

Contractor Focus

Charles Vander Kooi, Vander Kooi Associates

Overhead Recovery—Flying Without Crashing

Running a contracting business is like flying an F-14 fighter jet through the Grand Canyon. You drop into the canyon at Point A which is January 2nd of any business year. You fly 300 feet above the canyon floor with the walls of the canyon 1,000 feet off each wing. You have to fly in a perfectly straight line to Point B which is December 31st of any business year. You want to arrive with a profit—preferably a hefty one.

On the floorboard of your plane are two pedals. You must keep the pedals even with each other. If one pedal gets out of line, the plane will begin to “yaw” and turn into one of the canyon walls. “So, what are these two pedals in the fighter jet called; my business?” you ask.

One is the amount of overhead you must recover in a business year. The other pedal is the amount of business you must do in a business year to have enough money to recover that overhead and to make a profit. Let’s say that your overhead is \$100,000. You have determined that you must do \$400,000 in sales to recover that overhead and make a profit. You drop into the canyon on January 2nd, but by May 15 you see that you are behind your sales goal and you are not going to do \$400,000 in sales. You will be lucky to do \$350,000. Your pedals are now out of line. What is your plane doing? It is yawing. And, if it continues to yaw, you will crash your business into one of the walls of the Grand Canyon.

Now, if you were really in the Grand Canyon and your F-14 plane began to yaw, what would you do in a hurry? You would either push the left pedal forward or let off the right pedal until the pedals lined up perfectly. Do the same with your business. Push the sales pedal forward or let up on the overhead pedal.

Overhead is a fixed cost. It does not rise and fall based on what you charge for a certain job. You do not need to find out what others charge for overhead and charge the same. Overhead is not charged, it is recovered. You do not make any profit until you recover your overhead. To do this you must budget overhead, spend on overhead within that budget, allocate overhead properly, and recover it. In this article we’ll talk about controlling the overhead pedal.

I know a company that has an accountant who is very nice, except on January 2. She comes in half an hour before everyone else and with a wicked grin on her face she turns on her computer and puts an invoice into the printer. She prints out a bill to the management of that construction company for the amount of overhead they must recover in that business year and leaves a copy on each person’s desk.

When the staff comes in reeling from New Year’s festivities and football, they are faced with that invoice. They must real-



Flying and overhead recovery are balancing acts, moving smoothly through forces and situations around you while not crashing into the terrain. Photo by Dana Potts, U.S. Navy

ize quickly that their plane has taken off and is descending into the Grand Canyon. They know they’d better keep their pedals even so that they can arrive safely at the other end of the canyon on December 31st—with a profit. The staff knows where they stand, and that they had better go out that year and get enough work with enough overhead allocated on it to recover that overhead, and make a profit.

I recommend that you keep track of the number of overhead dollars you must recover in a year in a computer spreadsheet program or on a piece of paper. Every time you sign a contract for a new job, subtract the amount of overhead you have built into that bid from the year’s total. Make sure that within a business year you do enough work to bring the overhead dollars figure down to zero.

The staff of the construction company with the good accountant doesn’t even talk about profit from January through mid-November because they consider that there is none. Any money collected above what it costs to do a job goes to pay overhead. The accountant keeps track and when the overhead is recovered, she puts a copy of the original invoice on everyone’s desk stamped “PAID IN FULL.” At that point, they have a party, a Break-Even Party. Right after the party, they put the pedal to the metal, because everything else they collect over costs for the rest of the year will be the company’s profit.

Here is a point you must understand: You can make money on every job you perform but still lose money as a contractor. Some contractors do not understand what job costing really is. Job costing takes the original estimate of costs to do a job and compares it with the actual costs to do the job. This is done at the level of costs; that’s why it’s called job costing. Some contractors take their job costing to another level. They add overhead to costs and subtract costs with overhead from the contract amount to see if they have made a profit. That is no longer job costing; it is generating a financial statement or a profit-and-loss statement on each job.

Now, I don’t mind if a contractor does that, but they must understand the basic principle of job costing. You see, each of those financial statements on individual jobs is just snapshots. The company and its profitability are a mural made up of those pictures. Individual pictures may look pretty, but the company mural can look real ugly. Why would it look ugly?

Because there are not enough pictures in the mural with enough overhead allocated in them to cover all the company's overhead. In order to fill the holes of unrecovered overhead, we must take profit from jobs where you did to pay for the unrecovered overhead. That is why you can make money on every job you perform, but still lose money as a contractor.

Why not just add more overhead to the work the company's getting? A fine line defines the right amount of overhead for the kind of company doing certain kinds of work in certain areas. The goal is to find the fine line that gets you work and recovers your overhead. One of the things our consulting company has done for thousands of companies is to help them find that fine line.

For now, think of it this way, contractors make all their profit in four to six weeks. From January through mid-November they are just recovering overhead. Sometime in mid-November they start making profit—everything they do in that last four to six weeks of the year is their profit for that year.

I had a contractor call me just before Christmas one year. I think he waited until then on purpose. His company had broken even the first of October, which left them eight weeks in their business year. He said that they billed more work during those eight weeks than any other eight-week period of the whole year and drove their profit into the high six figures.

I always get a sick feeling in autumn and around the holidays—and it's not because of the holiday goodies. First, there is hunting season. Then Christmas music plays down at the mall. It's the holiday season and contractors put their planes on autopilot. At the very time they are making a profit, they slow their efforts. I get sick when I think of all the tens of thousands of contractors who have worked very hard to recover their overhead and are finally making a profit, but who coast out the business year just when they could be getting ahead. Remember this next year when you're flying through October toward December 31st! ❖

Charles Vander Kooi will be a featured speaker at Hardscape North America. He is the author of *The Complete Business Manual for Concrete Paver Contractors* and is scheduled to speak at the Hardscape North America national trade show on March 9 and 10, 2007 in Nashville, Tennessee. See page 52. For more information on this event, visit www.hardscape-northamerica.com. For more information on this contracting industry veteran, visit www.vanderkooi.com.

Contractor Focus CE Questions— November 2006

The May 2006 magazine issue announced that the ICPI Board of Directors approved higher levels of certification. Details will be announced to all ICPI Certified Concrete Paver Installers as courses are developed. The next level of certification will include hourly requirements for continuing education credits and this column continues to offer a one hour credit to those who successfully complete the questions below. Earned credits can be applied to hourly requirements for higher certification levels when the new programs are announced.

To complete the questions below, visit www.icpi.org and follow the home page Contractors link to Certification then to Online Training. This test is labeled Exam 9 and is offered

with all other exams at no charge to ICPI members until the February 2007 issue. After that issue exams will be offered for \$20 to ICPI members and non-members. Answers entered online will generate a certificate immediately upon successful completion and ICPI will maintain an automatic record of your continuing education credit. Please do not send faxed exams as they will not be accepted. If you'd like to earn more hourly credits, see the other continuing education programs offered on the web site.

- 1. It is possible to make money on every job, but still lose money as a contractor.**
 - a. True
 - b. False
- 2. Overhead is a variable cost that can be charged to each job.**
 - a. True
 - b. False
- 3. Overhead is recovered, not charged.**
 - a. True
 - b. False
- 4. "Profit and loss" and "job costing" are one in the same.**
 - a. True
 - b. False
- 5. Un-recovered overhead needs to be paid for by taking profit from each job**
 - a. True
 - b. False
- 6. Knowing the amount of overhead at the beginning of the year is all that matters.**
 - a. True
 - b. False
- 7. A company makes profit throughout the year.**
 - a. True
 - b. False
- 8. Comparing the original estimate of job costs with actual costs is called:**
 - a. Profit and Loss statements
 - b. Break even analysis
 - c. Job costing
 - d. Financial statement
- 9. There are two primary considerations to overhead recovery. The first is knowing the amount of overhead you must recover in a business year. The other is:**
 - a. Individual job costs
 - b. The amount of profit you want to make
 - c. The amount of business you need to do in the year to recover overhead
- 10. Contractors will have the opportunity to learn more excellent business skills in person from Charles Vander Kooi and other leading business consultants, on March 9-10, 2007 in Nashville, TN at:**
 - a. MCPX 2007
 - b. Hardscape North America 2007
 - c. Bauma 2007