although, ethical decisions and actions usually reinforce moral beliefs.

I suggest several methods of using reason to solve ethical questions . . . Three examples from the published literature and one from my experience.

First, I believe the philosopher Immanuel Kant had the key to ethics in his question: “If everybody did as I intend to do, would the world be a better or worse place?” This simple question is the beginning of a reasoning process that can lead to an ethical answer in many cases.
Second, Kenneth Blanchard and Norman Vincent Peale suggest a practical, reasoned approach that can be learned in *The Power of Ethical Management, (Integrity Pays! You Don’t Have to Cheat to Win)*.

They suggest that all ethical choices in business should be subjected to the “ETHICS CHECK” Questions.

1. Is it legal?
   - Will I be violating either civil law or company policy?

2. Is it balanced?
   - Is it fair to all concerned in the short term as well as the long term?
   - Does it promote win-win relationships?

3. How would it make me feel about myself?
   - Will it make me proud?
   - Would I feel good if my decision was published in the newspaper?
   - Would I feel good if my family knew about it?
Third, they suggest that there are “FIVE PRINCIPLES OF ETHICAL POWER FOR INDIVIDUALS” . . . and based on the principals for individuals, “FIVE PRINCIPLES OF ETHICAL POWER FOR ORGANIZATIONS” can be developed in any business organization.

**FIVE PRINCIPLES OF ETHICAL POWER FOR INDIVIDUALS**

1. **Purpose:** I can see myself as an ethically sound person if I let my conscience be my guide. No matter what happens, I am always able to face the mirror, look myself straight in the eye, and feel good about myself.

2. **Pride:** I feel good about myself. I don’t need the acceptance of other people to feel important. A balanced self-esteem keeps my ego and my desire to be accepted from influencing my decisions.

3. **Patience:** I believe that things will eventually work out well. I don’t need everything to happen right now. I am at peace with what comes my way!

4. **Persistence:** I stick to my purpose, especially when it seems inconvenient to do so! My behavior is consistent with my intentions. As Churchill said, “Never! Never! Never! Never! Never! Give up!”

5. **Perspective:** I take time to enter each day quietly in a mood of reflection. This helps me to get myself focused and allows me to listen to my inner self and to see things more clearly.

Source: The Power of Ethical Management, (Integrity Pays! You Don’t Have to Cheat to Win)
# Five Principles of Ethical Power for Organizations

1. **Purpose:** The mission of our organization is communicated from the top. Our organization is guided by the values, hopes, and a vision that helps us to determine what is acceptable and unacceptable behavior.

2. **Pride:** We feel proud of ourselves and of our organization. We know that when we feel this way, we can resist temptations to behave unethically.

3. **Patience:** We believe that holding to our ethical values will lead us to success in the long term. This involves maintaining a balance between obtaining results and caring how we achieve these results.

4. **Persistence:** We have a commitment to live by ethical principles. We are committed to our commitment. We make sure our actions are consistent with our purpose.

5. **Perspective:** Our managers and employees take time to pause and reflect, take stock of where we are, evaluate where we are going and determine how we are going to get there.

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Source: The Power of Ethical Management, (Integrity Pays! You Don’t Have to Cheat to Win)
Ethical Tool-kit

So now from the published literature, you have three more tools for your Business Tool-kit . . . Tools to help you make ethical choices and to succeed in business with integrity.

1. Kant’s question as a starting point to ethical reasoning: “If everybody did as I intend to do, would the world be a better or worse place?”
2. The “Ethics Check” for ethical dilemmas, and
3. The “Five Principals of Ethical Power” that can be integrated into your life and into your business.

To these I will add one final concept that I learned from an attorney who was for a time my legal advisor.

4. That is the ethical distinction between a customer and a client.

My attorney, who became my friend, taught me by example that how you view the people your company works for is very important. You should view them as clients and not as customers.

Brian Bricker was my attorney and although he was paid for his service, I was never his customer . . . I was his client. Brian made it clear that his clients were under his protection. He was the professional in a legal arena that we, (his clients) didn’t fully understand.

He protected our interests and made certain that we received as fair treatment as the law would allow. He didn’t make moral judgments concerning issues we brought to him. He never broke confidence on legal issues that were discussed with him in the course of his work and always gave us the full benefit of his years of training and experience to insure that we (his clients) would have the best outcome possible under the law.

He didn’t always believe in the laws on the books, but he had an unfailing faith in a concept he called “Rule of Law”, which simply meant that if there was a stupid law on the books, then it should be changed; but until it was, it had to be followed.

He was paid very well by clients for his service and no doubt, we could have found an attorney who would have worked for less . . . but we would not have dreamed of doing so because he was a man of integrity who we all relied upon, trusted and valued. His approach is an example of how integrity pays in business.
The lesson here . . . the concept that I want you to add to your toolkit is that there is an ethical difference between treating the people you work for as customers vs. treating them as clients.

- The definition of a customer is a person who buys goods or services or a person with whom one must deal. (a tough customer)
- The definition of a client is one for whom professional services are rendered; a customer or patron; one dependent on the protection of another . . . one who is under the protection of a professional who provides specialized service or advice for a fee.

The emphasis in the definition of a customer is on economic gain and a relationship based on necessity.

The emphasis in the definition of a client is on service provided by a professional protecting the interests of another. (service with integrity)

There is more than a subtle difference in approach between the two definitions.

Integrity pays. - Make this concept a cornerstone of your business by only having clients.

You are the professional with years training and experience. Take the people you work for under your wing and help them understand the type of systems that are available to them based on their site conditions, their plans for development and their budget. Help them understand their options under the law, the comparative costs involved and the requirements for maintenance with each option. Give them your best advice first, before you give them your bid for the work. Help them to understand all of their options. Show them your professionalism and let them know they will be your client and not just your customer . . . Educate them and help them decide what is best for them . . . then and only then give them your best bid.

If you have used all of the business tools provided in this manual, the bid you offer will be a fair price at a fair profit. It may not be the lowest bid, but if they perceive you as a professional with their best interest at heart, with a fair offer for a better system, you stand a very good chance of getting the work.

Continue the professional/client relationship through to the end of installation and on into system maintenance . . . recognizing always that you are the professional who understands the technical side of the system as well as the law . . . that your client needs your help but doesn’t always know how to ask relevant questions. It
is your duty as the knowledgeable professional to gain their confidence so you can guide them to what is best for them in a way that returns a fair profit to you.
Chapter 7

The Contractor/Client Relationship in Sales & Marketing

Overview

In this chapter we will discuss building ethical business practices into the process of personal influence, the concept of strategic influence, and their use in sales and marketing.

Learning Points

Good sales people are not just good communicators . . . They are able to influence decisions by understanding why people do what they do.

There are three components to human influence.

Recognizing and using peak states will increase your sales ability.

You must learn to recognize and deal with subconscious objections if you are to be successful at influencing people to buy what you are selling.

The most successful professional business people use ethical business practices to create strategic influence which causes high quality, profitable clients to seek them out and want to do business with them.

There are six steps to gaining the competitive edge through strategic influence.
Introduction

Sales and marketing skills are the final set of tools to add to your business tool-kit. The concepts in Chapter 7 are where all of the business skills we have discussed in this manual come together in the making of a professional/client relationship. It is an educational process where you, as the professional must understand the false perceptions, the lack of knowledge, wants, desires and fears that your client has and then gain their trust by displaying integrity so they will listen to your professional advice about what will best suit their needs, while complying with State and local regulations.

Over 25 years of business experience as an irrigation contractor, OSSF contractor, and continuing education provider to contractors has taught me that these one on one people skills in sales and marketing are the very minimum that contractors need for success.

The most successful contractors apply the additional concept of Strategic Influence. The process whereby they build integrity into their organization and develop a reputation by referrals from satisfied clients, as the one to contact first because of the way they treat their clients.

This chapter discusses skills that are essential for your success. As my client, I owe it to you to impress upon you how important these skills are . . . During my years in the business, I have rarely seen or heard of a contractor failing for lack of technical skills . . . but I often have seen failure and poor business performance for lack of sales and marketing skills.

A mentor once gave me advice on an approach to learning that I will share with you . . . Read Chapter VII three times. Read it once for the general ideas . . . Then sleep on it to anchor it in your subconscious mind . . . read it the second time for understanding . . . and read it again for ideas on how it applies to you and your company.

What gives you the edge in sales and marketing?

Good sales people are not just good communicators . . . They are able to influence decisions by understanding why people do what they do.

Influence is the process of getting your client to clearly associate their most desired feelings, states or sensations to your product or service.

Influence happens in a moment. The average television ad is only 30 seconds. That's not very much time. But they are very effective.

So what is that moment of influence? Most ads have nothing to do with the product at all. They create emotion. They are selling a feeling and the approach is at the level of your value system. They link that feeling to the product. To be successful in sales and marketing you must learn to recognize what your clients
value . . . and then build what you are selling around those values and gain credibility so you can communicate the value.

There are three components of human influence

In your communications recognize that the message is much more than what you say. It is also who you are, how you act and how you say it.
1. **Words** - Words account for only 7 percent of all human influence.

2. **Voice Cues** - Voice cues are the tone of voice or the quality of the sound that helps you know how to frame the meaning of words. Voice cues account for 38 percent of all human influence.

3. **Physiology**. Physiology is how we move and how we gesture. Our movements and gestures account for 55 percent of all human influence.

The ability to influence depends upon a congruent message where all three components match or make sense to the listener . . . By doing so you gain credibility.

If one of these components doesn't match the other two, or a several of them don't match, you are creating an incongruent message. You will have little credibility and little influence with the people you're talking to. However if they all consistently match, people will believe what you are saying and be influenced by what you are saying.

A belief in someone is nothing but a feeling of certainty about what they are saying. You noticed I used the word feeling. That is important, because research in the field of human psychology has shown that feelings and emotion really drive us . . . intellect helps to rationalize those feelings but emotion is the driver . . . And emotion happens in an instant.

For example people buy cars consistent with their identity.

- Pontiac advertises excitement and attitude
- Toyota wants you to get the feeling
- Hyundi is a value car

Advertisers try to show how not buying their make and model of car would be inconsistent with the person’s value system. In television advertisements the entire process happens in about 30 seconds because emotional response happens in an instant. Future buying decisions will then be influenced and driven by that emotional response.
Peak States

- Make yourself Believable
- Associate what the client values most with OSSF system you are selling

If you want to present a congruent message, a believable message, you need to put yourself into a peak state. You need to be at your best, drawing upon all of your abilities. Two things determine your state at any moment in time.

1. The way you use your physiology.
   The way that you walk, the way you hold yourself, your expressions, are your physiology. Your physiology determines the way you express confidence or lack of confidence.

2. What you choose to focus on
   Focus is reality to the individual even if it is not real in actuality. Questions control what we focus on. Thinking is really the process of asking and answering questions. The questions we ask will determine the answers we get. So get yourself into a peak state so you can present a credible message. Then use questions to determine what the client values most. Your customers don’t just buy an OSSF, they buy the solution to a problem and the solution they choose will be consistent with what they value most. So you are not a salesperson you are a problem solver, a people reader and an educator . . . Here is what I mean by that statement. Clients are motivated to buy a system from you not only because it will solve the immediate problem and the commode will flush. They will buy the system from you instead of your competition because what you have is more in line with what they value most.

   In many cases it may look like low cost is the only deciding factor but in reality many other factors are at play. For example if you are selling to a home builder, of course he will want the best price you can give him. But he also wants a subcontractor he can rely on to get the job done on time. He also wants a certain level of quality to insure that failed systems will not affect the reputation of his company in the future. He would prefer to work with someone who he likes and can relate to . . . and he will be very skeptical about doing business with someone who lacks credibility in his eyes about delivering the basic reliability and quality he values. The most successful sales people recognize these basic motivators and approach their clients at that level. They sell value at all levels that are important to their clients.

   So your job then is to put yourself in a peak state so that you can present a congruent believable message. Your job also is to associate what you are selling with the values that the homeowner or client is looking for.

   You must know what people value. The Stanford Research Institute’s Values and Lifestyles Survey outlines the values of the major market segments that exist in the United States. A summary of this survey is included in the last half of this chapter.
Recognizing Subconscious Objections

Another dimension of human nature is that we constantly make comparisons. We do this subconsciously often without even thinking about it, and often without a full understanding about what we are comparing.

Clients compare their image of the ideal contractor with the installer standing before them trying to sell them a system. That is often a fair comparison as long as we are presenting a professional image. However the subconscious comparisons go much farther.

Clients often compare the system that we are trying to describe, with some unrealistic idea in their mind about what it should be. The subconscious comparisons are usually not fair or accurate, due to the client’s limited understanding about the system we are describing. These unfair comparisons will usually never come to the surface if you wait for the customer to ask relevant questions . . . The job of a good salesperson is to recognize where the limited understanding is and lead the customer to an awareness of the right answer by directing the conversation with the right questions. This is a process that sales people describe as overcoming objections . . . Those unfair comparisons are really subconscious objections to the system or the service that you are selling . . . Most likely, your educated, professional recommendation is the system they really need . . . They just don’t understand it enough yet to appreciate that.

Influence

Sales and marketing involves associating the system or the service you are selling with all of the values your client really wants. It involves putting yourself in this peak state so that you can present your message and present yourself to the best of your ability. It means recognizing our human nature to make unfair subconscious comparisons about things. It means overcoming those objections by leading the client to the state or feeling they desire through a series of questions designed to help them explore the options and understand what you are selling.

Strategic Influence

Gaining the competitive edge in sales and marketing involves all of what was described and more . . . It involves not just influence but strategic influence. Strategic influence is a way to influence people before you even meet them. It will give you the competitive edge. It's part of that extra 10 percent that takes you from being average to being exceptional.

Strategic influence is similar to what happens with word of mouth advertising. People call you because they have formed a favorable opinion about you or your company. This can happen through word-of-mouth referrals from former clients who told them they were satisfied with the system or service you
sold them. These are the best kind of referrals because they have already connected your company and you to quality. You are already a step ahead in making the price/quality connection in your education & sales approach.

In small to medium size markets strategic influence through word of mouth referrals can take years to build. In larger markets like the Houston or Dallas Metroplex it may never fully develop in the market segments you are targeting. Strategic influence can be made to happen much faster in any market by the following six steps toward strategic influence outlined below.

**The Six Steps to Gaining the Competitive Edge through Strategic Influence**

**Using the Steps for Strategic Marketing**

The techniques and skills outlined in steps 1, 2 and 5 can be used to help develop a strategic marketing strategy that positions your company as a professional, quality, contracting firm that delivers what is valued most to the market segment you are targeting. You can identify and target the most profitable market segment . . . then develop a unique identity that matches the predominant value system of the people in that segment . . . followed by promoting and projecting that identity into the market segment.

This approach will cause the best, most profitable customers to seek you out.

**Using the Steps for Strategic Sales**

Once you have quality customers contacting you, the techniques and skills outlined in all six steps can be used to follow-up. First by establishing rapport and gaining credibility with the client. Second by determining what the client values most. Third by helping them understand OSSF’s so they will get the type of system that most closely matches those values. Finally recognizing when they have made the decision to buy from you and closing the sale.

**Step 1: Create a unique identity and consistently live it.**

Our ability to influence is tied directly to our ability to affect the way a person evaluates the product or service. Our evaluations are shaped and filtered through our current beliefs about the character and quality of the product, service, or individual who is selling it. Ultimately, the identity that the buyer attaches to you and your product will determine your level of success.

You must create a unique identity. The following questions will help you do so.

- Do you understand the true power of identity? A powerful and unique identity is the ultimate competitive advantage.
- What is your identity?
- What is your company’s identity?
• Can you identify and articulate your competitive advantage?
• What do you bring to the table?
• What value do you add?
• What is unique that you can give that is above and beyond the product you represent?
• Are you communicating congruently? Are you sending out a consistent message about the reasons people should buy from you instead of someone else? You need to practice communicating congruently.
• Do you walk your talk? There's nothing worse than promoting an identity that does not accurately represent the true nature of the individual or that of the product or products that go into your system.
• Can you market it? Do you promote your identity on a large-scale so that people seek you out instead of you seeking them out?

If you truly want to gain the competitive edge, you must be able to answer the following questions to yourself . . .

• Why should a customer buy from you vs. someone else?
• What makes you unique?
• What do you value?
• What do you believe?
• What skills do you possess?
• What value do you bring to the industry?
• What value do you bring to your clients?

This is where all of the skills presented in this book come together in the message you and your company are sending out and where the value you are selling becomes apparent. Your mission statement, core competencies, goals & objectives, strategic plans, bidding & pricing strategies, business ethics and sales and marketing skills become what you are and what your company is . . . It results in the message that goes out and the reputation you develop.

The Challenge . . .

You can be a quality person who cares deeply about your customers and the industry but still not have people recognize your identity in advance.

The Solution . . .

You must master the ability to pre-frame and your clients. To teach the client in advance what to look for and what it's going to mean when they find it.
The following is an example of how a contractor may create a unique identity within his business brochure.

If "out of sight, out of mind" is the way you look at the investment in your home, any installer will do. For extraordinary quality at a fair price from a company you can depend on.

THE ON-SITE WASTEWATER TREATMENT SPECIALISTS

- An exceptional team of residential specialists
- With commercial expertise . . .
  - That’s double the impact.

They’ve earned degrees and certifications . . .
Registered Sanitarians & Licensed Installers
- That means better service for you.

They take the time to listen . . .
And to understand your needs and goals . . .
- And team up to achieve them.

They affiliate with the best . . .
- The Texas On-site Wastewater Association,
- The Gulf Coast On-site Wastewater Association, and
- The On-site Research Council . . .
  - To bring you the latest innovations and a network of ideas.

And that’s who THE ON-SITE WASTEWATER TREATMENT SPECIALISTS are.

"... Thoroughly professional and efficient... my family and I are very grateful for all your help in putting our fears to rest at our new dream home. What we thought would be a difficult project became a pleasurable experience. You helped us determine the most practical solution. What was a wastewater treatment problem became a recycling opportunity."
Mr. & Mrs. Environmental E. Conscious

"... Such thorough attention to detail! The Onsite Wastewater Treatment Specialists know their business. I have confidence in their ability and know they will get the job done right."
Mr. George Sloan

"... Professionalism and expertise are exceptional..."
First State Bank

"... exceptional service... expertise and professionalism..."
Mr. Rocks N. Backyard
In order for an identity to have impact, it must be consistently reinforced until it is anchored within the marketplace.

Definition of an anchor: it is a created association between your company name and a specific set of the emotions and feelings, tied to a person’s value system. You must create an identity that makes people want to do business with you.

**Step 2: Do your homework. Know your clients.**

In advance of your meeting, ask yourself the following questions

- What does that person already believe about the industry, my product, and me? If you say something inconsistent with their beliefs they won’t believe you, even if you are right.
- How will the person evaluate you and your system?
- What are the questions I will have to answer in order for them to buy?
- What are they comparing me to? Remember it’s not apples to apples.
- What do they need?
- What do they desire? (This is a big one & it’s linked to their value system!)
- What are their concerns that you can answer?
- What are their interests?
- What are their role models?
- What are the most proud of?

*See the Stanford Research Institute’s Values & Lifestyles Survey for help on these.

Remember also that it is as valuable for a person to feel important, as it is to have their needs met.

Use contrast. It is a powerful, effective tool to change what things mean to us in a very short period of time. When you put two things side-by-side they look more different than they really are.

**Step 3: Get yourself into peak state.**

The emotional state you are in when you meet with a client will influence their feelings about your product or service as much as anything you say. The state of passion creates peak performance. You can change your state by changing your physiology.

- Breath deeply,
- Talk a little faster,
- Be more animated,
- Think faster,
- Have more eye contact.
Step 4: Become their friend

The most important part of the sales process is the development of rapport. How do you get rapport? Nothing works like sincere interest. Think of a child's approach to the world, a child's interest . . . Children ask why, why, why. They are interested in everything. Take a sincere interest in your customer, in what they need, why they need it, and the best most economical way to fill that need.

People like people who are like themselves or like they would like to be. Rapport is also created by a feeling of commonality. If you only use words you are leaving out 93 percent of communication. Matching behavior can build rapport much faster. To create rapport match the way they use their voice, its tempo, the words they are using and their volume. Match gestures, posture, eye contact and the way they react.

Step 5:
Discover what they really want and how they will know when they get it.

We are all motivated by our desire to achieve or avoid various states or feelings. Every individual has learned to value some states or feelings more than others. To discover someone's values, you simply ask the question -- What is most important to you in _______?

You should keep in mind the difference between the means value and the ends value. For example, means values are family, money, and education. Ends values are freedom, fun, energy, acceptance, and gratification. The order of these values in decision-making is important.

You must not only discover what a person's values are . . . You also need to discover how they know when their values are being met. The question to ask is -- What has to happen in order for you to feel ________?

(As we discussed in the section on strategy development, some people have rules that make it impossible for them to buy from you in a way that is profitable for you. You have to be able to recognize this then try to educate them . . . or if you can't, learn to say no to their business in a way that turns them on to your competition.)

Stanford Research Institutes Values and Lifestyle Survey

Stanford University developed a psychographics profile of Americans. It is a measure of the psychology driving Americans that is used by marketing professionals. The values shown are those most important to people in each group. It is their basic value system. All people base decisions upon what they
value most. Product & services that support these basic values will be a credible option for them. Any product or service that is inconsistent with any of these values will be rejected.

Review the groups summarized below, then read how to apply this information in your sales and marketing strategy in the following section. The information is used by all of the professional marketing firms to help clients like Coca Cola, Budweiser, and General Motors position themselves strategically in the market place and sell their product. You can do the same.

The survey found the five major groups of needs. It started with nine groups but it has been condensed here to five for practical application.

1. **Belongers:** 38 percent of the national population and 68 percent of the Midwest. This is the dominant value system in Texas.

   This is the traditional American values lifestyle. They value family first, hard work, and religion with structure and rules. They value patriotism. They love tradition and hate change.

2. **Emulators:** 20 percent of the U.S. Most in this group are between 17 and 38 years old. They want to succeed but lack the confidence. They would like a Mercedes but cannot afford it. Appearance is important if it makes them appear successful. Sex appeal sells to this group.

3. **Achievers:** 18 percent of the U.S. You tend to see concentrations of this group in some subdivisions surrounding Houston, Dallas/Fort Worth, and larger Texas Cities.

   These are the people who have made it. They are successful. They feel they must be unique. They are desperately afraid of being one of the pack. Achievers dislike emulators. They would rather spend extra money than have to spend extra time on something.

4. **Socially Conscious:** 22 percent and growing. There is a high concentration of this group in central Texas around Travis and Williamson Counties.

   This group cares . . . they care about the environment, the school system and everything. They want most of all to be intelligent. They don't want to be manipulated. They have to feel like they are in control and helping the environment.

   **There are two subgroups:**

   **Type A:** They are the experiential generation who grew up in the 1960s and have not changed . . . the old hippies. Less than 50 percent are employed. (some college kids have started to emulate this group)

   **Type B:** This group wants to be intelligent and they want to make a difference. The average age is between 45 and 48. They used to
hate achievers, however many are now successful. They sometimes do stupid things to feel smart about themselves.

5. Need Driven:
This group is surviving with government assistance. Many in this group are elderly and on welfare.

So How Can a Contractor Use This Information?
You can use it at two levels. First, use it in your strategic marketing effort to define a unique selling position in each market segment you are after . . . One that matches the values of those in that market segment. Second, use it at a one on one sales level to help determine what is most valued by the prospect you are selling to.

Look at a person’s lifestyle and try to determine which group they are in. You can usually guess right most of the time by looking at the kind of car they drive, the neighborhood they live in, and determining what's most important to them. You can usually place them in one of these groups with what you find.

Use this information to help relate to the client and to tailor the system and service you offer to what the client wants most. If you are making a sales presentation to a “belonger” talk about how you will make sure that you will design and install the system in a way that will be safe for kids and family activities. For example if you are selling an aerobic treatment system with surface spray disposal explain how you will include a holding tank with timer to insure that there is no surface spray during any time when the kids will be playing in the yard or when the family is having a Sunday afternoon barbecue. Explain how chlorination works and how effective it is at disinfecting the treated wastewater when properly maintained. Stress how you will insure the system is operating safely and the timer is set correctly with quarterly maintenance checks. Stress protection for the family and get them to visualize in their mind that the system you are selling will be safe for family members and be so reliable, because of the quality you build into it and the way you will service it, that they won’t feel the need for concern that there will be a malfunction causing problems for any family member or family function on the property . . . Sell what they value and then deliver it.

If you are selling to an “Achiever” talk about how you can offer a system that is better and different from the average installation. High-tech, new & different, and trendy will sell to this group. Explain how a state of the art system can increase property value. This group will also be willing to pay extra for extra service if it saves them time.

You can use the same approach in your marketing efforts. Marketing professionals also recognize that these value systems cluster by neighborhoods. People like to live by people who are like them. Look at the neighborhoods in the region you are doing business in and you will find this clustering effect. It will not be so obvious in rural areas and small towns were the predominant value system is that of “belongers”. However in larger cities you will find it. There will be neighborhoods with mostly “belongers”. There will be other
neighborhoods with mostly “Acheivers”. In some areas you can find neighborhoods that are mostly “Socially Conscious”.

Use this information to identify how the market segments cluster geographically in your area. Then focus your marketing efforts toward these market segments by neighborhood.

Recognize also that while the lifestyles & values survey is very useful, it is very generalized and has limitations. At the individual level, people are more complex than these generalizations. For example, you will find individuals with predominant values in one group who also have some of the values of another group. For example, a “belonger” may start to develop many of the “achiever” values as their children move on and they achieve business success. By the same token, many in the “socially conscious” group have matured and achieved financial success. Some of them are feeling conflicting values at a subconscious level. For example, they still care about the environment, but they need to stand out and feel unique. They want an environmentally friendly system but they may be willing pay for distinguishing extras as well as extra service that will save them time.
Step 6: Give them what they want and get their commitment.

You cannot just tell a person that they'll get what they want by buying a system from you. You must give them the feeling of owning it and benefiting from it today. You can't just tell the person they will get what they want and need from you. You must give them the experience. You must direct what they notice and tell them how to interpret it . . . You must get them to imagine it.

Questions are the primary tool you use the get them to experience it. For example, ask them a question like . . . If this does what I say it will, how will it affect you? If you tell them how the system will benefit them they may not believe it. But if you get them to think about it and say it to themselves they will believe it.

This is not a cheap sales technique . . . It's not about what used car salesmen call closing. You are providing what they need, and helping them to understand that you can provide what they need.

If . . .
1. You have created your identity and consistently reinforced it,
2. You have done your homework,
3. You are in a peak state,
4. You have created rapport and made them your friend,
5. You have determined their values,
6. You've met their needs, and
7. You have gotten several commitments . . .

Then it is your duty to assume the sale . . . Make it easy . . . Don’t ask them to decide if they want it. At this point they have already decided.

. . . Get out your sales contract and show them where to sign.
Congratulations!
You just solved your client's problem and in doing so, made a profit. You helped them understand what they needed, gave them what they valued most, and closed the sale.

To complete the course and receive your 8 hours of continuing education with the T.C.E.Q. Follow the enclosed instructions for completing and returning the examination and course materials.

Thanks for Choosing Environmental Training Systems as your continuing education provider. Our business is based on your success. We would like to hear from you. Please let us know what you thought of the training experience we provided by returning the evaluation form with the course materials.
APPENDICES

Ratio Industry Averages