Operating Efficiencies of a Contractor

By FocusCFO

The construction industry is facing major challenges due to the current recession. Companies are going out of business because of operating inefficiencies as well as overly aggressive bidding on significantly fewer available projects. Many of those contractors operated inefficiently in the past and still managed to maintain profitability because of the building boom, but in the current economic environment they are no longer profitable and facing liquidation.

In order to survive in this competitive market, contractors must focus on the following operating indicators:

Daily Job Costs

It is imperative to know the costs charged to each job on a daily basis. A contractor cannot wait until the end of the week, or even worse, the end of the month to determine what costs are being added to each job. This includes labor and material costs, and both must be properly tracked, measured, and recorded based on appropriate standards.

Cost to Date Compared to Estimated Cost

Contractors prepare estimates for each job to determine their bid price or contract amount, and the estimates for labor and material are computed separately. Subcontract and equipment will also be estimated if they are necessary for the job.

It is critical that the contractor constantly compare the cost to date to the estimated cost on each job. If there is a variance between actual cost and estimated cost, research needs to be done to determine what issues are causing the variance so that those issues can be managed appropriately.

Reasons for costs exceeding budget can vary. Some of the most common reasons are labor inefficiency, material overruns, incorrect estimates, and changes in the scope of the job. All of those reasons are caused by underlying factors that must be managed.

It is imperative to constantly monitor actual costs to estimated costs. A missed change order can be the difference between making a profit and losing money on a job.

Gross Profit

As in every industry, gross profit is an important measure in the construction industry. A contractor must maintain a certain gross profit on every job to cover the cost of overhead and to create a net profit.

The gross profit percentage starts with the estimating and bidding process, and it must be constantly monitored for each job in process. It is also necessary to determine the gross profit that will be earned on the backlog of work.

Over / Under Billing

Contractors define over billings as billings that exceed estimated revenue and under billings as billings that are less than estimated revenues. Many contractors give over / under billing little consideration because they view over/under billing as a computation by accountants to properly match revenue and costs for financial statement purposes. However, over/under billing should be used as a tool to determine if the contractor is billing properly. Constant under billing on a job or jobs can be a signal that there is an underlying problem on the job that the project manager does not want disclosed. Obviously, it is generally desired to over bill on all jobs to create positive cash flow. The concern with overbilling, however, is that contractors sometimes forget that the excess cash generated will be needed for future costs on the job, and then they spend the money on unrelated items.

In order to be competitive, contractors must monitor the above key performance indicators. With the help of an in-house or outsourced CFO there is no reason that any contractor should not be able to maintain these metrics in order to operate at maximum efficiency and profitability.

Founded in 2001, FocusCFO is the leading onsite fractional CFO services provider in the Midwest and Southeast, with more than 100 CFOs and Area Presidents throughout Ohio, Michigan, Kentucky, Indiana, Pennsylvania, Tennessee, and North Carolina. FocusCFO works closely with small to medium sized businesses helping business owners gain control over three key financial and operational areas: increasing cash flow, reducing business risk, and creating a platform for scalable growth. This allows business owners to then realize full financial control and increased value in their businesses.

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