Will Your Company Make Any Money This Year?

By IRVING J. CHASEN, President

Pretty good question, isn’t it? With all the talk of recession, inflation, high interest rates, and unemployment, what’s the bottom line going to look like?

Contractors have traditionally fallen on hard times during recessions and economic downturns. Many economists, accountants, and financial advisers blame this on the fact that new construction is the first segment of the American economy to slow down. We agree, but we feel the situation is further aggravated by un-sound pricing practices in the contracting industry.

A Nickel Cheaper

Some contractors use the following formula for success: they bid work a nickel cheaper than their competitors and obtain as much work as possible. Then they buy all the materials 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 had a year before.

The mistake in this system is the bidding on competition rather than 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 goes unnoticed until the end of the year. The successful contractor must know at what point to say “No.”

Produce the Job

The most important goal for many contractors is to procure the job. Yet most of the contractors that experience financial difficulty have all the business they can handle. Rarely does a contractor go broke because he doesn’t have enough work.

Again we come to the question: are you going to make any money this year? If you can’t predict this year’s bottom line, you may need to brush up on your day-to-day cost-analysis and pricing practices.

Sound Job Analysis

At PROOF, we have stressed the importance of sound job analysis and overhead mark-up as the basis of sound pricing practices. As a contractor, you must recover indirect cost on a day-by-day, job-by-job basis. You also must be able to adjust to changes in overhead costs as the number of billable or job-related hours increases or decreases. Obviously, we cannot offer a complete cost-analysis program in a brief article; but we can mention three major areas contractors must be aware of.

Overhead Cost

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.

Secondly, a contractor must be able to recover these costs on a job-by-job 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.

Thirdly, 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, and 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 the same, with fewer hours in which to recover this indirect cost.

Overhead Keys

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 changes in costs and volume be accounted for in the system? The three overhead keys 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 afford to wait? What if he tells you that the loss was substantial? What can you do about it at that point?

Will your company make any money this year? We hope so, but you can’t afford to sit around and wait to find out. If you don’t know what the end of the year will look like, we suggest that you review the three basic financial-management steps-prediction, application, and monitoring of all cost factors, especially overhead expense.

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