# ON-SITE

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# Winning the subcontractor lottery with prequalification

Sometimes getting the right subcontractor for a job may seem like playing the lottery. You can look over all the "numbers" and think about which one feels right but, at some point, you have to make a choice. Then the waiting game begins, as work gets underway and you see whether you've picked a winner or a loser.

A good way to help ensure you win the subcontractor lottery is to prequalify the subs with whom you intend to regularly work. From there, having a sound scheduling system can go a long way toward getting the most from subs that make the list.

## History and staffing

The first thing to look at in prequalifying a sub is its company history. When did the business get started? What kind of projects has it worked on? Generally, a sub that's been around for a while — say, more than five years — is probably doing something right.

Then again, a recent ownership change could affect this rule of thumb. So check into the sub's owners and managers. Are they reputable individuals with strong track records of being easy to work with? A good way to gather this information, as well as other important tidbits, is to simply ask for trade, financial and business references. Have your attorney check into any legal actions the sub might be involved in as well.

Of course, if a prospective sub happens to be a relatively recent startup, you shouldn't necessarily dismiss it outright. Maybe a star project manager has struck out on his or her own. In this case, you may need to rely on financial projections and direct interactions. It's not out of the question to pay a site visit to a sub, check out its office and, if possible, even see how it goes about its business on a job site.

## Financials

As mentioned, a sub's financials can and should play a critical role in your prequalification effort. Although the raw dollar amounts associated with the company may not tell you the whole story, they'll give you a strong foundation upon which to build a reasonably accurate assessment.

Request at least the most recent year's worth of financial statements and go over the numbers with your CPA. Look at items that give you an idea of the sub's cash flow and how well capitalized it is, such as:

- Current ratio (or quick ratio),
- Debt-to-equity ratio,
- Overhead expenses, and
- Total revenues.

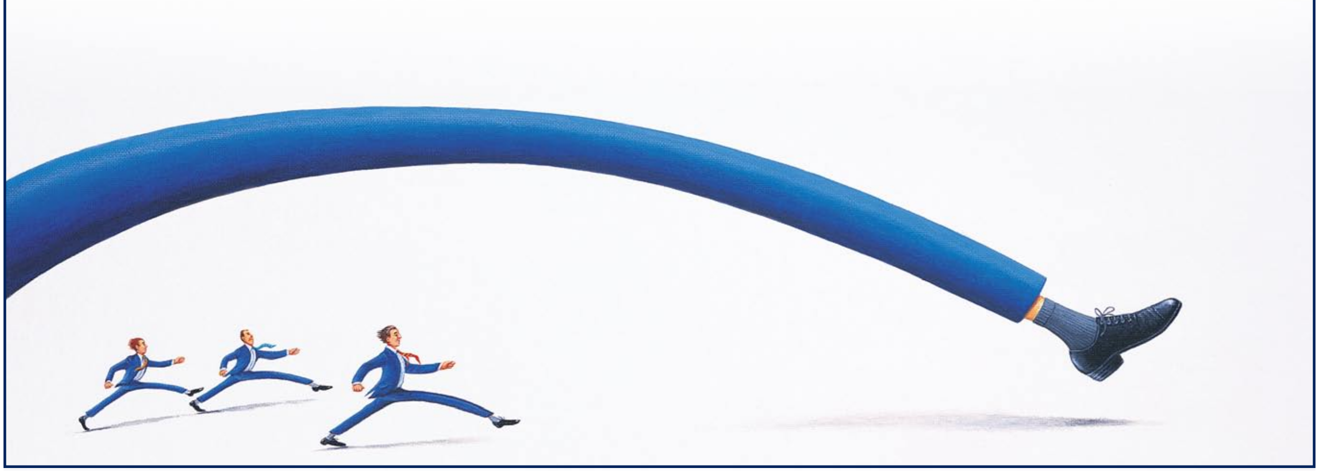
## Getting prequalified: 3 tips for subcontractors

If you're a subcontractor, you're probably aware that getting prequalified by a general contractor (see main article) is a big plus for your business. How can you make the process easier and increase your chances for success? Here are three tips to consider:

**1. Get and keep your financials in order.** Prequalification isn't entirely a numbers game, but your financial statements will likely form the core of their assessment of you. Ask your CPA to review yours with a specific eye toward highlighting information a general contractor would like to know.

**2. Optimize your bonding capacity.** Has your relationship with your surety slipped in recent months? Don't let it: General contractors won't likely take a chance on a sub that's not properly bonded. Communication and (as noted above) sound financial statements are key to strong bonding capacity.

**3. Put together a package.** Perhaps the most straightforward move you can make toward getting prequalified is anticipating the process itself. The American Institute of Architects (aia.org) and the Associated General Contractors of America (agc.org) both offer sample prequalification forms via the Internet. By filling one of these out in advance and using it as a cover sheet for your financial statements, company history and other information, you can make the general contractor's job easier and put yourself ahead of the competition.



Also inquire about the sub's bonding capacity. Does it have enough? Is its surety willing to give the company a thumbs-up? Other types of insurance are important, too — a subcontractor that skimps on coverage may be a legal disaster waiting to happen should something go wrong on the job site.

### Scheduling capacity

As part of the prequalification process, look into a subcontractor's scheduling capacity. That is, examine the company's ability to smoothly and effectively integrate itself into your job schedules.

How tech-savvy is the subcontractor? These days, a company you can contact only via landline telephone or clunky fax machine may not be as responsive as one whose owners and managers provide multiple means of communication (voice mail, e-mail, text messaging and so forth). This can make a big difference when you need to make last-minute adjustments to the job schedule.

In addition, use your interactions with a sub during prequalification to gauge how receptive it may be toward reminders about job scheduling. A company that responds quickly and in a friendly manner

should earn points in the "easy to work with" category. And scheduling reminders and updates play a big role in getting a job done right.

### Standard operating procedure

During a time when the rocky economy and its slow recovery are causing construction companies to look closely at risk management, prequalifying subcontractors is fast becoming standard operating procedure for many general contractors. After all, that's just what the prequalification process is: a way to manage the risk of bringing these outside providers into your projects and give yourself a better shot at keeping the project on time and within budget.

## Your bidding practices may have room for improvement

It's hard to say what the most important part of the construction process is for contractors, but the bidding process surely ranks pretty high. For it's here that you take your best shot at getting dibs on the contract and, assuming the legalities can be worked out, procuring the job. So do your bidding practices have room for improvement? At a time when, in many markets, construction work has almost never been as competitive, it's an important question to consider.

### Know your market

Begin by looking at your local market and asking yourself one simple question: What has changed?

For example, if you're a custom home-builder, you may decide, as many builders have, to build slightly smaller houses to better target baby boomers who wish to downsize their homes as they near retirement and customers in the middle-income range. Before getting started, look at how much the market will bear for new home prices, and what customers expect for that price.

If you're a commercial builder, keep your eye on major employers that are moving into or out of your area and what tax incentives may be available to build certain types of projects. If you're in a very competitive market, avoid incorporating into your bid a lot of high-end finishes, fixtures and other expensive features that can price you out of jobs.

For you to understand the market, you also must know who your competitors are and how many of them are bidding for the same work you're going after. Owners may believe that the best way to get a low price is to have a lot of bidders. Some contractors decline to bid, however, if they think the number of competitors is excessive.

## Think about costs

Along with a general concept of your market, the raw dollar amounts you include in your bids warrant a careful review.

Many contractors do a good job determining their direct costs for a project, but often fail to consider their indirect costs and thereby don't get a handle on all their true costs. If you're too busy to give your costs the attention they deserve, talk with your CPA. Contractors that don't properly allocate costs to their projects are missing out on opportunities to recoup expenses and submit accurate bids.

## Set your profit margin

From a business perspective, this is the trickiest part of any bid. Obviously, you want to offer a good price to keep in the running for a job. But you're in business to make money, so one of the most important elements of a successful bid is for it to be profitable.

Carefully consider the profit margin of each job, taking into account direct and indirect costs. The greater the perceived job risk, the higher you need to place the profit margin to accommodate possible losses. Experience helps here. If you bid work in which you're experienced, the risk generally will be lower, so your profit margin can be lower and your bid will be more competitive.

*Look at your local market and ask yourself one simple question: What has changed?*

In some instances, underpricing a job may make sense. You could offer a lowball bid to get a foothold in a new market or account, for example, or to build a relationship with a customer who might provide more business down the line. But before you give away your profit, make sure you've hit your "sweet spot" for the year. That is, make sure your business is close to or has already reached its ideal profit margin.

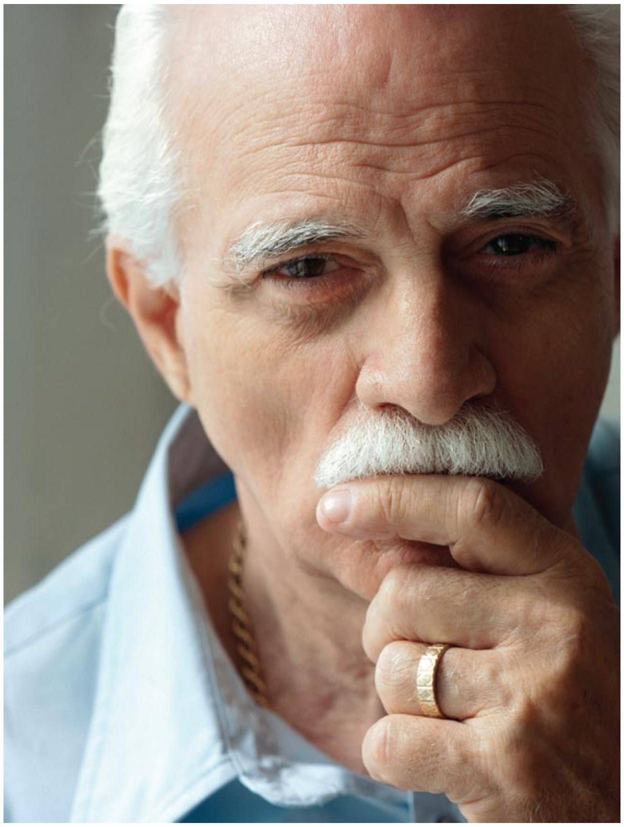
## Sharpen your skills

If you've been in business for any length of time, you've likely bid on many jobs and may be quite set in your ways. But bear in mind that times — and markets — change. Taking a critical look at your bidding practices can help you sharpen the skills that have kept your construction company successful up to this point.

# 5 prime suspects in an investigation of profit fade

We've all likely seen a movie in which the police parade a lineup of suspects in front of a two-way mirror and ask the witness behind the glass to finger the perp. Among the most common "crimes" of any construction project is profit fade — when the job's margin dims from view as work progresses (or finishes). So if you collared the five prime suspects in an investigation of profit fade at your company, whom would you likely see? Probably the following five bad guys:

**1. Unusual project type or scope.** The rocky economy may force you to turn to unusual jobs or those that involve work beyond your typical scope. Projects like these often trigger profit fade as unexpected costs and delays arise. So in these situations, be extra conservative in your estimates. Perhaps even do some networking with other contractors, architects or developers familiar with the work to get a heads-up about what could go wrong.



**2. Inaccurate estimating.** One could say that profitability begins with the estimate; therefore, invalid assumptions at this stage can doom the job's bottom line. Compare your estimates on jobs that lost money with those you used on profitable projects. Look at elements such as labor costs, direct costs and indirect costs. Can you see where you went wrong (and right)? Are your estimates relying on outdated concepts or data?

**3. Poor project management.** All too often, project managers lose sight of the contract once work is under way. This also can lead to profit fade. Try holding preproject meetings to discuss contractual provisions for scope of work and change orders as well as to remind your managers of your estimates. As the job goes on, check in with them (or ask them to submit reports) about how actual costs are comparing with bid cost amounts.

**4. Faulty cost reporting.** Sometimes profits aren't lost on the job site, but in the office. Bad information can lead to bad project management because decisions are being made with incorrect data. Ask your CPA to perform a fade analysis for all active jobs to see not only how profit fade is affecting your bottom line, but also where it might be originating.

**5. Fraudulent activity.** Obviously, profit will tend to fade when someone is stealing from you. So if profit fade has been an issue, and none of the other usual suspects seem to apply, it may be time to check into whether foul play is involved. Your CPA may be able to help you determine if any fraud has taken place.

# The Contractor's Corner

## Should we try our hand at social networking?

*It seems I can't open a newspaper or watch a news broadcast these days without hearing about social networking sites such as Facebook, Twitter and LinkedIn. Now one of my younger project managers is recommending that my construction company put up a Facebook page. Is there really any financial benefit to this?*

As your question indicates, the rise of social networking has become too prominent to ignore. Generally, construction companies have been slow to give social networking a try. But that doesn't necessarily mean you shouldn't listen to your young project manager.

### Add me?

Social networking sites allow you to set up a company profile containing all the pertinent basics (name, location, description, contact info) and then enable you to interact with anyone else who networks on that site by adding them as a contact.

So why would a contractor throw his virtual hardhat into this milieu? In a word, visibility. By keeping your construction company's name in front of customers, prospects and referral sources (such as architects and developers), you'll stay on their minds when a need arises for your construction services.

For example, on Facebook you can send out status updates (brief messages letting contacts know what you're up to) as often as you like. You might use this function to let everyone know when you, say, win a bid or complete a project. You could also post pictures — or even videos — of job progress or a finished project. You might also pass along important industry news or promote your company's involvement with local charities or community sports.

If done regularly and appropriately, your contacts should eventually begin to rely on you as a resource for what's going on nationally and locally construction-wise. You also can build goodwill by exchanging friendly messages and posting supportive statements on their pages.

### What's the problem?

Naturally, there are dangers to social networking. First and foremost, make sure you aren't inadvertently divulging sensitive information such as upcoming project targets or bid amounts.

Also beware of the dreaded "TMI" — too much information. If you update your page too often or with frivolous or even unintentionally offensive remarks, you could wind up turning off clients, prospects and referral sources.

On the flip side, if you don't update (or at least monitor) your page frequently, harmful items can end up on it, or the page can become embarrassingly out of date. So if you're unable to keep up with the rigors of social networking, you're probably best off deleting your profile.

### How to begin?

When carefully integrated with an overall marketing plan, social networking can pay off financially. But, as noted, it has its risks. Your best bet is to start slowly; stick to simple, friendly messages; and keep a close eye on what you say.