

Top 21 Reasons for HVAC and Plumbing Business Failures

Brandon Jacob has analyzed over 1,800 privately held HVAC and plumbing businesses since 1996. He has had the rare opportunity to study the financial statements of both successful and unsuccessful service businesses. Along the way, he noted that those businesses that were successful followed certain rules and those businesses that were unsuccessful failed to follow these rules. Compiled from eight years of analyzing privately held HVAC and plumbing businesses, Brandon Jacob has put together his list of the Top 21 Reason for HVAC and Plumbing Business Failure. Is your business in danger of failing?

1. Failure to understand the responsibilities associated with being a business owner

Do you have what it takes to be a business owner? Do you understand the responsibilities that come along with the title “owner” or “shareholder”? Many contractors fail to realize that the responsibilities of being an employee are far less than that of an owner. As an employee, you show up to work each day prepared to perform a specific job, be it as a technician, manger or salesman. At the end of the week, a check magically appears with no questions asked. As an owner, your responsibilities extend well beyond one job. As an owner of an HVAC or plumbing business you are not only responsible for the management of your employees, but also for making sure the sales and marketing and accounting and finance functions are working properly. At the end of the week, owners are the last ones to receive a paycheck!

Many contracting businesses start when a technician envisions the mounds of money that can be made as an owner (easy money). In many cases, the technician incorrectly concludes that the owner is “rolling in the dough” – after all, look at all the money the technician bills for the company. The truth is that all owners should be making a decent return on the huge risks and responsibilities that come along with owning a business.

Too often good employees with high levels of confidence and an excellent expertise in one area of a business ventures out and hangs his “own shingle” without the understanding that in order to turn all those big dollar billings into profits, one must become at least proficient in management, sales and marketing, financing and accounting, administration and the technical attributers of the business he is in. Failure to achieve at least a working knowledge in management, sales and marketing, accounting and finance will lead to a failed attempt at business.

2. Failure to seek advice/assistance from outside resources

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Knowledge of management, sales and marketing, finance and accounting, administration and technical attributes is a lot for anyone to know. Here is the good news, if you lack in any one of these areas, you are not alone - give yourself a break. No one is born with all this knowledge and some of the material may come easier than the other, but you are going to have to work hard to build a solid understanding of all the areas that must be known in order to run a successful HVAC or plumbing business.

The even better news is that there are ways to gain the knowledge in areas that you are lacking. Are you a little weak on understanding what it takes to market to your customers or were you sleeping when you took that accounting class in high school? Take a class, hire a consultant, seek outside professionals and attend seminars. There are resources that exist for all areas mentioned above.

Very few owners of contracting businesses have started their business with a complete understanding of what all it takes to be successful. If you waited until you knew everything, you would never start. However, if you find yourself completely lacking in a certain area, don't avoid the matter and hope your business survives despite this lack of understanding. They say a chain is as weak as the weakest link for a good reason, if you have a weak link in your organization, seek help to strengthen the weak link before the chain breaks and whatever it is holding up (in this case your business) shatters into a million pieces.

3. Failure to track and understand field technicians' performance

Do you know what your field technicians are doing with all of the calls you are sending them on? Who is your best technician? Who is your worst? What was your average service ticket last year and how many service calls did you run last month? These are all questions that an owner should be able to answer about his business. In addition to the monthly financial statements, tracking and understanding your technicians' performance is how you keep score. If you are not keeping score, you have no idea if you are winning or losing. It's kind of like driving down the road at night in an unfamiliar part of the world with your lights off. Chances are you are going to hit a tree.

Your technicians' efficiency will make or break your business. If you do not track what each and every technician is doing, you will never know where to train, where to make improvements or what technicians to let go to destroy someone else's business. Track your technicians' performance or brace for a collision!

4. Failure to charge for your services/implement flat rate pricing

Flat rate pricing is not an option, it's a must! To remain profitable today a service business must charge high enough labor rates that would make customers feel like they are being robbed. Similar to the field technician that feels his boss is making a mint, when in reality he is not, factoring in all the costs that must be considered. Many consumers are as equally unfamiliar with the expenses associated with an HVAC or plumbing service business and all they can do is equate the "hourly rate" to that of their own, their spouses or whomever.

Flat rate prices enable you to charge the labor rate that you need to charge in order to be profitable without alienating your customers. Remaining on "time and material" will prevent your business from achieving a gross profit necessary to guarantee success as you will never be able to earn the hourly labor rate required to be successful.

5. Failure to understand the cyclical nature of the HVAC business and to an extent, the plumbing business

In the morning the sun will come up and at night it will go back down. Bet on it! Another safe bet – the summer in your town will be hotter than the winter and you will sell more HVAC equipment when it is hot! The HVAC business is cyclical, the cycles vary from region to region, but all HVAC businesses will experience "the busy season" and "the slow season". Accept it, prepare for it, survive it!

A successful contractor recognizes this fact. Why be surprised that no one is calling for a new condenser in February when it is 35 degrees outside? How well you manage your business during both the busy season and slow season will further your chances of success and lessen the chances of failure. This not only means limiting expenditures and cash flow planning in the slow season, but also making sure your business is profitable through the busy season. This goes for plumbers as well (every region has periods that are busier than others). Plan how you will capture the increased calls during the holiday season and how to control expenses during the slower tax time (April) and back to school time (August/September).

Finally, instead complaining about yet another cool March, focus your mental energy on a new marketing program to attract customers during this pre-busy season period. March will never be as strong as June so quit wishing for that once in a lifetime hot spring!

6. Failure to build a service agreement base

As mentioned in number five, the HVAC business is cyclical and if that ever changes, we will have more important things to worry about rather than selling HVAC equipment. Your "ace in the hole" is service agreements! Service agreements enable your business to not only maintain a level of activity during the slower seasons, but also enables your technician to offer customers upgrades and services prior to the cooling or heating season. Finally, customers under service agreements will not stray too far and call on competitors when it is time for demand service.

Plumbers, although not nearly as critical as with HVAC, offering annual plumbing inspections to customers would insure that you locked down those customers that subscribed to your annual inspection program. Like the HVAC business, these inspections can be conducted during the slower periods within your region.

7. Failure to diversify advertising/ineffective advertising

If your businesses entire advertising and marketing campaign begins and ends when the yellow-page representative leaves your office – read on. It's not uncommon for HVAC and plumbing businesses to spend 10 cents of every dollar billed on advertising. Not too long ago, it seems that many successful businesses spent all of that on yellow-pages. I am not advocating leaving the yellow-pages, but think about it, when was the last time you dug out "the book" when you needed service?

Pick your advertng carefully and allocate a portion of your budget to new advertising. What works in one region may not be so great in another. A combination of two or more of the following should be considered: yellow-pages, direct mailers, newsletters, newspaper, community publications, television and radio.

Hoping and waiting that someone will pick up the yellow-pages in October and call your HVAC business or expecting someone to pick your plumbing business out of the 50 choices in the yellow-pages is like dreaming of winning the lottery – it's not likely to happen, but it is fun to sit around and think it will. The difference is that while you are hoping and waiting, your business is failing.

8. Failure to focus on your core business

Why do so many contractors feel that they will be more successful operating in both the new construction and service markets? No one has 100% of their local market completely locked down in any work segment, so why feel the necessity to branch out and become involved in two fronts.

If your focus is residential service and replacement, be the best residential service and replacement contractor in your market. Leave the new construction market to your friend who owns a new construction business.

One better, there are countless HVAC contractors contemplating opening up a plumbing service. Typically it's because many customers ask if they do plumbing. Although this "low hanging fruit" may appear too good to pass up, think about the lost opportunities in your core HVAC business. Develop a referral partner to hand these plumbing jobs to and hope in return this referral partner flips you all his HVAC leads.

9. Failure to build a reliable resource network

Are you out there operating totally alone without any help? Do you speak to your CPA, attorney, and insurance man more than once or twice a year? Do you associate with successful contractors in different lines of work in your market? Failure to establish a reliable resource network will put your business at a distinct disadvantage, as you will pass up on excellent business advice that is so hard to come by when you operate your own small business. This goes beyond seeking advice/assistance from outside experts; it involves establishing relationships with those people in order to help you successfully stay on course on a day to day basis.

10. Failure to set goals, properly plan and budget

No one looks forward to planning and budgeting. How are you supposed to predict what is going to happen next year anyway? First off, what do you want to achieve from your business next year? Determining what you hope to achieve is setting goals and setting goals is the first step in planning and budgeting. Secondly, how do you plan to achieve these goals? Planning how to achieve your goals is planning. Estimating what your business will earn by reaching these planned goals is budgeting. Without fresh goals, plans and a budget, your business starts the New Year aimlessly and ends up wherever. Hopefully along the way, you made some money and did not run into any major obstacles.

With a goal, plan and budget, you have something to keep your business on track and something to celebrate (or study for improvements) at the end of the year. In addition, while budgets are being created, the business owner is forced to address certain decisions that are often put off during the year. Last but not least, it is amazing how much business owners learn about their business when budgeting. These discoveries can be the difference between success and failure.

11. Failure to receive timely monthly financial statements

Operating without monthly financial statements is like hiking without a compass. You might not get lost, however if you do, the consequences will be severe and by the time you figure out that you are lost, it is already too late. At the very minimum, you must have an income statement and a balance sheet prepared for your business at the end of each month and the time frame in which these financial statements are completed must be shortly after the month ends and all the relevant vendor invoices are received.

If you are not generating timely financial statements or if you are generating these financial statements, but not taking the time to study and understand them each month, you are not managing your business and you may find that you “are lost in the woods”.

12. Failure to implement financial control/discipline

Financial control and discipline is about establishing procedures to ensure the financial aspects of your business are managed continuously, accurately, timely and consistently. Failure to implement financial control and discipline will lead to inaccurate financial statements which will then be useless as management tools. An additional by-product of poor financial control and discipline is office manger/bookkeeper fraud (more on fraud later).

13. Failure to understand income statement/financial ratios

It's just not enough to generate an income statement every month and not look at it or look at it and not understand what it says. You don't generate financial statements simply to tell the IRS what taxes you owe, they are tools used to operate a successful business. Just like tools, if you do not understand how to use them, you should take the time to learn how to use them properly.

Small businesses, especially small HVAC and plumbing businesses are blessed with rather simple and basic financial statements. Understanding these basic financial statements along with basic financial ratios is critical to a successful business. Basic financial ratios include an understanding of percentages to revenue (margins). Without understanding your businesses margins, you are doomed.

You do not need to have the background or knowledge of a CPA or Wall Street Investment Analyst to successfully run a small service business, but not understanding financial statements and ratios leads to business failure.

14. Failure to understand profits and cash flows

Profits and cash flows are two different things. Profitable business, both large and small, run out of cash and go out of business all the time. Unfortunately, these businesses are typically growing and everything appears to be in good order. Why is this?

Your income statement (which tells you how profitable your business is) does not take into consideration certain important cash flow particulars such as cash not collected (accounts receivable) and cash used to pay debt. A profitable business that does not collect cash and carries a lot of debt can run out of cash quickly. Without understanding the difference between profits and cash flows, you may find yourself in this predicament. Understand profits and cash flows and do everything in your power to create a positive cash flowing business.

15. Failure to understand the balance sheet

Just like the income statement, if you generate a balance sheet each month and fail to understand it, it really is useless. Whereas the income statement tells you how profitable your business is, the balance sheet tells you about the overall health of your business – do you have too much debt, are you building equity, what does your accounts receivable and accounts payable look like, etc?

An outsider familiar with how financial statements works should be able to pick up your most recent balance sheet and learn everything there is to know about your business. You should be able do the same. Your financial statements are your businesses report card and without studying them, you will not know if you are passing or failing.

16. Failure to control excessive personal expenditures

The beauty of small business ownership is that you get to do what you want to do within your business. To many, running non-business expenses through their business is done to “lower the amount of earnings for tax purposes”. Another term for this is tax fraud. Although the risks of being caught are slim, some business owners find themselves “living out of the business”. By doing so, their businesses are sucked dry of necessary cash to continue to replenish assets and grow. Another unhealthy by-product of such an ownership policy is the failure to fully understand what the business is capable of earning because the personal expenses cloud the overall financial picture. Finally, an IRS audit can be an unpleasant experience under such a scenario.

Resist the urge to treat your business like a personal checking account, treat it like what it is a real business.

17. Failure to understand the need to reinvest capital/replace assets

If you are running a successful business, chances are it generates excess cash. With that excess cash, you can either raise your salary, bonus employees (or yourself), run personal expenses through the business to remove the cash (unadvised – see number sixteen) or leave it in the business and reinvest in the assets that make your little cash machine operate.

Small businesses are machines and like all machine, they consist of parts. These parts wear-out and need replenishing. HVAC and plumbing businesses must constantly reinvest in vehicles and small tools. To simply take a salary out of your business without leaving capital in place for reinvestment is slow death to a small business. Eventually you will have a broken down machine that in no longer capable of generating the profits and cash that is expected and ultimately, the business will become worthless.

18. Failure to understand gross profits of all business segments

Gross profits are defined as revenue less direct costs. Gross profits tell you how much profits the business is earning BEFORE overhead costs. You must have a sound understanding of what to expect in terms of gross profits from each business segment (service, installation, new construction) and you must know what this gross margin is on a monthly basis.

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If you are operating a business with gross profits that are too low, there is not way to make up for this by cutting overhead. Eventually, the cuts you make to overhead will destroy your ability to generate gross profits and the cycle will manifests until your business is destroyed. This also relates back to flat rate pricing, there is no way to overcome charging too little for your services.

19. Failure to safeguard against fraud

Small business owners have to employ people to perform various tasks. Unfortunately, people will steal from a business. As a business owner, do you work to hard to build a customer base, book service calls and collect from customers, only to have a dishonest employee steal what the business has earned? No!

Failure to safeguard against fraud can have devastating affects on a small business. There are numerous ways in which a dishonest office manager and/or bookkeeper can steal money and only one way to prevent the problem – establish safeguards.

Establishing safeguards, among other things, involves separating certain functions (cash receipts from cash deposits), retaining control of certain administrative functions (receipt of bank statements) and remaining involved in the financial aspects of the business (receiving and understanding monthly financials statements).

20. Failure to purchase keyman life insurance

Let's face it most small contracting businesses rely on you, the owner, for survival. Without the owner's everyday presence, the business rapidly and quickly starts to unwind. How long can your business survive should you become incapacitated or worse, killed in an unexpected tragedy? Stop a minute and consider the horrible outcome of such an event and then consider a keyman life insurance policy.

21. Failure to formulate a buy/sell agreement or plan an exit

Successful business start, grow and are sold. Selling your business enables to realize a pay-off for your hard work when the day comes to move on (hopefully you made a decent living along the way). Many business owners failure to give the planning of an exit any thought and find themselves at a tremendous disadvantage when it comes time to retire or another unexpected life event takes place that forces them to sell. Planning your exit will enable you to address the issues that may prevent your business from building value and will also help you set goals so that when an opportunity to exit presents itself, it won't be squandered.

If you are in business with a partner, regardless of whether it is a family member or not, eventually the partnership will run its course and one partner will find himself buying out the other partner. When partnership tensions are high is no time to discuss methods of business

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valuation and other steps needed to be resolved before the partnership can be successfully wrapped-up. While your relationship with your partner is positive, put together a buy/sell agreement so that if/when the relationship is strained, you already have a course of action. Many HVAC and plumbing businesses are run into the ground as partners negotiate how one will buy the other out.

Brandon Jacob operates *Contractors Financial Opportunity* (www.Contractorscfo.com), a financial consulting business in which he calls upon his fifteen years as a CPA and an industry expertise gained as a valuation analyst and acquisition specialist in the HVAC, plumbing and electrical trades. A graduate of Texas A&M University, Mr. Jacob brings big business experience and expertise to small business owners who would otherwise never have access to such resources. To contact Mr. Jacob, call him direct at 713/426-4041 or email him at BGJacob@aol.com.
