



What's Profit and What's Not

by Jon Hardie

"After I figure the cost of the job—the cost of materials, cost of the crew and all—I add 15 percent for profit. How come I'm not making any money?"

For the past couple of years, I've been hammering away at how to determine the true cost of the goods you sell, how to value your time and how to figure your margins—but I keep hearing statements like this. I guess I haven't come right out and said it the way folks need to hear it.

You haven't made a dime in profit until all your costs—fixed and variable, direct and indirect—are covered. This includes the true cost of your time, your spouse's time, your office and supplies, the depreciation on your tools, truck and equipment, and the monthly or weekly portion of your yearly overhead expenses.

Until you pay for insurance, retirement plans, your rent or mortgage, interest expenses, withholding taxes, telephones, printing, maintenance, gas, utilities, bad debts—and even the dog food for the highly trained golden retriever who keeps all your materials from walking off the job—there isn't any profit.

(I have never seen a line on my accountant's income-tax forms for anything like "walkage." I can see it now: "Walkage: Deduct whichever is greater—what you thought you'd make, what walked off the job, or 10 percent of the gross.")

Well, it's tax time again, and we have a lot of surprised builders and remodelers

you to do business. If you find that your operation is not really profitable, you can raise your prices accordingly.

Take a hard look at how you bid your jobs and figure your profits. I'm willing to bet it's already low by at least 20 percent! I haven't found a single builder or remodeler who hasn't undervalued his time by at least 20 to 30 percent.

Don't pay your accountant to be your bookkeeper. If you bring your accountant your checkbook and a shoebox of receipts before tax time, that's what you're doing. (And not very efficiently at that, I might add: You should be using profit-and-loss statements that are no more than 35 days old.)

Every year at tax time, accountants for many builders and remodelers are scrambling to patch up poor record-keeping, undocumented expenses, low margins, imaginary profits and unsheltered income—mission impossible.

Putting your books in order and filing a return is a job for a bookkeeper. If you need a bookkeeper, hire one, train one, or go to a local college in the evenings and take a bookkeeping course yourself.

Accountants should be paid for their knowledge of tax law and their experience—not for pencil pushing and bean counting. They can't help you plan for the future if you assign them only the past to work on.

Use your accountant to help you plan

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Even worse, some actually finished the year with \$5,000 to \$50,000 in the bank that they haven't bothered to "shelter," so they'll end up giving half of it away in taxes to Uncle Sam. They haven't made the profit they thought, either!

I'm not sure what's worse: believing you are making a profit on every job and still coming up short, or making a profit and not knowing how to handle it to reduce your tax exposure. Either way, let's hope you're a better builder than a money manager!

Having said all that, let's figure out what's profit and what isn't—and how to make it and keep it so you can go about the business of business.

If you haven't got an accountant, get one. If you don't have an accountant who understands the construction business and will help you get out monthly profit-and-loss statements, get another accountant—today.

Your accountant should generate 10 times his or her fee in lower taxes and improved profitability, operating margins, cash-flow management and investment advice.

Keep track of all of the time and expenses involved in running your business. Not only can you use those expenses to offset your profits and pay less in taxes, but you can figure out what it really costs

in January for reducing your taxes in April a year away—to help you find your true cost of goods, set your margins, check your profits and losses each month so you can stay on track, manage your growth and raise cash, and evaluate your return on investments so you can increase your capital and have something to retire on.

If you don't ask your accountant to provide these services and don't see the value in paying for them, you can keep your money in the mattress and lose your retirement when the house burns down.

Know the difference between profit and working capital. Profit is something you accumulate over the course of the year. Working capital is what you need to stay in business from month to month. It's what you need to purchase supplies and pay labor in advance of payment by the customer—for most builders, its 10 to 15 percent of the gross.

Working capital is not profit. If you believe it is—and spend it like it is—you won't have what you need to pay your bills.

Fixed costs are the costs of being in business for 12 months: phone service, lights, heat, rent or mortgage payments, trucks and equipment, gasoline, advertising expenses, monthly and quarterly reports, and the salaries you probably aren't paying yourself or your spouse.

Variable costs are those that are related to the job at hand: labor (assuming your

crew isn't on salary), payroll taxes, supplies and materials. They go up and down with each job.

Know too the difference between direct and indirect costs. The indirect costs are all those costs and time not directly related to each job: insurance, rent, depreciation, some telephone usage, legal and accounting expenses.

Direct costs are directly attributed to each finished project, such as labor and materials. Typically the direct costs are easy to see and figure, while the indirect costs are the ones that sneak up on you.

If your fixed and indirect costs are too high, you will have to work on larger jobs with higher margins just to break even—just to keep gas in the truck and food on the table. If you don't control your costs and margins and you are losing \$5,000 a year on a volume of \$100,000, taking larger jobs to increase your volume to \$1 million simply means you will lose \$50,000.

If your fixed costs are low, you can afford to take smaller jobs on less margin and still make money or break even.

Calculating Profit

When you figure a job using the direct and variable costs of time, labor and materials, you have to add in your annual indirect and fixed costs of operating and running your business before you calculate your profit. You can calculate this in two ways:

- A percentage markup that you add to the estimate after you have a total of projected labor and materials, based upon your actual operating costs divided by 2,000 hours per year over the past several years, or
- An hourly base rate that you use in your time and materials calculations, based on the actual hourly costs calculated for the job, including a proportional share of the fixed or indirect costs of operating your business for the year.

For example: If your hourly rate (your projected yearly salary multiplied by 1.3 for fringe benefits and divided by 2,000 hours) for the job is \$45, you might need to adjust your billing rate—and the rate for all your employees as well as your spouse—at \$60 an hour to actually cover your overhead.

If this seems confusing, your accountant can help you to develop an hourly rate or percentage markup based on your fixed costs that you can then build into each job quote.

Finally, after you have determined your actual job costs (time and materials), plus a proportional share of your yearly overhead and operating expenses, then

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you can add your percentage for profit. Only then do you have a reasonable chance of keeping some of that at the end of the year.

It's not profitable to wing it—to believe you can double your profit on the next job to make up for your losses on this one. And it's not profitable to play ostrich and believe that it will all go away if you work hard enough—it won't, unless you want nothing to show for it at the end.

The spring is as good a time as any to get organized. If you lost money last year,

what was the percentage that you lost based on your gross volume? Double it and add it to your next quote, and make a profit.

And if you did make money, you should be investing in life insurance, tax-exempt bonds, real estate, gifts to your children, retirement plans or the stock market. You'll want to replace worn-out equipment, diversify your product line and shelter your income.

Taking no action is as much a decision as choosing to manage your business profitably. Now's your chance—go for it! ■

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