

# Construction

## *Industry Advisor*



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# How to keep money in your pocket by bidding for profit

**C**onstruction contractors know the basics of business: To stay afloat you must be competitive while offering reasonably priced quality service. Easier said than done, right?

The difficulty lies in being aggressive enough to win work without accepting an irresponsible level of risk against the business should something go wrong during the job.

## It's all in the details

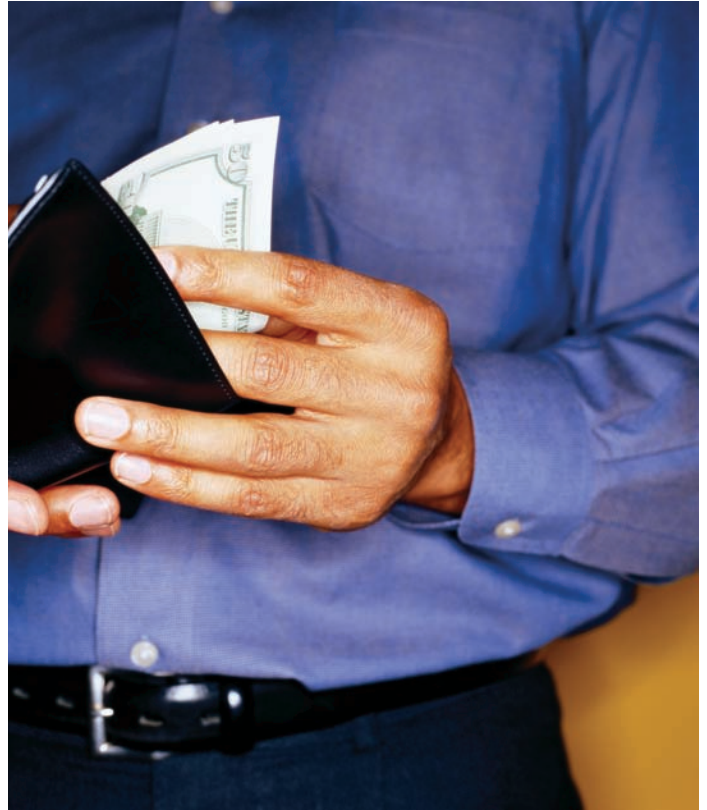
How much do you charge for your work? Is your pricing too aggressive? Are you losing jobs because your bids are too high? Before you can determine how much you'll charge for your work, you need to review three areas:

**1. Costs.** There are two categories of costs: direct and indirect. Direct costs are those that relate to the actual hands-on construction, such as labor, materials and taxes. Indirect costs are associated with running your business, including overhead, bonding and insurance.

*Carefully consider the profit margin of each job, taking into account direct and indirect costs.*

Many contractors fail to get a handle on their true costs. If you're too busy to give your costs the attention they deserve, talk with your CPA. Contractors who don't properly allocate costs to their projects are missing out on opportunities to recoup expenses and submit accurate bids.

**2. Market.** Who are your customers? Where are they located? How much can they afford to spend? Knowing the answers to these questions will help you set prices appropriately. For example, if you're a custom home builder, you may decide to build houses targeting customers with incomes in the middle- to upper-middle-class range. You need to look at how much the market will bear for new home prices, and what customers expect for that price.



Conversely, if you're a commercial builder, you might look at what major employers are moving into or out of your area and what tax incentives may be available to build certain types of projects. If you're in a very competitive market, avoid incorporating in your bid a lot of high-end finishes, fixtures and other expensive features that can price you out of jobs.

For you to understand the market, you must also know who your competitors are and how many of them are bidding for the same work you're going after. Some contractors decline to bid if they think the number of competitors is excessive. Owners may believe that the best way to get a low price is to have a lot of bidders. When there are too many, however, there's less incentive for contractors to submit bids and work up their lowest prices. That's because no one wants to be the lowest bidder among 20 contenders.

**3. Profit margin.** Obviously, you want to offer a good price to keep in the running for a job. But you're in business to make money, so one of the most important elements of a successful bid is for it to be profitable.

Carefully consider the profit margin of each job, taking into account direct and indirect costs. The greater the perceived job risk, the higher you need to place the profit margin to accommodate possible losses. Experience helps here. If you bid work in which you're experienced, your profit margin can be lower and the bid will be more competitive.

### Is lowballing ever a good idea?

There are times when underpricing a job may make sense. You could offer a lowball bid to get a foothold in a new market or account, for example, or to build a relationship with a customer who might provide more business down the line.

But before you give away your services, make sure you've hit your "sweet spot" for the year. That is, make sure your business is close to or has already reached its ideal profit margin. It's only then that you should consider lowballing a bid to bring in more business.

### Selling the job

The price you charge for your services can have a huge impact on your business's success — or failure. Charge too much and you may lose customers. Charge too little and your profits will be too low for long-term survival. The key is to know your costs, your market and your profit margin. **T**

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## Don't jeopardize your company's future: Create a succession plan

**M**aybe your construction business has been in the family for years, or perhaps you've built it from the ground up. In either case, you've worked hard to make it successful. To ensure your company survives after you leave, though, you must develop a succession plan.

A succession plan is vital for confirming, communicating and implementing next steps for the business. A thoughtfully implemented succession plan can pave the way for a nearly seamless transition when you decide to retire.

### Continuing the family legacy

The key operational issue addressed in any succession plan is: Who will one day lead the enterprise? If yours is a family-owned operation, finding a successor can be difficult. Family members may be qualified but have no interest in taking the reins. Or they may want to be involved but not have sufficient experience.

To deal with issues such as these, you must take time to encourage and develop future leaders. Early on, identify children or other key employees you believe hold leadership potential and expose them to all aspects of running the business.

Give them a well-defined path to find out what they need to do to become future leaders of the business. And create an environment in which they are assured that their hard work and time spent learning how to



run the business will be rewarded with a leadership role and ownership interests at a clearly defined point in the future. Finally, establish appropriate fringe benefit and deferred compensation plans, as well as incentive pay, to help retain them until you step down.

### Include your family in the planning process

It's important that you encourage the entire family, whether or not they're active in the business, to participate in the planning process and to understand the financial and personal consequences of an unsuccessful succession.

## Can your employees buy the company?

If a successor isn't immediately apparent, you may want to sell your business to your employees. An employee stock ownership plan (ESOP) is a defined-contribution plan in which your employees purchase shares in your company as an employee benefit. Many companies use ESOPs to motivate and reward their employees, provide an exit strategy for departing owners and borrow pretax dollars for acquiring new assets.

For construction companies, however, ESOPs may not be as attractive as they appear. That's because you must record the money you borrow for the ESOP as a liability and debit a like amount to a contra equity account. The resulting reduction in your business net worth may not be operationally significant, but it could affect your bonding capacity. Plus, employees who leave your company may require you to buy back their shares — creating an off-balance-sheet liability for you.

An ESOP requires a formal valuation of the business that considers its profits, cash flow, market conditions and outlook, assets, and other relevant factors. You'll also need to consider how to fund the ESOP. Your accountant can help you determine if an ESOP is the right move for you and your business.

A common issue is how to equitably divide assets among your heirs when only some of them will have control of or receive ownership interests in the business. If there are sufficient liquid assets, you can purchase life insurance to provide for any children who won't be involved in the business, and give ownership interests only to those who will be involved. Or, consider establishing a family trust to own and operate the business, so that the entire family shares the risks and benefits.

If handing down your business to family members isn't the best option, consider selling it to an outside party or to your employees. (See "Can your employees buy the company?" above.)

## Expanding the focus

No matter whom you choose as your successor, you should involve your accountant, lawyer, insurance advisor and a family business consultant. These experts can help you assess your circumstances and create a plan that accomplishes four goals:

1. To create a management structure that will survive your departure,
2. To put the business on sound financial footing while ensuring adequate liquidity to fund your retirement or a buyout,
3. To restrict transfers of ownership interests through the use of a buy-sell agreement, and
4. To minimize income and estate taxes.

Meeting these goals can be a juggling act. But without a clear succession plan, all the "balls" that you've juggled over the years to build a successful construction business can quickly fall to the ground.

*A common issue is how to divide assets among your heirs when only some of them will have control of the business.*

## Letting go

Passing the baton of ownership and control may be one of the most difficult challenges you'll ever face, but you need to prepare yourself for the day you're no longer in charge. Even if you stay involved with the business after you retire, find a new role for yourself, such as mentoring young employees or assisting with marketing efforts. This will allow the new leader to truly be seen as the "boss" and to make the big decisions.

The earlier succession planning begins, the better, even if you don't plan to retire until years from now. Developing and grooming your successor will take time, as will preparing your employees and managers to adjust to a new ownership structure.

## Planning is key

Succession planning is just as important as drawing up a will. In fact, estate planning and business succession planning go hand-in-hand, because transitioning a business will have a major impact on your estate and your heirs. A carefully considered and executed plan will ensure the continuity of your legacy. *T*

# Are you ready to hit pay dirt?

## Reuse and recycle jobsite materials

**H**itting pay dirt at demolition and construction sites is as easy as looking beyond piles of rubble for potential treasure. Reusing and recycling demolition and construction debris cuts waste, reduces purchasing and waste disposal costs, and may attract new clients who value environmental responsibility.

### Dollars in the dumpster

The reuse and recycling of materials is growing in popularity as the construction industry increasingly embraces environmentally responsible methods and practices. The opportunity for financial savings stems primarily from the landfill — less construction site waste means lower disposal fees.

To see just how much savings can be realized, consider the case of the former Division of Consolidated Laboratory Services building and the former Motor Fuel Lab, both in Richmond, Va. The buildings were demolished in 2003, yielding nearly 14,000 tons of asphalt, concrete, steel and other debris. A study revealed that conventional demolition methods would

have resulted in costs of more than \$590,000, while demolition with an aggressive recycling program cost less than \$100,000.

Some communities make reusing and recycling materials more attractive by offering contractors financial incentives for reducing the amount of waste they send to landfills. For example, county officials in a North Carolina community were charging \$30 a ton in 2005 to add unseparated construction wastes at the landfill, whereas the fee for clean wood was \$16 a ton and \$5 a ton for clean concrete brick and block.

To get the full benefit from these programs, some contractors give their subs an incentive to produce less waste by requiring them to include the cost of removing waste in their bids.

### Take a bite out of purchasing costs

Think of how much money you can save by reusing raw supplies. For example, wood forms can frequently be used up to 15 times, according to the Seattle/King County (Washington) *Contractors Guide*. Or, you can use reusable metal or fiberglass forms. You can pocket the money you would have otherwise spent on these reusable items:

- Wood beams and dimensional lumber,
- Steel fasteners,
- Sheetrock,
- Bricks and tile,
- Ceiling tiles, doors and flooring,
- Insulation, and
- Pipes.

One caveat: Some building materials may *not* be recyclable or reusable, because they're contaminated with hazardous materials, such as lead paint.

### Old becomes new again

Scores of job site materials can be recycled — including wood, metal and cardboard — but the markets for wood and metal tend to be the strongest. In fact, contractors can easily sell materials to scrap metal yards that are eager for aluminum, copper,





steel and brass. Glass, sheetrock, asphalt, concrete, brick, doors and fixtures are also recyclable, but the markets can be more volatile.

Learn about recycling opportunities in your project area from local solid waste managers, regional offices

of state solid waste management agencies and waste haulers. They may also give you some valuable tips on how to get started with a basic recycling program.

### Sort, store and haul away

Reusing and recycling materials is good for business and the environment, but it does require you to think outside the cardboard box, so to speak. For instance, you'll need debris bins that allow workers to sort and store salvageable building contents and components. Some projects, such as demolition, multifamily and commercial projects, will generate large quantities of reusable materials. So, you'll probably want to hire a commercial hauler to sort and haul away the materials.

Determining which method is most feasible for a particular site depends on the scope and nature of the project, its location, and available resources and labor.

### Good business

Small changes to your building practices can add up to more profits for your company. Activities that limit waste production and reduce the pressure on landfills save money and resources. They are also valuable marketing tools for bidding on projects that participate in local and national green building certification programs. *T*

## Regular maintenance helps protect your bottom line

Wear and tear are inevitable when it comes to construction equipment and parts. Preventive maintenance won't give new life to equipment already past its prime, but it will keep newer equipment in tip-top shape longer, protecting your investment — and your bottom line.

A preventive maintenance program includes the same basic steps you'd perform on your own truck or family car, such as maintaining proper levels of lubricants and coolants, keeping correct tire pressures, and performing mechanical adjustments and equipment tune-ups regularly. Taking the process a step further, look for structural cracks, loose bolts, and worn rubber seals and bearings that may start small but lead to big problems if not addressed.

Another tip: When changing fluids in your equipment, don't pinch pennies by going with cheaper brands. Generally, high-quality engine oils and other fluids can provide more protection and longer machine life than their less-expensive counterparts.

Finally, develop a comprehensive inspection process customized to your fleet and operations. Routine maintenance, backed up with accurate and detailed inspection records and multiple sets of eyes looking for potential problems, will maximize equipment availability and minimize downtime. Don't just look at equipment once a year — inspect it thoroughly every time it's used.

Knowing that dependable equipment performance is critical to your projects' success, view service and maintenance procedures as a smart investment rather than an unwanted expense. Whether it's a failed gasket or a loose-fitting hose, even the smallest annoyance can quickly turn into a major problem if left unchecked.

# Contractor's toolbox

## Smart shopping

*Finding the right construction and financial management software*

**T**echnology has exploded in recent years, fueling a dizzying array of construction and financial management applications from competing vendors — all of whom tout their products as the solution to better work processes. Let's look at how you can sift through the chaff to get the right solution.

### Assess your needs

Don't buy anything until you've really thought through your needs. For example, what type of system and functionality would you like? Do you need a basic estimating software program? Or would a more powerful system that integrates financial, project management, purchasing and inventory activity be more appropriate?

Consider the compatibility factor. If you're using an older operating system, new software may not be compatible. In that case, you'll be looking at additional costs to have an IT person update the older applications or start from scratch.

Ask your in-house accounting and scheduling personnel what types of reports they need from a new system, and then develop a "wish list" that you can use to measure different packages. Talk to customers who use the software you're considering and grill them on "the good, the bad and the ugly" application features. They can also grade the vendor's technical support — a critical factor with any software purchase. Also ask other contractors who have used the software for at least one year to see if they're satisfied with their purchase.

### Narrow your list of vendors

You'll find numerous vendors and products from which to choose. So, just as you'd do your homework on a heavy equipment purchase, do it for your software as well.

Seek companies that have been in business for at least five to 10 years and have a track record of successful implementations. While gathering information, find

out what kind of technical support is included with your software purchase. If you buy a top-of-the-line system but the vendor's customer service is nonexistent, you and your employees won't be happy.

When you've whittled down the vendor list to the serious contenders, ask for free trial periods or extensive online demos to help you determine the best product for you.

### Think through the implementation

Because implementing software is a sizable undertaking, be sure to designate a project manager to lead the transition to the new application.

And don't skimp on the training and support. You and your employees will need thorough training to learn about the software's functionality and how to extract its full potential.

### It's money well spent

Investing in top-of-the-line business and financial software will lead to fewer mistakes in estimating, bidding, project management and job-cost accounting and enable your company to be more competitive. **T**



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