

2C11

Business economics and entrepreneurship
Lesson 2

Business strategies:

Business strategies to minimize the risk of business failure, plan implementation/control strategies,
Case Study

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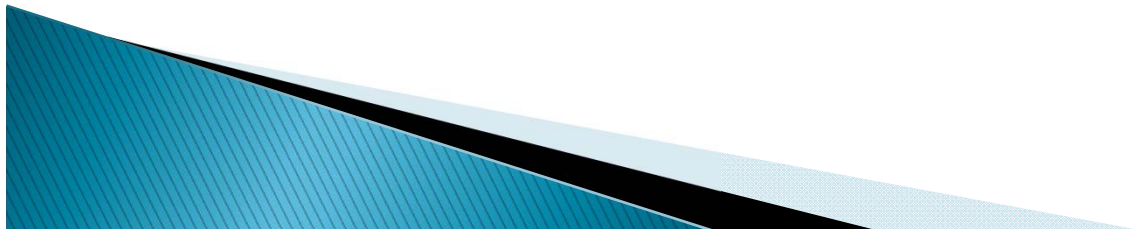
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<http://k126.fsv.cvut.cz/?p=lide&uid=26>



The Business Plan covers subjects such as:

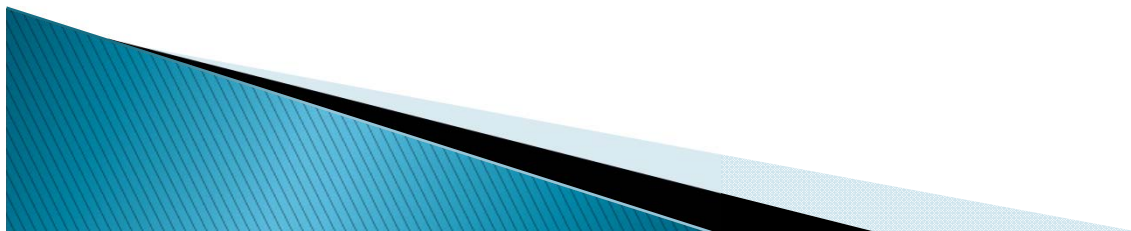
- ▶ organizational structure,
- ▶ financing (owners' equity, foreign capital),
- ▶ marketing (market analysis, business goals, marketing strategies, advertising),
- ▶ construction business operations (business identity, business location),
- ▶ construction business financials (projections, historic analysis, ratios) and more.



Construction Business Plan Template

Example of content

- ▶ Introduction
- ▶ Business description
- ▶ Business formation
- ▶ Directors
- ▶ Management team
- ▶ Business goals/mission
- ▶ Business philosophies/identity
- ▶ Geographical markets
- ▶ Vision of the future



Executive summary

- ▶ Main objectives
- ▶ Sales summary
- ▶ Strategic positioning
- ▶ Strategic alliances
- ▶ Licenses
- ▶ Key advantages
- ▶ Funds required



Marketing

- ▶ The product mix
- ▶ Sales estimates
- ▶ Analysis current product mix
- ▶ Competitive research
- ▶ Market analysis
- ▶ Marketing goals & strategies
- ▶ Pricing policy
- ▶ Advertising & promotion
- ▶ Distribution & service
- ▶ SWOT analysis



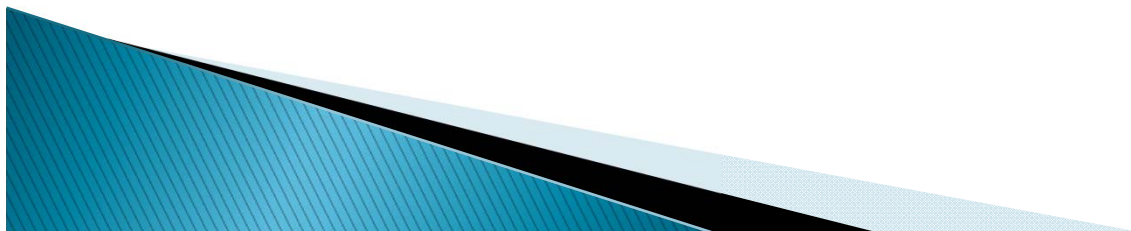
Historic analysis

- ▶ General view
- ▶ The market position
- ▶ Income statement historic
- ▶ Balance sheet historic



The organizational structure

- ▶ Management and personnel
- ▶ Staffing
- ▶ Personnel analysis & expenditures
- ▶ Administrative organization



Financial plan

- ▶ Financial projections and ratios
- ▶ Sales projections
- ▶ Investment budget
- ▶ Expense statement and Cashflow projection
- ▶ Income statement and Balance sheet forecast
- ▶ Loan capacity and bondability
- ▶ The charts and the time table of overall process



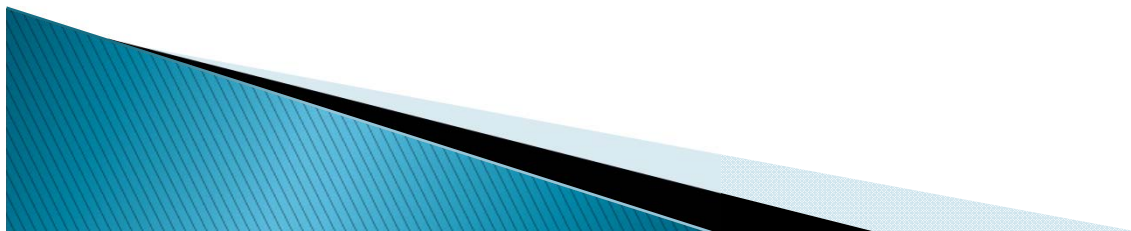
Risk Management

- ▶ Risk reduction – mitigation
- ▶ Exit strategy



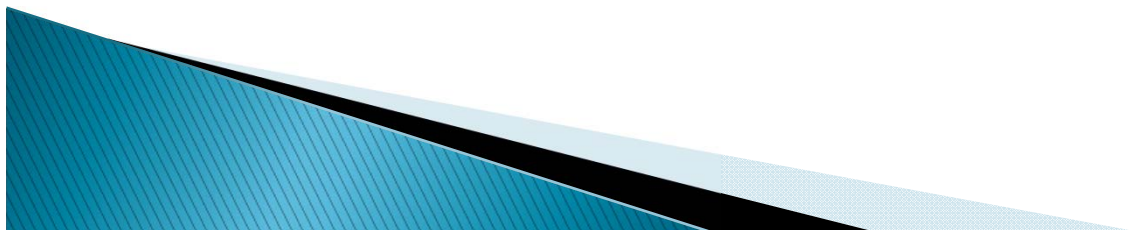
Other considerations

- ▶ Company formation
- ▶ Choosing a bank
- ▶ Choosing a location
- ▶ Choosing a CPA



Case Study

**Process of preparation and realization
of Strategic Plan of GBO Contracting,
Inc.**



GBO Contracting, Inc.

Company History

GBO Contracting, Inc. is a family owned business, established in 1955. Second generation family members occupy all significant decision-making positions. The company is not the only income source available to the family; thus, significant earnings have been retained in the business providing the company with a solid financial foundation and excellent bonding capacity.

The company, engaged in highway and road construction, is medium-sized with revenues of \$40,000,000 annually. The company is located in the western mountainous region of the state; maintains a business office, a fleet of modern trucks, and road-building equipment; and owns an asphalt plant.

Business Mission

To secure a significant and profitable position in the highway and road construction industry while creating a marketing advantage for the company and expanded opportunities for company personnel.

Internal Factors

- ▶ The convenient location of the company-owned asphalt plant to major work locations in the western part of the state has allowed the company to operate efficiently and, thereby, win a high percentage of competitive bids.
- ▶ Current levels of business are sufficient for stable and acceptable profitability, but have not required full utilization of personnel or equipment.



- ▶ Sales increased by 12 percent over that of the prior year thereby exceeding the target growth of 10 percent.
- ▶ The company's market share for the year is at 20.5 percent, 0.5 percent ahead of target.
- ▶ Business opportunities in the western part of the state continue to grow at a slow to moderate rate and consist primarily of repair and maintenance projects rather than major new construction.
- ▶ The company has substantial idle funds available for investment.
- ▶ Second generation family members in operational control of the company are well educated and seasoned contractors. The family members are committed to the business and want to create job opportunities for existing younger management

External Factors

The state has experienced rapid economic growth in recent years as the result of a major influx of business and industry to the area. This rapid rate of growth is expected to continue for the foreseeable future.

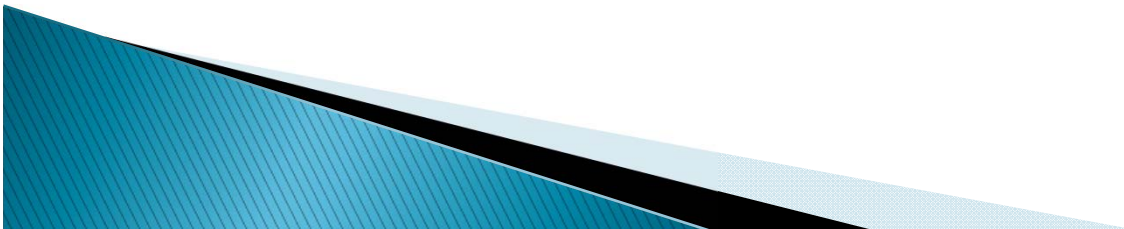
- ▶ Within the state, the primary growth area is concentrated in the center of the state in three cities within the same metropolitan statistical area. A major research university is located in each city, and substantial economic growth has occurred in recent years due to high technology development companies locating in the area. This dynamic growth has strained the already inadequate existing road and highway system. The current state political administration has also stressed major highway improvement and expansion from the center of the state eastward as a paramount concern and goal.

- ▶ A small (\$15,000,000 in annual revenues) company located in the eastern part of the state is available for acquisition. The company maintains an asphalt plant and a small fleet of fairly modern trucks and road-building equipment. The target company is readily accessible to existing major roads and highways.



Obstacles

- ▶ The distance to the source of new business necessitates an eastern facility in order for the company to bid competitively.
- ▶ Additional technical knowledge is required to adapt current construction techniques from mountainous to coastal terrains.
- ▶ Federal funding cutbacks under the current political administration have hampered the ability of many communities to build new roads or maintain existing ones.



Strategic Objectives

- ▶ Invest the company's available financial resources in construction-related opportunities that will provide an improved long-term rate of return.
- ▶ Increase management and employee morale by more fully using available capacity and providing greater career opportunities.
- ▶ Increase market share to 30 percent by the end of year five.
- ▶ Provide diverse and technologically current construction services that distinguish the company in the market place

Specific Near-Term Goals

- ▶ Expand business to the central and eastern sections of the state to take advantages of major growth opportunities in these areas.
- ▶ Within the next six months, open an eastern satellite office (or acquire an existing facility) to enable the company to remain competitive in the high-growth market areas.
- ▶ Restructure within the next six months middle and upper management positions by relocating some employees to the new facility to use more fully current competent personnel and to provide career development opportunities.
- ▶ Hire immediately a geological consultant with experience in coastal road building to be used in the eastern expansion.

- ▶ Maintain the revenue growth of 12 percent at the western facility.
- ▶ Successfully obtain new work for the new facility as follows:

Year 1 \$3,000,000

Year 2 5,000,000

Year 3 8,000,000

Year 4 12,000,000

Year 5 18,000,000

- ▶ Identify *new* financing sources for local communities to fund highway construction needs and develop necessary contacts with local officials to generate opportunities to use these funding sources by the end of year five.

- ▶ Evaluate existing road-building technologies within the next six months and develop a long-term strategic plan within the next 18 months to create a competitive edge for the company by the end of year five.

ANNUAL PLANNING IN CONSTRUCTION COMPANY

Annual planning is closely related to the strategic planning process. The annual planning process uses overall strategies, specific objectives, and goals developed in the strategic planning process as a basis for developing the contractor's annual budget for the upcoming year.

Annual budgets are prepared for many reasons, including the following:

- ▶ to serve as a control function over management operations and expenditures and as a form of risk management;
- ▶ to display management's understanding of the contractor's activities and business to outsiders such as bankers and sureties;
- ▶ to serve as a near-term performance measure; and
- ▶ to serve as a decision-making tool by providing management with useful information.

The annual planning process has the following purposes:

- ▶ to link the strategic plan to a formal commitment to meet operational and financial plans for a one-year period;
- ▶ to provide a means for monitoring performance that allows management to analyze key factors that affect profitability and growth;
- ▶ to provide a means of incorporating what is learned during the annual planning process into future strategic plans; and
- ▶ to promote communication and coordination within the construction firm.

The Annual Budget Contents

The primary product of the annual planning process is the annual budget. It should represent management's best practical approximation of the firm's organization and expected inputs and outputs for the year given its overall strategic plan. It should include the following:

- ▶ projected monthly or quarterly financial statements (i.e., balance sheets and statements of operations);
- ▶ monthly or quarterly overall cash flow projections;
- ▶ capital expenditure budgets;
- ▶ debt service or financing requirements budgets;
- ▶ overall performance indicators;
- ▶ monthly cash flow projections by construction project; and
- ▶ detail expense budgets by responsibility center.

GBO Contracting, Inc.
Quarterly Balance Sheets
 (All dollar amounts in 000's)

Year 1

	1st	2nd	3rd	4th
Cash	\$ 200	\$ 200	\$ 200	\$ 200
Temporary investments	2,000	2,415	2,140	2,305
Receivables	6,300	7,000	7,500	7,200
Unbilled work	200	300	375	350
Prepaid expenses	100	125	150	125
Inventory	300	350	350	325
 Total current assets	9,100	10,390	10,715	10,505
Land	250	250	300	300
Depreciable equipment	4,200	4,400	4,750	4,850
	4,450	4,650	5,050	5,150
Accumulated depreciation	1,350	1,500	1,675	1,875
	3,100	3,150	3,375	3,275
Total assets	\$ 12,200	\$ 13,540	\$ 14,090	\$ 13,780
Total current liabilities	\$ 3,300	\$ 4,300	\$ 4,600	\$ 4,000
Long-term debt	1,000	1,000	900	900
Deferred taxes	250	275	300	325
Equity:				
Common stock	100	100	100	100
Paid-in-capital	900	900	900	900
Retained earnings	6,650	6,965	7,290	7,555
 Total equity	7,650	7,965	8,290	8,555
Total liabilities and	\$ 12,200	\$ 13,540	\$ 14,090	\$ 13,780

GBO Contracting, Inc.
Quarterly Statement of Operations
 (All dollar amounts in 000's)

	Year 1				
	1st	2nd	3rd	4th	TOTAL
Construction revenues	\$ 8,100	\$ 12,200	\$ 13,200	\$ 11,300	\$ 44,800
Cost of construction	7,370	11,100	12,000	10,250	40,720
Gross margin	730	1,100	1,200	1,050	4,080
Operating expenses	240	325	375	300	1,240
Discretionary expenses	50	50	50	50	200
Interest expense (income)	(25)	(25)	(20)	(20)	(90)
Total expenses	265	350	405	330	1,350
Income before tax	465	750	795	720	2,730
Current income taxes	150	240	270	240	900
Deferred taxes	25	25	25	25	100
Total taxes	175	265	295	265	1,000
Net income	\$ 290	\$ 485	\$ 500	\$ 455	\$ 1,730

GBO Contracting, Inc.
Quarterly Cash Flow Statements
(All dollar amounts in 000's)

	Year 1				TOTAL
	1st	2nd	3rd	4th	
Net income	\$ 290	\$ 485	\$ 500	\$ 455	\$ 1,730
Depreciation expense	150	150	175	200	675
Deferred taxes	25	25	25	25	100
Total cash provided by operations	465	660	700	680	2,505
Reduction in long-term debt	100		100		200
Increase (decrease) in current assets*	(300)	875	600	(375)	800
Decrease (increase) in current liabilities	300	(1,000)	(300)	600	(400)
Purchase of land			50		50
Purchases of equipment	200	200	350	100	850
Cash dividends	165	170	175	190	700
Total cash used	465	245	975	515	2,200
Increase in cash and temporary investments	0	\$ 415	\$ (275)	\$ 165	\$ 305

*Excluding cash and temporary investments.

Major Inputs to the Annual Budget

- ▶ The major components of a contractor's annual budget are (1) projected construction revenues, (2) direct construction (or job) costs, (3) indirect costs, and (4) the owner's required return on investment (ROI). This information must be obtained if a detailed budget is to be developed congruent with management's overall strategic plan.
- ▶ The annual forecast of revenue begins with the work in backlog, which represents only a minority of the revenue that will be earned in the next year. Estimates of forecasted revenue must be made using knowledge of projects available for bid, prior experience, and estimates of the volume of work available.

Total construction revenue volumes and margins should be determined after considering the following:

- ▶ anticipated growth and revenue objectives;
- ▶ internal limitations including:
 - working capital,
 - bonding capacity,
 - management capabilities, and
 - available equipment;

- ▶ external limitations including:
 - market forecasts,
 - availability of adequate supply of financing for owners,
 - availability of qualified labor supply, and
 - type of work available—negotiated, bid, foreign, domestic, commercial, residential, etc.;
 - historical performance by market segment; and
 - existing backlog, known projects anticipated during the budget period, and unidentified new work.

FINAL STEPS OF PLANNING

The detailed annual plan should be reconciled to the overall strategic plan, and the final products of the annual planning process generated. Those final products include the following:

- ▶ overall ROI goals agreed to by management;
- ▶ detailed lists of planned activities, specific tasks, and milestone events;
- ▶ detailed budgets for all departments; and
- ▶ acceptance of the overall goals and detailed plans by all levels of management.

End of presentation

