

Good morning. I'm Travis Hendrick with The Family Business Institute, where it's our mission to *Build Better Contractors*. Today, I'm going to talk to you guys about what I feel is one of the least understood, under-leveraged, and underutilized roles within the construction industry and that's the role of the chief financial officer. So, we field a lot of questions about, what's the difference between a controller and a CFO? We field questions about, what should my CFO be doing? How do I know that they're doing a good job? And then thirdly, we get a lot of questions about when do I need a CFO? At what time, at what volume? How will I know? I'm going to attempt to answer that question as I go through the six components to what I feel will make a best-in-class, a really successful CFO in the construction industry? And then, we'll hopefully answer some questions here at the end.

So, component number one, it's just financial management. This is going to be the most recognizable piece. You have somebody in your office already who does this, maybe it's your controller, it could be a bookkeeper, office manager, but this is overseeing day-to-day accounting activities. It's compliance, it's being the point person for tax questions, the audit, and then the regular production of financial statements. So, just very transactional role.

The next component is the financial performance piece, and this is starting to put the story behind the numbers. So, this requires a solid understanding of the business and overall operations. For construction companies, over and under-billings on the WIP report are a really big deal and really factor into our financial report. So, really understanding more importantly the under-billings and what's driving under-billings is critical in this component. Also, understanding your financial performance versus your plan.

There's a lot of benchmarks that are out there and therefore, industry-wide, they may be lagging indicators or lagging results. I highly suggest coming up with your own plan. If you have a CFO in place, very likely you have a business plan in place. I prefer a rolling forecast, 12 months, because the construction business doesn't end at the end of December. So, I'm always looking ahead at a rolling 12-month period. So, I want to be looking at how are results comparing to our plan and what's driving the variance. So, all CFOs will be looking into that. It's also about processes and systems, to make sure that we're collecting the right data and transforming that data into information the best that we can. And then just maybe a little bit of an analysis of historical performance, types of projects, profitability by customer, maybe it's by superintendent, duration of jobs, things of that nature.

And then we start moving closer to that CFO role, and we move into a financial advisor and risk mitigator. So, what is this? This is looking at contract review. This is somebody that's looking at insurances and helping to manage claims. It may be subcontractor pre-qualifications, maybe looking for client's proof of financing. And so, it's not necessarily saying no to all of these risks, but it is someone who can properly identify the risks that are inherent in any project that we undertake, and then figuring out how to shed some of that risk through insurance and bonding, and passing some of that risk off to our construction team, or pricing that risk in on the price side, getting more of a reward for the additional risk that we're going to be taking. And what we see a lot of times with a lot of clients is they may see a riskier project, but once they decide, "Yes, we're going to move forward," they don't price in the reward for that risk.

And so, I think a good CFO, a high performing CFO will not only identify the risk, but they'll help you to price in an additional reward for taking on some of that additional risk. Other things like looking at trade and customer concentrations to make sure we don't have too much of our work with any one client, or any one trade partner. And it's also speaking into a go no-go criteria. Another thing that I always like to do in a CFO role is looking at a return on investment of superintendents. I think superintendents are what drive the projects and they're one of the most valuable assets to a construction company. So, I'm going to see what return should we be expecting from each one of our subcontractors. So, it's financial advisor and risk mitigator.

The 4th component is for full on CFO, this is forecasting and modeling. So, this is looking at longer range plans. How are we going to get there? What resources will be required for us to get there? It's also looking at cash. Having a statement of cash flows is, I think a basic financial report that all construction companies should have, whether you have CFO or a controller in place, you should have a statement of cash flow. We understand that cash is king. So, a cash flow model, like looking into the future saying, "Hey, where do we expect our trend to be on cashflow?" So, if somebody comes to us, we have a loss on a project, or we have an owner that wants to make a distribution or we're looking at making a big investment, what's that going to do to our cash position and how would that impact additional operations? We'd also be looking at what-if scenarios.

When we're starting to face some headwinds like we were seeing, they feel like they're lifting now, but I want to look at backlog and say, "Hey, if we have a significant project that makes up a good portion of our backlog, what happens?" What is the what-if scenario, if that thing pushes six months, 12 months? How is that going to impact our overall business? And what decisions would we have to make if that news were presented to us? Presenting back to your operations team, "Hey, if we were able to squeeze out another half percent of gross margin, what would that do to the bottom line?" Understanding breakeven analysis for the company-wide, or for each division if you have operating units that are separate of the entire company. So, what volume of work? At what margins do we have to do just to cover overhead and making sure that everybody's aware of those breakeven analysis?

And then looking at resources that are required for us to meet our objectives of the future, not currently today, but what do we need to be doing today to make sure that we can support the operation that we want to be in three years or in five years? So, that's full-on CFO. That is forward-looking forecasting and modeling.

And then, the 5th component is becoming a strategic business partner. It's having that strategic mind. It's somebody that looks at the business, not from an operation standpoint, but more of a financial and a risk management standpoint. So, somebody that's going to help you define where you want to go, but how are we going to get there? Do we have the financial resources to get there? Are we still in alignment with our core values? And then once we develop these strategic initiatives, what should the key performance indicators be?

And then how are we going to capture that data, and how are we going to report that back, so we can measure our progress as we're moving forward? If we're going to move into new markets, are we going to do that organically, and what investment is that going to require and when do we expect to get a return on that investment? And how much of a return to make that new market successful, versus maybe we're going to make an acquisition, we're going to go buy, what's the capital requirements to do that? What's the return on that as well? With acquisitions comes due diligence, so there're going to be a heavy member in the due diligence team just trying to decide, "Hey, is this a company that would fit well culturally with us and will it provide us an advantage in these new markets?"

And then, the 6th piece is just overall leadership. I really believe that a CFO just garners a high level of trust and credibility amongst all employees of a construction operation. So, how do we get that person more involved? We get them out into the field, we get them out at job sites. We get them face time with superintendents and craft employees, and that could be with the teaching on personal finance, it could be business acumen to project managers and project engineers, going beyond constructability of jobs. But how do you run a successful construction company? It's also being the bank relationship, being the bonding company's primary relationship and having strong relationships with trade partners, so we can open that communication. Especially if you're a general contractor, a lot of your risk comes from whether your trade partners can deliver for you and for your clients.

So, making sure that we have an open door of communication there and developing those strong relationships. Then also getting them to present on financial results to the company, getting them face time, making sure that people know who your CFO is. It's not somebody that's in the back office that's never seen amongst the organization. So, those are the six

primary components. So, I hope I've answered the difference between a controller and a CFO. I hope I've answered what should my CFO be doing. The last question was, how do I know when I need a CFO? And there's no cut and dry answer to this, but I will tell you, if you're a strategic minded company, you make data-driven decisions, I'd be getting a CFO sooner than later. More importantly, I would ask you, where do you expect to go in the next three to five years?

If it's significant growth and it's a wider geographic footprint, I'd be pushing you to get a CFO sooner rather than later. If you have a high employee count, high assets, again, the greater geographical spread, I'd be looking to get a CFO. And I would highly advise against, one of the pitfalls I see a lot of construction companies do, is where they promote a controller into a CFO role as the company grows. And while there are some people who can make that leap, what makes someone a really, really good controller, typically does not translate well into making them a strategic leadership forward, future-focused employee. So, I'd highly advise against doing that. I have a preferred CFO job description that you could reach out to whoever your contact is here at FBI. They'll be able to gather it for you and we'll send it to you for a roadmap, or for you to evaluate your current CFO. So, please reach out on that.

Again, my name is Travis Hendrick with FBI, where *We Build Better Contractors*.