

Bad Ideas in Good Times

10 sure-fire mistakes that can lead to contractor failure

BY MICHAEL BALTER

Now that the economy finally appears to be headed in the right direction, many contractors are thinking about hiring talent, acquiring bonding and raising capital to help complete their growing backlogs. Many of those business owners with large backlogs are taking an optimistic view that the new construction economy is half full and are quickly forgetting the lessons of the recent past. For contractors showing over-exuberance in this current market, the following list includes some of the top mistakes that can lead to contractor failure, even in an expanding economy.



1. GROWING TOO FAST

Growing backlogs are generally a positive indicator. However, it is important to recognize how growth will impact other areas of your business. Often, growing too quickly creates problems with cash flow, lack of talent and communication strains due to everyone being so busy. Focus on growing profits and plan for potential pitfalls.

2. OBTAINING WORK IN A NEW GEOGRAPHIC REGION

Being successful in a new geographic region is a tough accomplishment. There are many factors to consider, such as transportation costs, availability of talent

and the risks inherent in a newly established relationship with a subcontractor or general contractor. Consider establishing a joint venture with another firm that has already conducted business in the region and knows the local landscape. Wait until you have some experience there before you consider going it alone.

3. TAKING ON A JOB TOO BIG

Unfortunately, many contractors fail when they decide to take on a new job substantially larger and more complex than any other contract they have handled previously. If you are channeling all your resources into managing that job and it negatively impacts your bottom line,

your other profitable jobs will likely not be large enough to sustain your business. In addition, working on a larger job requires working with a larger general contractor, which tends to bring more complexities than you may have experienced in the past. While there is risk in every new relationship, with proper planning and budgeting and the assistance of experienced advisors, many risks can be reduced and managed.

4. OBTAINING NEW WORK OUTSIDE YOUR EXPERTISE

This should be self-explanatory. Unfortunately, on many occasions, entrepreneurial contractors look at an opportunity

and fail to recognize the potential exposure. When a company performs work outside of its core expertise, it should do so both cautiously and slowly.

5. HIGH EMPLOYEE TURNOVER

A construction business is particularly susceptible to inconsistent teams come with inefficiencies. It is important to keep turnover to a minimum by offering fair compensation, facilitating open communication and providing opportunities for advancement.

6. INADEQUATE CAPITALIZATION

It is crucial to have a CFO and/or controller who fully understands the construction industry. Employ the benchmarking statistics by the Construction Financial Managers Association (CFMA) to compare capitalization ratios with other best-in-class contractors.

7. POOR ESTIMATING & JOB COSTING

The estimating and job costing process is the baseline for every contractor. It is essential to have open communication among the estimators, project managers and accountants in order to avoid unexpected overages in the job budget.

8. INEFFECTIVE ACCOUNTING SYSTEM & LACK OF CASH FLOW ANALYSIS

Invest in a proper construction-related accounting system. There are many useful management reports provided by an effective accounting software program that can be highly valuable in helping you make appropriate decisions about running your business profitably.

Remarkably, the reason most contractors fail is because they run out of cash. Perform weekly cash flow projections to avoid any surprises and to secure necessary funding when needed.

9. BUYING ITEMS NOT RELATED TO THE CORE FOCUS OF CONSTRUCTION

Remember to stick to what you do best and what has brought you success in the past. All construction companies should have "rainy day funds" for the leaner times when backlog lags. Contractors should not own yachts, jets, bars or restaurants as assets in the company, but they should feel free to build them for customers.

10. NOT BEING SURROUNDED BY PROFESSIONALS WHO UNDERSTAND THE BUSINESS

The construction industry has the second-highest industry failure rate. It is critical to the mission that you have a banker, bonding agent, CPA and attorney who have construction industry experience. Once you have the right people, be sure

to hold regular meetings with them. Their insight and experience can be instrumental in helping you avoid failure.

There may be other potential risks that can lead to a contractor's demise, but this checklist is a sound starting point to help protect you and your company. Refer to it frequently, but use it especially when times are good. **CBO**

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