



Introduction

Have you ever wondered what other builders like you are earning? Or more importantly, how much you should be making in your home building business? *The Cost of Doing Business Study* is designed to provide you with “insider” information on how your business compares with similar types of home building companies as well as with the industry as a whole. The study reveals how much profit your competitors are earning and helps you make informed decisions in setting profit goals. It provides a snapshot of builders’ profitability and expenditures by category. Are you maximizing your use of scarce financial resources? *The Cost of Doing Business Study* tells you. By providing up-to-date information on how various types of home-building companies have fared recently, the book helps builders navigate through an uncertain marketplace.

How the Study was Prepared

The Cost of Doing Business Study survey questionnaire was sent electronically to more than 9,000 companies in March 2009. The questionnaire asked for 2008 financial and operational information as well as details about the type of single-family units closed in 2008. The analysis presented in *The Cost of Doing Business Study* is based only on responses from single-family home builders who reported their main operation in 2008 to be single-family production or custom home building (both on owners’ lots and builders’ lots). NAHB received 312 responses. Not every question was answered by all respondents.

Organization of the Study

The Cost of Doing Business Study, 2010 Edition, comprises nine chapters of study results and three related chapters:

Chapters 1–6 provide detailed information on gross profit, net profit, a balance sheet with averages, financial ratios, profit margins and owner’s compensation as a percent of revenue. Chapter 1 provides this information aggregated for all survey respondents and subsequent chapters present the data for specific types of companies. Each chapter also compares profitability of the top 25% and bottom 25% of builders who responded.

Chapter 7 compares builders’ performance by region (Northeast, Midwest, South, and West) and business model (builders with land cost, without land cost, and combination builders). Chapter 8 provides data about the main operations of respondents and average share of business derived from each operation. Chapter 9 discusses historical performance and new findings about subcontracted work in the home building industry. Chapters 10–12 discuss ways to increase net profit, why to use a balance sheet, and how new technology can improve home-building companies.

How to Use the Study

The Cost of Doing Business Study contains a wealth of information about the residential construction industry, but it is much more than a statistical report. Rather, the study is a tool builders can use as a benchmark for their businesses, using the most critical determinant of a company’s success or failure: its ability to generate adequate net profit. By sharing information about what other comparable builders are earning, the study allows builders to draw their own conclusions about their financial performance and how well, or even whether, they are achieving their business goals. The study helps company owners pinpoint areas for improvement, set budget targets, and create a road map for boosting profitability and increasing efficiency. The study breaks down survey findings by construction volume, operation type, and whether builders have land costs. Where applicable, the data for each builder category are categorized by top and bottom 25% of performers and average performance. In addition, the study compares data from the most recent survey (2008 data) with the previous survey (2006 data).

To make the most of the study, gather your financial information, including your income statement and balance sheet, and see how your performance compared with other builders’.

Once you have analyzed your company’s performance compared with other similar companies, you can use the findings to make better business decisions and influence the behavior of others who impact your company’s success or failure. For example, you can use the study as a selling point to lenders. If your company performs better than or even at the same level as the industry average, present these facts to negotiate better loan terms or interest rates.

Also use the findings to motivate your employees: you can use industry averages as the basic performance level for rewarding employees with merit increases or bonuses.

Industry Profitability

How profitable were the builders surveyed? Profits were the lowest recorded since the inception of *The Cost of Doing Business Study* series in 1970, illustrating the housing recession’s impact on the financial performance of builders nationwide.

- The average gross profit among survey participants was 14.4%.
- The average net loss was 3.0%¹.

Gross profit equals sales minus the *cost of sales*. Cost of sales comprises

- materials and labor used in a home’s construction
- land on which the home is built
- indirect construction costs (field or construction expenses) that cannot be specifically tied to a particular home

Gross profit is measured before deducting operating expenses (financing, sales and marketing, and general and administrative costs). To calculate gross profit as a percentage of sales

1. Subtract the cost of goods sold from the sales price.
2. Divide the gross profit by the sales price.

¹Losses are indicated by parentheses around the numbers in tables and graphs.

The following example shows the calculation of gross profit margin for a home with a \$200,000 price tag and \$140,000 in cost of sales.

$$\begin{aligned} \$200,000 - \$140,000 &= \$60,000 \\ \$60,000 \div \$200,000 &= .30 \text{ or } 30\% \end{aligned}$$

You can (and should) calculate gross profit at all operational levels—by home, by community, and by all jobs over the course of a year.

Net profit is the income from sales after deducting the cost of sales, expenses, and owner’s compensation. In other words, net profit is the money a business earns after it has paid all the costs of both the project (hard costs) and the operating expenses (soft costs). When comparing your net profits with other builders’ or with overall industry performance, it is best to consider the pretax net profits because many factors determine the taxes a business pays.

Consider a company in which total sales are \$2,545,000, *cost of sales*, or cost of goods sold, is \$1,908,750, and operating expenses plus owner’s compensation equal \$432,650. The *gross margin*, or gross profit, is \$636,250, or 25%. Operating expenses are 17%, and net profit is 8%. To calculate the net profit as a percentage of sales, subtract the cost of sales, operating expenses, and owner’s compensation from total sales; then divide net profit by total sales as follows:

$$\begin{aligned} \$2,545,000 - \$1,908,750 - \$432,650 &= \$203,600 \\ \$203,600 \div \$2,545,000 &= .08 \text{ or } 8\%. \end{aligned}$$

Applying the Information to Your Business

How much profit should you be earning? Although there really is no ideal number, industry experts suggest aiming for gross profit margins of 22%–27% and net profits of 8%–15%. Although many companies post higher numbers, others do not achieve these levels. The averages presented in *The Cost of Doing Business Study* aren’t necessarily appropriate goals for every company. To determine your profit goals, consider your level of risk, the cyclical nature of the industry, and the return you could get for your capital if you invested it in another business sector or in a money market account.

Be cautious when considering changing your business plan based on information in this publication. Consider not only the benefits of the proposed change, but its costs. For example, although you could dou-

ble your home sales price to increase your profit margin, that probably is not a realistic strategy for growing your bottom line. Because your homes probably would be too expensive for the market, your sales velocity would slow or stop.

Although *The Cost of Doing Business Study* is an essential resource to help you manage your business more effectively and profitably, you need other tools as well. These include your annual operating budget, which you can use to evaluate monthly financial performance. You also need tools to monitor construction quality, employee or trade contractor performance, schedules, and pre- and post-construction systems. When you measure performance in essential areas, you will have the information needed to improve management, quality, and profitability.