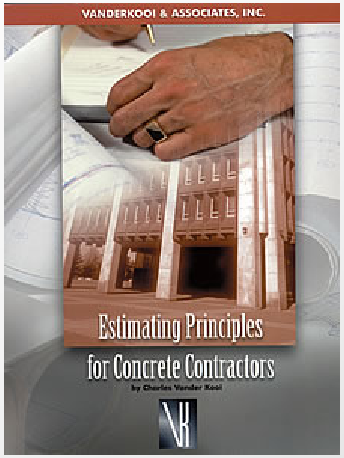
Understanding Profit

An excerpt from
Estimating Principles for Concrete Contractors
by Charles Vander Kooi

There are two concepts about profit that contractors must understand. First, profit is a payment for risk. The profit should go to those who take the risk of losing their investment and even their personal wealth. It is a reward to those who are willing to take those risks. Continue >



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Second, profit is a return on investment. If you put your money in a bank or invest in mutual funds or stocks, you can expect interest. (Your stocks and mutual funds you expect to increase in value). Profit in a company is the return on the retained earnings and the initial capital that was put into the company.

The combination of these two concepts in construction comes together as follows.

A balanced portfolio of money market accounts, certificates of deposit, mutual funds and stock investments is returning an average of 9 to 11 percent on investment. However, these types of investment are fairly low-risk. Because construction is a high-risk business, the payment for that risk should be two to three times as much as the lower risk investments. This means that construction companies, as a return on investment and a payment for risk should have a 20 to 30 percent return on retained earnings and original capital.

The truth about profit is we often deceive ourselves about… what it is and is not.

With these thoughts in mind, I would encourage you to look at the last couple of years profit as it relates to your investment.

Before you can measure your profit, however, you must know what true profit is or is not. Let me give you some examples of how contractors deceive themselves about the nature of true profit.

Contractors can show an excessively large profit for any or all of the following reasons:

•The owner does not take a salary, only draws on profit shown only on the balance sheet or a conservative below-market-value salary for themselves.

• Family members (usually the wife) works for the company without receiving a salary.

• The company offices are in the home and because of IRS rulings, nothing is paid by the company as rent.

• Old equipment is being used by the company, which has a zero net worth because it has been depreciated. The company is not setting aside expense money for future replacement equipment.

In order to determine a "true" profit, these shortfalls in expenses must be deducted from the existing profit.

Contractors can show an excessively low profit for any or all of the following reasons:

• The owner(s) are taking a larger-than-market value salary for themselves. They are taking profit out of the company as salary.

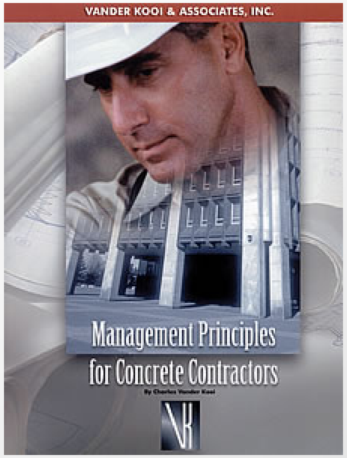
• They are building a house or remodeling a house and writing off some of the expenses through the company. Or, they are maintaining their, or a relative's, house by doing the same thing.

• They have started another company or profit center in their existing company and they are getting the start-up costs out of profit.

• They have made a large contribution or taken an expensive trip (business, of course) and the company has expensed it out.

• They made some large purchase of computers or other equipment that has been expensed.

The total of these items, if they exceed a reasonable cost in a given year, must be added back into profit in order to determine a "true profit".



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I suggest that, in order to establish your profit mark-up on a bid, you begin by having a profit range. Establish the lowest profit that you would accept. For example, let's say the low range is 10 to 15 percent, and the high range is 25 to 30 percent. Then you must consider four things about the job and apply a profit figure to each of the four considerations between the low and high to each as if each item is the only thing you are considering. After you have done that, then add up the four profit percentages, divide that number by four, and you will have an average profit percentage for that job, based on your considerations. I like this systematic method better than adding 12 percent profit to a job and, saying when asked why, "On 'Good Morning America' this morning they said there was a 12 percent chance of rain, and it sounded like a good profit figure to me." Let me tell you what those four considerations are:

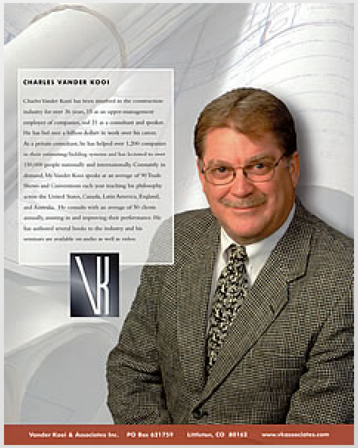
Need **-** That is, how badly do you need the job? The greater the need, the lower the profit percentage should be. But, if you have a lot of work, then the profit percentage should be towards the higher end of the range.

Risk **-** Risk comes in several different ways. Labor is the biggest item of risk in construction. Therefore, the more labor there is in a job in relationship to material costs, the greater the risk. If you do not feel comfortable with the number of hours you have estimated to do the project, then your estimate becomes a risk. If there are unusual or potentially troublesome conditions on the site, e.g., rock, water, poor accessibility, etc., then the job is a greater risk. The more risky the job, the greater the profit you should seek. If it is a "piece of-cake" job that anybody can do, then anybody and everybody will want to bid it and, hence, the profit will have to below. But, if it is very difficult, then very few will be dumb enough to bid it, and those who do had better go high on the profit because of the risk involved.

Size **-** That is, size in relationship to what you are accustomed to doing and the size of the jobs upon which you have based your strategy. Let’s say that your best size project is $30,000 and along comes a job for $50,000: Go lower on the profit. If the job is only$8,000, go higher on the profit.

Marketplace **-** This is the one we all like. The question here is, how many people are bidding the job and who are they? Is it ‘The Good Times”, with lots of work for everyone, or ‘The Lean Times” when contractors are cutting each other’s throats? The more bidders there are or the tougher the times, the lower the profit you add.

Now with the above concepts in mind, take a look at the last couple of years profit as it relates to your investment and make any needed adjustments to reward you for your risk. Being honest with yourself, completing an analysis of your profits, and paying attention to the details, should payoff and improve your profits.



Charles Vander Kooi has been involved in the construction industry for over 36 years, 15 years as an upper-management employee of companies, and 21 years as a consultant and speaker. He has bid over a billion dollars in work over his career. As a private consultant, he has helped over 1,200 companies in their estimating/bidding systems and has lectured to over 150,000 people nationally and internationally. Constantly in demand, Mr. Vander Kooi speaks at an average of 90 Trade Shows and Conventions each year teaching his philosophy across the United States, Canada, Latin America, England, and Australia. He consults with an average of 50 clients annually, assisting in and improving their performance. He has authored several books to the industry and his seminars are available on audio as well as video. Click here to visit the *Vander Kooi and Associates Web Site*.

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ABOUT THE AUTHOR

Charles Vander Kooi is the founder of Vander Kooi & Associates a consulting firm for the construction industry. For questions regarding this guide please contact Charles by email at vanderkooi@starband.net. To learn more from Charles visit the Concrete Sherpa, or read more on the Concrete Network, or visit his web site at http://www.vkassociates.com

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Zoom out	[Ctrl] [-]	[⌘] [-]
Full screen/normal screen view	[Ctrl] [L]	[⌘] [L]

ABOUT THE CONCRETE SHERPA

The Concrete Sherpa is a team of people that represent the experience, teaching and learning of our team members and other industry leaders *on a mission to make life better for the concrete contractor*. We are an idea center striving to deliver thought provoking ideas based on “Concrete Advice for Business and Life” to stimulate you to reach new heights. As a user, you should remember to consider all information you receive, here at the Concrete Sherpa or elsewhere, not as a *cast in concrete* recommendation, but rather as an idea for you to consider and ponder.

Sherpa info

THE JOURNEY LEADING TO THE CONCRETE SHERPA PROJECT

The Concrete Sherpa Project (A Sherpa is a “guide”) was born at The Concrete Network in mid 2004. Here is how it happened:

The biggest surprise, or gift, since starting The Concrete Network in 1999 has been the concrete contractor friends from around the country we’ve made and witnessing the passion they have for what they do. These people include Dave Pettigrew, up in the San Francisco Bay Area, or the Verlennich brothers in Minnesota, or Bob Harris in Georgia, the list goes on and on. It’s quite inspiring.

We were once asked, “How are you so excited every day about concrete?” Well the answer is simple, it is impossible to not be excited about concrete when you have the job we do-interacting with hundreds of concrete contractors from every state in the country.

The thing we’ve learned about concrete contractors is that most are passionate *craftsmen*-they are often less passionate and experienced in the “office stuff”. Human nature channels us to do what we are most comfortable with; learning how to use a new saw-cutting tool is comfortable; learning and implementing a new estimating strategy, or job management tool, is not so comfortable.

Sherpa info

THE JOURNEY CONTINUES…

So Sherpa was born to provide FREE and easy to use information on topics many contractors are not too comfortable with.

- Concrete Sherpa is here to provide help to contractors who are often ‘Lone Rangers’ and don’t have anyone to get solid business advice from.
- Concrete Sherpa is here to provide help for contractors who have to work too hard and too many hours in their business, and one day realize they need to work *on their business, not in their business.*
- Have fun with Concrete Sherpa and go faster towards reaching success than you might have on your own.
- To skeptics who think something free can’t be valuable, or there must be a trick- visit Concrete Sherpa and decide for yourself.

We hope you make great use of the Concrete Sherpa and it helps you to become an awesome success for yourself, your family, your church, and your community.

VISIT THE CONCRETE SHERPA

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