Business

Are You Spending Your Time Profitably?

by Paul Eldrenkamp

Economists use the term "opportunity cost" to describe the cost of taking one action instead of another. Here's an example that should bring the concept close to home: Let's say I choose project A over project B. If project A makes me $10,000 and Project B would have made me only $3,000 with the same effort, I have chosen well. If the reverse is true — Project A made me $3,000 and Project B would have made me $10,000 — the opportunity cost of my choice is, in dollar terms, $7,000, and I have not chosen so well.

To the extent that I was even conscious of such choices in the early years of owning my business, I often felt that they were being made for me. Once I was able to get my business to the point where I had some control over it, however, I began thinking about opportunity costs.

Calculating the opportunity costs of your business decisions can help your company thrive.

In this column, I'll discuss two types of opportunity costs: business costs and career costs. I'll spend more time on the business costs, because they tend to be more concrete and therefore better examples of how to think about the concept of opportunity costs.

Keep in mind, though, that in real life (as opposed to in economics textbooks), it's rare for opportunity costs to be clear and readily quantifiable; more often, an opportunity-cost calculation involves some guesswork.

Business Opportunity Costs

Let's say I run a design-build company and choose to do some of the design work myself. I put in 200 hours of design time over the course of two years (or an average of two hours per week) at a billing rate of $75 per hour. I generate $15,000 over the course of the two years (200 hours times $75 per hour).

But what if, instead, I spend 50 hours to identify and find a good architect who costs me $75 per hour and whom I can bill out at $100 per hour because she's a licensed architect? I spend 50 hours drafting a design agreement and business plan, and then 100 hours of sales time to land some design-build jobs that lead to 1,000 hours of design time over two years. I have spent 200 hours of my time over the course of two years in this scenario, too, but have generated $25,000 (a $25-per-hour margin on 1,000 hours of architect's time).

In these two scenarios, the opportunity cost of doing my own design work as opposed to cultivating the architect relationship is $10,000.

But how about over the next two years? What happens to the opportunity cost then? In the first scenario, I spend another 200 hours and generate another $15,000. In the second, assuming that the original ratio holds (one hour of sales time to sell 10 hours of design time), I spend 200 hours selling 2,000 hours of design time, and generate $50,000 in gross margin for the design work. Over four years, the opportunity cost of doing my own design work is $45,000.

Expert witness. Let's look at a different example. Say I decide to spend my time as an expert witness rather than selling remodeling jobs. If I spend 10 hours billing at $100 per hour as an expert witness, I've generated $1,000. If I instead spend those 10 hours selling a $60,000 job at a 33 percent margin, I've generated $20,000. The opportunity cost of the expert witness work is $19,000.

Both these examples — doing my own design work and serving as an expert witness — involve decisions about how I spend my time. Do I spend it on low-leverage, low-return work? Or do I spend it on high-leverage, high-return work? In other words, the opportunity costs of selling my own time rather than using my sales and management skills to sell other people's time can be very high.

Other considerations. I'm oversimplifying, of course. There's a chance, for instance, that the expert witness work could be an effective marketing strategy — that you'd get exposure as a qualified professional that you wouldn't otherwise have received. And that exposure could tip the balance toward doing the expert witness work, because it might change the overall equation. Just remember: Time spent on one marketing effort is time *not* spent on another.

It's easy to see how nuanced and multilayered this sort of analysis can be — but that's no reason not to do it. Performed thoughtfully, the analysis can only help your business decision-making strategies and abilities.

Career Opportunity Costs

If you're struggling to make a good living in our industry, you already know that something as fundamental as a career choice comes with its own opportunity cost. The owner of a contracting company might spend 60 to 70 hours a week making 40 hours of wages. Most of us have had a personal taste of this at some point, or know a colleague who's struggling through such a time in his career. But painful as they are, these years may be of value — if the owner *eventually* is able to take enough out of the business to make the early, underpaid years worthwhile.

Let's look at two more scenarios. Say I work 60 hours a week, 40 at a full-time job and 20 at a half-time job, for 10 years. I earn $90,000 a year total ($60,000 at the full-time job, $30,000 at the other). I invest the $30,000 at 5 percent return on investment. After 10 years, I drop the half-time job and settle for the $60,000 a year, leaving the investment account alone. After 30 years, I've earned $1.8 million from the $60,000-a-year job (30 times $60,000). I've also earned about $1 million from the savings account (which was worth almost $400,000 after the 10 years of the $30,000-a-year-job, and then continued to earn 5 percent interest each year for 20 years). So that's $2.8 million total over 30 years.

Or, instead, let's say I work 60 hours a week for 10 years building my own business; I pay myself $60,000 a year, figuring that the 20 uncompensated hours is an investment in the future. After 10 years, I find I can indeed cut back to 40 hours per week.

So what does my annual salary need to be for the next 20 years to equal the total income I would have earned in the first scenario? Well, $60,000 times 10 years is $600,000. The $2.8 million I earned in the first scenario, minus this $600,000, leaves $2.2 million that I need to earn for the next 20 years to make up the difference — $110,000 a year.

To make those first 10 years of subsidized labor worthwhile, I need to be able to almost double my first 10 years' salary for the next 20 years. If I don't think I can do that, I might be better off switching to another career — the sooner the better.

Think About It

You can play with numbers like these using the built-in financial functions in any spreadsheet. Match them to your current situation and come up with your own conclusion, but be honest with your assumptions or it's a pointless exercise.

Of course, there's more to life than dollars and percentages, and in many ways a lower-paying job you love can be a better investment than a higher-paying one you loathe. That makes it all the sadder to see a contractor working long hours for short money and feeling constantly stressed, angry, and depressed. If you're in that category, it's time to step back and think hard about opportunity costs as applied to your career.

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Four-Day Workweek Pays Off

by Joel Doherty

I'm a hands-on kind of guy. I prefer working out in the field, framing or running trim, to putting together estimates or talking on the phone. But like it or not, every contractor knows that doing paperwork and dealing with clients are necessary parts of our chosen profession.

I've finally gained that elusive eighth day a week that I needed to take care of actually running the business.

Until about a year ago, my days were spent reacting to clients and scrambling to satisfy their demands. On a typical day, I'd arrive at a job site late — after meeting with another client to go over a punch list and pick up a final check. Then, as soon as I was set up and ready to work, my cell phone would ring and a prospective client would be on the line, asking to go over a job proposal and sign a contract — ASAP, of course. I'd look longingly at the stack of 2x6s I'd been about to cut and head back out on the road.

Over the years, my construction company — which does remodels and additions along with a couple of new construction projects each year — grew to the point where I was dealing with clients all the time. Managing the success became a problem — a good one, but a problem nonetheless. There had to be a better way.

Four Tens

After much deliberation, I switched my company's work schedule from five eight-hour days per week to four 10-hour days. My thinking was that two four-man crews would still get in a 40-hour workweek, but I'd gain that elusive eighth day a week I needed to take care of actually running the business.

Not only did my plan work — although not exactly as I'd foreseen — but there have been some unanticipated benefits.

Scheduled time with clients. Now Mondays are my "free" days. I try to schedule all my client meetings then; if necessary, I use the evenings, too. That way I'm not constantly leaving the job site during the rest of the week. As it turns out, most clients are happy to schedule meetings on Monday; occasionally, of course, I have to make an exception and meet with someone on a different day — but I've still minimized the number of interruptions throughout the week.

An unanticipated benefit is that I arrive at my Monday appointments in a "meeting" frame of mind, rather than covered in sawdust and with notes on a 2x4. Clients appreciate my professional appearance, and I'm free to focus on their job without wondering how my crew is doing without me.

Scheduled time for paperwork. On Mondays, I get up at my normal early time and head into my office with a good cup of coffee. Until my first meeting, I do paperwork: generating change orders, invoicing for work completed, and assembling estimates I've spent the week researching.

Setting aside an allotted time for these tasks has proved to be beneficial in more ways than one: My clients notice that I'm more responsive to them. In the past, I'd promise change orders in a day or two, then go home and get absorbed in family life or simply feel too tired to get anything done. Now when I tell my clients I'll have that paperwork for them next Monday, sure enough, on the promised day I give it to them.

Maintenance. Like most small builders, I haul all my company's tools and equipment around in an enclosed trailer. Having a tool I didn't think I'd need no farther away than the back of my truck can be a lifesaver. Unfortunately, with a handful of employees, tools don't always get put back where they belong, and broken tools don't always get reported. Likewise, when we run out of something we need, it doesn't always make it onto the supply list.

So now I take the time on Mondays to reorganize the trailer and make sure it's properly outfitted. I clean and repair tools, change oil, lube the skid steer, wash the truck and trailer — whatever on my long list needs doing. I never get to the bottom of the list, even when I have an entire Monday free. Still, this approach is an improvement over the past, when the discovery of a broken tool could bring a day's work to a halt while we fixed it.

Workflow. Setup and teardown always take time, regardless of how long you actually use the tools. We spend about an hour per day setting up and tearing down — so working one less day per week essentially gives us an additional hour of production. Also, working nine hours each day instead of seven means there's less starting and stopping and my crew can get into a more efficient groove.

Employee Reaction

None of the employees who made the schedule switch with me would like to go back. Before, they had to take care of personal and family business after work, which was hardly enough time. Having Mondays free gives them much greater flexibility.

Another perk has been a greater sense of urgency among the crew to keep up the work pace. Knowing they have to work only four days seems to motivate them — they put more effort into the job to make sure all of the week's tasks still get done.

New hires like the schedule too. A few months ago I was looking to hire an additional framer and found out that one prospect was also interviewing with a contractor friend of mine. Both of our companies have solid reputations and offer good benefits, but the applicant decided to come to work for me. "They both seem like great companies," he said, "but this one gives me three days off. I'll bust my hump for you on the other four." He's been true to his word.

The four-day workweek is not perfect by any means, but for us it's been a big leap forward in efficiency and time management. No longer am I constantly reacting; instead, I feel in control of my business. That means my weekends are my own again, rather than serving as my catch-up days. And with four children to take fishing and camping, that's been the best benefit of all.

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