The Construction Executive's Interactive Guide to Business Visibility

PART 4: PREDICTING

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THE PREDICTING PREDICAMENT

Yogi Berra was famously quoted as having said, “It’s hard to make predictions, especially about the future.” Wit and humor aside, many construction management teams would agree with the former Yankee catcher/philosopher. At times, predicting business performance or project profitability can be a challenging endeavor. It’s little surprise that the overriding tendency among construction leaders is to rely almost exclusively on past and present indicators.

As described in Parts 1, 2 and 3 of this guide, the traditional approaches to business visibility (reporting, monitoring, and analyzing) are important and can help you gain insight into what already happened and what is happening now. But considering the fierce competition and razor-thin margins that exist in this industry, that style of rear-view management simply isn’t good enough.

To succeed in today’s climate, it’s important to understand what might happen in the future—so you can prepare for it, control it, and take action today to attain tomorrow’s goals. What follows are some tips, best practices, and basic steps you can take to develop more informed forecasts and what-if scenarios.

IN THEIR OWN WORDS

What your peers and experts say about predicting.

"Look for trends in overhead burden and forecast a breakeven point and review its status regularly. Communicate this information to your estimating department."

Martha-Ann Marley
President
Gardner Associates, Inc.

"Accurate forecasting . . . has really improved our cash flow. I can compare work done against the budget and allocate variances. Project managers can prepare projections in an afternoon instead of two or three days."

Bob Scott
Controller
Thor Construction

"Taking the time to accurately prepare a cash flow projection for each project, as well as all combined projects, could make the difference between success and failure."

Michael B. Ceschini
Managing Partner
Ceschini & Co., CPAs

"Project cost forecasting is more than just for revenue recognition. Increasing the accuracy of these projections will improve your decision making, strengthen your profit margin, and reduce your risk."

Dennis Stejskal
Vice President, Product Management
Sage Construction and Real Estate Solutions

TOMORROW TODAY

It's helpful to think of forecasting in the context of strategic planning since the two are so closely intertwined. Strategic planning requires you to envision an ideal outcome for your business and then work backward—focusing on the actions you need to take in order to achieve your vision. However, before you can lay out that vision, it's critical to first forecast what might happen in key areas of the business (such as expenses, new contracts, and interest rates).

Five reasons to improve your forecasts:

1 So you can establish the best roadmap for your business

By performing what-if scenarios, you can better visualize answers to questions such as:

- What is the revenue impact if we focus on one type of work?
- Are we better off buying or renting equipment?
- If we win 20% less work, how can we offset the loss?

2 So you can protect and improve your bonding and credit

Bond companies, surety brokers, and banks want to see if you will be able to pay your debts on time. Many require sound cash forecasts to confirm your performance will meet the minimum criteria.

3 So you can manage more confidently

Periodic forecasting will enable you to know when to be more aggressive and when to tighten the purse strings.

4 So you can course correct

Well-devised forecasts give you time to make changes if you're in trouble. For example, if you projected an 11% year-over-year increase in annual contracts but in your first quarter you only saw a 2% increase, you may need to make changes in sales and marketing or cut your projections.

5 So you can better understand what you can control and what you can't

When you forecast, it becomes clear that much of what happens in your business is beyond your control (costs increase, the market cools). But there are many aspects you can influence. For example, if you can devise strategies to get paid days earlier, it can give you the freedom to borrow less.

THE BUSINESS PLANNING CYCLE

FORECASTING AT THE BUSINESS LEVEL

When forecasting revenue, embrace your aspirations and build at least one set of projections with aggressive assumptions.

Be leery of forecasts that have your gross margin making a significant leap. Costs that are high today will likely remain so in the future.

At the business level, your forecasts help you develop your budgets, establish a vision for the future, and create benchmarks to measure and reward performance. Using various predictive indicators such as customer satisfaction, sales pipeline, and accounts receivable turnover, you can create your forecasts.

Recommended forecasts include:

- Backlog
- New contract awards
- Revenue
- Direct and indirect costs
- Cash flow
- Gross margin
- Net profits before taxes

Put together a contingency plan in case actual results fall below projections. Always plan for the worst but project for the best.

FORECASTING AT THE PROJECT LEVEL

Learn how to improve your job costs forecast process:

Each project must be controlled carefully from beginning to end. Forecasting plays a vital role in identifying potential problem areas—after all, how can you know when a project gets off course unless you first understand the destination? Successful contractors are systematic with their project forecast, typically requiring finance and operations to work together to provide monthly project forecasts.

Key project areas to forecast include:

- Net profit
- Cash flow
- Cost to complete
- Equipment resources

Construction forecasts typically rely on accurate and timely input from field management for information such as percent complete and units in place. From these indicators, you can derive a forecast variance and make adjustments. To improve the timeliness of this data, companies are increasingly providing mobile access so field personnel can record project progress from the jobsite.

FORECASTING EXTERNAL FORCES

In addition to making projections regarding internal business performance, it's important to consider how external factors will impact your organization. For construction businesses, these external driving forces typically fall into five categories:

- **Economic**—Continued recession or rebound?
- **Political**—What new regulations are on the horizon? Where are taxes headed? How will government spending affect available work?
- **Social**—How will an aging population change the type of buildings and services in demand?
- **Technological**—How will innovations in mobile, cloud, and BIM impact the industry?
- **Environmental**—In what new directions will the "green" movement pull the industry?

Scenario planning: Prepare for what might happen.

Without a crystal ball, the best way for construction executives to understand these forces is to use a method called scenario planning. According to the Journal of Accountancy, scenario planning is focused on answering three questions:

1. What could happen?
2. What would be the impact on our strategies, plans, and budgets?
3. How should we respond?

To better understand how to approach scenario planning in your business, read the Journal's excellent article, Scenario Planning: Navigating Through Today's Uncertain World.

Scenario planning is only as effective as the actions you take. Develop a playbook to respond to various triggers identified during the planning process. This allows you to take proactive steps quickly and strategically, protecting—and potentially helping—your bottom line.

LEARN MORE ABOUT THE FIVE TYPES OF VISIBILITY EVERY CONSTRUCTION FIRM SHOULD HAVE

Read the entire five-part series on business visibility:

1 Reporting

2 Monitoring

3 Analyzing

4 Predicting

5 Mobilizing

Download the business visibility basics poster:

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