



# THE SAGA OF RB BUILDERS

## THE STORY OF ONE HOMEBUILDING COMPANY'S APPROACH TO IMPROVING OPERATING PERFORMANCE AND BUSINESS OUTCOMES

### **THE SAGA OF RB BUILDERS:**

This is a story about a homebuilding company, that we will simply call 'RB Builders'. As this story is being told, it is the end of 2012, and the company is looking back on the previous six years . . .

In 2007, RB Builders had generated \$50 million in Revenue, on the sale of 200 homes in a down housing market. Its owners were determined to improve operating performance and business outcomes in 2008. The owners had recently begun discussions with a consulting firm (with whom they had never worked), to work with RB Builders under a new, radically different consulting arrangement, in large measure, because the high six-figure total the company spent with various consulting firms over the previous 10 years had not accomplished anything worthwhile.

As RB Builders did its planning and budgeting for the then-upcoming year, 2008 looked to have market and economic conditions very similar to those in 2007. In 2007, RB Builders produced Gross Margins of 22%, earning Gross Income of \$11 million, down significantly from the 30%+ margins it enjoyed during the final, halcyon years of what had since become famously known as 'The Age of Homebuilder Entitlement'.

In many ways, RB Builders was a product of that age, just another homebuilding company, satisfied with occasionally adopting other builders' 'best practices', content to be good, no-better-but-no-worse than the other builders with whom it competed. It was a homebuilding company with a middle-of-the-road approach to delivering the value homebuyers demanded. Although its owners knew what

housing cycles were like, its management did not. Terms like TEFRA and RTC were faint acronyms from a different era. For the past 10 years, life had been good. But, it was becoming a dangerous approach, because – as the saying went – ‘the only thing in the middle of the road are yellow lines and dead armadillos’.

It was becoming homebuilding no-man’s land.

Locked into an operating model – into organizational structures, management systems, processes, cultures, and employees – that could not deliver extraordinary levels of distinctive value, the company found itself dumped into a teeming mass of homebuilders that looked-alike and sounded-alike. Now, indistinguishable from other builders, and unable to create any type of competitive advantage, RB Builders was trapped and sinking – like a modern-day dinosaur – into the tar pits of average-ness.

In 2007, Operating Expense (comprised of indirect, non-variable costs, and now seen as a reflection of the company’s annual investment in production capacity) was 17% of Revenue, earning RB Builders \$2,500,000 in Net Income; the resulting Net Income Margin (5%) was less than half the previous year’s margin. Return on Assets was in the single-digit range.

From a production standpoint, RB Builders had long cycle times (close to 180 days), low inventory turns, an uneven rate of sales, starts, and closings, and what it believed was either unused or excess production capacity. From a job costing point-of-view, the company had high job budget variation and slippage, and the resulting number of variance purchase orders was large. In terms of workflow, its processes were largely undocumented, unrepeatable, and unreliable, and a lot of the work it did was of questionable value. From a product/plan design standpoint, RB Builders maintained a large plan collection, many of which never sold. In terms of architectural interpretation, its homes offered a shallow illusion of architectural style, not a meaningful interpretive allusion; its plans were frou-frou to death.

There was ample room for improvement.

However – there was also a certain pervasiveness, an attitude of complacency, entitlement, acclimation to easier times, and resignation toward current conditions.

Management and staff had become accustomed to a salaried life, supplemented by performance bonuses based on individual job performance. Moreover – there had been no underlying focus to the previous improvement efforts. And – now – there was no consensus on where to start, and there was little confidence that future improvement projects would fare differently.

The new, intrepid, results-based consultant started out by offering RB Builders some assurances.

She told RB Builders that her firm would be compensated on exactly the same basis as everyone else. She told them that there was no limit to the time and effort her firm would expend to achieve the outcome, that she would work hand-in-hand with them, and do whatever it took to reach their goal. She assured them that she would do whatever it took to help foster a willingness and capacity for change, create a sustainable capability for implementing the things that would continuously improve operating performance and business outcomes, increase innovation and learning, and make RB Builders less dependent on their consultants.

The new, intrepid, results-based consultant then demanded some assurances of her own.

She made it clear that this was a client-consultant partnership, and that (because the consultant's compensation was completely results-based, of finite duration, and self-funding) her firm was assuming the higher level of risk. She allowed that the new, results-focused consulting arrangement they were jointly undertaking did provide ample incentive to everyone for taking action, making changes, and improving operating performance and business outcomes, but that there also needed to be an understanding.

She told RB Builders that she (and her firm) were as serious as a heart attack about getting results. She made it clear that she had no intention of wasting her firm's time and effort. She informed RB Builders that they did not have to do everything she told them, but they did have to come to terms with her. She wanted assurances that the company would, in fact, take action, make needed changes, and do whatever it took to achieve the targeted results, or – if there was no action, no change, no results – then the responsible heads at RB Builders would roll.

The intrepid, results-based consultant continued, making it clear that – for this new results-based approach to work (and as a condition of her firm's involvement) – RB Builders would have to make some changes.

She told RB Builders that it had to end its practice of paying individual bonuses based on multiple measures and, and replace it with a team-based approach focused on performance related to a single business outcome. Next, she then told the company that it had to change its current thinking on cost behavior and cost reporting (by adopting variable costing methods, by embracing Cost-Volume-Profit relationships, and by preparing financial reports that included a Contribution Income Statement). Then, she told RB Builders that all of the

current (or existing) manifestations of improvement initiatives – failed or otherwise – had to be subordinated to the new approach.

Finally – the intrepid, results-based consultant spoke with RB Builders about the candor, purpose, will, rigor, and risk<sup>1</sup> this arrangement would require, and about her expectations, in regard to their intra- and inter-relationships. She told them she expected them to speak – and to hear – the truth, to pursue goals that seemed unreachable, to see every situation as they chose to make it (not as they were told it had to be), to stick to agreements and keep commitments, to trust each other.

She told them failure would not be an option.

With this mutual understanding – with these mutual assurances and mutual trust in place – she began by helping RB Builders understand (and confront) the facts of their current reality, starting with an objective analysis and assessment of the company's current performance, resources, and capabilities, and its current limitations and constraints, followed by an analysis of the chain of events and factors that had led to that condition. The Current Reality Assessment was completed within a matter of days.

She then challenged RB Builders to chart a new and different course, one that would focus on improving the outcome in a single, pivotal measure of business performance, a measure that affected a range of issues (like pricing, direct costs, and productivity) and had implications for every home RB Builders sold. The intrepid, results-based consultant allowed that there were a lot of important measures of operating and business performance, but she suggested that RB Builders look at a measure like Gross Income. She recommended that the company start by establishing a baseline that represented the performance the company was currently capable of achieving, and then target a new level of performance that was considered 'beyond current capability', but would be possible, with sufficient urgency, intensity, focus, and motivation.

The company and its owners weighed a similar measure (Contribution Margin) before concluding that – while either measure would work – they would use Gross Income. The current baseline performance was referred to as the Gross Income Baseline (GI Baseline), while the new target was dubbed the Gross Income Target (or GI Target). The difference – the gap – between the GI Baseline and the GI Target was referred to as the Gross Income Reserve (GI Reserve), and it would become an important part of the new plan.

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<sup>1</sup> Read *The Courage to Act* (Klein, Napier).

From their new-found perspective of current reality (as viewed from their new-found understanding for how systems work), a GI Baseline (2007) and a GI Target (2008) emerged (Table 1, below).

Table 1 (2008)

Description	GI Baseline	%	GI Target	%
Closings	200		250	
Average Sales Price	250,000		240,000	
Revenue	50,000,000	100	60,000,000	100
less Cost of Sales	-39,000,000	78	-47,500,000	79
Gross Income	11,000,000	22	12,500,000	21
less Operating Exp.	-8,500,000	17	-8,500,000	14
less RBC Costs	--		-600,000	1
Net Income	2,500,000	5	3,400,000	6
Average Assets	30,000,000		30,000,000	
Return on Assets (%)		8		11

Prior to the adoption of its results-based approach, RB Builders had a ‘mental model’ that was a ‘more-for-more’ proposition, wherein the answer to more revenue and more output was more of everything else – more capacity, more resources, more plans, more steps, more reports, more money, more starts, more work-in-process. What the company really needed was a mental model that was ‘more-for-less’, a way to produce more revenue/output with less of everything else – less waste, less rework, fewer non-value-added steps, fewer (but better) measures, fewer resources, a smaller (but more intelligent) plan portfolio, less capital (debt and equity), and less work-in-process.

So – one of the necessary conditions that the owners of RB Builders placed on signing-on to the results-based approach was tight control on both the amount of assets and the cost of production capacity – neither work-in-process nor Operating Expense would be allowed to rise above 2007 levels; the company would have to meet its GI Targets without any additional work-in-process or overhead (and without any additional equity or debt). At the same time, the owners made it clear that they preferred to utilize the existing investment in production capacity, not cut it.

As business outcomes – profitability and economic return were more important than Gross Income, however (in terms of cause-and-effect), it was Gross Income that drove profitability and economic return. The focus on Gross Income (as the

driver) could not come at the expense of either Net Income or Return on Assets (as the outcome). So – a positive impact on Net Income was another requirement for the owners of RB Builders signing-on to the plan.

The final condition imposed by RB Builders' owners was that any cost associated with this results-based approach be self-funding (in other words, it had to be paid for from the outcomes it produced). Therefore, payouts under the plan had to come from performance above the GI Baseline, not from Net Income.

Mindful of the self-funding requirement and comfortable with the decision to focus on Gross Income – as well as wanting a plan that would be seen as reasonable and would motivate the behavior of all its internal stakeholders – RB Builders' owners agreed to distribute all of the 2008 Gross Income Reserve (the Gross Income earned above the GI Baseline, projected to be the difference between the GI Baseline and the GI Target) on the following basis:

Retained Earnings:	30%	(\$450,000)
Distributions to Owners:	30%	(\$450,000)
Employees:	30%	(\$450,000)
R-B Consultant:	10%	(\$150,000)

Having the same percentage distribution (30%) as RB Builders' owners made the company's employees – for the first time – want to think, care, and act more like business-owners. They began to view RB Builders' owners (even their intrepid, results-based consultant) as partners with common goals and mutual self-interests.

To maintain the level of intensity and interest throughout the year – and to avoid paying distributions from Gross Income the company would have expected to receive anyway – RB Builders created a progressive, rear-weighted payout system based on the achievement of Gross Income Milestones.

If RB Builders achieved its Gross Income Target, the plan was designed to pay out eight times a year. The amount of a GI Milestone was determined by dividing the Gross Income Target (\$12.5 million) by the number of milestones (8). In 2008, the way the numbers worked out, it resulted in GI Milestones sized at a little over \$1.5 million:

$$\$12,500,000 \div 8 = \$1,562,500$$

Whenever the company reached a GI Milestone (i.e., generated \$1,562,500 in Gross Income), the plan would pay out the employee and consultant portions of the distribution. By design, each successive GI Milestone was worth more than its predecessor. The first payout was only worth \$30,000, but it would payout early in the year, around mid-February; the eighth payout was worth \$150,000,

but the team would probably be in a race to reach that milestone before the end of the year. The amounts of payouts two through seven fell progressively between payouts one and eight.

The distribution of Gross Income above the GI Baseline was strictly conditioned upon the generation and receipt of Gross Income: If fewer milestones were reached, the number of payouts was automatically reduced, and – owing to the progressive nature of the payouts – the amount of the payouts from the milestones that were reached was considerably less. The arrangement applied to everyone – owners, executives, employees, intrepid results-based consultant, alike. It was perceived as fair. It was an arrangement ideally suited to a savvy, mutually-accountable, motivated team pursuing a common goal, one in which there would no longer be winners and losers, only winners or losers. It was an arrangement that gave company leaders the credibility to lead, to demand performance and results.

And so, RB Builders set out on the road to improving operating performance and business outcomes. The company's owners constantly and consistently emphasized the importance of achieving the desired results. They shared the financial performance and condition of the company openly with the entire team, and taught every team member what was needed to run a homebuilding company as a business.

Over the course of the next two years (with the guidance of its intrepid results-based consultant), the company designed first one, then another, then several more projects, each with short timeframes and targeted results, each the logical successive step in the pursuit of the overall goal.

For example, one project targeted finding/creating an additional \$5,000 in value (price minus cost) per base plan within 90 days, without reducing the net value to a single trade partner. Another project aimed at an average of 45 days in cycle time reductions within three months (from its current level of 180 days, down to 135 days), by removing unmanageable float and resolving resource conflicts, so that jobs finished sooner. A third project indexed RB Builders' processes by order of importance and performance, and set out to completely eliminate non-value-adding work in the most critical processes within 90 days. A fourth project aimed at completely redefining the product offering portion of the company's value proposition.

On it went, one project after the next. Some projects addressed margins, while others targeted productivity; some targeted scheduling, some targeted workflow, and some targeted product design. Most of the projects were done in sequence (not in parallel), and the active projects always focused on some constraint,

focused on relieving something that limited or restricted RB Builders' ability to generate higher levels of Gross Income.

Along the road, RB Builders embraced flexibility and innovation; it experimented with different techniques and approaches, but initially shunned major systems or technology conversions out of concerns about its capability to implement the changes. The company learned from the outcomes of each project, and incorporated what it learned into each successive project. As RB Builders did more for itself, its confidence in its own capacity and capability to manage change and get results grew; and, as its own capability and capacity increased, its dependence on the work of its intrepid results-based consultant (now considered a trusted advisor) lessened.

Along the road, the intrepid, results-based consultant kept RB Builders focused on the outcome. She helped them change their mental models, their way of thinking, in a number of areas. She taught the company how and when to use all of the tools in the toolbox, without regard to the consulting religion or denomination from which they came.

She challenged assumptions and decisions. She taught RB Builders how to 'see' production, how to look at its production capacity, productivity, and production planning and management. She shared business principles. She taught them how to solve core problems. She helped them design new processes, new production systems, and new measurement systems. And – because she was invested in the same results as her client – the intrepid, results-based consultant was usually the most reliable barometer for gauging the choices of where and when RB Builders should expend effort and resources.

Throughout the journey, the intrepid, results-based consultant shouldered her load, coordinated (as needed) the different roles of other consultants, assumed exactly the same risks, and shared in the accomplishment, recognition, and rewards on the same basis as her RB Builders partners.

By the end of the first year (2008), RB Builders had generated \$1.2 million in Gross Income above the GI Baseline, distributed more than \$450,000 in bonuses and compensation, and increased Net Income by almost \$750,000 (half of which was left in the company as additional Retained Earnings, and the other half distributed to owners). Net Income Margin and Return on Assets improved by more than 20% (from 5% to 6%, and from 8% to 11%, respectively).

Encouraged by the initial success of their Results-Based approach, RB Builders continued to systematically exploit opportunities to increase Gross Income in the year immediately following 2008, by investing intelligently and sensibly in new technology, in enhancements and upgrades to existing systems, and by taking

on additional and more challenging constraints to what had by now become their unifying focus: achieving year-over-year increases in targeted levels of Gross Income over every year's baseline.

With the housing market finally expected to rebound somewhat, RB Builders' 2010 GI Baseline and GI Target now looked like Table 2 (below). The 2010 GI Baseline was considerably higher than the 2007 GI Baseline, reflecting the different (better) market and economic conditions; as such, the baseline representing 'business-as-usual' and 'expected' performance had moved up, but it was still just that, 'the performance expected under current reality', and the differences between the 2010 GI Baseline and GI Target reflected those expectations.

RB Builders achieved its 2010 GI Target. Viewed over time, the company's results clearly speak for themselves.

Table 2 (2010)

Description	GI Baseline	%	GI Target	%
Closings	270		325	
Average Sales Price	260,000		280,000	
Revenue	70,200,000	100	91,000,000	100
less Cost of Sales	-53,300,000	76	-67,400,000	74
Gross Income	16,900,000	24	23,600,000	26
less Operating Exp.	-10,500,000	15	-10,500,000	12
less RBC	--		-2,700,000	3
Net Income	6,400,000	9	10,400,000	11
Average Assets	30,000,000		30,000,000	
Return on Assets (%)		21		35

Under the new program, the company's Revenue had increased by more than 80%, from \$50 million in 2007, to \$91 million in 2010. Gross Income had more than doubled, from \$11 million in 2007, to almost \$24 million in 2010. The growth in Revenue and Gross Income occurred with only a 23% increase in the level of Operating Expense, from \$8.5 million in 2007, to \$10.5 million in 2010. As a result, RB Builders' Net Income had more than quadrupled, from \$2.5 million in 2007, to \$10.4 million in 2010.

Because the level of invested assets had not changed, RB Builders' Return on Assets had also quadrupled, from just over an 8% return in 2007, to almost a

35% return in 2010. Distributions to teammates (employees) had increased from \$450,000 in 2008, to \$2,025,000 in 2010, while additions to Retained Earnings and distributions to owners had increased from a total of \$900,000 in 2008, to more than \$4,000,000 in 2010.

And – what of RB Builders’ intrepid results-based consultant?

Her firm received more than \$1.2 million over their three years of involvement with RB Builders, more than it would have received under a conventional, fee-for-service arrangement. However, its compensation was proportional to its partners at RB Builders, commensurate with the risk it assumed, and reasonable in view of its role in the business outcomes they had helped RB Builders achieve over that period. After all, RB Builders had pocketed \$12 million in additional Gross Income above the GI Baselines (income RB Builders acknowledged it wouldn’t have otherwise earned), which it was then able to allocate in the form of \$3.6 million to additional Retained Earnings, \$3.6 million in additional distributions to owners, and \$3.6 million in performance compensation to the company’s employees under the RBC.

Confident the company had learned from all of its projects and was now capable of going forward on its own, RB Builders’ intrepid, results-based consultant turned a valued client loose at the end of 2010, and moved on to new and different challenges.

For its part, RB Builders bid farewell to a trusted advisor, whom it viewed as the architect and project manager that had guided and sustained the company’s turnaround, a partner (in every meaning of the word), and a consultant whom it admired for having the courage to invest in results and learning.

The story did not stop there.

As RB Builders did its now-customary results-based planning and budgeting for 2012, the company found the housing market in mid-cycle, with stronger demand and higher margins than 2007-08, but not as strong a market as 2010-11. It was a different playing field, in part due to market conditions, and in part, due to the company’s improved operations.

In the time since it had started its Results-Based Consulting arrangement five years ago (the company still used the name, despite its intrepid, results-based consultant having been gone for two years), RB Builders had clearly become a more productive building operation. The company’s average cycle time had dropped to 112 days (in 2010), and RB Builders now believed it was capable of generating twice as many closings as it had in 2007, with the same level of work-

in-process and the same amount of production capacity. That would put RB Builders' average cycle time at 90 days, well below the 180+ day average durations it had in 2007.

However, as the company was preparing to enter 2012, concerns about market conditions outweighed the possibility of higher productivity, and brought into question whether – and how – RB Builders could utilize any additional capacity or productivity. The GI Baseline for 2012 was set at the actual performance from 2010 (with overhead adjusted for inflation), although using 2010's performance put the 2012 GI Baseline below what the company had achieved in 2011. But – they agreed that the GI Target for 2012 needed to reflect the results that could happen if RB Builders found a way to utilize the additional capacity and productivity under the anticipated market conditions (Table 3, below).

Table 3 (2012)

Description	GI Baseline	%	GI Target	%
Closings	325		400	
Average Sales Price	280,000		270,000	
Revenue	91,000,000	100	108,000,000	100
less Cost of Sales	-67,400,000	74	-82,100,000	76
Gross Income	23,600,000	26	25,900,000	24
less Operating Exp.	-11,000,000	12	-11,000,000	10
less RBC			-800,000	1
Net Income	12,600,000	14	14,100,000	13
Average Assets	30,000,000		25,800,000	
Return on Assets (%)		35		55

The housing market had enjoyed a three-year turnaround, following the two-year downturn at the close of 'The Age of Homebuilder Entitlement'. 2012 would see lower sales prices, particularly if the company intended to close almost 25% more homes. If the company achieved its 2012 GI Target, RB Builders would be a larger homebuilding company, but it would not be a more profitable homebuilding company. The prospect of still another downturn in the housing market turned the company's attention back to the risks inherent in a market/industry where capacity exceeded demand.

RB Builders knew that it had never really achieved the 'more-for-less' proposition its trusted, results-based advisor had helped them envision back in 2007. The best it had been able to do was 'more-for-the-same' – more Revenue, more

Gross Income, produced with the same level of work-in-process and a slightly higher level of Operating Expense – an improvement from the ‘more-for-more’ proposition it started with, but nowhere near ‘more-for-less’. In the improving housing market of 2009-2011, ‘more-for-more’ had been sufficient; in a deteriorating housing market, it would no longer be sufficient.

The company was curious about what it would take to get to ‘more-for-less’. It was curiosity worth a quick call to the trusted, results-based advisor, who had always left the door open. When asked, ‘What does it take to do ‘more-for-less’ – to become a ‘more-for-less’ homebuilder?’, the trusted, results-based advisor smiled, and simply replied, ‘Less enables more’.

RB Builders began to take a harder look at ways to ‘do less, but provide more’, at ways to ‘do less, while providing more’. The point of separation was always about value, viewed from the homebuyer’s perspective. They simultaneously looked for ways to eliminate waste, and use the resources and capacity that it freed to provide more value. The company still applied systems-thinking to the cause-and-effect relationships of every improvement it made, but the day-to-day effort became a broader, more Lean-based approach, in part, because of the widespread nature of the improvement, in part because of RB Builders’ increased implantation capability and capacity, in part because RB Builders’ team now believed in the approach. Much of the effort was still organized into short duration projects with measurable results, but there were more projects, run concurrent, and the projects were not restricted to constraints.

In its search for ways to ‘do less, but provide more’, RB Builders revisited areas it had worked on previously. The company had earlier redesigned its critical processes, but it knew the new process designs had settled for ‘should-be’; most of the purely non-value-added work had been eliminated, but much of what was considered only value-enabling work remained. The new process designs had restructured and reordered the remaining value-enabling and value-added work, but they had never truly ventured toward ‘could-be’, where the goal would have been to only do value-added work. So – one of the rapid-results projects<sup>2</sup> in 2012 focused on process workflow. Another project focused on eliminating all of the ‘things’ – the meetings, reports, and policies, etc – that RB Builders could just as easily do without, particularly if having them or doing them didn’t add any value. Complexity of any kind was a target for elimination, to be replaced with clear, simple, effective ways of doing things.

They continued to focus on project management, on removing unmanageable float and resolving resource conflicts, so that jobs finished sooner, but now, the company also turned its attention to the amount of work-in-process. When RB

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<sup>2</sup> The term ‘rapid results’ comes from *Rapid Results!* (Schaffer, Ashkenas, 2005).

Builders looked around, and asked, ‘What’s still the same? What hasn’t changed?’, the most obvious answer was work-in-process.

RB Builders’ intrepid, results-based consultant/advisor had taught the company to think of its production capacity as the rate of closings it could generate with a planned, finite, and controlled amount of work-in-process, and with a fixed overhead. As a result, RB Builders had religiously maintained its average work-in-process at 2007-levels (100 homes under construction), Better scheduling and production management had resulted in more than a 60% increase in the rate of closings, from 200 homes in 2007, to 325 homes in 2010. Improved flow of sales, starts, and closings had resulted in a more even spread of the work-in-process. But – it was still 100 homes.

She had shown them how excessive levels of work-in-process reduced the rate of throughput. It was in the formula she had given them for calculating cycle time. RB Builders reasoned, what would happen if the level of work-in-process was purposely lowered? No longer afraid of trying, failing, and learning from new ideas, the company decided to reduce current work-in-process and limit maximum work-in-process to 80 homes in 2012.

RB Builders’ GI Targets had always reflected a level of performance that was considered ‘beyond current capability’, a level of performance that was possible, but only through extraordinary amounts of urgency, intensity, focus, and motivation. Far from ‘business-as-usual’, the 2012 GI Baseline had not cut the company any slack – it was a stretch, itself, under the anticipated market conditions. Every year, RB Builders had reached its GI Target. 2012 was a different story (see Table 4, below).

Table 4 (2012)

Description	GI Target	%	GI Actual	%
Closings	400		453	
Average Sales Price	270,000		268,000	
Revenue	108,000,000	100	121,400,000	100
less Cost of Sales	-82,100,000	76	-91,900,000	76
Gross Income	25,900,000	24	29,500,000	24
less Operating Exp.	-11,000,000	10	-11,000,000	9
less RBC	-800,000	1	-2,000,000	1
Net Income	14,100,000	13	16,500,000	14
Average Assets	25,800,000		25,800,000	
Return on Assets (%)		55		64

RB Builders went 'beyond current capability'. It went 'beyond current possibility'.

The company got serious about increasing productivity and utilizing its production capacity. It attacked resource constraints, as well as the excessive safety built into schedules to protect phase completion dates. It relentlessly attacked anything that didn't add or create value, from the homebuyer's perspective. It reallocated personnel (freed by 'doing less, but delivering more') to more productive work, work that generated more Gross Income.

RB Builders continued to refine the ability of its operating model to deliver on its value proposition – it continued to improve the capability of its organizational structure, management and operating systems, business processes, homebuilding team, and culture to deliver extraordinary levels of the distinctive product and service value demanded by the narrowly-defined segment of the new home-buying market the company had purposely chosen to serve. Its product (its plans, elevations, specifications, finishes, features, options, and communities) became more distinctive and evocative; its service became more focused, more useful, and more to the point.

During 2012, RB Builders closed 453 homes, 53 more than its target. With only 80 homes under construction, cycle time dropped to 65 calendar days, 25 days less than its target (90 days). Acquiring the additional market share in a down housing market resulted in a lower average sales price, but the company had held the line on direct, variable costs, so that it met its Gross Margin Target (24%).

RB Builders' 2012 GI Target was \$25.9 million; the company generated Gross Income of \$29.5 million, \$3.6 million above its target. The company also held the line on indirect, non-variable costs, so that its Net Margin exceeded the target (14% versus 13%), even considering the higher cost of its results-based compensation. RB Builders had targeted Net Income of \$14.1 million; when all was said and done, the company actually earned \$16.5 million, \$2.4 million above its target. The combination of higher Net Income and lower levels of work-in-process pushed Return on Assets to 64%, exactly eight times the economic return the company earned in 2007.

Not only had RB Builders reached its 2012 GI Target (and achieved all eight GI Milestones), it had exceeded the GI Target to the point of achieving a ninth milestone.

Since its GI Target was the sum of its GI Baseline and (projected) GI Reserve, the milestones that made up RB Builders' GI Target (milestones 1-8) were always considered to be a blend of the 'expected' and the 'extraordinary',

progressing toward the extraordinary. However, the achievement of 2012's GI Milestone 9 was purely extraordinary, in terms of anything the company had accomplished before.

With its annual overhead and the cost of its production capacity fully absorbed in the previous eight milestones – and with its projected GI Reserve more than doubled – the \$3,600,000 in additional Gross Income from GI Milestone 9 was distributed in its entirety.

The employee payout went to one-third of the milestone<sup>3</sup>, to \$1,200,000, more than doubling the payout for the entire year. The remainder of GI Milestone 9 (\$2,400,000) was left in the company as an additional \$1,200,000 in Retained Earnings, matched by distributions to owners (\$1,200,000).

### **A NEW APPROACH:**

Although it looks back to the future, the saga of RB Builders reads like historical fiction. The characters (RB Builders and its intrepid, results-based consultant) are fictional, but the events and circumstances are all-too-real for most homebuilders.

The results-focused approach that the intrepid, results-based consultant used with RB Builders is anything but fictional; it is the exact approach we are using to transform the delivery of consulting services to our clients in the homebuilding industry.

If the ideas contained in the story of RB Builders intrigue you, contact us.

There's more to tell.

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<sup>3</sup> Remember – by this time, RB builders was on its own. The 10% that had gone to RB Builders' intrepid, results-based consultant was being allocated evenly between additional retained Earnings, Cash Distributions to owners, and employees.

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