Will your company make money in 1980?

That’s a good question you can take straight to the bottom line; here are a few thoughts on how contractors can get the answer

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Will your company make money this year?
That’s a pretty good question in today’s market. With all the conversation centering around recession, inflation, high interest rates, and unemployment, it is not always easy to forecast what the bottom line will look like.

Contractors have traditionally fallen on hard times during recessions and other forms of economic downturns. Many economists, accountants and financial advisors blame this tradition on the fact that construction is the first segment of the economy to slow down.

That is a fact that cannot be disputed. However, another truth is that tight economic situations are often aggravated by unsound pricing practices within the contracting industry.

Some contractors use a very simple formula for success: they bid work a nickel cheaper than their competitors and obtain as much work as possible. Then, they buy the material and expend the labor necessary to complete the job. They hope that at the end of the year, they will have more money in the bank than they did the previous year.

The mistake in this system is the bidding against competition rather than the bidding of costs. When work is plentiful, competition is less intense, and prices are higher. As fewer and fewer jobs become available, the “nickel-cheaper-than-the-other-guy” method can easily result in a loss which may go unnoticed until the end of the year. The successful contractor must know at what point to say no.

The most important goal for many contractors is to procure the job. Yet, most of the contractors who experience financial difficulty have all of the business they can handle. Rarely does a contractor go out of business simply because he does not have enough work.

So, we again come to the question at hand: are you going to make any money this year? If you are unable to predict what this year’s bottom line is going to be, you may need to brush up on your day-to-day cost analysis and pricing practices.

You cannot overstate the importance of sound job analysis and overhead markup as the basis of sound pricing practices. As a contrac-
tor, you must recover the indirect costs on a day-to-day, job-by-job basis. You must also be able to adjust to changes in overhead costs as the number of billable or job-related hours increases or decreases. It is pretty obvious that a single article cannot completely set out a total cost analysis program, but it can address three major areas in which contractor awareness is imperative:

- First, a contractor must establish and budget reliable overhead cost figures for the coming year. These figures must be realistic and may differ from the overhead or operating expense figures used for tax purposes.
- Second, a contractor must be able to recover these costs on a job-by-job or hour-by-hour basis. For example, if a contractor expects to spend $200,000 in labor cost and $100,000 in overhead cost, then he will spend 50 cents for overhead on every dollar’s worth of labor.
- Third, a contractor must be able to adjust to changes in costs. For example, if gasoline increases from 50 cents to $1.25 per gallon, this increase must be worked into the budget. The cost figures must be adjusted accordingly. The contractor needs to adjust—not only to changes in actual costs, but also to changes in volume. Should he produce fewer hours of field employment, his per-hour overhead cost will increase, because fixed overhead will remain constant versus a smaller base from which to recover these costs.

So, there are three vital questions for the financial manager. What will overhead costs be? How can overhead be recovered on a day-to-day basis? How will the changes in costs and volume be accounted for in the system? The key to answering these overhead questions are: prediction, application and monitoring.

As a contractor, you may find that when the accountant pulls your books together at the end of the year, it is too late for you to take corrective action. Can you really afford to wait? What if your accountant tells you that you blundered into a substantial loss? What can you do about it at that point?

If you really cannot answer whether or not your company will make money this year, you should realize that you are in no position to wait and find out. Instead, review the three basic financial steps—prediction, application and monitoring—and apply them to all cost factors, especially overhead expense.

You will not only have a better picture of what’s ahead on the bottom line, you’ll have lead time for making adjustments and will be in the position to answer “Will I make money this year?”

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