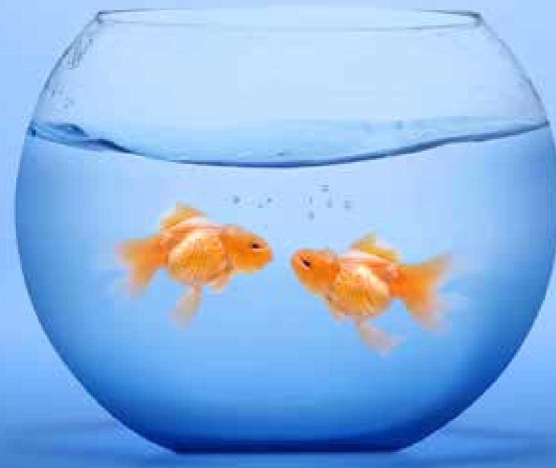
Peer to Peer



"If your friends did that, would you do it too?" Well-meaning parents have repeated this trouble-stopping phrase for decades. But when it comes to evaluating your construction business' success, measuring against your peers might not be such a bad idea after all.

BY MICHAEL MCLIN

In the construction industry, where project success hinges on a variety of factors from financial management to safety practices, peer-group benchmarking serves as a critical tool for gaining competitive advantage and ensuring operational excellence. Benchmarking involves comparing key performance metrics with those of peers to identify areas for improvement and where to implement best practices identified by the results peer group members are achieving. This article explores the various types of benchmarking–financial, compensation, insurance, strategy and overhead–and their value specifically within the construction sector.

Benchmarking is best conducted in a true peer setting where the member companies are paired by revenue and discipline. Experience has shown that geographically non-competing firms who are of similar size and disciplines (general contractors, electrical, mechanical, etc.) yield the most insight. Interestingly, the key metrics in each type of benchmarking are the same regardless of discipline. The difference lies in the resulting values and the associated ranges of healthy and unhealthy results.

FINANCIAL BENCHMARKING

Financial benchmarking involves comparing financial metrics such as revenue, gross margin, SG&A, net profit before tax and return on equity with those of similar companies in the industry. For construction firms, this type of benchmarking is crucial to understand how a company is performing against a peer company given the required capital, risk involved and the ultimate return on investment. The primary aim is to assess a company's financial health and performance relative to its peers. This includes understanding how efficiently a company is using its resources and how well it manages its capital.

1. **Key Metrics**:
   - **Budget vs. Actual Results**: Measures how a company plans their budget based on their cost structure (marginal contribution analysis or bottom-up budgeting) and then compares actual results–looking for sources of margin gain and fade–and guides management decisions.
   - **Cash Management**: Evaluates how well a company is managing cash flow. More contractors go bankrupt due to cash flow than profitability. Evaluating cash balances, lines of credit, receivables, retention, payables, cash demand and cost incurred on unapproved change orders are all vital cash-management health indicators.
   - **Backlog:** Evaluates the sales funnel and if there are any revenue cliffs, allows for resource planning and helps a company focus on the timing and amount of project inflows needed.
   - **Staff and Revenue Metrics:** Understanding leverage ratios of staff such as field-to-office ratios, margin contributions by employee, material costs per work hour, etc. helps keep a pulse on where margin is being driven.
   - **Performance Indicators:** These metrics are focused on big-picture balance sheet and income statement matters. Items such as capitalization, R-score, ratio analysis, etc. need to be monitored for organizational health.

2. **Benefits:**
   - **Identifying Financial Strengths and Weaknesses**: Helps in pinpointing areas where a company is performing well or lagging.
   - **Improving Financial Strategy**: Provides insights to refine budgeting, forecasting, cash management and other investment decisions.

COMPENSATION BENCHMARKING

Compensation benchmarking is essential for attracting and retaining top talent in the competitive construction industry, where skilled professionals are in high demand and wage pressure has been tremendous in the past several years. This type of benchmarking aligns compensation packages with industry standards to ensure they are competitive and fair.

1. **Key Metrics:**
   - **Salaries**: Comparison of base salaries for similar roles across the industry.
   - **Bonuses**: Analysis of performance-based incentives offered by peers.
   - **Benefits**: Review of additional benefits such as health insurance, retirement plans and allowances (vehicles, memberships, phones, etc.)
2. **Benefits:**
   - **Attracting and Retaining Talent**: Ensures compensation packages are appealing to prospective and current employees.
   - **Ensuring Competitive Pay Structures**: Helps maintain a competitive edge in recruiting and retaining skilled workers.

INSURANCE BENCHMARKING

Insurance is typically the second largest overhead expense behind salaries. Insurance benchmarking focuses on evaluating insurance costs and coverage relative to industry norms, which is vital for managing risk in the construction sector. This entails comparing insurance policies and premiums with those of similar firms to ensure adequate coverage while optimizing costs, as well as understanding the spectrum of insurance coverage from open market to high-deductible plans and captives.

1. **Key Metrics:**
   - **Premium Costs**: Analysis of insurance premiums paid for various policies.
   - **Coverage Scope**: Comparison of the extent and limits of coverage provided.
   - **Claims Ratios**: Assessment of the frequency and severity of insurance claims.
2. **Benefits:**
   - **Optimizing Insurance Expenditures**: Helps in negotiating better rates or adjusting coverage as needed or changing to self-insured or a captive program where appropriate based on spend (generally over $250K in annual premiums on workers compensation, general liability and auto combined).
   - **Ensuring Adequate Coverage**: Ensures that all potential risks are covered adequately.

STRATEGIC BENCHMARKING

Strategic benchmarking involves assessing a company's strategic performance against those of industry leaders to refine and improve its own strategies. A proper benchmarking tool evaluates the opinions of the management team and employees to generate a score. That score informs a company as to how its strategic goals and practices compare with those of its competitors, as well as evaluates organizational structure, alignment and culture.

1. **Key Metrics:**
   - **Strengths**: What is the company doing well?
   - **Weaknesses**: In which areas, compared to the model, does the company not perform well?
   - **Alignment:** Evaluates how aligned the management team is as well as the employee base.
2. **Benefits:**
   - **Enhancing Strategic Planning**: Provides insights into successful strategies used by competitors. Helps companies understand where they thrive and where they may need assistance.
   - **Identifying Best Practices**: Helps in adopting effective strategies that have proven successful elsewhere (i.e. go-to-market strategies, market segmentation, pricing strategies, etc.)

OVERHEAD BENCHMARKING

Overhead benchmarking focuses on comparing overhead costs such as administrative and operational expenses with those of peer companies. This helps in evaluating and managing indirect costs that affect overall profitability and aligns companies in what is "above-the-line" and what is in SG&A for an apples-to-apples comparison.

1. **Key Metrics:**
   - **Fixed Costs**: Comparison of fixed expenses and administrative overheads.
   - **Variable Costs**: Analysis of costs associated with day-to-day operations that are dependent on having a project.
2. **Benefits:**
   - **Reducing Overhead**: Identifies areas where costs can be cut without affecting project quality (e.g. audit versus an opinion, cell phone costs, IT, etc.).
   - **Improving Cost Efficiency**: Promotes more efficient use of resources and cost-saving measures.

OTHER TYPES OF BENCHMARKING

Apart from the primary benchmarking categories, construction firms can benefit from additional types of benchmarking to further refine their operations.

1. **Project Management Efficiency:**
   - **Purpose**: Compares project timelines, budgets and outcomes with those of industry peers.
   - **Benefits**: Improves project execution and delivery times.
2. **Safety Performance:**
   - **Purpose**: Evaluates safety records and practices against industry standards.
   - **Benefits**: Enhances safety protocols and reduces accident rates

Peer-group benchmarking is an invaluable tool for construction companies aiming to excel in a highly competitive and challenging industry. By employing various types of benchmarking, companies can gain critical insights into their performance, optimize their operations and maintain a competitive edge. CE

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