Emerging Contractor Reference Manual
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Introduction

In the fall of 1998 during a strategic planning process, ABC identified the need for a publication that would capture critical information, concepts and practices for operating successful construction contracting businesses. Such a publication would help build strong companies for a large number of ABC members who manage their own relatively small contracting firms. The term used to describe these members and this project became "emerging contractor."

Defining an "emerging contractor" is a difficult task, and certainly not an exact science. People have different notions of what an emerging contractor looks like. Some have tried to define them as small contractors, with no more than a defined number of years in business, less than a certain annual sales volume or no more than a certain number of employees. Just about any specific definition has exceptions because there are so many different types of contracting businesses with a wide variety of owner experiences and multiple measures of success. A general description seems more universally applicable such as the following:

You have made that all-important life changing decision to start your own construction company. Maybe you've previously been a skilled craftsman, or even a manager for a construction company. Your peers and your competition recognize your personal reputation for quality, ability and customer service. You likely got most of your business training through the school of hard knocks. So with a couple of friendly customers, perhaps a few start-up projects in hand, and minimal overhead expenses you established a start-up plan and set out to grow a business. You managed to make a decent wage for yourself, hire and pay a few employees, pay your suppliers and produce a profit.

Now comes the next stage in your contracting career. Times start to change and the competitive reality of the construction industry is kicking-in. Those friendly customers that gave you some start-up work are now telling you that they were happy with your performance and they would be happy to continue having your firm do their work in the future...as long as your price is lower than your competitors. Meanwhile as your company has grown you have developed some operating expenses (e.g., office rent, utilities, tools & equipment, a computer, an administrative assistant, contributions, associations dues, insurance, etc.) All these items to manage and still be competitive. Congratulations you're an Emerging Contractor!
With a little over one year in production, ABC proudly introduces the new *Emerging Contractor Reference Manual*. This manual is a comprehensive collection of best practices to help contractors move more quickly through the start-up phase to "emerge" as more mature businesses ready to face the competition.

The manual:

- Outlines and explains best practices for your company,
- Provides contact information and sources for additional information,
- Focuses your thinking,
- Spurs you to action,
- Pushes your company performance, and
- Enables you to help your company succeed.

This publication was developed as a self-study reference manual. A book that every contractor (and senior executives working for construction firms) would keep close at hand and reference when confronted with a new challenge or perhaps for some new insight into old business challenges. It was not written to be read cover-to-cover nor memorized.

I sincerely hope that this publication helps you to build your company into a better contracting firm.

K. Adams, Chair
Emerging Contractor Task Force
Emerging Contractor Reference Manual

Reader Feedback Form

If you have comments or ideas for improving this publication, we would like to hear from you. Please complete this form or write a letter and send it to us at:

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Module A

Reassessing the Business
A. Reassessing the Business

Overview

Introduction

This is an appropriate time to reassess your business in terms of your business development plans, organization, and financial planning. If you have analyzed your proposed plan of business operation thoughtfully and have established a business plan, communication with your bank, financial institutions, or other sources of financing should be easier and more favorably received.

A detailed business plan reflects your skills as a business manager. Further, if your plan includes a thorough analysis of your future business operation, the possibility of unexpected adverse financial circumstances may be minimized or avoided.

In this module

This module is divided into three broad categories with specific topics in each. Each topic identifies a basic business activity that is critical to your success as an emerging contractor. Each topic comprises specific tasks to enable you to perform the business activity.

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Business Development

Overview

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This first section of Module A covers basic business development processes. The five business activities and their corresponding tasks covered are outlined below.

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Introduction

To know where you are going, you have to know where you have been. What products and services have built your success? Which new avenues for success are available to you? To understand where you fit into the larger picture, you must research not only your products and services, but also those already available in the market and those the market is lacking.

Define who you are

An important step in understanding how and where you want to grow your business is being able to define who you are. Describe your company from a customer point of view. Approach this task from the perspective of what your customers expect and want from you. Describe

- What you are selling
- How your product or service benefits the customer
- What sets your company apart from your competitors
- Which products are in demand and will likely remain popular into the future

Define your product and/or service

The product and/or service you offer is the purpose of your business. It should be defined precisely in terms of

- What is the product/service?
- What does the product/service provide?
- What doesn’t the product/service provide?
- How is the product/service created and/or delivered?
- What value does this product/service have in the market?
- Who wants or needs the product/service?
- How does it relate to similar products/services available?

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Research the Products/Services/Market (continued)

Define your customers

You must know who you want to get and keep as a customer. Define your customer by deciding the following, as appropriate:

- Your current customer base;
- How your customers learn about your product or service—radio, television, advertising, word of mouth, billboards;
- Patterns or habits your customers and potential customers share—where they shop, what they read, watch, listen to;
- Characteristics your customers value most about your product or service—quality, service, reliability, availability, affordability;
- Factors your customers like least about your product or service—can they be adjusted to serve your customers better?

Define the marketplace

Who wants or needs your product/service? Define who you are targeting as likely to buy and use your product/service. The more refined your definition, the more accurately you can determine the size of your potential market.

Questions to answer about your potential market include:

- Where are the customers located? Local, regional, national, or international customers?
- Prospective customers you aren’t currently reaching
- How large is the market geographically? If local, is it within a 5-mile, 10-mile, 25-mile radius?
- How many consumers comprise this market?
- Are there any cyclical factors that influence this market?

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Research the Products/Services/Market (continued)

Obtain marketplace data

Consider gathering in-depth information regarding your geographic area, your target market’s demographics, and spending trends in your industry. From your local library, obtain at least the following reports:

- The Statistical Abstract of the United States (US Census Bureau): Geographic data about education attainment (available employees), types of housing (determination of product/service needs), household/disposable income, and trends in population characteristics (what is happening within the targeted age, gender, etc.)

- State and Metropolitan Area Data Book (US Census Bureau): A supplement to the Statistical Abstract, provides statistics on states and metropolitan areas in the United States and on subjects such as area, housing, income, manufacturers, population, retail and wholesale trade.

- County and City Data Book (US Census Bureau): A supplement to the Statistical Abstract, provides 144 statistical items for each county and 148 items for cities with a population of 25,000 or more. The information is organized by region, division, state, and SMSA for income, banking, capital expenditures, education, employment, housing, manufacturing, population, retail and wholesale trade, and other factors.

- County Business Patterns (US Census Bureau): Annual publication includes a summary of statistics on the number and type (NAICS code) of business establishments as well as their employment and taxable payroll. This information is organized by industry and county.

- The Survey of Current Business (US Bureau of Economic Analysis): Contains excellent details about how consumers are spending their money.

continued on the next page
Research the Products/Services/Market (continued)

Obtain market research data

Sources available for market research include:

- Small Business Administration (www.sba.gov/regions/states.html)
- US Department of Commerce, Bureau of Economic Analysis (www.bea.doc.gov)

Customized economic research

You may choose to hire a research firm to gather and analyze market data for you. Much of the information the firm will gather for you comes from the sources listed above. If your business has a high financial risk factor, it may be worth hiring a professional research firm.

North American Industry Classification System (NAICS)

The North American Industry Classification System (NAICS) is replacing the US Standard Industrial Classification (SIC) system. NAICS was developed jointly by the United States, Canada, and Mexico to provide new comparability in statistics about business activity across North America.

The list of 1997 NAICS codes, tables showing correspondence between NAICS and SIC, and other files for downloading are all new as of July 1998.

Use the NAICS system to find specific information on the construction industry. For more information on this system, go to: http://www.census.gov/epcd/www/naics.html.

continued on the next page
Research the Products/Services/Market (continued)

**Determine industry scope**

The industry is defined as the set of competitors in your market or trading area. The scope of the industry will depend on the size of your marketplace. For example, are your operations local, regional, national, or international? Define the industry as it is today and where it will likely be in the future. This definition allows you to make estimates on sales, growth, and promotions.

**Analyze industry sales**

Your industry is designated by a NAICS number. Your industry classification can be obtained from several sources available at most libraries or at the NAICS website (www.census.gov/epcd/www/naics.html).

You can use this NAICS number when researching the industry’s sales. Studies, books, and reports that reveal your industry’s historical and projected sales are available through the Internet and at most libraries. Using varied sources gives you a more accurate representation of the industry.

**Determine market share**

Market share is the percent of business your company holds when compared to the industry. Determine market share by comparing your projected or actual business sales to industry’s sales. For example, if your company had sales of $100,000, and the total industry sales were $1,000,000, your market share is 10 percent.

Market share is a measure of your progress in the industry. Market share can also be used to determine if your company’s projected sales figures are realistic. If your initial sales are more than the industry’s or are a large percentage of existing industry sales, the figures may be inaccurate.

*continued on the next page*
Research the Products/Services/Market (continued)

Define the supply

Supply can be determined by studying the competition in your market and in the industry. You should determine the number of suppliers—companies like yours—that provide your same product or service. This information determines whether a market is saturated or if there is room for more suppliers (your company).

Find this information by researching any of the following sources:

- ABC member information services
- Library resources
- Internet
- Government resources
- Yellow Pages
- Local Chamber of Commerce

Define the demand

Demand is a determination of the number of customers who want or need your product or service. You should know the demand for your product or service to decide if your company will satisfy a need in the market. You may have an excellent product or service, but if there is no market demand for it, your product or service is worthless.

Determine demand by researching any of the following sources:

- Trade magazines
- Industry sales figures
- Industry publications

Define growth opportunities

Identify segments outside of your target market that could become interested in your product/service with slight modifications. These potential market expansions represent a strong growth opportunity for your company.

continued on the next page
Research the Products/Services/Market (continued)

SCORE—Free business counseling

An organization called Service Corps of Retired Executives (SCORE) is a national organization sponsored by the US Small Business Administration (SBA). With more than 13,000 member volunteers, SCORE provides free counseling to new and existing small businesses.

SCORE volunteers help businesses identify management problems, determine causes, and help develop strategies to solve the problems. Volunteers can also help an expanding business by evaluating expansion plans and helping with other types of business counseling. For more information, visit the SCORE website at www.score.org.
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Research the Competition and Trends

Introduction

An integral factor in taking your business forward is understanding the competition and industry trends that influence your company.

Understand industry history

Identifying your industry’s history will give you insight into where the industry has been. Is this market coming off some good or bad times? Past performance does not necessarily reflect future performance but it is valuable information, nonetheless. The purpose of industry history is to understand where the industry has been and where you believe it is going. Many lessons can be learned from the past. Identifying trends from the past will help ensure success in the future.

Identify the competition

Your first step is identifying the competition.

- Who and where are they?
- How does your product/service measure up to that of your competitors (higher quality, lower cost, etc.)?
- What sets you apart from the competition?

Definition: Primary competitors

A primary competitor is a company or business that competes for the same customers. Also known as direct competitors, these are business entities offering a product or service that is interchangeable with yours—in the eyes of your customers. How you position your product or service in relation to primary competitors is crucial to capturing the loyalty of customers.

In many cases, you will know your primary competitors by name. You may all be ABC members. You must learn all you can about these competitors. Study their marketing and sales literature; drive past their locations; talk to their customers. Evaluate what they do well and where they may be lacking.

continued on the next page
Research the Competition and Trends (continued)

Definition: Secondary competitors

A secondary competitor is a company or organization that is in your same industry but that does not compete for the same customers. A secondary competitor may also be a business entity that offers similar products or services in a different business category (e.g., industrial versus commercial) or is not in your immediate geographic area.

The impact this level of competition has on your company depends on how well you fine tune your marketing appeal to target members of the secondary competitor’s primary market. You may even use ideas from secondary competitors to improve your operations in the primary competitor arena.

Define your competitors

You must focus specific attention on major competitors or forces in your market. List the competitors and their strengths and weaknesses. Determine which are primary and which are secondary competitors. Answer these questions:

- How many competitors are in your market?
- How many competitors have entered the market in the last year? Two years?
- Is the number of competitors increasing? Decreasing? Remaining steady? Why?
- Who are the competitors?
- What are the sales figures for each competitor? What is the market share for each?
- What are the promotional dollars spent by each competitor?
- Who are each competitor's customers?
- How do customers judge your competition’s product/service?
- Who are each competitor’s suppliers?
- What does the leading competitor do better than anyone else?
- How well does each competitor adapt to industry innovations and technological developments?

continued on the next page
Research the Competition and Trends (continued)

Define your competitors (continued)

- What separates the leader from the rest of the competitors?
- Who are your secondary competitors?
- Will secondary competitors become a direct threat to your customer base in the future?

Evaluate your product/service against the competition's

You have determined who your competitors are. Now you must know how your product/service compares. One effective method for evaluating your product/service is to survey current and potential customers.

A customer survey to evaluate your product/service should include questions such as:

- Were you satisfied with our product/service?
- What changes, if any, would you suggest?
- What advantages does our product/service have over the competition?
- What improvements can be made?
- How would you rate our product/service against the competition?
- What additional product(s)/service(s) features would you like for us to offer?

Gauge competitors’ reactions

If you are entering or expanding into a marketplace with established businesses, you may need to expect an unwelcome response. Responses can range from price slashing to negotiating exclusive contracts with suppliers. Anticipate possible reactions by existing businesses and determine the amount of impact this might have on your company.

continued on the next page
Research the Competition and Trends (continued)

Cost of direct competition

In certain situations, it is unrealistic to take on larger competitors directly. Your careful analysis of the primary competitors’ operations should indicate if you are outgunned in the marketplace. This doesn’t mean you cannot do well, it simply means that you may need to specialize in or create a niche where the larger competitors won’t go.

Identify industry trends

What are the trends in the industry? Are your competitors going to fewer services? What is going on in your market? If you enter or expand in an industry and are not aware of the current trends you may be at a competitive disadvantage from the start. Don’t let a new trend set you back. Be aware of the changes and adapt quickly.

What are any relevant factors that may influence your company’s plans? There are many changes occurring every day that are likely to affect your growth. Reports used in analyzing the marketplace (see Research the Product/Service/Market) will often contain important information on demographic and industry trends.

Identify influential factors

There are a number of material factors that can affect your industry positively or negatively. What economic factors will influence your industry? How do your funding sources and customers react to economic factors (e.g., public works, interest rates, money policy)? Can you take steps to limit the effect of these influences?

Identify the industry factors that may affect your company. Is there a government regulation that may change the way your company operates? Employees’ rights, consumer protection regulations, and acts of nature are some examples of influential factors. By identifying all the influential factors, you can develop proactive strategies. Careful planning to anticipate influential factors is better than racing around reacting to unforeseen changes.

continued on the next page
Research the Competition and Trends (continued)

Identify influential factors (continued)

Identify the increasing globalization of businesses in your industry. Evaluate what is happening in businesses expanding into third-world markets and if this affects your company.

Locate more information about trends

Trade organizations are often the best source of information on industry trends. You might contact the following organizations for more information.

- Chamber of Commerce, Rotary Clubs, banks
- City or regional planning commissions
- Minority-aid offices, small business development centers, state banking associations

Track government regulation

Specifically track government regulation trends. Investigate and identify any ordinances, laws, taxes, and regulatory efforts that will affect your business. ABC National is a source of current and proposed legislative action you should know about.
Develop a Niche or Specialty

Introduction

These are times of greater and greater specialization. Companies are offering narrow product and service lines that allow them to focus better on an area of expertise. They are identifying new customers for existing products and developing new products for existing customers.

Definition: Niche

A niche is a market specialization whereby a company offers a limited or tightly focused product or service to customers.

Types of niches

Types of niches include but are not limited to:

- New construction, retrofit, or remodeling
- General contracting or subcontracting
- Infrastructure (heavy) construction or building
- Industrial, commercial, institutional, or residential

When do you find a niche?

Most companies are already serving a niche in the marketplace. Purposeful identification of the niche—in terms of target market, product preferences, and specialized services required—helps you position yourself to take full advantage of your area of expertise. To determine your niche, ask yourself:

- Who are we?
- What do we do?

Mature companies also can develop niches based on their current business. Each time a mature company considers expanding into a new area, it should consider these same basic questions.

continued on the next page
Develop a Niche or Specialty (continued)

Evolving niches

Your niche may change over time as well. For example, a company specializing in alarm systems might start off with both residential and commercial installations. Over time, the company may begin to specialize and thus occupy a niche concentrating on new residential construction alarm systems. As its expertise and experience continue to grow, the company may add other specialized niches for multiple systems installations.

Niche marketing

Niche marketing describes a company’s attempt to secure a large market share of a segment of the target market by

- Identifying the heaviest users and/or potential consumers of their product/service
- Communicating with those users and potential consumers to define their needs
- Selling a product/service that satisfies those needs
  - More existing products to existing users
  - New products to existing users
  - Existing products to new users
  - New products to new users
- Obtaining feedback from all users

continued on the next page
Develop a Niche or Specialty (continued)

Product/client marketing matrix

There are four basic approaches to niche marketing as illustrated in the following matrix.

![Product/client marketing matrix diagram]

Determine company strengths/weaknesses

Strengths are reflected in your bottom line. Identify those areas of product/service that result in the highest net profit. Weaknesses can in large part be determined by research, financial reports, and feasibility studies.

Know the right reasons

Determine why the client will or will NOT buy from you. Just because you build it, they may or may not come. Clients may have different reasons for choosing your product and services than those reasons that you believe. There are three primary reasons for any buying decision—best price, best product, best solution. You must ask your clients why they are choosing you.

continued on the next page
Develop a Niche or Specialty (continued)

Identify a developing niche

Using many of the same reports and information sources as you did to determine industry trends and market data, look for a developing niche in the statistics and sales figures.

Ask yourself if this development is suited to your company’s strengths and weaknesses.

The ego factor

Pride is a good factor in many ways. Most importantly, pride (your ego) drives you to supply the best product/service. But, pride may get in the way of good business decisions. Successful entrepreneurs may develop an invincible feeling as a result of success. This feeling can cloud a business decision when considering a new niche or market opportunity.

You must learn to balance your ego—which says you can do anything—with basic business sense. Do this by considering both your feasibility studies and your gut feeling.

Advantages and disadvantages of a niche company

Most small companies are vulnerable to larger companies with similar products or services. A niche approach allows a smaller company to specialize and achieve market share while not confronting with the larger competition head-on. In general, you have to be exceptional at what you do or you need to do something that no one else is doing.

The niche—specialized target market—must be large enough to support your company’s product/service on an ongoing basis. There must be enough buyers on a continual basis to sustain company sales, spending, and profits over the years.

continued on the next page
Develop a Niche or Specialty *(continued)*

**Niches and market downturns**

If different segments of the economy drop, a particular niche market may dry up. You must be flexible enough to change niche markets for a period of time. You may do this by finding a secondary strength and building from it.

**Opportunities in downturns**

Take advantage of downturns by incorporating them into the business plan. If you don't have debt and you have cash, a downturn is actually an opportunity. Weaker businesses fade from the marketplace and leave new clients for your prepared company. It can be a chance to increase your market share.

One of the best ways to learn about and survive market downturns is by relying on your advisors and mentors.

**Special requirements of particular niches**

Certain niches require specialized skills and equipment. When determining whether to enter into a particular niche, research the basics of the niche. For example, certain niches require specific training, equipment, knowledge, or certification/licenses.

**Tricks of the trade**

With any niche, there are some trade secrets that come with experience. These trade secrets help you save time and money. Some niches require lots of *inside knowledge* to be successful. You can obtain the experience in three ways:

- Hire the experience
- Learn it as you go
- Draw on mentors

*continued on the next page*
Develop a Niche or Specialty (continued)

Volume matters

Niche is not only about the trade. It is also a matter of volume and marketing. You must understand who the competitors are and the economics of the playing field. Some companies are positioned to work at cost for a certain percent of their gross profit but then operate at 50 percent or more markup on other types of work.

Design/build services

Design/build services are generally more overhead intensive because they require engineers. While a niche company that offers a turn-key product may have a competitive advantage over one that doesn’t, the design/build company takes on more liability.

More and more companies are requiring that the contractor have a design/build capability. Bids require that the contractor submit the design. You must rely on your attorney for legal advice concerning contract requirements and on your insurance agent about liability issues.
Consider Participating in Joint Ventures

Introduction

It may be to your advantage to team up with another company to accomplish a project you might not be able to take on alone. Rather than feel forced into a partnership, a joint venture offers the option of mutual benefit on a limited and specific basis.

Definition: Joint venture

A joint venture is a special combination of two or more people or companies jointly seeking a profit in a specific venture without actual partnership or corporate designation.

The primary difference between a partnership and a joint venture is that a partnership is usually created for the transaction of business of a particular type. A joint venture is usually limited to a single transaction.

Examples of joint ventures

Some typical joint venture arrangements include:

- Item joint ventures (materials on a turnpike job)
- Silent joint ventures
- Project joint ventures (road and bridge job)

Legal nature of a joint venture

The rights of people who intend to do business as a joint venture are governed substantially by the same rules that govern partnerships. An oral agreement between the parties may be sufficient to form a joint venture. However, to avoid misunderstandings, it is always preferable to have the agreement in writing.

continued on the next page
Consider Participating in Joint Ventures *(continued)*

**Advantages and disadvantages**

The advantages of a joint venture include:
- Increasing ability to raise capital
- Pooling of financial resources
- Pooling of individual talents
- Sharing of ideas and management responsibility
- Minimizing administrative costs

The disadvantages of a joint venture include:
- Assuming unlimited personal liability
- Losing a measure of control
- Differing company philosophies

**Identify possible joint venture partners**

Draw up a chart to compare and contrast the operations of both your company and those of a possible joint venture partner. Look for the following information:
- Resources
- Strengths/weaknesses
- Manpower
- Reputation
- Philosophy
- Bonding capacity
- Workload

**Tax and legal implications of a joint venture**

Be sure to consult with your attorney and accountant regarding the possible implications of a joint venture. Include your bonding agent and insurance agent in the discussions.
Maintain a Record of Customer Leads and Referrals

Introduction

You need to have a consistent and complete system that stores all the essential information regarding current and potential customers. This information can direct future marketing efforts.

Types of customer information

Use a database program that is simple. It should provide for the collection of the 5 Ws—who, what, where, when, and why. Include the following key information.

- Name
- Address
- Contact person
- Description of company
- Telephone, fax, email
- Contact dates
- Product/service needed

How does this information help?

You can use this information to determine where your prospects and customers come from as a means of evaluating your marketing efforts.

You can refer to this information when times are slow and you want to generate more sales.

continued on the next page
Maintain a Record of Customer Leads and Referrals (continued)

When to refer a customer to a competitor

When it is in the best interests of everyone involved. In this situation, the client is best served and you stay out of an area where you maybe shouldn’t go.
Organization

Overview

Introduction

This second section of Module A covers basic business organization issues. The 15 business activities and their corresponding tasks covered are outlined below.

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Develop Business Goals

Introduction

Goal setting is similar to drawing blueprints. You need some idea of where you are headed and how you will get there to build a successful project. If the goals don’t exist, there is no way to measure how close you are to achieving success.

Uses of business goals

A written goal gives you a specific, measurable target to strive for with your business operations. The goal’s supporting objectives provide a series of guideposts for you to follow as you grow your business.

Business goals are both inspirational and informative. By measuring your goals, you can see how far you have advanced with your business. If you are not making headway, reevaluating your goals may give you insight into why this is happening.

Potential investors will be interested not only in where the business is today but also on where the business is headed in the future. Future goals emphasize short- and long-term financial and business objectives.

Setting goals

Use the following general guidelines to develop and set your business goals.

- Carefully weigh the importance of the goal. Is this something you are willing to work toward, or does it just sound good?
- Create your goals in line with your value system.
- Set goals that do not contradict each other.
- Write goals in positive language.
- Be explicit when goal setting and include details.
- Set goals high to encourage and motivate your pursuit of them.
- Date your goals (goals without a deadline are not met)
- Think about whether you will enjoy the journey and the results.

continued on the next page
Develop Business Goals (continued)

Elements of a goal statement
A goal statement should be specific and attainable. It can address elements such as
- number of clients
- number of service contracts
- gross profit
- percent of repeat business

Sample goal statement
The following is a typical goal statement for a growing business.
We (the company) will achieve a 5 percent growth with an increase of 1 percent gross profit at the end of fiscal year 2001.
Reassess Legal Form of Organization

Introduction

The legal organization of the company is important for establishing a business foundation. With the advice of your legal, tax, and financial advisors, determine if your current legal structure is the best choice in relation to your business goals.

Different types of business structures

There are several different types of business structures to choose from. Be sure to consult with an attorney and/or accountant when evaluating the choices.

- Sole proprietorship
- Partnerships
- Corporations (C or S)
- Limited liability company (LLC) and limited liability partnership (LLP)

Sole proprietorship

A sole proprietorship has been defined as “one who has the legal right or exclusive title to anything.” In many instances, it is synonymous with owner.

Essentially a sole proprietorship is a business or professional enterprise owned entirely by one individual. Frequently, business is conducted alone or in conjunction with a small number of employees. There are no formal legal agreements required to start up a sole proprietorship. It is often created by simply bringing together assets, space, and talent. During lifetime, or at death, the proprietorship assets and liabilities are simply the individual assets and liabilities of the proprietor. Without a buy-sell agreement, the proprietorship is typically liquidated at the proprietor’s death, disability, or retirement.

For income tax purposes, all income and losses are reported by the proprietor as individual income or loss on Form 1040.

continued on the next page
Sole proprietorship (continued)

Advantages
- Easy and inexpensive to create (no government approval unless a license is required)
- Nominal start-up costs
- Total control by owner (also full responsibility)
- Owner can sell, alter, or exchange all or part of the business

Disadvantages
- Owner has unlimited personal liability
- Business is terminated upon the death of the owner
- Personal credit, funds, and property must be used as security for loans
- Difficult to attract capital due to total personal liability and no successor management
- Business profits are taxed as ordinary income to the owner
- Fringe benefits are not tax deductible

Partnerships

A partnership is defined under the Uniform Partnership Act as “an association of two or more people to carry on as co-owners a business for profit (UPA, §101).”

A partnership is created by the partner’s voluntary acts and may be by written or oral contract. Partnerships may be limited or general partnerships—commercial or professional. Each partner is co-owner of all partnership assets with each other partner. In addition to the partner’s interest in tangible assets, each partner has an intangible interest referred to as “his/her share of the profits and surplus.” Each partner is likewise a principal of the business and, simultaneously, a general agent as to each of his or her co-partners. As a general agent, any partner may bind his or her co-partners in business dealings conducted within the scope of the partnership business. In addition, each partner’s personal assets are jointly liable for all partnership liabilities, and jointly and severally liable for wrongful acts (subject to first claims of the partner’s personal creditors).
Reassess Legal Form of Organization (continued)

Partnership (continued)

Because a partnership is considered a unique, personal, and voluntary relationship, the law provides (in the absence of a written continuation plan) the following upon death of a partner:

- Dissolution of the partnership
- Winding up of partnership business

Surviving partners become “liquidating trustees,” with limited authority to

- Wind up business in progress
- Pay all partnership debts
- Reduce assets to cash
- Distribute and account to the surviving partners, heirs, etc.

Termination is simply the end result of the winding-up process and the ultimate cessation of the partnership.

Advantages

- Increased ability to raise capital
- Pooling of financial resources
- Pooling of individual talents
- Sharing of ideas and management responsibility
- Minimal administrative costs
- Income passes through to the partners

Disadvantages

- General partners have unlimited personal liability
- Losses pass through to the partners
- Any partner can enter into a contract on behalf of the partnership, thus binding all partners
- Partnership may be terminated upon the death of a partner, by bankruptcy, or withdrawal of a partner
- Transferability of a partnership is usually restricted by partnership agreement
- Fringe benefits are not tax deductible

continued on the next page
**Reassess Legal Form of Organization** *(continued)*

**General versus limited partnership**

A *general* partnership is defined as any association of two or more people operating for profit. It only requires compliance with state and local licensing requirements. General partners share the management duties and are personally responsible for the partnership’s obligations.

A *limited* partnership may include any number of limited partners but there must always be at least one general partner. This business organization often is used for a single construction project. A limited partner:

- Invests capital in the partnership and receives a share of the partnership proceeds
- Is immune from liability for partnership debts beyond the amount of his or her investment
- Cannot be involved in the day-to-day operations of the business without risking the loss of their immunity from liability

In addition to the conditions of a general partnership, a limited partnership should specify:

- Amount and timing of contributions made by each partner
- Whether some or all of the general partners have management and control responsibilities
- Distribution of profits and losses to general and limited partners
- When distributions of cash or property will be made
- Detailed level of responsibility and duties of general partners
- Value of a partner’s interest in case of the partner’s withdrawal
- Value of a partner’s interest in case of the death of the partner

*continued on the next page*
Reassess Legal Form of Organization (continued)

Buy/sell agreement

A buy/sell agreement specifies how the value of a partner’s share of the business is determined if a partner wants to leave the partnership. This type of agreement minimizes potential disputes over value and enables the withdrawal of a partner to occur smoothly. (See section on Succession Plan/Business Continuation Plan.)

Key member life insurance

A life insurance policy on the life of key members of a partnership is designed to provide cash in the event of the death of a key member. The beneficiary of the life insurance policy is the partnership itself or the company’s members. Usually the proceeds are used to keep the business operating if a key partner dies. The proceeds may also be used to buy out the deceased partner’s interest according to the terms of the buy/sell agreement. (See section on Succession Plan/Business Continuation Plan.)

Close corporations (C Corp)

The corporate form of business is usually the most costly to organize. A corporation has four characteristics:

- Continuity of life
- Centralization of management
- Limited liability
- Free transferability of interests

A corporation is considered a legal entity separate and distinct from its stockholders—an artificial creature of the law. As such, a corporation has perpetual life. Further, a corporation is liable for its own debts and improper acts. It can, however, only be held liable to the extent of the corporation’s assets. This means that the stockholders enjoy limited liability to the extent of their investment in corporate stock.

continued on the next page
Reassess Legal Form of Organization (continued)

Close corporations (C Corp)
(continued)

The death, disability, retirement, or withdrawal of a stockholder does not automatically trigger the end of the corporation. A deceased stockholder’s stock passes to his or her heirs as intangible personal property with only the following rights granted to the heirs:

- Right to vote the stock
- Right to participate in dividends, if any are declared
- Right to participate proportionately in the net assets, if the corporation is dissolved

Income taxation of a C Corp stockholders differs from the individual taxation of sole proprietors and partners. The corporation is an individual taxable entity.

Corporate income that is not distributed to stockholders is not taxed to them individually. However, corporate dividends are taxed as ordinary income to the stockholders with no corresponding deduction to the corporation.

Management authority is vested in the corporation’s directors, not its stockholders. (In C Corps this distinction is frequently illusory, since stockholders are usually the directors as well as employees.)

Advantages
- Exemption of stockholders from personal liability
- Continuity of existence
- Unaffected by death or withdrawal of employee or shareholder
- Specialized management
- Retention of earnings for future investment or dividends
- Ownership is transferable unless restricted by agreement
- Fringe benefits are tax deductible
- Increased ability to raise capital
- Standardized statutory methods of organization, management, and finance

continued on the next page
Close corporations (C Corp)  
(continued)

Disadvantages
- Closely regulated; state charter required
- Most expensive business form to organize
- Record keeping can be extensive
- Recurring attorney and accountant fees
- Potential double taxation of corporate earnings (i.e., earning distributed as dividends to stockholders)

Protective measures
Consider creating a buy/sell agreement similar to the one used in a partnership. Consider having key member insurance on the life of any key member of the corporation to provide cash in case of death. (See section on Succession Plan/Business Continuation Plan.)

S Corporations
Provisions allow shareholders to absorb all corporate income or losses as partners and report it as individual taxpayers. In essence, the S corporation is not affected by corporate income taxes, thereby eliminating the double taxation feature of standard corporations.

Aside from being treated as a partnership from a federal tax standpoint, the S corporation shares most of the same advantages and disadvantages as a standard corporation. There are a few exceptions.

The requirements for an S corporation include:
- Must be a domestic entity (incorporated within the United States)
- Can have only one class of stock
- Can have only individuals or estates as shareholders
- Cannot be part of another organization

continued on the next page
Reassess Legal Form of Organization (continued)

**S Corporations (continued)**

- Can have a maximum of 75 shareholders
- Cannot have any nonresident alien shareholders
- Must generate 20 percent or more of its revenue domestically
- Cannot have dividends, interest, royalties, rents, annuities, and securities transactions total more than 20 percent of revenues

**Advantages**

- Cash method of accounting (unless the S corporation has inventory, then it must use the accrual method)
- An S corporation does not have earnings and profits so it can accumulate passive income that can be passed to shareholders
- Capital gains are passed through to shareholders at the lower maximum tax rate on long-term capital gains (20 percent for property held for longer than one year)

**Disadvantages**

- Limited number of shareholders
- Shareholders may be limited on the amount of losses they can deduct as pass-through losses from the S corporation
- Must use the calendar year as a tax year
- One class of stock (may limit ability to raise capital)
- Fringe benefits are taxable as income to employee-shareholders owning more than 2 percent of the corporation

*continued on the next page*
Reassess Legal Form of Organization (continued)

Limited liability company (LLC)

A limited liability company (LLC) has positive attributes of both a partnership and a close corporation. The members (owners) of an LLC have limited liability like stockholders of a close corporation without the double taxation. Also, the LLC may general elect to be taxed as a partnership.

**Advantages**

- Limited personal liability for LLC members
- Flexible membership allows members to be individuals, partnerships, trust, or corporations
- No limit on number of members
- Flow-through tax treatment allows income, losses, deductions, and tax credits to flow to members

**Disadvantages**

- Cannot be a single-member LLC (a single-member LLC is considered a sole proprietorship)
- Free transferability of interest makes this entity function differently from a partnership
- Nontraditional entity with a short track record of legislative and legal precedent
- More expensive to set up than a sole proprietorship or partnership

Limited liability partnership (LLP)

An LLP is similar to an LLC in terms of tax advantages. An LLP, however, is usually only available to select professions such as doctors, lawyers, and architects. LLPs are not as common as LLCs in most states.

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Reassess Legal Form of Organization (continued)

Evaluate current business organization

Working in conjunction with your legal, tax, and financial advisors, evaluate whether your current organization structure is best suited to attain your business goals.

Determine if your current structure provides for managed growth. Ask yourself questions such as:

- What is the legal form of the company today?
- What are the terms of the partnership and who are the partners?
- Who owns stock and in what proportions?
- What type of stock is offered?
- Who sits on the board of directors? What is their history?
- What levels of authority are granted and to whom?
- What laws have changed recently that may effect my business organization?
- Who owns the business?
- Who will own the business if I die?
Develop a Basic Business Plan

Introduction

A business plan is essential. It can be used as a guideline for expanding a current business and it is a critical document in obtaining financing. No two business plans are identical, but all answer the questions Where am I now? Where am I going? How will I get there?

Definition: Business plan

A business plan is both a management tool and an organizational guide that helps define the business as it exists, describes where the business is going, and explains how it will get there. The business plan should consist of specific sections that contain information regarding the company and industry, marketing, sales, design and development, staffing, operations, and finances.

Benefits of a written plan

A written plan is essential for complete planning. In a written form, a business plan can be communicated to interested parties, bank officers, and licensing officials. Ideas swirling around in a principal’s head may have merit, but are difficult to pin down and compare to market analysis figures, financing requirements, and job descriptions unless written down.

Putting it in writing helps prevent errors of omission when planning a new or expanding business. It helps organize your information, fill in any possible gaps, clarify misunderstandings, or identify wrong assumptions.

continued on the next page
Develop a Basic Business Plan (continued)

**Function of a written business plan**

A written business plan can help:
- Evaluate the many variables that affect your business
- Project a timetable for operations
- Create a business resume for your company when seeking financing and investments
- Define your goals and the milestones toward their achievement
- Provide a means to measure your progress toward goals
- Describe future growth initiatives and strategies
- Provide a basis for feasibility checks

**Intended audience of your business plan**

Beyond being an excellent planning tool for yourself and your managers, the business plan can also be used for at least four separate audiences.

**Lenders**

Take your business plan to lending institutions when seeking debt financing. Banks, credit unions, and commercial lending institutions will consider a company with a comprehensive and coherent plan for making money and paying off loans. The business plan will include your cash flow projections and financial plans.

**Suppliers**

You may seek extended payment terms from key suppliers. In the event you ask a supplier to provide this type of business credit, you must have documentation that supports your claims that you operate a viable, growing company. The business plan will support your claim through its market analysis section.

continued on the next page
Develop a Basic Business Plan *(continued)*

**Intended audience of your business plan (continued)**

**Investors**
Investors will seek reassurances that money they put into your company will provide them with a financial benefit. The business plan includes short- and long-term financial goals and strategies.

**Customers**
How will a customer know your company will deliver what it promises? The business plan answers questions regarding products/services, management abilities, industry track record, and operations.

**When to write a business plan**
You should write a business plan if you

- Want to start a new business
- Plan on expanding an existing business
- Plan on introducing a new product/service
- Want to enter a new marketplace

**Business plan failures**
Despite your best efforts, you may find that your plans do not succeed. The following are typical reasons why a business plan fails.

- Inadequate projections of required investment
- Essential information is missing
- Financial projections are over stated
- Projections are based on broad assumptions
- Inadequate market analysis
- Vague strategies for marketing and financing
- Not written down

*continued on the next page*
**Develop a Basic Business Plan (continued)**

**Key components of a business plan**

A business plan will vary from company to company but certain key elements must be covered regardless. The key components of a business plan include:

- Cover page and table of contents
- Executive summary
- Business section
  - Description of the business
  - Product/service
  - Industry analysis
  - Facilities/location
  - Design and development plans
  - Operations plan
  - Management team and employees
- Marketing plan
  - Analysis of customers/competition
  - Product
  - Price
  - Promotion
  - Place
- Financial plan
  - Descriptive summary of financial analysis
  - Financial statements
  - Contingency plan (See section on Succession Plan/Business Continuation Plan.)

Appendices

*continued on the next page*
Develop a Basic Business Plan (continued)

Cover page and table of contents

The cover page creates an overall impression in the eyes of the reader. It should be well designed and include your company logo, motto, or other identifying symbols. The cover page should also include the following information:

- Contact person
- Company address
- Company telephone and fax numbers
- Date of report preparation
- Period of time covered by the plan (e.g., 2001-2003)
- Copy number, if applicable (e.g., Copy 1 of 5)

The table of contents serves as a pre-organizer for the reader. It allows the reader to scan the contents of the plan quickly before getting into details. Later, it provides the reader with a means of locating specific information by referencing a section and page number. The table of contents should be

- Short—one page if possible
- Accurate—page numbers and titles must be correct
- Divided into sections for easy scanning

Executive summary

The executive summary is the most critical section of your business plan. It is also written after all the other sections are complete. The executive summary is a brief outline—no more than three pages—of the entire business plan. It needs to create interest and enthusiasm in the mind of the reader. It should provide enough information to convey the realistic and sound principles underlying your proposals and assumptions.

continued on the next page
Develop a Basic Business Plan (continued)

Executive summary (continued)

The executive summary should convey to the readers

- The nature of the company
- Product/service goals
- Industry history and competitive environment
- Market analysis support for the proposed business plan
- Company management
- Proposed and existing financial/investment strategies and plans
- Three-year projections for revenue and expenses
- Marketing plans and goals

Business section

This section provides a detailed description of your business. It will describe your product/service, target market, and why your company is unique in the marketplace.

Business description

This subsection should describe the business entity and its general operation. The description of your business should identify goals and objectives and describe what makes you unique in the marketplace. This includes the current management structure and organization. It should list and describe key personnel. For existing businesses, this section should also include a historical background of the company. Be sure to include the following information.

- Legal structure of company
- Type of business (e.g., general contracting, subcontracting, industrial, commercial, etc.)
- Description of products/services
- Historical data (i.e., date established, years in business), if applicable
- Management structure and organization chart
- Number and type of employees (i.e., hourly, salary)

continued on the next page
Develop a Basic Business Plan (continued)

Business section (continued)

Business description (continued)
- Description of key employees
- Location
- Overview of facilities
- Operations (e.g., hours and days of business per week)

Product/Service
Earlier you devoted time to researching the products/services and market (Module A.1 Research the Product/Service/Market). You analyzed your product/service and its relative position in the industry. In this subsection, describe the benefits of your product/service from the customers’ perspective. Indicate what your research has shown about current and potential customer loyalty and satisfaction. Include information that describes
- What you are selling
- How your product/service will benefit the customer
- Which products/services are in demand; whether the demand is steady, increasing, decreasing
- What makes your product/service different and, therefore, more desirable in customers’ minds

Industry analysis
This subsection evaluates the playing field in which you will be competing. You researched these data earlier (A.1 Research the Competition and Trends). Include information that describes
- Unit and dollar size of the market where you are (will be) competing
- Market trends, if any, that affect the market size
- Major competitors and their market shares
- Products/services in direct competition and in secondary competition
- Any barriers to entry or expansion into the market
- Industry data that favor your company’s position

continued on the next page
Develop a Basic Business Plan (continued)

Business section (continued)

Facilities/location
The location of your company can play a decisive role in its success or failure. Your location should be built around your customers’ needs. Address the following information in this subsection.

- What your facility needs are
- What kind of space you need and how much
- Which location is most desirable
- What accessibility and security issues might arise
- Whether market or demographic shifts might occur
- Whether renting or buying is best and why

Design and development plans
This subsection presents your strategy for taking your idea from concept to reality. Include information about the following issues.

- Current status of your product/service development
- Proposed start date
- Obstacles, if any, that you must overcome
- Estimated costs of product/service development
- List of anyone outside your company who will be involved
- Any issues or concerns regarding proprietary information/technology

Operations plan
Your operations plan details how you will create and deliver your product/service to the target market. You will explain what functions are necessary from the sales call to the completed project. Present information about

- How many people are needed
- How to keep employees
- Each individual’s precise function during the process
- Key steps in delivering quality products and services
- How quality will be controlled

continued on the next page
Develop a Basic Business Plan (continued)

Business section (continued)

Operations plan (continued)
Remember to include your administrative activities in the operational plan. These everyday tasks consume an enormous amount of time and must be planned for. These activities include handling the mail, invoicing and collections, payroll, and bookkeeping, among others.

Management team and employees
Depending on the complexity of your business, you may need a subsection devoted to management and staff responsibilities. This subsection demonstrates that you have the required human resources to make the company a success. Address key issues such as

- Your company organization
- Key management personnel and their backgrounds
- Investors and/or shareholders, if any
- Members of the Board of Directors and/or Board of Advisors, if any
- Professional advisors (e.g., lawyer, accounting firm) [see Module B, Building the Business Team]
- Employment options (e.g., full-time, part-time, temporary employees)

continued on the next page
Develop a Basic Business Plan (continued)

Marketing plan

The marketing plan is your strategy for turning your company’s plan for products/services into a commercially successful enterprise. It must be based on thorough market analysis. All marketing plans must address the basic factors known as the Four Ps.

- Product
- Price
- Promotion (advertising)
- Place (distribution)

*Module F presents an in-depth discussion of developing and implementing a marketing plan.*

Analysis of customers and competition

In previous tasks you have analyzed your target market and the competition (Module A.1 Research the Product/Service/Market and Research the Competition and Trends). In this section of the business plan, be sure to discuss the following information.

- Existing and proposed customers—their demographics
- Products/services these customers currently use to fulfill the need which your company hopes to meet
- Customers’ underlying needs and any trends that affect those needs
- Primary and secondary competitors
- Market data for all competitors
- Possible reaction to your company’s entry into the market

Product

Provide specific and detailed information regarding the composition of your product(s)/service(s). You presented an overview in the Business Description section of the business plan.

*continued on the next page*
Develop a Basic Business Plan (continued)

Marketing plan (continued)

Price
Include information regarding the price point(s) at which your product(s)/service(s) will be sold. Describe your pricing philosophy. For example, discuss

- Pricing below competition
- Pricing above competition
- Balance between sales volume and price

Promotion (advertising)
Detail your proposed advertising and promotional budget. Specify the goals of each marketing method. Describe marketing issues such as

- Competitive position
- Advertisements and media
- Public relations
- Evaluation of marketing strategy

Place (distribution)
Discuss how your product(s)/service(s) move from your company to the end-user. This includes your sales approach (e.g., using direct sales force).

continued on the next page
Develop a Basic Business Plan (continued)

Financial plan

The financial plan indicates how much money your company needs and how much it projects to earn in the future. This material is covered in-depth in section A.3 Financial.

Descriptive summary of financial analysis

This financial plan section includes both detailed financial analyses and a written discussion of how this analysis affects the business and any investment decisions. You should prepare a written discussion containing highlights of your financial data analysis and indicate your financing needs and use of funds. Include a discussion of any investment offerings and the projected investor’s return.

Financial statements

The timing of revenues and expenses is critically important to all businesses. When your cash arrives makes the difference between paying your bills or not. The planning process is referred to as cash flow projections. This is just one type of financial statement you will have in your business plan. Include at least the following financial statements/projections.

- Actual profit/loss statements and balance sheets, if applicable
- Proforma profit/loss statements (monthly for Year 1, and quarterly and annually for Years 2-3)
- Proforma balance sheets (monthly for Year 1, and quarterly and annually for Years 2-3)
- Proforma cash flow statements (monthly for Year 1, and quarterly and annually for Years 2-3)
- Gross and operating margins
- Fixed and variable costs
- Break-even analysis in time and units sold
- Analysis of return on investment (ROI)

continued on the next page
Contingency plan

Prepare a contingency plan to outline possible responses to changes in economic and market conditions. These changes include factors such as rising or falling interest rates, availability and cost of building supplies, higher or lower than expected sales, and so on. Contingency plans document to lenders and investors that you have planned for uncontrolled variables and are more likely to respond well to change.

Appendices

Place supporting documents in the appendices. These include but are not limited to:

- Three years of principals' tax returns
- Personal financial statement from the bank
- Statistical analyses
- Copy of licenses and other legal documents
- Resumes of all principals
- Copies of letter of intent from suppliers
- Copy of proposed lease or purchase agreement for facility space
- Product/service marketing materials
Review the Business Organization Chart

Introduction

During the preparation of your business plan, you have had to articulate the management structure of your company. Most businesses use a simple organizational chart to depict the relationship between key members of the company.

Definition: Organizational chart

An organizational chart is a formalized illustration of the hierarchy and reporting responsibilities of each employee. The chart is important because it indicates the line of authority and who controls the company. Every position on the organization chart should have a job description with a list of duties and responsibilities, requirements, and compensation.

Sample organization chart

The following is a typical organizational chart for a construction company.

[Diagram of organizational chart]

continued on the next page
Review the Business Organization Chart (continued)

Review the business organization chart

As a consequence of preparing or reviewing your business plan, you have had to establish a clear management strategy. Using the information you gathered and analyzed during the preparation of the business plan, review your company's organizational chart for appropriateness.

Determine if there are areas of weakness in skills and whether outside experience or expertise would strengthen the company. (See next section: Assess the Management Team/Personnel.)
Assess the Management Team/Personnel

Introduction

At some point in your company’s growth, you took on or will take on employees. Being able to assess their skills and weaknesses in terms of their contribution to the company is essential both for your continued success and for the employees' development. It is equally important to understand your own abilities and limitations.

"Just because you own the company doesn’t mean you make the best company president. What are you best at doing?"

Owner qualities

Most business owners share common traits and skills. These qualities tend to foster your success. In general, business owners demonstrate strong

- Leadership skills
- Interpersonal skills
- Dedication to the company and hard work
- Optimism
- Organizational skills
- Business savvy or know-how
- Management ability

Those qualities that you lack or are weak in should not be fatal to the company’s success—if you can compensate.

Evaluate yourself

Understand your own strengths and weaknesses. This allows you to compensate for a weakness by finding management personnel to complement your skills and abilities. You have the option of hiring someone who has strengths in your areas of weakness, finding a partner who complements you, training yourself in weak skills, or any combination of these.

continued on the next page
Assess the Management Team/Personnel (continued)

Assessment categories

The following are some general categories of skills and abilities required by yourself and your management team.

Business
- Oral presentation skills
- Written communication skills
- Computer skills
- Typing/word processing skills
- Office equipment skills (e.g., fax, copier, cell phone)
- Organizational skills
- Time management skills

Administrative
- Ability to schedule
- Ability to process payroll
- Benefits administration skills

Accounting
- Bookkeeping skills
- Ability to track billing, payables, receivables
- Ability to produce financial statements
- Tax preparation skills

Financial management
- Cash flow planning skills
- Monthly financial planning skills
- Ability to manage accounts and investments
- Ability to maintain professional relationships

Personnel management
- Ability to handle personnel issues
- Leadership skills
- Motivation skills

continued on the next page
Assess the Management Team/Personnel (continued)

Assessment categories (continued)

- Marketing
  - Ability to develop marketing strategies
  - Ability to develop annual marketing plans
  - Media planning and purchasing skills
  - Advertisement preparation skills
  - Ability to develop pricing strategies

- Sales
  - Negotiation skills
  - Selling skills
  - Estimating skills
  - Market analysis skills
  - Ability to manage sales personnel
  - Ability to maintain relationships with customers, suppliers, and other professionals
  - Ability to create annual sales plans

- Personal
  - Ability to deal with stress
  - Ability to manage risk
  - Ability to work alone
  - Ability to work with and/or manage others
  - Ability to manage time
  - Ability to deal with failure
  - Ability to balance work and family

continued on the next page
Assess the Management Team/Personnel (continued)

Critical skills

Certain skills must be present in the management personnel you bring on board. Other skills can be developed through on-the-job experience and/or formal training.

These are key skills important for someone to assume a management position.

- People management
- Systems management
- Problem solving
- Decision making

The following skills are desirable and usually can be developed.

- Communication
- Organization
- Time management
- Conflict resolution

Develop current staff or hire new personnel

There comes a time in your growing business when you must decide to close a skill gap by either developing current staff further or hiring in new personnel. According to successful contractors,

"Hire what you must; hire and develop what you would like to have."

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Delegate responsibility and authority

Having management staff with skills and abilities is only part of the picture. You must delegate responsibility and authority in proportion to a person’s skills and abilities.

Some general guidelines for delegating include:

- Delegate what others can do for you to allow you to do what you must do.
- Anything that can be done effectively by someone else should be delegated.
- Delegating helps develop managers and supervisors: This is the domino effect of passing duties and responsibilities to another.
- Remember the value of “staying in the dirt” with the employees to know what is going on.
- Don't delegate so much that the employees feel like you are dumping on them.
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Assess Skill Gaps

Introduction

In much the same manner as you evaluated your management team’s skills and abilities, you will need to assess your employees. You will need to determine if there are skill gaps in your current staff and how to deal with them.

Employment decision guidelines

As your company grows, you are faced with employment decisions. The following are some general guidelines for deciding to hire employees.

- Do I need someone to help me run the business?
- Do I need someone to perform the work?
- Where do I find qualified employees?
- What duties and responsibilities will I assign?
- What skills, experience, and characteristics should employees have?
- What training will I need to provide?
- Do I have a training plan?
- Do I have written policies and procedures?
- What federal and state requirements and regulations will affect my business once I hire employees?

Many of these issues are covered in Modules D Legal Issues and Module E Managing Human Resources.

Assessment tools

There are a number of skill assessment tools available in the industry. Contact your ABC Chapter or the National Office for more information.
Develop a Succession/Business Continuation Plan

Introduction

When you decided on the business organization for your company, you may have put in place a continuity or succession plan. If not, you should do so. This is a vital part of your business strategy—a means of deciding the ultimate fate of the company. It answers the question—What am I working toward?

Definition: Succession/business continuation plan

A succession plan outlines in detail the financial and legal steps to take either upon your (or partners') decision to leave the company or upon your (or partners') death. Premature death or disability is second only to bankruptcy as a leading cause for business failures.

In legally regulated business structures such as partnerships and corporations, the steps are stipulated by law and outlined in a buy/sell agreement. In the case of a sole proprietorship, the survival or dissolution of the company depends entirely on your succession plan/business continuation plan.

Components of a succession/business continuation plan

At a minimum, a succession plan should contain provisions for

- Transfer of power: Control over the business's operation is transferred to those best suited to exercising it
- Transfer of assets: The wealth concentrated in the business is transferred to designated members, who may be a different or larger group than the person or persons who will be assuming power

continued on the next page
Develop a Succession/Business Continuation Plan (continued)

When to plan

The best time to create a succession plan is when you start your business. The plan needs to be redefined periodically as internal and external circumstances change.

Strategic planning can prevent situations where the founder’s/owner’s and the successor(s)’ agendas differ. The two parties need to sit down and define the mission of the business. Differences can be dealt with or managed around when they are identified during planning sessions.

Objectives of planning

In general, there are four key objectives in business continuation planning.

**Preservation of the business**

Business owners usually spend many long hours creating their businesses and bringing them to maturity. Because of that, the business owner has an intense interest in a smooth transition of the business to other capable people. This involves making the transfer as a trauma-free as possible. Without a plan, the business, its employees, customers, and financiers all may be thrown into turmoil.

A plan helps ensure that the business can continue with as little disruption as possible. It is critical that the plan be in place if the survivors are to receive full value of the business if it to be sold or otherwise disposed of in a timely fashion. Such a plan is vital to those whose income is dependent on the continuing profitability of the business. This would include both employees and family members.

**Maximization of business value**

If there is no continuation plan, the business may be subject to various forms of financial scavengers. Any federal estate taxes payable are due within nine months following a partner’s death. If a partner dies, and the major asset at death is a business interest, then the business or its assets may have to be liquidated to pay the tax.
Maximization of business value (continued)
Competitors—who know this rule—may significantly underbid the value of the business or its assets because they know that the business is under the gun to raise cash. This can result in substantial financial loss to the survivors. One alternative may be to take out a loan to pay estate taxes. In essence, the loan transfers the tax liability to the survivors. On the other hand, this financial burden, in addition to normal business concerns, may be too great for the business and its survivors to bear.

Minimization of transfer taxes
Properly structured succession planning can result in a dramatic lessening of estate taxes. The University of Connecticut has surveyed business failures to continue into the next generation. The two most frequent financial reasons given are lack of a transfer plan and lack of a tax and estate plan. The federal estate tax can be as expensive as a flat 55 percent, without any lower tax brackets. As such, the financial burden can be so great as to cause a liquidation of the business. What is most unfortunate in these situations is that there are a number of valid estate planning techniques that can substantially lower federal estate taxes.

Transference of ownership
There are two key transitions that occur in business succession. The first involves the transition of ownership. This often involves family members. Because it involves family, a high emotional component accompanies any ownership changes. Likewise, the departing owner can be involved in an emotionally charged decision. Where there is to be a transfer during the lifetime of the departing owner, the emotion can involve doubts about whether the new owners will continue business profitability at a level sufficient to provide the income on which the departing owner is depending.

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Develop a Succession/Business Continuation Plan (continued)

Objectives of planning
(continued)

Transference of ownership (continued)
Involved with ownership transition decisions are questions of equitable treatment of family members, particularly children of the departing owner. If a decision is made to transfer the business to some, but not all, of the children, then it is often necessary to find a means of equalizing treatment to the non-owner children. All of this can be traumatic. It is of critical importance that all parties know of the succession/business continuation plan. Secret or uncommunicated decisions in this context can prove fatal to successful business continuation. There are ways to do all of this correctly.

The buy-sell agreement
The buy-sell agreement should contain the following essential provisions.

Agreement to buy and sell
Both the buyer(s) and the seller, as well as their heirs, successors, and personal representatives, agree to buy and sell, respectively, all of the interests now owned or later acquired.

Valuation
Valuation is a provision establishing an agreed-on purchase price, with additional provisions for future reevaluation. Alternatively, a formula may be used to establish value at date of death, disability, or retirement.

Life insurance
One needs to set terms for purchasing life insurance to fund the agreement, the requirements to maintain the policy in force, and the treatment of any life or disability policies that the deceased owner maintained on the surviving owners.

continued on the next page
Develop a Succession/Business Continuation Plan (continued)

The buy-sell agreement (continued)

Terms of payment upon death
Establish the duties of the parties to exchange cash proceeds in consideration for a transfer of business interests. Provide for the installment purchase of any uninsured amounts.

Lifetime purchases and restrictions upon sale
Set the terms of purchase for a withdrawing or retiring owner, including any installment sales terms.

Buy-out at disability
Define disability. Set a waiting period to determine if the disability is permanent. Stipulate the terms of payment, including installment sale and collateral agreements for any unpaid balance.

Disability insurance
The parties have a duty to obtain disability insurance and maintain the insurance in force. Establish a provision relating to the disposition of life and disability policies, if any, the disabled owner maintained on the non-disabled owners.

Insurer’s duties
The insurer’s liabilities are limited to performance under the terms of the policies.

Stock notations (for corporations)
Stock certificates shall be endorsed to reflect that the stock is subject to the agreement.

Remedies for failure to perform
Have a statement concerning the consequences of a party failing to perform. This could include a specification of the amount of monetary damages, whether specific performance may be obtained, and if attorney fees may be recovered.

continued on the next page
Develop a Succession/Business Continuation Plan (continued)

The buy-sell agreement
(continued)

Amendment or alteration
Have a provision permitting an amendment to the agreement in writing at any time.

Governing law
Specify which state’s law will govern the agreement.

Termination
Set the conditions under which the agreement will automatically terminate.

Execution and witnesses
Meet the legal requirements for signatures.

Schedules
Attach a schedule of annual business valuation revisions, life and disability insurance policies, etc.

Problems created by the death of a key person

The following are five problems created by the death of a key person.

Credit can be seriously threatened or greatly impaired
Every successful business person fully appreciates the importance of credit. Credit is the lifeblood of business. Companies whose physical assets are meager or whose credit is dependent on the reputation, energy, and ability of one person, would suffer a tremendous shock following the untimely death of such an individual.

continued on the next page
Develop a Succession/Business Continuation Plan (continued)

Problems created by the death of a key person (continued)

Credit (continued)
Creditors, concerned about the future, would press for payment; banks would curtail credit and await developments; debtors would delay payment of their obligations. As a result, many firms would be forced into dissolution or receivership.

Efficient operation is disturbed, with consequent heavy monetary losses
A sudden change, such as death of one of a company’s principal officers, can disturb efficient operation. This is true under ordinary circumstances, but especially so if the loss comes during a campaign of expansion or opening up new territory, experiments in the production department, or any one of a thousand things that require the special attention of a key person to bring them to a successful conclusion. And, if the death of the key person in charge of such an operation occurs at a particularly sensitive time, the whole enterprise may be thrown out of gear. Delay will result. New people must be found or the head of another department must accept an additional burden. It might even be necessary to abandon the project entirely, with the loss of funds invested to-date.

Business-getting ability is diminished
Business can slow down as a result of the credit problems, and the jolt can throw the entire business mechanism out of gear, at least for a time.

If, for example, the marketing director should die, the entire sales organization might be demoralized and some of the best salespeople might leave. Other employees could then grow restless; competitors might increase activity; the efficiency of the whole organization could be impaired, and soon the production loss could amount to a substantial figure.

continued on the next page
Develop a Succession/Business Continuation Plan (continued)

Problems created by the death of a key person (continued)

**Dividend earnings may be reduced**

If the credit of a firm has been weakened and the efficiency of its operations disturbed, its earning power, as reflected in dividends, will suffer. Many firms have found it necessary to defer dividends entirely for several years to recover from the shock that resulted from the death of a key individual.

**A new person must be found as a replacement**

The sudden death of an executive head, a technical expert in production techniques, an experienced and efficient buyer, or a marketing director under whose guiding hand the business has grown leaves a serious vacancy. It may not always be possible to replace the person from within the company. Even if an understudy has been in training, he or she may not be ready to take over. In the case of small companies, there may not be an understudy at all.

In a majority of companies, each employee is pressed to the limit of his or her time and may not be in a position to take over a new department and operate it efficiently. Under the circumstances, it would be necessary to go outside of the business to find a successor. This means delay, reduced efficiency, and possible change of policy—any of which can involve a serious financial loss.

This is especially true when there is a shortage of really able people to fill executive positions. The price tag on a qualified successor goes up under these circumstances and can add to the financial loss. In this kind of executive market, corporations frequently find they have to offer the person they want 30 to 40 percent more than he or she is presently making, plus other enticements, to lure the executive away from a competitor.

**Key employee valuation**

Use the chart on the next page to assign value to key employees.

*continued on the next page*
### Key Employee Valuation

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<td>First Name</td>
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<td>Age / Ownership</td>
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<td>%</td>
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<tr>
<td>Buy/Sell Life Insurance In-Force</td>
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<tr>
<td>Buy/Sell Disability Insurance In-Force</td>
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<td>Years To Protect</td>
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<tr>
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### Replacement Cost

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<td>Business Overhead Expense Coverage In-Force</td>
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Reassess Site/Facilities

Introduction

Outgrowing a facility is an issue that can be resolved through careful planning. Reevaluate the suitability of your physical work environment in terms of operational efficiency, company image, overhead costs, and expansion possibilities.

Facility criteria

Your business facility should contribute to your overall profitability, not detract from it. A business facility should

- Support operational efficiency
- Create a positive company image
- Allow for business expansion
- Be economical

If you are currently in business, think about which aspects of your present facility you are satisfied with and how you would improve upon those aspects that are unsatisfactory. Rely on your experience running your business in the present facility. Ask your management staff and employees to review your proposed solutions.

Operational efficiency

Evaluate your present or proposed site in relation to an efficiently operating business. Does the facility

- Provide adequate space for all of your operating processes?
- Permit changes to interior layout?
- Have storage, loading dock, and waste facilities, if needed?
- Provide convenient access for suppliers and employees?
- Have supporting or beneficial business neighbors?
- Have any environmental problems?
- Provide satisfactory security for employees, equipment, and materials?
- Qualify for affordable insurance protection?

continued on the next page
Reassess Site/Facilities (continued)

Company image

Everything connected with your business should reinforce a positive, professional, and quality-oriented image. This is true for everything from your business cards to company headquarters. Your business facility can make a powerful statement about your company.

Who will see the facility? If customers don’t come to your facility, then appearance will be less important. But this doesn’t mean that you can totally ignore the issue. Even if only your employees and suppliers will see your facility, it should be clean and well-maintained, and should serve as an efficient tool of your business. With a dilapidated or dirty facility, you risk having suppliers and employees wonder about your company’s long-term survival.

Future expansion

Should you pay more now for additional space that would be useful only if the business expands? Experienced contractors suggest a conservative approach. Many business advisors suggest that a new or expanding businesses keep a tight rein on costs. Include a larger or expanded facility in your business plan, but delay actually renting or buying the additional space until business activity and profits justify taking on the added expense.

Economical

Your business may be at a disadvantage if you are not able to negotiate a favorable purchase price or rental fee. The misspent facility dollars will be a drag on your company’s profitability. The dollars spent on your facility will be diverted from other needed expenses. Also, overspending on the facility will make your company’s profit and loss statement less attractive. A mediocre profit and loss statement can make it more difficult for the company to approach lenders for money.

continued on the next page
Reassess Site/Facilities (continued)

Lease versus buy

When evaluating a decision to lease or buy property or a facility, consider

- Short-term and long-term cash flow implications
- Possible tax implications
- Your desire to stay in this location indefinitely
- The importance of mobility

Lease

A lease may be better than a purchase from a cash flow perspective. Up-front costs associated with a lease are usually limited to your security deposit, plus first rent payment.

Consider the following factors when leasing:

- Maintenance: Many leases place the duty of maintaining the property on the landlord.
- Mobility: Question whether the facility that you will select now will serve your needs several years in the future.
- Credit: If your business is new or has experienced some financial difficulties, lenders may not be willing to extend it sufficient credit for a mortgage on the facility.
- Real estate values: Consider whether the real estate values in the area are stagnant or may actually drop in value.
- Tax savings: Rent is deductible as a business expense; a lease is likely to cut your near-term tax bill when compared with a purchase.

continued on the next page
Reassess Site/Facilities (continued)

**Buy**

With a purchase, you must have the lump-sum purchase price, or at least a down payment on a mortgage. A purchase, however, is usually less than the accumulated lease payments.

Consider the following factors when buying.

- Property control: Owning the property allows you to make any physical changes you need to improve operational efficiency.
- Stability: Rising rents or loss of lease will not affect your company when you own the property.
- Real estate values: Land values may rise and the property become more valuable in the future.
- Tax savings: Property can be depreciated on tax returns; interest payments on a mortgage are also tax deductible.

**Insurance protection for your facility**

You will have to maintain insurance coverage whether you lease or buy a facility. The rates are determined, in large measure, on actuary tables based on your location, type of business, hours of operations, etc., and may be out of your control. Factors that may influence your premiums that are under your control when choosing a possible site include

- Accessibility to police and fire departments
- Fire protection features in the facility
- Security lighting and fencing
- Age of building, mechanical, and electrical systems

*continued on the next page*
Reassess Site/Facilities *(continued)*

Site location considerations

Consider the following factors when selecting a site.

- Zoning ordinances
- Building permits
- Covenants
- Topographical maps
- Soil boring reports
- Flood-prone area maps
- Permits to connect to
  - Private drives
  - City streets
  - County roads
  - State highways
  - Interstate highways
- Permits to discharge waste
- Pollution abatement system
- National Pollutant Discharge Elimination System (NPDES)
- New potable water supplies
- Municipal water supplies
- Permits to dredge and fill
Review IT Systems

Introduction

A computer system requires having someone who knows how to use it properly to get full advantage from its capital expense. Part of reviewing your IT systems is knowing who is going to use the computer(s) and which tasks the computers will accomplish.

Definition: IT system

An IT system is the integrated set of hardware and software programs that helps you manage your business.

Computer-based tasks

Before buying a computer system, evaluate how much of your business process could benefit from the introduction of technology. Which business tasks could be better accomplished using a computer (and someone who knows how to use it)? Computers help with labor-intensive, repetitive, and creative tasks. For example,

- Bookkeeping
- Accounting
- Payroll
- Invoicing
- Estimating
- Benefits management
- Record keeping
- Correspondence
- Working drawings (CAD)
- Advertising and promotional materials

continued on the next page
Review IT Systems (continued)

Software

Understand the options and limitations of software. Although software programs surely make many tasks easier and faster, they depend entirely on the quality of information entered into the system.

A basic list of software for any size company includes

- Word processing program: for producing correspondence, contracts, change orders, and all manner of paper-based communications
- Spreadsheet program: for creating budgets, business plans, financial statements, and any report using mathematical calculations
- Database management program: for maintaining records, organizing data, and tracking customers, suppliers, and inventory
- Accounting and bookkeeping programs: for managing finances with specialized construction industry-oriented programs
- Desktop publishing programs: for designing and producing advertisements and promotional materials, professional looking reports, and newsletters
- CAD programs: for producing construction drawings, details, elevations, and maps

Software recommendations

Ask your colleagues and chapter members for recommendations. Find out what works and what doesn’t before you buy it.

continued on the next page
Review IT Systems (continued)

Hardware

Most computer retailers have expert advisors available to help you make choices. The direct sellers of computer systems also provide extensive assistance in configuring a system that meets your current and future needs.

A basic computer system is likely to include the following components.

- Central processing unit (CPU): The brain of the system
- Monitor: A television-like screen where the information is displayed
- Keyboard: An input device with keys similar to a typewriter
- Printer: An output device with a broad range of options for quality of print, color, and size
- Hard drive: The CPU’s internal storage device where the software programs are loaded and kept
- Disk drive: Device that enables the computer to read and write information to storage units called disks
- CD-ROM drive: Device that reads (and writes) information to high-capacity CDs. Most software is now packaged on CDs; therefore, consider this essential in even a basic system
- Tape drive: Usually only used by companies that keep large quantities of data backed up (stored and safeguarded)
- Modem: Device that allows the computer to communicate over telephone lines; most are built-in to the CPU
- Fax/modem: A device that combines a facsimile machine with a modem to allow you to send faxes directly from the computer without printing onto paper first
- Scanner: An input device used to capture information from existing documents, photographs, and drawings and to convert the information into a digital computer file

Hardware recommendations

Ask your colleagues and chapter members for recommendations. Find out which systems are easiest and most user-friendly.

continued on the next page
Review IT Systems (continued)

Protect your investment

As with any asset, your computer system should be insured. Computers must also be protected from everyday accidents, natural disasters, and from

- Dust
- Spills
- Drops, bangs, and bumps
- Electrical surges
- Lightening
- Computer viruses

Protect against data loss by establishing procedures for backing up key data on a regular basis. If you have proprietary or business-sensitive information on the system, you may institute a password protection system to restrict access to some areas.

Company website

It will pay to have your company on the World Wide Web. It lends an air of sophistication and technological awareness to potential customers. Have your web site professionally created and maintained.
Review Forms and File/Information Retrieval System

Introduction

The world of business is the world of information. You have to be able to access information constantly to get your work done. How you organize and safeguard your information will affect the ultimate success of your company.

Types of information

Nowadays, when someone says information, we think of computers. Although it is true that most information is being converted and stored on computers worldwide, most of your daily business information is still kept in files and folders in your office. This includes:

- Real estate documents (e.g., deeds, leases, mortgages, loans, insurance policies)
- Purchase records (e.g., equipment, materials, supplier receipts)
- Tax returns
- Financial statements and reports
- Business plans
- Personnel records
- Contracts
- Certificates, licenses, registrations
- Organizational records (e.g., corporate bylaws, partnership agreements, buy/sell agreements)
- Marketing and sales materials
- Business forms (e.g., change orders, purchase orders, invoices)
- Training records
- Customer correspondence
- Catalogs, price lists, reference materials
- Blueprints

continued on the next page
Review Forms and File/Information Retrieval System (continued)

Information gathering tools

First and foremost, when evaluating your information retrieval system, is determining whether you will be gathering all of the information you need in the first place. This is especially true for information destined to be entered on the computer. “Garbage in—garbage out” is a common computer user’s adage. If you haven’t gathered the correct information at the start, no computer system will improve it simply by printing it out into a report format.

Review your standard forms. Are they complete and thorough? Do you find yourself having to go back for more answers? Are there always notes written in the margins? How can your information gathering process be improved?

Information filing tools

In this age of technology, many people overlook the value of an old fashioned, well-designed filing system. Shopping at one of the office superstores is enough to make you realize the infinite possibilities for setting up and using a paper-based file system.

The key to using either a file folder system or converting information into computer files is organization. Develop a set of procedures for filing manually or electronically and then stick to it.

Definition: Integrated systems

An integrated system is a file/information retrieval system that links information in different locations to streamline reporting and analysis tasks. In computer systems, the integrated systems may link the database with the word processing and spreadsheet functions, estimating, budgeting, and accounting programs.
Manage/Control Growth

Introduction

Growth must be part of your five-year plan and integrated into the business plan. A business that plans on growth will achieve greater success.

Strategies for controlled growth

Review the following strategies for controlled growth offered by successful contractors.

- Know the critical number for supervision—maximum number of people reporting to a supervisor, maximum number of people reporting to a field foreman—for effective control
- Recognize the balance between sales, operational activities, and financial ability
- Understand your return-on-investment for each planned growth opportunity
- Measure capital outlay through each planned growth opportunity
- Evaluate advantages and disadvantages
- Have a reason for growth

What doesn’t work

A vehicle at 90 mph with no brakes. A company that has a huge sales effort without supporting operational ability.

Planning growth based on your gut feeling without the careful review of your company financials.
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Balance Volume Against Profitability

Introduction

Bigger is not necessarily better. Volume added in ever-increasing amounts does not lead to a more profitable business. Focusing on price structure and profit margin is a more profitable and productive business strategy.

Factors that contribute to profitability

Lower volume can result in a variety of factors that influence profitability, including

- More intensive management applied to each project
- Elimination of marginal employees
- Focus on types of work in the company’s areas of strength
- Enhanced productivity
- More efficient application of resources
- More work with long-time customers
- Lower overhead expenses
- Less time spent managing cash flow
- Less demand for fixed asset purchases

Volume and profitability

Dr. Emol Fails (FMI) has worked since 1953 to have contractors understand the concept of doing less volume for more profit. He showed how the profitability of a construction company often increases during a year when volume decreases. The survival of a company is based on its ability to establish an equity base that can endure inevitable financial reverses. This requires a focus on profit margin rather than volume. It means that you need to increase billings while lowering your costs.

When “big” is big enough

“Big” is big enough when you can’t sleep at night.
Select Projects Carefully

Introduction

"I should never have taken this job!" Sound familiar? When is it better to walk away from a prospective job? How much trouble is too much trouble?

Warning signs

When should you turn your back and walk away? Consider some of the following warning signs.

- Complicated contract terms
- Unreasonableness concerning price and change order process
- Broad or vague contracts, incomplete specifications or drawings
- Owner safety requirements
- Requirements for dual signature on checks
- Contracts with liquidated damages, paid-if-paid, paid-when-paid, hold harmless, pollution/hazardous condition clauses
- Requirements for substantially increased liability insurance

Potential problems

The following are examples of what can go wrong when you are caught in an unsatisfactory job arrangement.

- Financial losses
- Damaged reputation
- Legal liabilities

Job acceptance criteria

Consider the following criteria when deciding whether or not to accept or bid on a job.

- Meets your company’s operational abilities
- Meets your company’s design abilities
- Meets your company’s financial abilities

continued on the next page
# Select Projects Carefully (continued)

## Example Project Selection Guide

### HIGHWAY PROJECTS

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<th>Selection Criteria for Project</th>
<th>Rating</th>
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<th>Score</th>
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<tr>
<td>2. Availability of partner, captive subcontractor</td>
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<td>6. Number of bidders</td>
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<td>7. Knowledge of site/area</td>
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<td>8. Unique competitive advantage</td>
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### Selection Criteria for Customer

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<td>2. Expediency of decisions</td>
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<td></td>
<td></td>
<td><strong>0.9</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>5.7</strong></td>
</tr>
</tbody>
</table>

### Project Selection Scoring

- Project Score: 12.3
- Maximum Score: 21.0
- % of Maximum: 59%

### Customer Selection Scoring

- Customer Score: 5.7
- Maximum Score: 10.0
- % of Maximum: 57%

### Evaluation Summary

<table>
<thead>
<tr>
<th></th>
<th>% of Maximum</th>
<th>Weight</th>
<th>Weighted Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Evaluation</td>
<td>59%</td>
<td>80%</td>
<td>46.9%</td>
</tr>
<tr>
<td>Customer Evaluation</td>
<td>57%</td>
<td>20%</td>
<td>11.4%</td>
</tr>
</tbody>
</table>

**Total**

|                     |               |        | 58.3%               |
Job Selection Analysis

This tool can be used to evaluate the true return on investment of a job or jobs. It takes into consideration the length of the job, the time it is estimated to get paid on the job, the accounts payable commitment (in days), etc.

Use of this tool is at user’s risk. FMI assumes no responsibility for its accuracy, completeness, correctness, or usefulness.

<table>
<thead>
<tr>
<th>Instructions</th>
<th>Job 1</th>
<th>Job 2</th>
<th>Job 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract or bid amount of job</td>
<td>$ 48,435</td>
<td>$ 52,340</td>
<td>$ 39,380</td>
</tr>
<tr>
<td>Costs:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Material</td>
<td>$ 22,800</td>
<td>$ 28,900</td>
<td>$ 22,500</td>
</tr>
<tr>
<td>Labor</td>
<td>$ 18,600</td>
<td>$ 16,100</td>
<td>$ 11,400</td>
</tr>
<tr>
<td>Overhead on materials</td>
<td>$ 1,824</td>
<td>$ 2,312</td>
<td>$ 1,800</td>
</tr>
<tr>
<td>Overhead on labor</td>
<td>$ 2,790</td>
<td>$ 2,415</td>
<td>$ 1,710</td>
</tr>
<tr>
<td>Total Costs</td>
<td>$ 46,014</td>
<td>$ 49,727</td>
<td>$ 37,410</td>
</tr>
<tr>
<td>Profit expected in dollars</td>
<td>$ 2,421</td>
<td>$ 2,613</td>
<td>$ 1,970</td>
</tr>
<tr>
<td>Profit expected as a percent of contract</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Length of job (in months) | 3 | 4 | 2
Expected lag in receipt of funds after billing customer (in months) | 3 | 1 | 2
Supplier (for material) credit terms (in months) | 1 | 1 | 2
Current working capital (in dollars) | $ 30,000

2. Click on "Analysis" folder and see the analysis
### Select Projects Carefully (continued)

#### Job Selection Analysis

<table>
<thead>
<tr>
<th></th>
<th>Job 1</th>
<th>Job 2</th>
<th>Job 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length of job (in days)</td>
<td>90</td>
<td>120</td>
<td>60</td>
</tr>
<tr>
<td>Length of receivables commitment (in days)</td>
<td>90</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>Length of payables (in days)</td>
<td>30</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>Net material cost days</td>
<td>60</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net labor cost days</td>
<td>90</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>Net investment rate per day</td>
<td>$511.27</td>
<td>$414.39</td>
<td>$623.50</td>
</tr>
<tr>
<td>Material costs per day</td>
<td>$273.60</td>
<td>$260.10</td>
<td>$405.00</td>
</tr>
<tr>
<td>Labor costs per day</td>
<td>$237.67</td>
<td>$154.29</td>
<td>$218.50</td>
</tr>
</tbody>
</table>

#### Investment in Each Job

<table>
<thead>
<tr>
<th></th>
<th>Job 1</th>
<th>Job 2</th>
<th>Job 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total investment in material</td>
<td>$16,416.00</td>
<td>$-</td>
<td>$-</td>
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<tr>
<td>Total investment in labor</td>
<td>$21,390.00</td>
<td>$4,628.75</td>
<td>$13,110.00</td>
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<tr>
<td>Total working capital investment</td>
<td>$37,806.00</td>
<td>$4,628.75</td>
<td>$13,110.00</td>
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<tr>
<td>Profit generated</td>
<td>$2,421.00</td>
<td>$2,613.00</td>
<td>$1,970.00</td>
</tr>
<tr>
<td>Job payback period (in days)</td>
<td>180</td>
<td>150</td>
<td>120</td>
</tr>
<tr>
<td>Return on investment (annual)</td>
<td>12.81%</td>
<td>135.48%</td>
<td>45.08%</td>
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<tr>
<td>Working capital situation assessment</td>
<td>EXCEEDED</td>
<td>OKAY</td>
<td>OKAY</td>
</tr>
</tbody>
</table>
Minimize Risk

Introduction

There are two categories of risk that you must protect against. The first risk category concerns people, equipment, and materials.

The second category concerns financial risks (see next Module A Section).

Types of insurance coverage

Insurance policies are designed to minimize risk. Typical types of insurance coverages in the construction industry include

- Property
- Casualty
- Life
- Miscellaneous benefits
- Surety and bonding (see Module B, Select an Insurance/Bonding Agent)
Ensure Adequate Time is Spent on Management

Introduction
During the preparation (revision) of your business plan, you came face to face with the enormous amount of time it takes to plan and manage your business. Once the plans are set and the company is rolling along, many owners forget to spend adequate time managing the business because of the efforts of meeting production and delivery deadlines. This can be fatal.

Role of organization in managing
Organization should be the underpinning of any successful business. It’s all in the percentages. The average company runs at 3 to 5 percent net profit. Managing allows you to control factors that will erode that net profit.

Make time
Use the following strategies to allow yourself enough time to manage the business while you are busy making money.

- Ensure that you have systems that work
- Ensure that you have people who run the systems efficiently and effectively

Where your time goes
Keep track of where your time goes during the course of a business week. You can analyze the results to see if you are spending enough time managing or too much time working the business. Use a chart to see where you spend your time during a typical week.

continued on the next page
Ensure Adequate Time is Spent on Management (continued)

Time management

Because you cannot possibly do everything, concentrate on doing the important stuff. There are many courses and books available on time management skills. Take the time to improve your skills.

Resources

The following are some books that successful contractors have found helpful.

- How to Win Friends and Influence People by Dale Carnegie
- The Magic of Thinking Big by David J. Schwartz, PhD
- Built to Last by James Collins
- Raving Fans by Ken Blanchard
- The Great Game of Business by Jack Stack
- 7 Habits of Highly Effective People by Steven Covey
Financial

Overview

Introduction

This third section of Module A covers basic business financial processes. The four business activities and their corresponding tasks covered are outlined below.

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<td>Components of the operating budget</td>
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<td>Construction revenue estimate</td>
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<td>Direct cost estimate</td>
<td></td>
</tr>
<tr>
<td>Indirect costs and G&amp;A estimate</td>
<td></td>
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<td>Owner's required ROI estimate</td>
<td></td>
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<td>A–165</td>
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<td>Responsibility for cash management</td>
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<td>Assign responsibility and authority</td>
<td>A–166</td>
</tr>
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<td>The project manager’s involvement in the process</td>
<td>A–167</td>
</tr>
<tr>
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<td>A–168</td>
</tr>
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<td>A–168</td>
</tr>
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<td>A–170</td>
</tr>
<tr>
<td>Types of short-term financing</td>
<td>A–170</td>
</tr>
<tr>
<td>Lines of credit</td>
<td>A–170</td>
</tr>
<tr>
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<td>A–171</td>
</tr>
<tr>
<td>Receivable financing and factoring</td>
<td>A–171</td>
</tr>
<tr>
<td>Asset-based lending</td>
<td>A–171</td>
</tr>
<tr>
<td>Sources of financing</td>
<td>A–172</td>
</tr>
</tbody>
</table>
Develop a Financial Plan and Budget

Introduction

Successful construction companies recognize that the future can be greatly influenced by a planning process that sets specific objectives, strategies, and tactics. A key component of the planning process is an operations budget and forecast. A budgeting process helps minimize reactive management and lays the groundwork for creating opportunities for the controller to guide the company during the year. If an emerging contractor wants to be successful, he or she should be certain to prepare and monitor a budget throughout the year.

Definition: budget

A budget is a financial plan used as a key management tool to forecast where you expect to spend money and what your expected revenues will be. It is a fluid document that must be reviewed periodically to determine its appropriateness. Changes can be made to the budget during the course of a business year.

Operating budget

Profitable contractors plan for the future by setting objectives and taking action to meet those objectives. A key component of the planning processes is the operating budget, which is simply a numerical plan of operation. It identifies the anticipated billings, cost, gross profit, and overhead of the company during a defined period. The budget provides the opportunity to compare planned progress against actual progress.

Without a reliable budget, decisions are based purely on historical facts and gut feelings of management. The controller’s objective is to prevent decisions from being made based solely on hunches.

continued on the next page
Develop a Financial Plan and Budget (continued)

Components of the operating budget

The contractor’s operating budget can be broken down into the following major components.

- Construction revenue
- Direct construction costs
- Indirect costs
- General and administrative expenses
- Owner’s required return on investment (ROI)

Construction revenue estimate

The annual projection of revenue begins with the work in backlog, which often represents only a small portion of the revenue that will be earned in the next year. Estimates of forecasted revenue must be made using knowledge of projects available for bid, prior reserves, and estimates of volume of new work anticipated.

Direct cost estimate

Estimates of direct cost will correspond with the anticipated revenues for new work but should include budgeted cost for individual jobs. Gross profit contracts should be reviewed to ensure the contractor could achieve the project margins. Consider the current work on hand and anticipated volume and type of contract work. Obviously, in determining the budgeted revenue, consider any internal restrictions the company has and the external limitations that cannot be controlled by the company.

Internal restrictions

Internal limitations can include working capital, bonding capacity, management capabilities, and equipment availability.

continued on the next page
Develop a Financial Plan and Budget (continued)

Direct cost estimate (continued)

External limitations
External limitations include market forecasts, financing availability, and labor availability.

Indirect costs and G&A estimate

Indirect costs and general and administrative expenses need to be estimated using high-level goals for specific budgeted activities such as
- Estimating
- Project management
- Insurance
- General and administrative expenses

The indirect cost estimates should cover the forecasted volume of construction activity and include other activities and services necessary to achieve desired progress toward strategic goals and objectives.

Owner's required ROI estimate

The required return on investment is the desired return through the company’s earned profits divided by the owner’s investments. This measure should consider the risk inherent in the construction business. Factors determining this risk include the following:
- Market activity/availability of construction work
- Type of construction work performed by the company
- Amount of debt maintained by the company
- Operation risk associated with construction
- Owner’s assets invested in the construction operation

continued on the next page
Develop a Financial Plan and Budget (continued)

Organization

It is important that the budgeting process be organized. Determine what information you need and who will prepare it. Outline the steps that are needed within your construction company and assign a timetable to those steps. Allow time for budget review and revisions.

Key employee involvement

Be certain to involve key employees in the budgetary process. Seek the opinions of department heads and other key personnel to help prepare the most meaningful budget possible for the company.

To generate an achievable budget and to identify how you can make the company more profitable, you may need to complete a number of different versions of the budget and have a number of review sessions.

Prepare a monthly budget

Annual budgets should be broken down further to monthly budgets. These monthly budgets should be compared to and monitored along with the actual results for the month.

Work the budget

As soon as the final budget is adopted, begin any changes that you plan to make and initiate all other efforts needed to accomplish the budget. Keep in mind that the budget is nothing more than a financial statement of what you plan to do. It can be accurate only if your efforts are focused on making it a reality. The controller must be certain the final product is a reality. He or she must take steps to monitor the budget in detail throughout the year. Otherwise, it will be of little value.

continued on the next page
Develop a Financial Plan and Budget (continued)

Work the budget (continued)

Monthly financial statements are essential. Every month you should compare your progress with where you planned to be at that point. Determine how unfavorable variances can be corrected.

Evaluate performance

Use the budget as a means of evaluating your performance. Make decisions on the basis of the effect they will have on the operations of the company as compared to budget. Work to meet your anticipated growth but continue to monitor cost. By using and monitoring this key management tool, a controller can significantly influence the decisions of executive management and enhance the success of your company.

Sample monthly statement with budget comparison

The sample on the next page reflects a report that can be used first to develop the budget and then to monitor the budget throughout the year to identify variances. This summarized format focuses on the detail of operating expenses. The detail summary/variances related to contract gross profit would be monitored at the contract schedule level.

Resources for help with the budget process

Key resources that will help you plan and carry out a budget include:

- www.toolkit.cch.com
- www.venplan.com/outline.htm
- www.sbaonline.sba.gov/starting/indexbusplans.html
- www.smallbusinesspoint.com
### Budgeting

**Sample Monthly Statement with Budget Comparison**

<table>
<thead>
<tr>
<th></th>
<th>Budget Amount</th>
<th>% of Revenue</th>
<th>Actual Amount</th>
<th>% of Revenue</th>
<th>Variance Amount</th>
<th>% of Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$2,675,700</td>
<td>100.00</td>
<td>$2,737,000</td>
<td>100.00</td>
<td>$61,300</td>
<td>100.00</td>
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<tr>
<td>Direct Cost</td>
<td>2,022,850</td>
<td>75.60</td>
<td>2,076,250</td>
<td>75.86</td>
<td>53,400</td>
<td>87.11</td>
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<tr>
<td>GROSS PROFIT</td>
<td>652,850</td>
<td>24.40</td>
<td>660,750</td>
<td>24.14</td>
<td>7,900</td>
<td>12.89</td>
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<td><strong>G&amp;A Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>Advertising</td>
<td>9,600</td>
<td>.36</td>
<td>9,300</td>
<td>.34</td>
<td>(300)</td>
<td>(.49)</td>
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<tr>
<td>Auto and Truck Expenses</td>
<td>19,500</td>
<td>.73</td>
<td>18,700</td>
<td>.68</td>
<td>(800)</td>
<td>(1.31)</td>
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<td>3,100</td>
<td>.11</td>
<td>400</td>
<td>.65</td>
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<td>Communications</td>
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<td>.26</td>
<td>6,400</td>
<td>.24</td>
<td>(500)</td>
<td>(.82)</td>
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<td>.05</td>
<td>(100)</td>
<td>(.16)</td>
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<td>Office Expenses</td>
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<td>.15</td>
<td>3,800</td>
<td>.14</td>
<td>(200)</td>
<td>(.32)</td>
</tr>
<tr>
<td>Taxes</td>
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<td>.23</td>
<td>6,400</td>
<td>.24</td>
<td>300</td>
<td>.49</td>
</tr>
<tr>
<td>Travel and Entertainment</td>
<td>6,400</td>
<td>.24</td>
<td>6,200</td>
<td>.23</td>
<td>(200)</td>
<td>(.32)</td>
</tr>
<tr>
<td>Labor</td>
<td>17,400</td>
<td>.65</td>
<td>18,200</td>
<td>.65</td>
<td>800</td>
<td>1.31</td>
</tr>
<tr>
<td>Small Tools</td>
<td>8,800</td>
<td>.33</td>
<td>9,000</td>
<td>.33</td>
<td>200</td>
<td>.32</td>
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<tr>
<td>Warranty Costs</td>
<td>5,900</td>
<td>.21</td>
<td>5,300</td>
<td>.19</td>
<td>(600)</td>
<td>(.98)</td>
</tr>
<tr>
<td><strong>Total Variable Overhead</strong></td>
<td>102,500</td>
<td>3.83</td>
<td>101,900</td>
<td>3.72</td>
<td>(600)</td>
<td>(.98)</td>
</tr>
<tr>
<td><strong>Fixed Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Contributions</td>
<td>1,350</td>
<td>.05</td>
<td>1,100</td>
<td>.04</td>
<td>(250)</td>
<td>(.41)</td>
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<tr>
<td>Depreciation</td>
<td>27,300</td>
<td>1.02</td>
<td>30,000</td>
<td>1.10</td>
<td>2,700</td>
<td>4.40</td>
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<tr>
<td>Dues and Subscriptions</td>
<td>2,400</td>
<td>.09</td>
<td>2,200</td>
<td>.08</td>
<td>(200)</td>
<td>(.32)</td>
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<tr>
<td>Insurance</td>
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<td>32,000</td>
<td>1.17</td>
<td>(2,000)</td>
<td>(3.26)</td>
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<td>Legal and Audit</td>
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<td>500</td>
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<tr>
<td>Payroll Taxes (Office Only)</td>
<td>16,050</td>
<td>.60</td>
<td>17,850</td>
<td>.65</td>
<td>1,800</td>
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<td>Rent</td>
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<td>21,000</td>
<td>.77</td>
<td>950</td>
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<td>Repairs and Maintenance</td>
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<td>3,750</td>
<td>.14</td>
<td>(800)</td>
<td>(1.31)</td>
</tr>
<tr>
<td>Salaries - Officers</td>
<td>99,000</td>
<td>3.70</td>
<td>108,000</td>
<td>3.73</td>
<td>3,000</td>
<td>4.89</td>
</tr>
<tr>
<td>Salaries - Office</td>
<td>34,800</td>
<td>1.30</td>
<td>36,200</td>
<td>1.32</td>
<td>1,400</td>
<td>2.28</td>
</tr>
<tr>
<td>Salaries - Other</td>
<td>143,950</td>
<td>5.38</td>
<td>149,250</td>
<td>5.45</td>
<td>5,300</td>
<td>8.65</td>
</tr>
<tr>
<td>Shop Supplies and Tools</td>
<td>14,450</td>
<td>.54</td>
<td>9,250</td>
<td>.34</td>
<td>(5,200)</td>
<td>(8.48)</td>
</tr>
<tr>
<td>Utilities</td>
<td>7,950</td>
<td>.30</td>
<td>8,700</td>
<td>.32</td>
<td>750</td>
<td>1.22</td>
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<tr>
<td><strong>Total Fixed Overhead</strong></td>
<td>412,550</td>
<td>15.42</td>
<td>420,500</td>
<td>15.37</td>
<td>7,950</td>
<td>12.97</td>
</tr>
<tr>
<td><strong>NET PROFIT BEFORE TAX</strong></td>
<td>$137,800</td>
<td>5.15</td>
<td>$138,350</td>
<td>5.05</td>
<td>(550)</td>
<td>.90</td>
</tr>
</tbody>
</table>
Review a System for Financial Record Keeping

Introduction
Keeping accurate and up-to-date records is essential. You use your financial records to make sound business decisions and to request funding from lending institutions. Accurate financial records help answer important questions about your operations. Is your company making money, or losing it? How much? Is your company on sound financial ground, or are troubles heading your way?

Definition: Bookkeeping
Bookkeeping is the recording and maintaining of financial records pertaining to the day-to-day operations of a company.

It involves tracking income, daily recording of transactions, maintenance of a general ledger, and maintenance of your cash records. There are some other records you may need to maintain, depending on your business, such as accounts receivable ledgers and accounts payable ledgers.

Importance of bookkeeping
One of your most valuable business tools is financial analysis based on your financial records. A sound bookkeeping system is the foundation on which all of this valuable financial information can be built.

Definition: accounting
Accounting is the method by which financial information is gathered, processed, and summarized into financial statements and reports.

continued on the next page
Review a System for Financial Record Keeping (continued)

Importance of accounting
You must have accurate and timely reports of your business operations. An accountant will help you prepare the required financial statements. These statements allow you to

- Identify unfavorable trends in your business operations
- Monitor your cash flow
- Monitor important financial indicators (e.g., break-even analysis, liquidity ratios, profitability ratios, solvency ratios)
- Monitor equity periodically
- Monitor performance compared to your plans

Types of records
At a minimum, your company’s system for financial records must include:

- Payroll (including benefits)
- Taxes
- Sales
- Inventory
- Cash flow

Types of financial statements
The following are typical financial statements.

Profit and Loss Statement
The profit and loss statement (also known as the income statement) shows the income earned during the accounting period, the expenses incurred by the business in the accounting period, and the difference between those two figures—net profit or loss—during the period.

Balance Sheet
The balance sheet is a statement of a company’s relative financial position at a specific point in time (e.g., as of March 31, 2000). It shows assets, liabilities, and owner’s equity.

continued on the next page
Review a System for Financial Record Keeping (continued)

Types of financial statements (continued)

**Position Statement**
The position statement (also known as Sources and Uses of Cash) indicates how a company made its money and how the money was spent.

**Statement of Changes in Owners' Equity**
This statement compares owners' equity at the beginning of the period and the amount of owners' equity at the end of the period.

**Cash-Flow Statement**
The cash flow indicates how business operations have affected its cash position and helps determine whether enough cash is being generated to pay for additional expenses. This report is similar to the Profit and Loss Statement but handles depreciation very differently.

**Break-even Analysis**
The breakeven point for a business is the determination of the total dollars that must be generated before the company covers all operating costs (i.e., breaks even). The three factors contributing to the breakeven analysis are fixed costs, variable costs, and selling price of products or services. This is expressed as a formula: Breakeven point (BEP) = (Fixed costs) / (Selling price – Variable costs).
Monitor Financial Results

Introduction

Monitoring results is a positive management technique used not only to identify problems or deviations from the plan, but also to ensure the company is operating according to plan. It highlights potential areas of opportunity for the company. This area is one where the emerging contractor can make a difference by understanding the process and using the information to manage the business.

Summary management report

Monitoring financial results can be accomplished, in part, through the use of a summary management report that identifies various operating activities of the company. The information for this report can be extracted easily from the accounting records. This information can be reported for any period, including:

- daily
- weekly
- monthly
- quarterly
- annually

continued on the next page
## Sample summary management report

<table>
<thead>
<tr>
<th>Accounting Item</th>
<th>Description of Activity</th>
<th>Week No.</th>
<th>Month No.</th>
<th>Quarter-to-Date</th>
<th>Year To Date</th>
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<tbody>
<tr>
<td>Cash</td>
<td>Cash beginning of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plus: cash receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>disbursement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less: cash activity</td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>End of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivable</td>
<td>Beginning of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plus: net billing</td>
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<tr>
<td></td>
<td>Less: cash receipts</td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>receivables</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>End of period</td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Payable</td>
<td>Beginning of period</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plus: purchases</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less: payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>End of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Line of Credit</td>
<td>Beginning of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plus: draws</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less: repayments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>End of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Backlog Revenue</td>
<td>Beginning of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plus: new signed work</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less: gross profit to date</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>End of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Backlog Gross Profit</td>
<td>Beginning of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Plus: new signed work</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less: gross billing to date</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>End of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Monitor Financial Results (continued)

Key operating factors report

Also, a good starting point for a detailed review of the company’s performance should begin with a review of the company’s current monthly and year-to-date operating performance as compared to prior years’ and prior months’ results. The controller should include a financial ratio analysis and a budget-to-actual analysis.

continued on the next page
### Sample key operating factors report

<table>
<thead>
<tr>
<th></th>
<th>19X5</th>
<th>19X6</th>
<th>19X7</th>
<th>19X8</th>
<th>19X9</th>
<th>19X10</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amount</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>%</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contract Revenue</td>
<td>$7,565,000</td>
<td>$5,400,000</td>
<td>$4,000,000</td>
<td>$3,400,000</td>
<td>$2,675,000</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Work in Process Revenue</td>
<td>68.8</td>
<td>31.2</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
<tr>
<td>Completed Contract Revenue</td>
<td>65.0</td>
<td>35.0</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
<tr>
<td>Gross Profit from Work in Process</td>
<td>65.0</td>
<td>35.0</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
<tr>
<td>Officers' Salaries and Bonuses</td>
<td>65.0</td>
<td>35.0</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
<tr>
<td>Gross Profit from Completed Contracts</td>
<td>65.0</td>
<td>35.0</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
<tr>
<td>Backlog in Contracts (Revenue)</td>
<td>65.0</td>
<td>35.0</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
<tr>
<td>Gross Profit in Backlog (Revenue)</td>
<td>65.0</td>
<td>35.0</td>
<td>12.3</td>
<td>12.6</td>
<td>13.7</td>
<td>14.8</td>
</tr>
</tbody>
</table>

*Based on a percentage of revenue*
Monitor Financial Results *(continued)*

**Internal financial statements**

Although monitoring financial results goes beyond the traditional financial statements, these traditional reports are still the core from which the information is developed. These internal financial statements also can provide meaningful information if a reader knows how to identify trends and where to search for variances. The following three approaches can be useful in determining what areas may need attention.

- Common-sized financial statements
- Balance sheet components restated to revenue
- Trend analysis

**Common-sized financial statements**

Common-sized financial statements reflect the dollar amounts as a percentage of the total. This provides another perspective on the business and provides a tool for analyzing changes in relation to a total. For example, it shows changes in accounts receivable as a percentage of total assets or changes in debt as compared to total equity. The following *Balance Sheet* and *Statement of Income* provide a common-sized analysis for Emerging Contractor Company, Inc., for 19X1 to 19X5.

*continued on the next page*
EMERGING CONTRACTOR COMPANY, INC.
BALANCE SHEET
DECEMBER 31, 19X5, 19X4, 19X3, 19X2 AND 19X1

**ASSETS**

<table>
<thead>
<tr>
<th></th>
<th>19X5</th>
<th></th>
<th>19X4</th>
<th></th>
<th>19X3</th>
<th></th>
<th>19X2</th>
<th></th>
<th>19X1</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$382,000</td>
<td>11.8</td>
<td>$139,000</td>
<td>3.7</td>
<td>$325,000</td>
<td>9.1</td>
<td>$291,000</td>
<td>8.1</td>
<td>$500,000</td>
<td>14.6</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contracts - current</td>
<td>1,658,000</td>
<td>51.2</td>
<td>1,684,000</td>
<td>44.3</td>
<td>1,302,000</td>
<td>36.2</td>
<td>1,214,000</td>
<td>33.8</td>
<td>1,200,000</td>
<td>34.9</td>
</tr>
<tr>
<td>Contracts - retention</td>
<td>442,000</td>
<td>13.7</td>
<td>547,000</td>
<td>14.4</td>
<td>622,000</td>
<td>17.3</td>
<td>602,000</td>
<td>16.8</td>
<td>530,000</td>
<td>15.4</td>
</tr>
<tr>
<td>Other</td>
<td>32,000</td>
<td>1.0</td>
<td>152,000</td>
<td>4.1</td>
<td>356,000</td>
<td>9.9</td>
<td>350,000</td>
<td>9.8</td>
<td>287,000</td>
<td>8.4</td>
</tr>
<tr>
<td>Total accounts receivable</td>
<td>$2,132,000</td>
<td>65.9</td>
<td>$2,583,000</td>
<td>67.9</td>
<td>$2,280,000</td>
<td>63.4</td>
<td>$2,166,000</td>
<td>60.3</td>
<td>$2,017,000</td>
<td>58.7</td>
</tr>
<tr>
<td>Marketable securities</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>69,000</td>
<td>2.0</td>
<td>66,000</td>
<td>2.0</td>
</tr>
<tr>
<td>Loans Receivable</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>83,000</td>
<td>2.3</td>
<td>83,000</td>
<td>2.5</td>
</tr>
<tr>
<td>Work in process</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>20,000</td>
<td>--</td>
<td>121,000</td>
<td>3.4</td>
<td>119,000</td>
<td>3.5</td>
</tr>
<tr>
<td>Costs and estimated earnings in excess of billings on incomplete contracts</td>
<td>134,000</td>
<td>4.2</td>
<td>225,000</td>
<td>6.0</td>
<td>308,000</td>
<td>8.6</td>
<td>169,000</td>
<td>4.7</td>
<td>150,000</td>
<td>4.4</td>
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<td>Prepaid expenses</td>
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<td>--</td>
<td>75,000</td>
<td>2.1</td>
<td>75,000</td>
<td>2.2</td>
</tr>
<tr>
<td>Other current assets</td>
<td>175,000</td>
<td>5.4</td>
<td>175,000</td>
<td>4.6</td>
<td>155,000</td>
<td>4.3</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Total current assets</td>
<td>$2,823,000</td>
<td>87.2</td>
<td>$3,122,000</td>
<td>82.0</td>
<td>$2,088,000</td>
<td>55.9</td>
<td>$2,974,000</td>
<td>82.7</td>
<td>$3,010,000</td>
<td>87.4</td>
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<tr>
<td><strong>PROPERTY AND EQUIPMENT</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Total</td>
<td>836,000</td>
<td>25.9</td>
<td>934,000</td>
<td>24.6</td>
<td>810,000</td>
<td>22.6</td>
<td>873,000</td>
<td>24.3</td>
<td>637,000</td>
<td>18.6</td>
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<tr>
<td>Less: accumulated depreciation</td>
<td>$(466,000)</td>
<td>14.4</td>
<td>$(485,000)</td>
<td>12.8</td>
<td>$(488,000)</td>
<td>12.5</td>
<td>$(426,000)</td>
<td>11.9</td>
<td>$(386,000)</td>
<td>11.3</td>
</tr>
<tr>
<td>Net Property and Equipment</td>
<td>370,000</td>
<td>11.5</td>
<td>449,000</td>
<td>11.8</td>
<td>322,000</td>
<td>10.1</td>
<td>447,000</td>
<td>12.5</td>
<td>251,000</td>
<td>7.3</td>
</tr>
<tr>
<td><strong>OTHER ASSETS</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Investment in joint ventures</td>
<td>5,000</td>
<td>.2</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>24,000</td>
<td>.7</td>
<td>34,000</td>
<td>1.0</td>
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<tr>
<td>Cash surrender value - officers life ins.</td>
<td>38,000</td>
<td>1.2</td>
<td>208,000</td>
<td>5.5</td>
<td>148,000</td>
<td>4.2</td>
<td>25,000</td>
<td>.7</td>
<td>20,000</td>
<td>.6</td>
</tr>
<tr>
<td>Deposits</td>
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<td>--</td>
<td>--</td>
<td>--</td>
<td>1,000</td>
<td>.1</td>
<td>1,000</td>
<td>.1</td>
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<tr>
<td>Loans receivable</td>
<td>--</td>
<td>--</td>
<td>28,000</td>
<td>.8</td>
<td>--</td>
<td>--</td>
<td>125,000</td>
<td>3.6</td>
<td>125,000</td>
<td>3.7</td>
</tr>
<tr>
<td>Total other assets</td>
<td>45,000</td>
<td>1.4</td>
<td>236,000</td>
<td>6.2</td>
<td>148,000</td>
<td>4.2</td>
<td>175,000</td>
<td>4.9</td>
<td>180,000</td>
<td>5.3</td>
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<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$3,235,000</td>
<td>100%</td>
<td>$3,807,000</td>
<td>100%</td>
<td>$3,598,000</td>
<td>100%</td>
<td>$3,596,000</td>
<td>100%</td>
<td>$3,441,000</td>
<td>100%</td>
</tr>
</tbody>
</table>
EMERGING CONTRACTOR COMPANY, INC.
BALANCE SHEET
DECEMBER 31, 19X5, 19X4, 19X3, 19X2 AND 19X1

LIABILITIES AND STOCKHOLDERS' EQUITY

<table>
<thead>
<tr>
<th></th>
<th>19X5 Amount</th>
<th>19X5 %</th>
<th>19X4 Amount</th>
<th>19X4 %</th>
<th>19X3 Amount</th>
<th>19X3 %</th>
<th>19X2 Amount</th>
<th>19X2 %</th>
<th>19X1 Amount</th>
<th>19X1 %</th>
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<td>CURRENT LIABILITIES</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Note payable - line of credit</td>
<td>$</td>
<td>-</td>
<td>$</td>
<td>-</td>
<td>$</td>
<td>-</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.5</td>
</tr>
<tr>
<td>Current portion of long-term debt</td>
<td>$420,000</td>
<td>13.0</td>
<td>$513,000</td>
<td>13.5</td>
<td>$599,000</td>
<td>16.7</td>
<td>$110,000</td>
<td>3.1</td>
<td>$150,000</td>
<td>4.4</td>
</tr>
<tr>
<td>Accounts payable - current</td>
<td>$687,000</td>
<td>21.3</td>
<td>$743,000</td>
<td>19.6</td>
<td>$926,000</td>
<td>25.8</td>
<td>$1,000,000</td>
<td>27.8</td>
<td>$1,117,000</td>
<td>32.5</td>
</tr>
<tr>
<td>Accounts payable - retention</td>
<td>$202,000</td>
<td>6.3</td>
<td>$181,000</td>
<td>4.8</td>
<td>$189,000</td>
<td>5.3</td>
<td>$251,000</td>
<td>7.0</td>
<td>$200,000</td>
<td>5.9</td>
</tr>
<tr>
<td>Accrued compensation, payroll taxes &amp; amounts withheld from employees</td>
<td>$27,000</td>
<td>.9</td>
<td>$221,000</td>
<td>5.8</td>
<td>$229,000</td>
<td>6.4</td>
<td>$55,000</td>
<td>1.6</td>
<td>$52,000</td>
<td>1.6</td>
</tr>
<tr>
<td>Billings in excess of costs &amp; estimated earnings on incomplete contracts</td>
<td>$515,000</td>
<td>15.9</td>
<td>$565,000</td>
<td>14.9</td>
<td>$553,000</td>
<td>15.4</td>
<td>$547,000</td>
<td>15.3</td>
<td>$447,000</td>
<td>13.0</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>$87,000</td>
<td>2.7</td>
<td>$62,000</td>
<td>1.7</td>
<td>$5,000</td>
<td>.2</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Accrued income taxes</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>--</td>
<td>--</td>
<td>2,000</td>
<td>.1</td>
<td>--</td>
<td>--</td>
<td>185,000</td>
<td>5.2</td>
<td>216,000</td>
<td>6.3</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>$1,938,000</td>
<td>59.9</td>
<td>$2,287,000</td>
<td>60.1</td>
<td>$2,501,000</td>
<td>69.6</td>
<td>$2,278,000</td>
<td>63.4</td>
<td>$2,232,000</td>
<td>64.9</td>
</tr>
<tr>
<td>LONG-TERM LIABILITIES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term debt, net of current portion</td>
<td>$8,000</td>
<td>.3</td>
<td>$335,000</td>
<td>8.8</td>
<td>$55,000</td>
<td>1.6</td>
<td>$450,000</td>
<td>12.6</td>
<td>$505,000</td>
<td>14.7</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>$70,000</td>
<td>2.0</td>
<td>$70,000</td>
<td>2.1</td>
</tr>
<tr>
<td>Total long-term liabilities</td>
<td>$8,000</td>
<td>.3</td>
<td>$335,000</td>
<td>8.8</td>
<td>$55,000</td>
<td>1.6</td>
<td>$520,000</td>
<td>14.5</td>
<td>$575,000</td>
<td>16.3</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>$1,946,000</td>
<td>60.1</td>
<td>$2,622,000</td>
<td>68.9</td>
<td>$2,556,000</td>
<td>71.1</td>
<td>$2,798,000</td>
<td>77.8</td>
<td>$2,807,000</td>
<td>81.6</td>
</tr>
<tr>
<td>STOCKHOLDERS' EQUITY</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock</td>
<td>$50,000</td>
<td>1.6</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.5</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>$50,000</td>
<td>1.6</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.4</td>
<td>$50,000</td>
<td>1.5</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>$1,182,000</td>
<td>36.9</td>
<td>$1,085,000</td>
<td>28.5</td>
<td>$942,000</td>
<td>26.2</td>
<td>$698,000</td>
<td>19.5</td>
<td>$534,000</td>
<td>15.6</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>$1,292,000</td>
<td>39.9</td>
<td>$1,185,000</td>
<td>31.2</td>
<td>$1,042,000</td>
<td>29.0</td>
<td>$798,000</td>
<td>22.2</td>
<td>$634,000</td>
<td>18.5</td>
</tr>
<tr>
<td>TOTAL LIABILITIES AND STOCKHOLDERS'</td>
<td>$3,238,000</td>
<td>100.0</td>
<td>$3,807,000</td>
<td>100.0</td>
<td>$3,598,000</td>
<td>100.0</td>
<td>$3,596,000</td>
<td>100.0</td>
<td>$3,441,000</td>
<td>100.0</td>
</tr>
</tbody>
</table>
EMERGING CONTRACTOR COMPANY, INC.
STATEMENT OF INCOME
DECEMBER 31, 19X5, 19X4, 19X3, 19X2 AND 19X1

<table>
<thead>
<tr>
<th></th>
<th>19X5</th>
<th>%</th>
<th>19X4</th>
<th>%</th>
<th>19X3</th>
<th>%</th>
<th>19X2</th>
<th>%</th>
<th>19X1</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract Revenue</td>
<td>$7,865,000</td>
<td>100%</td>
<td>$8,751,000</td>
<td>100%</td>
<td>$10,153,000</td>
<td>100%</td>
<td>$9,000,000</td>
<td>100%</td>
<td>$7,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>Contract Costs</td>
<td>$7,049,000</td>
<td>89.7%</td>
<td>$7,815,000</td>
<td>89.3%</td>
<td>$9,084,000</td>
<td>89.5%</td>
<td>$8,000,000</td>
<td>88.9%</td>
<td>$6,300,000</td>
<td>90.0%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>816,000</td>
<td>10.4%</td>
<td>936,000</td>
<td>10.7%</td>
<td>1,069,000</td>
<td>10.6%</td>
<td>1,000,000</td>
<td>11.2%</td>
<td>700,000</td>
<td>10.0%</td>
</tr>
<tr>
<td>General &amp; Administrative Expenses</td>
<td>740,000</td>
<td>9.4%</td>
<td>667,000</td>
<td>7.7%</td>
<td>763,000</td>
<td>7.0%</td>
<td>770,000</td>
<td>8.6%</td>
<td>650,000</td>
<td>9.3%</td>
</tr>
<tr>
<td>Income From Operations</td>
<td>76,000</td>
<td>1.0%</td>
<td>269,000</td>
<td>3.1%</td>
<td>366,000</td>
<td>3.6%</td>
<td>230,000</td>
<td>2.6%</td>
<td>50,000</td>
<td>.8%</td>
</tr>
<tr>
<td>Other Income (Expense)</td>
<td>40,000</td>
<td>.5%</td>
<td>(81,000)</td>
<td>1.0%</td>
<td>(25,000)</td>
<td>.3%</td>
<td>60,000</td>
<td>.7%</td>
<td>(10,000)</td>
<td>.2%</td>
</tr>
<tr>
<td>Income Before Equity In Net Income (Loss) Of Joint Ventures</td>
<td>116,000</td>
<td>1.5%</td>
<td>188,000</td>
<td>2.2%</td>
<td>341,000</td>
<td>3.4%</td>
<td>290,000</td>
<td>3.3%</td>
<td>40,000</td>
<td>.6%</td>
</tr>
<tr>
<td>Equity In Net Income (Loss) Of Joint Ventures</td>
<td>6,000</td>
<td>.1%</td>
<td>(7,000)</td>
<td>.1%</td>
<td>(3,000)</td>
<td>.1%</td>
<td>(10,000)</td>
<td>.2%</td>
<td>(5,000)</td>
<td>.1%</td>
</tr>
<tr>
<td>Income Before Provision (Benefit) For Income Taxes</td>
<td>122,000</td>
<td>1.6%</td>
<td>181,000</td>
<td>2.1%</td>
<td>338,000</td>
<td>3.4%</td>
<td>295,000</td>
<td>3.2%</td>
<td>35,000</td>
<td>.5%</td>
</tr>
<tr>
<td>Provision (Benefit) For Income Taxes</td>
<td>12,000</td>
<td>2%</td>
<td>38,000</td>
<td>5%</td>
<td>95,000</td>
<td>1.0%</td>
<td>106,000</td>
<td>1.2%</td>
<td>6,000</td>
<td>.1%</td>
</tr>
<tr>
<td>Net Income (Loss)</td>
<td>$110,000</td>
<td>1.4%</td>
<td>$143,000</td>
<td>1.7%</td>
<td>$243,000</td>
<td>2.4%</td>
<td>$189,000</td>
<td>2.1%</td>
<td>$29,000</td>
<td>.5%</td>
</tr>
</tbody>
</table>
Monitor Financial Results (continued)

Balance sheet components restated to revenue

To assist the contractor and others in reading the financial statements on a broader level, the balance sheet can be restated to a percentage of sales. Assets and liabilities can be monitored more effectively from an operating standpoint when measured against an activity such as sales rather than against total asset value. For example, accounts receivable is more closely associated to sales revenues than total assets. The same can apply to accounts payable and direct cost. The Key Assets and Liabilities report provides an analysis of balance sheet components compared to current-year revenue.

continued on the next page
### EMERGING CONTRACTOR COMPANY, INC.
#### KEY ASSETS AND LIABILITIES

<table>
<thead>
<tr>
<th></th>
<th>19X5</th>
<th>%</th>
<th>19X4</th>
<th>%</th>
<th>19X3</th>
<th>%</th>
<th>19X2</th>
<th>%</th>
<th>19X1</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contract Revenues</strong></td>
<td>$7,865,000</td>
<td>100%</td>
<td>$8,751,000</td>
<td>100%</td>
<td>$10,153,000</td>
<td>100%</td>
<td>$9,000,000</td>
<td>100%</td>
<td>$7,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>Cash</td>
<td>$382,000</td>
<td>4.9%</td>
<td>$139,000</td>
<td>1.6%</td>
<td>$325,000</td>
<td>3.2%</td>
<td>$291,000</td>
<td>3.3%</td>
<td>$500,000</td>
<td>7.2%</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contracts - Current</td>
<td>$1,658,000</td>
<td>21.1%</td>
<td>$1,684,000</td>
<td>19.3%</td>
<td>$1,302,000</td>
<td>12.9%</td>
<td>$1,214,000</td>
<td>13.5%</td>
<td>$1,200,000</td>
<td>17.2%</td>
</tr>
<tr>
<td>Contracts - Retention</td>
<td>442,000</td>
<td>5.7%</td>
<td>547,000</td>
<td>6.3%</td>
<td>622,000</td>
<td>6.2%</td>
<td>602,000</td>
<td>6.7%</td>
<td>530,000</td>
<td>7.6%</td>
</tr>
<tr>
<td>Other</td>
<td>32,000</td>
<td>0.4%</td>
<td>352,000</td>
<td>4.1%</td>
<td>356,000</td>
<td>3.5%</td>
<td>350,000</td>
<td>3.8%</td>
<td>287,000</td>
<td>4.1%</td>
</tr>
<tr>
<td>Total Accounts Receivable</td>
<td>$2,132,000</td>
<td>27.1%</td>
<td>$2,583,000</td>
<td>29.6%</td>
<td>$2,280,000</td>
<td>22.5%</td>
<td>$2,166,000</td>
<td>24.1%</td>
<td>$2,017,000</td>
<td>28.2%</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td>$687,000</td>
<td>8.8%</td>
<td>$743,000</td>
<td>8.5%</td>
<td>$926,000</td>
<td>9.2%</td>
<td>$1,000,000</td>
<td>11.2%</td>
<td>$1,117,000</td>
<td>16.0%</td>
</tr>
<tr>
<td>Retention</td>
<td>202,000</td>
<td>2.6%</td>
<td>181,000</td>
<td>2.1%</td>
<td>189,000</td>
<td>1.9%</td>
<td>251,000</td>
<td>2.8%</td>
<td>200,000</td>
<td>2.2%</td>
</tr>
<tr>
<td>Total Accounts Payable</td>
<td>$889,000</td>
<td>11.3%</td>
<td>$924,000</td>
<td>10.6%</td>
<td>$1,115,000</td>
<td>11.0%</td>
<td>$1,251,000</td>
<td>13.9%</td>
<td>$1,317,000</td>
<td>18.8%</td>
</tr>
<tr>
<td>Underbilling</td>
<td>$134,000</td>
<td>1.7%</td>
<td>$225,000</td>
<td>2.6%</td>
<td>$308,000</td>
<td>3.1%</td>
<td>$169,000</td>
<td>1.9%</td>
<td>$150,000</td>
<td>2.2%</td>
</tr>
<tr>
<td>Overbillings</td>
<td>$515,000</td>
<td>6.6%</td>
<td>$565,000</td>
<td>6.5%</td>
<td>$553,000</td>
<td>5.5%</td>
<td>$547,000</td>
<td>6.1%</td>
<td>$447,000</td>
<td>6.4%</td>
</tr>
</tbody>
</table>

*Based on the percentage of revenue*
Monitor Financial Results (continued)

Trend analysis

The income statement and balance sheets for a period of time, either prior months or prior years, can be useful in identifying trends that may identify areas needing attention. The Balance Sheet, Statement of Income, and Key Assets and Liabilities reports also provide a trend analysis for Emerging Contractor Company, Inc., for 19X1 to 19X5.
Conduct Financial Ratio Analysis

Introduction

Financial ratio analysis is a monitoring technique that should be used by controllers on a frequent basis. Financial ratio analysis is a study undertaken to assist in evaluating past, current, and future financial performance of a company. It also identifies a company’s strengths and weaknesses.

Financial ratio analysis

Financial ratio analysis involves the review of financial data generally in the form of ratios extracted from financial statements and other reports that are then compared to industry standards, prior reporting periods, and company-established goals.

Benefits of ratio analysis

Financial ratio analysis applied on a regular and consistent basis by controllers can become an extremely effective technique to identify and, more importantly, to respond to negative and positive trends. At a minimum, the analysis can be used to notify the owners or other management members of trends.

Taking action after a negative trend is identified may prevent future problems. Acting on positive trends enables you to obtain the maximum benefit possible. Additionally, a regular and consistent financial analysis provides the controller with information that may help a construction company

- Control growth
- Control cost
- Establish realistic goals
- Operate at the lowest possible cost
- Identify operational problems

continued on the next page
Comparing the analysis

To obtain the maximum benefit from the analysis of ratios, make a comparison to industry standards, prior reporting periods, and company-established goals. Ratio analysis without comparisons is much less meaningful and may provide inaccurate conclusions regarding the analysis.

Additionally, comparisons of industry ratios over a period of time are much more meaningful than a simple comparison to published industry averages. Industry averages are useful as a benchmark for comparison and an indication of your competitiveness within the industry.

Factors affecting financial data

There are several factors that a controller must consider during an analysis to draw the proper conclusion regarding his or her company’s financial strengths and weakness. Not only does the controller need to consider the company’s trends over several periods, but he or she must also consider the internal and external events or factors that influence the company’s performance during the evaluation period and the various industry practices that may differ from contractor to contractor. These events or factors may affect one ratio or all the ratios. Some of the factors include, but are not limited to, the following:

- Method of accounting
- Geographic location and seasonality
- Company size and structure
- Assets owned vs. leased
- Level of owners compensation
- Account classification
- Market conditions and competition
- Employee productivity
- Marketing
- Debt/equity structure

continued on the next page
Conduct Financial Ratio Analysis (continued)

Factors affecting financial data (continued)

Each of these factors must be considered individually and in combination when evaluating the results of the financial analysis.

Pitfalls in analysis

Pitfalls to avoid when evaluating financial ratios include the following.

Insufficient historical analysis
If the historical analysis covers an insufficient number of years, trends and current performance may be misinterpreted. For example, if the analysis covers only a two-year period in which substantial capital investments were made, any ratio using total assets or net income will be affected by the capital investment.

Non-averaged or non-weighted average
Failing to use an average or weighted average where applicable can distort ratios, which distorts the analysis. For example, if the average accounts receivable balance is $300,000, the ending balance $500,000, and revenues of the year are $3 million, the days sales outstanding would be thirty days, based on the average balance, as opposed to 60 days, based on the ending balance.

Improper comparative
Selecting an improper comparative can result in potentially misleading conclusions. For example, a client may be primarily a mechanical controls specialty contractor. Using a composite of raw mechanical contractors rather than those providing primarily controls services may produce misleading results.

continued on the next page
Pitfalls in analysis (continued)

Differing accounting method
Most comparative sources do not disclose the accounting methods used by the contractors from which the comparative figures or ratios have been compiled. Thus, based on your awareness of the industry, you must consider the potential impact the differences in accounting methods might have on the results of comparative analysis.

Internal and external factors
The nature and size of your construction company, contractor, geographic location, business practices, and other factors pertaining to the comparative may introduce differences in the comparative analysis that may affect the results.

Calculations must be consistent
A critical concept to understand is that one ratio standing alone is rarely meaningful. Ratios that are consistently calculated over time will generally provide better and more interpretive information.

continued on the next page
Common financial ratios

The financial ratios identified below represent those commonly used by lenders and bond underwriters to analyze a contractor’s financial strengths and weaknesses. These results are consistent with the standards used by the Construction Financial Management Association (CFMA) to report the results of their annual financial surveys. This is an appropriate source for controllers to compare their company to the industry. Sources of information include the following:

- Dun’s Review, Dun and Bradstreet
- Annual Statement Studies, Robert Morris Associates
- Construction Industry Annual Financial Surveys, CFMA
- Almanac of Business and Industrial Financial Ratios, Prentice Hall

In addition, numerous industry trade associations often provide information that can be useful for comparative purposes.

Categories of ratios

The categories of financial ratios controllers should use to monitor their operations include the following:

**Liquidity ratios**

Liquidity measures the ability to meet current obligations when they become due. The ratios measure the quality and adequacy of the current assets available to satisfy any current liabilities. A lack of liquidity generally results in cash flow problems, decreased ability to obtain short- or long-term credit, and inability to increase volume.

**Profitability ratios**

Profitability ratios identify the operating performance of the company and indicates management’s ability to effectively use available resources to generate profits.
Leverage ratios
Leverage ratios focus on the level of debt used to operate the business and the potential risk to creditors in the event of financial difficulties. The ratios are also indicators of the ability to service debt.

Efficiency ratios
Efficiency ratios measure the duration of various components of the operating cycle and management’s ability to complete contract activities in a minimal time period.

Construction risk ratios
Construction risk ratios indicate the risk associated with recognizing construction contract profits using the percentage of completion method of accounting. This factor is important to sureties because they want to monitor the number of projects in process so contractors do not overextend themselves operationally or financially. Banks are also interested in these data to ensure that contractors have control over their projects and have sufficient receivable collections before providing additional credit to the contractor.

continued on the next page
Conduct Financial Ratio Analysis (continued)

Liquidity ratios

The following sections identify various liquidity ratios and provide a general explanation of the ratio, its usefulness, and the formula used to calculate the ratio.

Current ratio

The current ratio indicates how many dollars of current assets the company has for each dollar of current liabilities. Restated, the current ratio measures the number of times that current assets cover current liabilities. It is a rough indication of a firm's ability to service its current obligations. Generally, the higher the current ratio, the greater the "cushion" between current obligations and a firm's ability to pay them. However, the composition and quality of current assets is a critical factor in the analysis of an individual firm's liquidity. A ratio of 1.0 indicates current assets equal current liabilities. Anything less than 1.0 indicates at least a temporary cash flow problem. The current ratio is obtained by dividing total current assets by total current liabilities.

The current ratio is probably the ratio best known to business people. Because of this fact, this ratio is sometimes given more weight than it really deserves. However, because this ratio is often emphasized, especially by lenders, it takes on a relatively high degree of importance.

A weakness in the current ratio is that it is strictly a quantitative measurement. To further analyze a company's ability to pay its short-term liabilities, one must assess the quality of the current assets, beginning with an analysis of the composition of the current assets. For example, do current assets consist of 10 percent cash, 65 percent accounts receivable, and 25 percent underbilling, or are they 80 percent cash, 15 percent receivables, and 5 percent underbilling? Obviously, these situations are significantly different.

continued on the next page
Liquidity ratios (continued)

A further investigation would include a valuation of the assets. Are the receivables all collectible? When? On the liability side, the key question relates to the timing of payments. For example, accounts payable could be seriously past due. At the other extreme, the current liabilities may consist primarily of term debt, possibly even including a credit line, which technically could be due on demand, but which, as a practical matter, may be constantly rolled over.

Current Ratio = \[
\frac{\text{Current Assets}}{\text{Current Liabilities}}
\]

Quick ratio

The quick ratio, also known as the acid test ratio, is a more conservative measure of liquidity. The quick ratio indicates the liquidity position without inventories and prepaid expenses, and indicates the extent to which liquid assets are available to satisfy current liabilities. Inventories and prepaid expenses are excluded from this ratio because they are more difficult or impossible to convert into cash on short notice to satisfy current liabilities.

A ratio of less than 1.0 indicates that other assets, such as inventory or long-term assets, must be relied on to satisfy current obligations. The quick ratio is computed by dividing all monetary current assets (cash, accounts receivable, and marketable securities) by total current liabilities.

Quick Ratio = \[
\frac{\text{Cash} + \text{Accounts Receivable} + \text{Marketable Securities}}{\text{Current Liabilities}}
\]

Days of cash

The days-of-cash indicates the number of days in cash available to cover annual volume. Generally, a ratio of 7 days or more is considered adequate. The days-of-cash is calculated by dividing cash and cash equivalents by revenues and multiplying by 360 days.

Days of Cash = \[
\frac{(\text{Cash & Cash Equivalents}) \times 360}{\text{Revenue}}
\]

continued on the next page
Liquidity ratios (continued)

Working capital turnover
Working capital turnover indicates the adequacy of the company’s capitalization at a particular revenue level. A high turnover normally indicates undercapitalization. A low turnover indicates excess capitalization or that assets are not being used effectively. Working capital turnover is computed by dividing annual revenue by the company’s working capital. Working capital consists of current assets minus current liabilities.

\[
\text{Working Capital Turnover} = \frac{\text{Revenue}}{\text{Working Capital (Current Assets - Current Liabilities)}}
\]

Profitability ratios

The following sections identify various profitability ratios and provide a general explanation of the ratio, its usefulness, and the formula used to calculate the ratio.

Return on assets
The return-on-assets ratio measures the ability to generate profit in relation to total assets. It should be used to compare specific industry groups and in conjunction with other operating ratios to determine the effective use of assets. A higher ratio reflects the earnings potential and effective use of the assets. The return-on-assets ratio is computed by dividing net income after taxes by total assets less intangibles.

\[
\text{Return on Assets} = \frac{\text{Net Income After Taxes}}{\text{Total Assets less Intangibles}}
\]

continued on the next page
Conduct Financial Ratio Analysis (continued)

Profitability ratios (continued)

**Return on assets before officers' salaries and taxes**

The return-on-assets-before-officers'-salaries-and-taxes ratio is another measure of the ability to generate income in relation to total assets. Because it excludes officers' salaries, this ratio may provide a better indication of the company's ability to generate income in those instances where officers' salaries or bonuses may be extreme. This ratio is computed by dividing net income before officers' salaries and taxes by total assets less intangibles, such as goodwill.

\[
\frac{\text{Net Income Before Officers' Salaries and Taxes}}{\text{Total Assets Less Intangibles}}
\]

**Return on equity**

The return-on-equity ratio indicates the profit generated by the net assets employed and reflects the stockholders' return on investment. A very high ratio may indicate an undercapitalization or conversely, a very profitable company. Low returns may indicate a conservative managerial approach or subpar performance. The ratio is computed by dividing net income after taxes by total equity.

\[
\frac{\text{Net Income After Taxes}}{\text{Equity}}
\]

**Return on equity before officers' salaries and taxes**

Return-on-equity-before-officers'-salaries-and-taxes ratio is another measure of the ability to generate income based upon the net assets employed. This ratio also reflects the stockholders' return on investment. Because it excludes officers' salaries, this ratio may be a better indication of the company's ability to generate profit in those instances where an officers' salary or bonuses may be extreme. This ratio is computed by dividing net income before officers' salaries and taxes by total equity.

\[
\frac{\text{Net Income Before Officers' Salaries and Taxes}}{\text{Equity}}
\]

continued on the next page
Conduct Financial Ratio Analysis (continued)

Profitability ratios (continued)

**Gross-profit-as-a-percentage-of-revenue**

Gross-profit-as-a-percentage-of-revenue represents the funds available to cover general and administrative expenses and provide for a net operating profit. Gross profit dollars are obtained by deducting contract costs, including indirect overhead costs, from revenue. Gross-profit-as-a-percentage-of-revenue is calculated by dividing gross profit dollars by annual revenue.

\[
\text{Gross Profit as a Percentage of Revenue} = \frac{\text{Gross Profit Dollars}}{\text{Revenue}}
\]

**G&A-expenses-as-a-percentage-of-revenue**

G&A-expenses-as-a-percentage-of-revenue represents the funds available to cover general and administrative expenses. G&A-expenses-as-a-percentage-of-revenue is calculated by dividing total G&A expenses by annual revenue.

\[
\text{G&A Expenses as a Percentage of Revenue} = \frac{\text{G&A Expenses}}{\text{Revenue}}
\]

**Net-earnings-before-income-taxes**

Net-earnings-before-income-taxes measures profitability and shows the amount of earnings before taxes generated from each dollar of contract revenue. A low ratio in this area may reflect a lack of one or more of the following:

- financial control and budgets;
- close supervision and production control;
- an efficient cost accounting system; or
- proper methods of bidding.

Net-earnings-before-income-taxes is calculated by dividing net earnings before income taxes by annual revenue.

\[
\text{Net Earnings Before Income Taxes} = \frac{\text{Net Earnings Before Income Taxes}}{\text{Revenue}}
\]

*continued on the next page*
Conduct Financial Ratio Analysis (continued)

Profitability ratios (continued)

**Net earnings before officers’ salaries and taxes**

Net-earnings-before-officers’-salaries-and-taxes ratio is another measure of a company’s profitability and shows the amount of earnings before officers’ salaries and taxes generated from each dollar of contract revenue. Because this ratio excludes officers’ salaries, it may provide a better indication of the company’s ability to generate profit in those instances where an officers’ salaries and bonuses may be extreme, especially when comparing this information to other companies. Also, consideration must be given to the type of entity being evaluated, i.e., S-corporation versus C-corporation. Net-earnings-before-officers’-salaries-and-taxes ratio is calculated by dividing net earnings before officers’ salaries and taxes by annual revenue.

\[
\text{Net Earnings Before Officers' Salaries and Taxes} = \frac{\text{Net Earnings Before Officers' Salaries and Taxes}}{\text{Revenue}}
\]

**Times interest earned**

The times-interest-earned ratio, also referred to as the interest-coverage ratio, measures the ability to meet interest payments from operations. The trend in this ratio is very important. A low ratio may indicate an overleveraged situation and possibly a need for more permanent equity. A high ratio indicates that the company may have little difficulty meeting current interest obligations. This ratio also serves as an indicator of a company’s capacity to take on additional debt. The times-interest-earned ratio is calculated by dividing net income plus interest expense by interest expense.

\[
\text{Times Interest Earned} = \frac{\text{Net Income Before Taxes + Interest Expense}}{\text{Interest Expense}}
\]

continued on the next page
Leverage ratios

The following sections identify various leverage ratios and provide a general explanation of the ratio, its usefulness, and the formula used to calculate the ratio.

**Debt to equity**

The debt-to-equity ratio indicates the relationship of the stockholders' investment in the business contrasted with the investment by outside creditors. The higher the ratio, the greater the risk the creditors are assuming. A lower ratio generally indicates greater long-term financial safety. A firm with a low debt-worth ratio usually has greater flexibility to borrow in the future. A more highly leveraged company has a more limited debt capacity. Generally, a ratio of 3.0 or lower is considered acceptable. The debt-to-equity ratio is calculated by dividing total liabilities by equity or net worth.

With a greater debt load, the contractor has less latitude in making management decisions and, as a result, must at times be less competitive. This is particularly true when decisions are significantly influenced by creditor consideration and pressures. The ratio expresses the degree of protection provided by the owners for the creditors. The higher the ratio, the greater the risk being assumed by creditors.

This ratio is heavily weighted by lenders and bonding companies. They often view this ratio as an indicator of the owner's level of commitment.

**Debt to Equity = \( \frac{\text{Total Liabilities}}{\text{Equity}} \)**

*continued on the next page*
Conduct Financial Ratio Analysis (continued)

Leverage Ratios (continued)

**Revenue to equity**

The revenue-to-equity ratio indicates the level of revenue being supported by each dollar of equity. This ratio is considered an excellent barometer of a trend toward overtrading—generating more and more revenues on a relatively smaller basis of net worth. Generally, a ratio of 15 or less is considered acceptable. A high ratio may indicate a highly leveraged position. A low ratio may reflect a conservative approach to obtaining contract work. Although it might seem desirable to obtain a maximum number of sales dollars for each dollar of investment, there is typically a level at which increased sales without commensurate increases in net worth will lead to serious problems.

An increase in revenue-to-equity ratio may be an indicator of rapidly increasing revenue growth, which may be “out of control.” If such growth in revenues is not supported by equity, then liquidity, leverage, and/or profitability deteriorates. Higher revenues without corresponding growth in equity results in higher business risk.

Most “overtraders” are obsessed with return and profit; many pay little attention to risk. Often such contractors place over emphasis on revenue growth. Some may even be experiencing slight increases in net profit margins, yet still be overtrading. In addition, an overtrader usually becomes burdened with excessive debt and inadequate working capital, even when revenues are increasing. It is also the company that may be headed for trouble.

\[
\text{Revenue to Equity} = \frac{\text{Revenue}}{\text{Equity}}
\]

**Asset turnover**

The asset-turnover ratio is a general measure of the ability to generate revenues in relation to total assets. By reviewing the trend of this ratio, one can determine the effectiveness of generating revenues through asset expansion. The asset-turnover ratio is calculated by dividing annual revenue by total assets. A higher figure is indicative of greater sales being generated by the asset base.

\[
\text{Asset Turnover} = \frac{\text{Revenue}}{\text{Total Assets}}
\]

continued on the next page
Leverage ratios (continued)

Fixed assets to equity
The fixed-assets-to-equity ratio indicates the level of stockholders’ equity invested in net fixed assets. Usually, a low ratio indicates a proportionately smaller investment in fixed assets in relation to net worth and a better cushion for creditors in case of liquidation. However, the presence of leased equipment not shown on the balance sheet may offset this apparent positive position. A higher ratio may indicate a lack of funds for current operations. The fixed assets to equity ratio is calculated by dividing net fixed assets by total equity. The presence of substantial leased fixed assets not reflected on the balance sheet may deceptively lower this ratio.

Fixed Asset Ratio = \( \frac{\text{Net Fixed Assets}}{\text{Equity}} \)

Equity to G&A expenses
The equity-to-G&A-expenses ratio indicates the level of overhead in relation to total equity. Generally, a ratio of 1.0 or more is considered acceptable. This ratio is calculated by dividing equity by general and administrative expenses.

Equity to G&A Expenses = \( \frac{\text{Equity}}{\text{G&A Expenses}} \)

Underbillings to equity
The underbillings-to-equity ratio indicates the level of contract volume financed by the stockholders. Generally stated as a percentage, a ratio of 30 percent or less is considered acceptable. This ratio is calculated by dividing the sum of unbilled work and cost and earnings in excess by billings by total equity.

Underbillings to Equity = \( \frac{\text{Unbilled Work} + \text{Cost and Earnings in Excess of Billings}}{\text{Equity}} \)

continued on the next page
Conduct Financial Ratio Analysis (continued)

Leverage ratios (continued)

Backlog to equity
The backlog-to-equity ratio indicates the relationship of work under contract to total equity. This ratio is also an indicator of the ability to generate future revenue and future profits. Generally, a ratio of 20 or less is considered acceptable. A high ratio may indicate the need for additional permanent equity. A low ratio may indicate a need to secure more contracts to support future operations. The backlog-to-equity ratio is calculated by dividing the amount of contract backlog by total equity.

\[
\text{Backlog to Equity} = \frac{\text{Contract Backlog}}{\text{Equity}}
\]

Backlog to working capital
The backlog-to-working-capital ratio indicates the relationship between work under contract and working capital. Generally, a ratio of 30 or less is considered acceptable. A higher ratio may indicate the need for an increase in permanent working capital. A low ratio may indicate overcapitalization. The backlog-to-working-capital ratio is calculated by dividing the amount of contract backlog by working capital (current assets - current liabilities).

\[
\text{Backlog of Working Capital} = \frac{\text{Contract Backlog}}{\text{Working Capital (Current Assets - Current Liabilities)}}
\]

Months in backlog
The months in backlog indicates the number of months it will take to complete all work under contract. A ratio of less than 12 months indicates a need to secure new contracts in the next year to maintain a constant level of revenue. The months in backlog is calculated by dividing the amount of contract backlog by the average monthly revenue.

\[
\text{Months in Backlog} = \frac{\text{Contract Backlog}}{\text{Revenue} / 12}
\]

continued on the next page
Efficiency ratios

The following sections identify various efficiency ratios and provide a general explanation of the ratio, its usefulness, and the formula used to calculate the ratio.

**Days in accounts receivable**

The days-in-accounts-receivable figure indicates the number of days it will take to collect the accounts receivable balance. A lower ratio indicates faster collection, thus greater liquidity. A lower ratio can help place greater reliance on the current and quick ratios. A higher ratio may indicate a need to depend more heavily on financing to meet obligations. Consideration should also be given to the days-in-accounts-payable figure because a day-in-accounts-payable ratio less than a day-in-accounts-receivable ratio may indicate a drain on cash flow. Days-in-accounts-receivable is calculated by dividing net accounts receivable (excluding retention) by annual revenue and multiplying the quotient by 360 days.

\[
\text{Days in Accounts Receivable} = \frac{\text{Net Accounts Receivable} \times 360}{\text{Revenue}}
\]

**Days in accounts payable**

Days in accounts payable indicates the number of days it will take to liquidate trade payables. Restated, this ratio tells creditors how many days, on average, they will have to wait before receiving payment from a customer. Though this ratio should be compared to vendors’ credit terms, a ratio of 45 days or less is generally considered adequate. However, if this ratio is lower than the days-in-accounts-receivable number, cash flow may be negatively affected. Days in accounts payable is calculated by dividing net accounts payable (excluding retention) by contract costs and multiplying the result by 360 days.

\[
\text{Days in Accounts Payable} = \frac{\text{Net Accounts Payable} \times 360}{\text{Contract Costs}}
\]

*continued on the next page*
Conduct Financial Ratio Analysis (continued)

Efficiency ratios (continued)

Operating cycle
The operating cycle indicates the length of time it takes for a company to complete a normal operating cycle. An operating cycle is the time period commencing with the payment of cash for costs on a project until the cash is collected related to the amount billed on a project. A low ratio may indicate a need for more permanent working capital. A high ratio may indicate the ability to increase contract volume. The operating cycle is calculated by adding the days in cash plus days in accounts receivable less days in accounts payable.

Operating Cycle = Days in Cash + Days in Accounts Receivable - Days in Accounts Payable

Construction risk ratios
The following sections identify various construction risk ratios and provide a general explanation of the ratio, its usefulness, and the formula used to calculate the ratio.

Gross profit risk factor
The gross profit risk factor indicates the amount of gross profit dollars from completed contracts, which are not influenced by the estimating process, versus the gross profit dollars from contracts in process, which are based on the estimating process. Ratios greater than 1.0 may indicate a poor backlog or a significant decrease in the company's profit margin.

Gross Profit Risk Factor = \frac{\text{Gross Profit from Completed Contracts}}{\text{Gross Profit from WIP}}

Equity risk factor
The equity risk factor indicates the amount of equity that is based on the estimating process and is subject to change. Amounts greater than 2.0 may indicate a poor backlog of a company that is overcapitalized.

Equity Risk Factor = \frac{\text{Equity}}{\text{Gross Profit from WIP}}

continued on the next page
Construction risk ratios
(continued)

Estimating risk factor
The estimating risk factor identifies the consistency of the company’s estimating function by comparing actual gross profit realized on completed contracts with the estimated gross profit on contracts in progress. An even balance of gross profit between completed contracts and work in process is 1.0. A factor greater than 1.0 means a larger percentage of profits is taken from closed jobs. This could indicate that open jobs are not profitable, have lower profit margins, or be fewer in number than closed jobs.

Estimating Risk Factor = \frac{GP\% \text{ from Completed Contracts}}{GP\% \text{ from WIP}}

Construction comfort risk factor
The construction comfort risk factor indicates the overall risk associated with the percentage-of-completion method of accounting. In general, a score of 2.0 or greater indicates good performance.

Construction Comfort Risk Factors = \text{Gross Profit Risk Factor} \times \text{Equity Risk Factor} \times \text{Estimating Risk Factor}
Use Job Cost Reporting

Introduction

Sound and fundamental job cost reporting may be the most critical management reporting function for the emerging contractor. A growing company is dependent on the profitability of job activities to drive the company’s operations; therefore, particular attention must be given to ensuring the information is provided.

Why job cost

Whether the company has two jobs or 100 jobs in a period, the eventual results of all these jobs are reported in the profit and loss statement. However, the profit and loss statement tells management very little about the nature of the costs incurred and profits earned and, therefore, management must use more detailed reporting tools.

Job costs reports serve as tools that can be prepared and managed by controllers to help company management control job costs, operate more effectively, get more profitable jobs, and minimize the risks associated with construction contracting.

Estimated versus actual cost

A major use for job cost information is to compare estimated cost with actual cost. This information provides a means to detect problems so they can be corrected immediately. This information also identifies opportunities in time to capitalize on them by taking appropriate action. Furthermore, such information, if used effectively, can improve the accuracy of future estimates.

From the broad picture of a profit and loss statement for a particular period all the way to the detailed cost of installing ductwork, wire, concrete, asphalt, or any other type of material cost information can be arranged to tell management what it needs to know about the cost of its construction activities.

continued on the next page
Use Job Cost Reporting (continued)

Components of cost information

The components of cost information that provide the basic hierarchy by which cost information should be accumulated and used for management reporting is as follows:

- Units
- Activities
- Phases
- Jobs
- Divisions
- Total company

By tracking cost based on this hierarchy, estimated costs can be compared to actual costs.

Unit cost

Unit cost refers to the total cost required to perform some tangible measure of work. For example, unit costs may be expressed as dollars per pound of a specific metal, dollars per fitting of a specific type, dollars per connection in the installation of a specific system, dollars per square foot of a specific building or floor of a building, dollars per cubic yard of concrete, dollars per lineal foot of a specific duct line, or any other total cost dollars per measurable work unit. Unit costs on a particular job can be used to measure the cost of the installed unit of material.

Activity cost

Activity costing can be used to measure the actual cost of the different activities involved in the job. Job activities refer to the type of work being performed by the personnel on the job, such as moving materials, hanging drywall, installing equipment, wrapping duct, etc. Activity costing allows each activity to be measured, for example, every floor, or some other portion of the job.
Use Job Cost Reporting (continued)

Phase cost

A phase refers to some distinct, readily identifiable portion of the job—floor, building number, section within a floor, etc. Phase costing summarizes the total cost of the activities and units within each phase of the job, i.e., total job cost tells us the amount of materials, labor, etc., as well as the gross dollar cost of the job.

Job, division, and company cost

By summarizing the cost of similar jobs, you can determine divisional or departmental (type of job) costs and, therefore, measure the profitability of different kinds of work. Finally, all types of work performed in the period are summarized in the income statement of the company for that period.

Effective job costing begins with the estimate

The first principle of good job cost reporting is a good estimate. The estimate should be arranged to match the cost categories used in accumulating actual job cost information. This allows you to compare job cost information to estimated costs. It is necessary to arrange the estimate summary in the same format used to accumulate job cost information. Comparing actual and estimated costs can lead to improved accuracy in estimating future jobs and to the identification of the probable cost overruns or even savings while the job is in process.

continued on the next page
Use Job Cost Reporting (continued)

Estimate summary

The specific form of the estimate summary depends on the number of levels of the job costing hierarchy used in the estimate. On small jobs, simple totals for materials, labor, subcontracts, etc., are sufficient. On larger jobs, phase, activity, or even unit costing may be required. If you perform service-type work, your needs for cost information may include only job totals by labor, materials, and other costs. The level of detail decision should be dictated to some degree by all of the following:

- the manner in which you estimate work,
- the detail needed for controlling the cost of the job while it is in process, and
- other information you need upon completion of a job to estimate costs for future jobs.

Reporting contracts-in-process

Job cost reporting during the life of a job is essential to control the cost of the job. To control contract cost during the contract period, management must monitor actual progress-to-date compared with planned progress-to-date. Doing this helps determine where the job is at a particular time with respect to where it is expected to be during the course of a job. Corrective action cannot be taken until you know something is varying from the way it was planned to be. Gut feelings regarding how costs may be running with respect to how they were estimated is not sufficient. This is the approach most emerging contractors take but it can’t be used long if you expect to mature as a business. Facts regarding the cost activities must come from some type of jobs-in-process reports.

continued on the next page
Use Job Cost Reporting (continued)

Guidelines for reporting contracts in process

Some guidelines related to contracts-in-process reporting are as follows:

- Job cost reports should be designed to show only the information used to control job costs. They should be kept as simple as possible to allow the person using them to concentrate their efforts on controlling job costs rather than reconciling or proving the accuracy or inaccuracy of the report.

- Contract reporting should use the same cost breakdowns that were used when making the estimate. At the time of estimating a job, establish the cost elements to be reported on the job. Again, in conjunction with estimators, these reports should be standardized as much as possible based on type of job.

- Interim contract reporting should include cost information that is accurate and can be used to produce better job cost control on the job.

- Depending on how the information is set up, many cost systems provide information that either is so inaccurate or so detailed that it has limited use. A small amount of accurate and useful information is of far greater value than a large quantity of inaccurate or otherwise useless information. Keep the reports simple.

- This report could also indicate the contract price and billings to-date. The primary pitfall is when it does not indicate whether the job is running under or over the estimate at its current stage.

- A separate field report for each job could be prepared and included on a periodic report to show the percent of each cost that should have been used to date, considering the quantities of work actually performed on the job to date.

- A monthly contract report for larger jobs or jobs that will last several months should contain the same information as the estimate contains. If phases, activities, and units are used in the estimate summary, then the contract-in-process report should contain the same information.

continued on the next page
Use Job Cost Reporting (continued)

Guidelines for reporting contracts in process (continued)

- The normal format for a contracts-in-process report shows the estimate in one column, the actual to-date in another, and the amount or percent used or remaining in a third column. In most cases, limited information such as this may not enhance a manager’s opportunity to identify problems or trends.

Projections with unit reporting

Many companies have extended the unit reporting to show the number of units (or percent of the total unit(s) completed through the reporting period. From this, a unit production rate is determined and then extended over the remaining quantities of work to be done. This indicates how much over (or under) the estimate the total units will be if the present trends continue.

This type of detailed reporting system usually requires a fairly sophisticated job-cost accounting program, many of which are available today. Given today’s competitive environment, controllers must recognize that such projection reporting is virtually essential to the person supervising the job. In addition, it provides executive management with a tool to review the status of jobs by reviewing a detailed report on unit progress.

Labor costing

A major key to accurate job costing is accurate labor costing. All coding in the labor-costing process should be done exactly in accordance with the codes used on the original estimate. In most companies, the labor information can be stated accurately each week. Therefore, although many companies prepare an accurate weekly labor report, they produce only a monthly in-process report for other costs on the job. Such a report can be prepared for either the various activities or units of labor on the job.

continued on the next page
Use Job Cost Reporting (continued)

Labor costing (continued)

If phase costing is used, such a report is normally prepared for each phase within the job. Hours are much more useful in controlling labor costs. Typically, controlling labor hours and related productivity is the reason the job results in a profit and loss.

Completed job reporting

In addition to being an absolute necessity during the life of a job, finalizing job cost information can be of great value after the job is completed. Its primary use (other than for accounting purposes) is for job review and analysis. By analyzing the performance on individual jobs, the accuracy of future estimates can be improved, which can result in the company winning more profitable jobs. Furthermore, completed production cost information enables the company to decide the areas in which it needs production improvement. Contractors typically find that such reporting also enables them to do a better job of evaluating individual employees and their performance on jobs as well as individual crews.

Completed job information should be studied by the estimator who estimated the job and the superintendent or person who had the responsibility for the production of the job. Additionally, a copy should be retained in the job cost file for future reference on any particulars of that job.

continued on the next page
Use Job Cost Reporting (continued)

Revising job cost estimates

Preparing a revised cost estimate during the progress of a job is considered by some contractors as a waste of time because of the many variables in the contracting business. Therefore, these contractors do not bother, but continue to run the job on a day-to-day basis until completed without making any periodic estimates of job status during the job.

This may be acceptable—although not advisable—if there are only one or two jobs being managed at any one time and the company does not require financial statements that must be reported on a percentage of completion basis. But when a contractor runs several jobs at a time with overlapping starting and completion dates, the preparation of formalized revised estimates becomes necessary for the effective planning, control, and financial reporting.

Data for the revised estimate

The development of a revised estimate should be completed by the project manager or estimator. The controller, however, needs to be certain that these individuals have current and accurate information through the most recent data possible including the following information.

- The original cost estimate used in arriving at the initial bid price.
- The estimated cost of change orders to the original estimate as they are approved.
- Actual cost incurred for labor, materials, and other direct job costs.
- The efficiency of labor-to-date figures to calculate the amount of labor required to complete the job.
- The gain or loss from the initial estimate of subcontracts or material and equipment suppliers to include in the final cost for these items.

continued on the next page
Use Job Cost Reporting (continued)

Importance of revising the estimate

Revising cost estimates lays the groundwork for providing more accurate job information during the progress of the job. This can result in more accurate information that will have an impact on such things as company-wide forecasts and budgets, break even analysis, etc. These results will further affect management decisions regarding company operations, jobs to bid, aggressiveness on contract bids, etc. Revising the cost estimates will also effect the accuracy of the following:

- Earned gross profit amount and percent to date
- Unabsorbed gross profit
- Over and underbillings
- Current markup percent on costs

Management reports affected by revised estimates

The above data secured for each job at any time during its progress can be used to provide management reports that will provide a more accurate presentation of the company’s financial position. These reports include:

- Monthly Job Status Reports
- Profit Forecasts
- Cash Forecasts

Comparisons

Comparisons can be made between original estimated costs, present forecast of final cost, and the revised contract value to determine the financial health of the project. Comparisons can also be made between costs-to-date figures and the net amount invoiced to date so that the project manager can be sure his or her invoicing runs ahead of cost. If necessary, he or she can make adjustments to the monthly billing to the customer.

continued on the next page
Use Job Cost Reporting (continued)

Comparisons (continued)

The completed report can offer a concise picture of the costs, profits, contract value, billings, and field effort for management information and control purposes.
Manage Business Cash

Introduction

Managing cash effectively can mean the difference between success and failure in the construction industry where more contractors fail because of poor cash flow than because of poor profitability. Therefore, the skill with which the emerging contractor manages cash has a direct effect on the contractor’s overall financial health.

Importance of cash

Cash is not just a number on a balance sheet—cash is a tool that, when used effectively, drives the company’s operations. Cash enables the company to meet current financing obligations and provides an opportunity to generate additional profit with the investment of disposable cash in either new contract activities, fixed assets, or investments.

Responsibility for cash management

In very large construction organizations, an individual may be assigned the sole responsibility for cash management. In smaller or emerging companies, the owner or accounting manager may assume the cash management responsibilities as part of his or her other primary responsibilities.

Cash responsibilities include:

- custody of the cash funds and administration of the bank accounts.
- maintenance of good bank and other creditor relationships.
- cash receipts and disbursements procedures.

continued on the next page
Manage Business Cash (continued)

Responsibility for cash management (continued)

In addition, these responsibilities typically include the following activities:

- development of some or all of the cash forecast/projection;
- review of the internal control system with respect to cash receipts and disbursements to assure its adequacy and effectiveness and procedures established;
- reconciliation of bank accounts; and
- preparation of cash management reports.

In the emerging contractor environment, these responsibilities may be shared with the accounting manager and/or the company’s outside accounting service.

Assign responsibility and authority

It is important that both large and small construction companies assign cash management responsibilities to an individual who participates as part of the company’s management team. Cash management should become part of that individual’s job description and should specifically describe his or her responsibilities including authority over cash transactions.

When defining responsibilities, consider the controls over cash particularly when addressing the segregation of duties. An ideal situation assigns the cash management responsibilities to an individual who is not involved with the day-to-day accounting of cash transactions. For the small emerging contractor this may not be possible; therefore, the owner’s involvement in this area is critical.

continued on the next page
The project manager's involvement in the process

Regardless of the company's size, the controller, accounting manager, or bookkeeper must include the owner and project manager in the cash management process. A project manager can have more influence on the cash flow of a contractor than any single individual in the organization. This is the case because a project manager is more aware of the job activities and is typically responsible and/or knowledgeable about the following:

- has the direct line of communication with the owner or general contractor;
- manages the subcontractors including coordination of the delivery of materials and supplies;
- knows the exact job status on a daily or weekly basis;
- has the authority to resolve performance problems as they arise;
- knows why payment is being delayed by the owner or general contractor; and
- knows why payments to subcontractors or suppliers should be delayed.

The project manager can more effectively negotiate the timing and amount of collection because of his or her relationship with the owner and knowledge of job specifics. He or she can resolve owner disputes and can determine whether subcontractors and suppliers have performed according to the contract.
Manage Business Cash (continued)

Controller, accounting manager, or bookkeeper involvement

The project manager's involvement does not diminish the controller's, accounting manager's, or bookkeeper's responsibilities. These individuals must provide cash flow forecast models and cash flow reports on each contract. The accounting department must generate accurate and timely information, such as regular contract receivables aging and cash receipt schedules, so that the project manager can effectively manage contract billings and collections.

Although cash management is clearly a team effort, the project manager can have a substantial impact on cash flow; therefore, the project manager must be very involved in the process.

Cash management functions

The objective of a cash management is to maximize cash as an investment and as a vehicle to meet current obligations. Each of the following cash management functions can be performed exclusive of each other, however, a properly managed plan will consist of a balance of all four functions.

Forecasting cash flow

A cash flow forecast enables your company to predict future cash needs by examining past and future project billings, cost, overhead expenses, etc. The forecast can be prepared on a project by project basis, and combined to produce a company-wide forecast. Additionally, a cash forecast will help identify those periods surplus cash is available for investment.

continued on the next page
Manage Business Cash (continued)

Cash management functions (continued)

Accelerating cash receipts and decelerating cash disbursements
This strategy is an attempt to create and maintain as much usable cash as possible by speeding the billing process, slowing the disbursement process and managing bank float. These strategies are often employed for both project-related receipts and disbursements, and fixed and variable operating expense disbursements.

Using surplus cash
Surplus cash generally follows peak seasonal billings, receipt of proceeds from loans, and earlier than expected collection of accounts receivable/retainage. The company's daily cash reports for its operating and investment accounts can be used to identify the excess cash. When a contractor finds himself or herself in an excess cash position, the company must determine whether to make an investment or to pay off outstanding debt. When making an investment, the contractor must consider the safety, liquidity, return, and taxability of the investments.

Obtaining short-term financing
Cash on a short-term basis is often required to meet current obligations and restore balances to required levels. The need to obtain short-term cash can be satisfied by looking first to suppliers and customers. Next, the contractor may have to turn to the bank or a factor.

continued on the next page
**Manage Business Cash (continued)**

**Short-term financing**

Just about any emerging contractor has to obtain some short-term financing. Obtaining short-term financing is often necessary to fund cash flow shortages. Financing should be done internally first and then externally with third-party lenders. Obviously, internal financing is cheaper. Short-term financing is also generally cheaper and easier to obtain than long-term loans because of the reduced risk and lack of collateral. Risk is reduced because the loan period is short term. And, because the loans are often unsecured, they are easier to process than secured loans.

**Types of short-term financing**

Various types of financing are available for contractors to fund their short-term cash shortages. These alternatives can vary significantly in regard to borrowing cost and collateral. With the exception of a traditional bank line of credit, controllers should avoid these alternatives due to increased financing costs.

Types of short-term financing available include the following:

- Lines of credit
- Demand notes
- Factoring and receivable financing
- Asset-based lending

**Lines of credit**

Lines of credit exist in varying types and are generally available through banks. A line of credit is a financing solution whereby the bank lends a predetermined amount as the company needs it. Because sureties often require contractors to have lines of credit to support negative cash flows, these credit facilities are widely used in the construction industry. Lines of credit can be secured and unsecured, but in the case of an emerging contractor, creditors will expect to obtain collateral and guarantees. Interest rates charged on balances outstanding are often at a rate that floats with other market rates, such as the prime rate. Lines of credit are generally renegotiated annually.

*continued on the next page*
Manage Business Cash (continued)

Demand notes
Demand notes are sometimes unsecured notes with no particular maturity date but are due on the demand of the noteholder. Lines of credit are sometimes converted into demand notes. This financing solution also fluctuates with various market rate indices, such as the prime rate.

Receivable financing and factoring
A contractor’s receivables can be used to obtain financing from commercial finance companies. Generally, advances are made with accounts receivable pledged as collateral for the short-term financing. The advance is usually limited to 50 to 80 percent of the available account receivable pledged. Liens rights are often not obtainable by the finance companies. The mechanics of collections and advances can be negotiated with the finance company.

Receivable factoring results in a sale of the accounts receivable at a discount to either a bank or, more often, a finance company. The receivables are often sold with or without recourse. Because discounts typically range in the 10 to 20 percent range, controllers should avoid this source of financing as the discount is often greater than the profit on their contracts.

Asset-based lending
Asset-based lending is typically awarded by commercial finance companies that will generally maintain tight control over the collateral, which is typically inventory or fixed assets. This approach generally is used when contractors are a high risk for banks or the banks will not accept the available collateral. Obviously, the effective rates of interest are higher than lines of credit or demand loans, making these loans unattractive to contractors.

continued on the next page
Manage Business Cash (continued)

Sources of financing

There are generally two approaches to take when seeking additional cash funds to finance operations or asset acquisitions of an emerging contractor. Before pursuing outside financing, contractors should critically assess whether cash can be found in the company.

Internal sources

Controllers should carefully analyze each of the company’s key functional areas before pursuing external financing sources. The company’s cash needs may be satisfied by improving working capital management and internal cash management. Even if lenders are willing to provide funds, the company can reduce its financing cost—resulting in improved profits.

Most contractors can find various opportunities to improve key functional areas and increase cash flows. Common areas for generating internal financing, some of which have been addressed earlier, include the following:

- Improved cash management
- Improved accounts receivable management
- Reducing material or supplies inventory
- Managing accounts payable
- Controlling capital expenditures
- Reducing expenses

To capitalize on each of these areas, owners—with the help of the accountant—must take a disciplined approach to analyzing when and how much additional cash can be generated in each area.

continued on the next page
Manage Business Cash (continued)

Sources of financing (continued)

External sources
When external financing is necessary, generally a controller’s first impulse may be to pursue a loan from the bank with which the company has its deposit account relationship. At a minimum, the contractor should contact several banks to increase competition among the banks. Competition may result in more favorable financing terms. However, the controller should also consider other external sources that may prove easier to procure and less costly.

The following summarizes some of the types of external financing available to contractors. In some instances, several sources may be able to provide the necessary financing. This may be more cost effective than using one source of financing. The external sources and types of financing are as follows:

- Private Sources
  - Related businesses
  - Partners, stockholders, or employees
  - Relatives or friends
  - Vendors
- Commercial Banks
  - Lines of credit
  - Accounts receivable financing
  - Real estate loans
  - Government-guaranteed loans
  - Equipment term loans
  - Commercial term loans
  - Letters of credit
- Leasing Companies
  - Equipment leasing
  - Sales and leaseback
- Commercial Finance Companies
  - Secured loans
  - Factoring

continued on the next page
Manage Business Cash (continued)

Sources of financing (continued)

External sources

- Government Agencies
  - Small Business Administration
  - Other specialized federal or state programs
Module B

Building the Business Team
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B. Building the Business Team

Overview

Introduction

Your success lies in the mutually productive relationships your company develops with other professionals. As an emerging contractor, your business has grown beyond the one-person shop. Your projects are more complex and the business management of your company must grow to meet the new challenges.

In this module

This module is divided into 10 topics. Each topic identifies a basic business activity that is critical to your success as an emerging contractor. Each topic comprises specific tasks to enable you to perform the business activity.

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Select a Construction Accountant

Introduction

Construction accounting is unique to the industry. A construction accountant is familiar with the particular challenges faced in the construction industry. For example, these specialized accountants know what the profit margins are on a national and local level so they can advise you on your relative performance. They are experienced in issues that only affect contractors.

Definition: Bookkeeper

A bookkeeper is a professional who records the accounts and transactions of a business. These records are the basis for financial and tax reports prepared by an accountant.

Definition: Accountant

An accountant is a professional who keeps, audits, and inspects financial records of a business and who prepares financial and tax reports.

Definition: Certified Public Accountant (CPA)

A CPA is an accountant who has met state legal requirements for certification based on demonstrated knowledge. A CPA is required to complete a specific number of continuing education hours on an annual basis to maintain the certification.

Why do I need a construction accountant?

An accountant familiar with the typical pitfalls and trials that face a construction company can take a proactive approach to help prevent problems from developing. A specialized accountant also understands the terminology that is used in the industry (e.g., work-in-progress, overbilling, underbilling).

continued on the next page
Select a Construction Accountant (continued)

Why do I need a construction accountant? (continued)

These professionals can advise you in setting up your bookkeeping system, organizing tax reporting information, and possibly selecting accounting software that best suits your size company.

What does this professional do for my business?

In general, an accountant influences and promotes better financial discipline in the company and may free up some time for the owner to focus on other areas of the business.

An accountant prepares financial and tax reports that help management to

- understand past performance (income statement),
- evaluate present status (balance sheet), and
- plan for future results (budget).

An accountant can also advise you on

- Budgets
- Job costing
- Taxes (sales, withholding, state, federal, property, income)
- 1099s, W-2s
- Lease versus own options
- Depreciation
- IRS and state tax audits
- Lines of credit
- Financing applications and reporting procedures
- Business organization (corporation, LLP, LLC, etc.)
- Bonus or incentive options
- Hiring a bookkeeper

From the Field
Get a construction-specialized professional.

continued on the next page
Select a Construction Accountant (continued)

What is the fair market value for this service?

Hourly fees range from $20 to $150 per hour. This varies not only by region of the country, but also by the level of involvement and services provided to the company. Check with your local professional association for ranges.

Keep in mind that your own bookkeeping and accounting methods influence the fee. If your information is clearly organized, systematically gathered, and accurately reported, this lessens the amount of time an accountant spends in report preparation.

How do I select this team member?

Ask friendly competitors which accounting firm they use. You want to find someone who is knowledgeable about both the industry and the local market. Word-of-mouth recommendations are valuable. You can network with your peers to locate a team player who adds value to your emerging enterprise.

Consider asking the following questions of prospective accountants:

- Are you a member of the American Institute of Certified Public Accountants (AICPA) or similar organization?
- Are you a member of a construction industry group?
- What other construction clients do you work with?
- Do you have experience with various tax methods and job costing/revenue recognition procedures?
- Do you have professional liability insurance?
- Do you have peer reviews available as references?
- Is there sufficient staff to handle busy periods and/or illness, disability, vacation, etc.?
- Who will be assigned to work with my company accounts?

continued on the next page
Select a Construction Accountant (continued)

Select an accountant

Use the following steps to select an accountant.

**Step Action**

1. Ask competitors, banker, bonding agent, and/or association members for recommendations.

2. Develop a list of three candidates.

3. Interview each candidate. Ask
   - What services they propose to offer
   - What the fees for these services are
   - What construction-specific references they have
   - What their opinion of your business philosophy is
   - How they view their relationship with your company

4. Select an accountant that best matches your company needs and who can help you get where you want to go.

How do I know if I need staff on board for this work?

This decision will depend on several issues. When your business grows beyond the point where you or other existing members of your staff can keep current on record keeping issues, it is certainly time to hire a bookkeeper. When you need an accountant on staff depends on the complexity of your business, types and levels of financing sought, sophistication of your reporting systems, and the like.

*continued on the next page*
Who within my company deals with money issues?

As an emerging contractor, you will more than likely deal with all money issues until you reach the size where a bookkeeper is necessary. Depending on the size of your operations, any of the following people are involved in money management issues.

- Owner
- Chief financial officer (CFO)
- Bookkeeper
- Payroll
- Accounts receivable
- Accounts payable
- Purchasing
- Project manager

Depending on their role, project managers are sometimes responsible for ordering supplies, materials, and equipment. This makes them aware of the job cost impact of these items. Project managers may not necessarily be aware of the financial condition of the business, but they know the job costs and how these relate to the projects.

Who in my company maintains a daily awareness of finances?

As a small business owner, you should always be aware of your financial position. As you grow, you can hire others to share this knowledge.

continued on the next page
Select a Construction Accountant (continued)

How often should I evaluate my financial status?

Have an accounting evaluation at the following milestones.

- Tax year end: Audited, reviewed, or compiled financials as needed internally or as required by bank and/or surety
- Six-month interim: Usually a step down in form from year-end report, i.e., if audit at year-end, then review at six months; if review at year-end, then compiled at six months
- Monthly: In-house balance sheet and income statement (another step down from the six-month report)
- Tax audits
- Requests from banks, surety, bonding agents, etc.

Definition: Audit

An audit is when a CPA verifies the balance sheet and income entries on the financial statement via outside sources, with the necessary reference notes to back up the balance sheet data. The CPA can be held accountable for these data when it is used by credit/surety lenders.

Definition: Review

A review is when a CPA personally reviews the accounting records of the contractor and gives his or her professional opinion on the data.

Definition: Compiled financials

Compiled financials result from when the contractor gives data to the CPA and the CPA simply compiles it into a standard format without checking its authenticity. In other words, the data may or may not be true. Good CPAs still do some verifying of information.
Select a Corporate Lawyer

Introduction

You know how to build. This is your area of expertise, as demonstrated by your continuing success as an emerging contractor. There are many legalities involved in owning and running a business. In some instances, a business owner may also be a legal authority, but in most cases not. You need a professional who will advocate your company in business dealings.

Why do I need a corporate lawyer?

You need a corporate lawyer to advise you so that you are proactive instead of reactive on legal questions and concerns. Not only do corporate lawyers advise on legal issues, but they also maintain your corporate status to keep the company in compliance with current laws and regulations.

Lawyers also can research concerns you may have regarding possible employee fraud, labor issues, execution of contract provisions, and other such issues.

What does this professional do for my business?

A corporate lawyer may provide any of the following services.

- Interpret contract language
- Select best business structure
- File lien notices
- File and respond to lawsuits
- File surety claims
- Set up wills, continuity plans, estate plans, trusts
- Advise on legal liability insurance needs
- Advise on bankruptcy issues of owners, general contractors, or trade contractors
- Help develop employee handbooks and benefit plans

continued on the next page
Select a Corporate Lawyer (continued)

What is the fair market value for this service?

Fees are directly related to the lawyer’s level of experience. In some parts of the country, fees may range from $50 to $250 per hour or higher.

Some firms require a retainer and then invoice monthly depending on services provided. Others may charge by the task completed. Understand the billing structure before you hire a lawyer.

How do I select this team member?

Ask friendly competitors which legal firm they use. Word-of-mouth recommendations are valuable. You can network with your peers to locate a team player who adds value to your emerging enterprise.

Consider asking the following questions of prospective corporate lawyers.

- Are you a member of a construction trade association?
- Are you a member of the local bar association?
- Is there someone on staff with specific construction law experience?
- Do you have professional liability insurance?
- Are you current on claims (liens, surety, government) processes in my company’s area of business?
- Are you active in trade area construction legislative efforts?
- Do you work for any of my competitors?
- Do you work for any of my clients?
- Is there sufficient staff to handle busy periods and/or illness, disability, vacation, etc.?
- Who will be assigned to work with my company’s issues?
- How do you charge?

From the Field

Don’t hire the first or the cheapest team member candidate.

continued on the next page
Select a Corporate Lawyer *(continued)*

What is the difference between types of lawyers?

Law is a highly specialized field. Just like doctors practice a specialty such as internal medicine or pediatrics, lawyers devote time to different types of legal issues. Areas of expertise may include, but are not limited to

- Foreclosures, real estate issues
- Contract law (contracts, liens, private/local/state/federal projects)
- Family law (divorce, custody, inheritance, trusts)
- Business (incorporation, joint venture, LLP, LLC, IPO)
- Estate, tax, continuity, buy-sell agreements, wills, trusts, life insurance
- Political

How do large and small law firms compare?

**Small firms**

- Usually deal with the founding partner or owner
- Clients are treated as valued individuals
- Less likely to be assigned to a junior partner
- Usually have good understanding of local market and practices
- May not have the resources to handle complicated issues

**Large firms**

- High overhead cost
- Less likely to deal with founding partner or owner
- More likely to be assigned to a junior partner
- Have ample staff available
- Can handle complicated issues
- Have offices in other states
- May cross sell other services

*continued on the next page*
Select a Corporate Lawyer (continued)

How do I know if I need staff on board for this work?

Small organizations rarely need legal counsel on staff.
Select a Construction Lawyer

Introduction

As previously discussed, legal issues are complex and exacting. It is often to your benefit to seek expertise. By finding a lawyer with experience in construction-related legal matters, you increase the likelihood of solving problems quickly and efficiently.

Why do I need a construction lawyer?

Although any lawyer may, theoretically, solve any legal question or issue, someone who specializes in industry-specific law saves you time and money. Research is an integral part of any legal proceeding. The more familiar a lawyer is with the construction industry and its unique situations, the faster an issue can be addressed and resolved.

What does this professional do for my business?

A construction lawyer may provide any of the following services.

- Interpret contract language
- Select best business structure
- File lien notices
- Respond to lawsuits
- File lawsuits
- File surety claims
- Advise on legal liability insurance needs
- Advise on compliance issues for state, local, and federal contracts
- Advise on bankruptcy issues of owners, general contractors, or trade contractors

From the Field

Count on fellow contractors to recommend or refer candidates for your teambuilding.

continued on the next page
What is the fair market value for this service?

As with corporate lawyers, fees are directly related to the lawyer’s level of experience. In some parts of the country, fees may range from $50 to $250 per hour or higher.

Some firms require a retainer and then invoice monthly depending on services provided. Others may charge by the task completed. Understand the billing structure before you hire a lawyer.

How do I select this team member?

Follow the suggestions given earlier for selecting a corporate lawyer, including contacting your state or national trade association.

Consider asking the following questions of prospective construction lawyers.

- Are you a member of a construction trade association?
- Are you a member of the local bar association?
- Do you have professional liability insurance?
- What percent of your business is construction-related?
- Are you current on claims (liens, surety, government) processes in my company’s area of business?
- Are you active in trade area construction legislative efforts?
- Do you work for any of my competitors?
- Do you work for any of my clients?
- Is there sufficient staff to handle busy periods and/or illness, disability, vacation, etc.?
- Who will be assigned to work with my company’s issues?
- How do you charge?

How do I know if I need staff on board for this work?

Small organizations rarely need legal counsel on staff.
Select/Establish a Relationship with a Commercial Bank

Introduction

Commercial banks are much better equipped to provide construction loans, working capital lines of credit, and equipment financing than are typical savings and loan-type banks. A personal banker can be an ally in your business dealings.

Why do I need a commercial bank?

Most lending institutions can establish a savings and checking account for your company. You will need the resources of a commercial bank when establishing a line of credit for cash flow purposes during construction projects. Construction projects require a certain amount of working capital for mobilization or start-up. There will be times when your cash flow will require you to borrow working capital on a short-term basis. An already established line of credit keeps your business moving.

Commercial banks will understand the nature of your business and be able to interpret your financial statements. Experience leads them to understand that you may have retainage on your company books while payroll costs continue to be expended. Commercial banks are prepared for owners who must catch up with payments and are prepared to extend a line of credit to the contractor.

Commercial institutions can help you navigate through the typical workload/backlogs that affect a construction company. They are in a position to help you when prepaying long lead items, adjusting to seasonal demands, awaiting settlement on disputed items, and supplying cashier checks. The institutions can also provide your company with an Irrevocable Letter of Credit, if required.

continued on the next page
Select/Establish a Relationship with a Commercial Bank (continued)

What does this professional relationship do for my business?

An established relationship with a commercial bank helps secure your financial standing. These institutions

- Establish lines of credit
- Provide financing for
  - Equipment
  - Buildings
  - Expansion of the business
  - Inventory
- Provide letters of credit
- Acts as a credit reference to
  - Suppliers
  - Sureties
  - Credit reporting agencies
  - Other businesses, contractors, etc.
- Cover overdrafts
- Set up money market accounts, certificates of deposit
- Set up business checking and savings accounts
- Provide investment advice
- Provide depository withholding tax
- Provide for electronic draft of payroll taxes deposits

Why do I need a line of credit?

An established line of credit is a financial safety net. It allows you to meet payroll demands that occur before you have collected from the owner. It may also enable you to pay suppliers to receive special discounted payment terms. In some situations it makes business sense to borrow against a line of credit to reap these discounts.

Remember the adage, “When you don’t need it, it’s available and when you need it, it isn’t.” Establish a line of credit even if you don’t need it right now.

continued on the next page
What is the fair market value for this service?

Costs may run from zero to 18 percent or more. This varies from bank to bank depending on market conditions and the size of your business account. There are bankers who specifically seek out small businesses.

Charges that may be assessed include but are not limited to the following situations:

- Using the line of credit (current interest rate, e.g., Wall Street Journal, Prime Rate)
- Using credit card (may be 18 percent or more)
- Using CDs as collateral (may be 2 to 3 percent)
- Buying automobiles (may be 2 percent via manufacturer versus bank)
- Buying equipment (may be 4 to 8 percent, depending on manufacturer versus bank, new versus used)

What a bank charges its customer depends in some part on:

- Collateral
- Personal guarantees
- Financial strength of the contractor
- Credit history
- Percent of work that is bonded

continued on the next page
Select/Establish a Relationship with a Commercial Bank (continued)

How do I select this team member?

Most importantly, you want to find someone you can work with. Establish a rapport with your personal banker, someone who will be your business ally. You want to find a banker who will help you in times of need and understands your company.

Consider asking the following questions of prospective commercial banks.

- Does the bank solicit or look favorably on contractors?
- Does the bank have other contractor clients?
- Does the bank have local authority?
- Will you have access to the local president and senior loan officer?
- What is the background of your contact person?
- Which surety agents has the bank worked with who can provide references?
- Which equipment suppliers has the bank worked with who can provide references?
- What other references can the bank provide?

Who do I see when I go to a commercial bank?

Always go as high up the organizational ladder as possible. If you can meet with the bank president or the senior loan officer, you have more chance at speaking with the actual decision makers at the bank. Loan officers seldom have the vested authority to approve financial decisions alone. In larger banks, you may be meeting with the branch manager or vice president for operations.

continued on the next page
Select/Establish a Relationship with a Commercial Bank (continued)

How do I decide between a regional or local bank and a national bank?

This depends on your needs and the size of your company. Most small businesses do well with a locally owned bank. If you are a national contractor, a national bank may be better. You have to find someone you feel comfortable dealing with and who inspires confidence in his or her ability to understand your particular business needs.

Regional or local banks
At a regional or local bank, there is a better chance that you will work with the top management of the bank. Local banks have more authority and can often move faster on decisions. You can also monitor progress more easily.

Local banks may not have the capacity or products that best suit your business. These banks are more volatile because of their relationship with the local economy that affects your company as well. If your company’s deals depend on one person, you may be stuck waiting if that person is out of the office.

National banks
At a national bank, there are often more resources and products available to serve your company. These banks are often staffed with sufficient personnel that you don’t have to wait for a particular officer of the bank to conduct business. National banks are less dependent on the local economy and may be less volatile.

It is not likely that you will work with top management at a national bank. These banks seldom have local authority and may have to process your business through a central office in a different city or state. There are more levels to work through, which may slow down the process. Small contractors may not get much attention at a large national bank.
Select a Construction Bonding Agent

Introduction
Since 1893, the US government has required contractors undertaking federal public work contracts to post contract surety bonds guaranteeing that they will perform such contracts and pay certain labor and material bills.

The Miller Act of 1935 requires performance and payment bonds for all public works contracts in excess of $100,000.

Definition: Contract surety bond
A contract surety bond is a risk transfer mechanism where one party guarantees to another that a third party will perform a contract. The three parties involved are the surety, the owner, and the contractor.

A surety bond provides financial security and construction assurance on building and construction projects by assuring project owners that contractors will perform the work and pay certain subcontractors, laborers, and material suppliers.

Types of contract bonds
There are three basic types of contract surety bonds
- bid
- performance
- payment

For years, contract surety bonds have been mandated by law for federal public construction projects. Many state and local governments also require contract surety bonds on their public construction projects. Contract surety bonds have also been used voluntarily for many private projects as well. Moreover, an increasing number of construction financiers are now recognizing the wisdom of requiring contract surety bonds to protect loans secured by private sector projects.

continued on the next page
Select a Construction Bonding Agent (continued)

Definition: Bid bond
A bid bond provides financial assurance that the bid has been submitted in good faith and that the contractor intends to enter into the contract for the bid price and will provide the required performance and payment bonds. There is seldom a premium charge or fee for bid bonds or bid letters.

Definition: Performance bond
A performance bond protects the owner from financial loss should the contractor fail to perform the contract in accordance with its terms and conditions.

Definition: Payment bond
A payment bond guarantees that the contractor will pay certain subcontractors, laborers, and material suppliers associated with the project.

Functions of contract surety bonds
Contract surety bonds perform the following functions:

- Performance bonds guarantee that the bonded project will be completed according to the terms of the contract and at the determined price of the contract
- Payment bonds (also called labor and material payment bonds) guarantee that certain laborers, suppliers, and subcontractors will be paid even if the contractor defaults and can result in lower prices and expedited deliveries
- Relieve the owner from the risk of financial loss arising from liens filed by unpaid laborers, suppliers, and subcontractors
- Smooth the transition from construction to permanent financing by eliminating liens
- Reduce the possibility of the contractor diverting funds from the project
- Provide an intermediary—the surety—to who the owner can air complaints and grievances
- Lower the cost of construction in some cases by facilitating the use of competitive bids

continued on the next page
Select a Construction Bonding Agent (continued)

Primary function of suretyship

The primary function of suretyship is to qualify contractors. A surety must shoulder the burden of risk. Because of this, surety companies prequalify contractors through an in-depth look at the business operations of the contractor.

Sureties have played an important role in the construction industry’s success, allowing the industry to sustain its position as one of the largest contributors to the nation’s economic stability and growth.

Before issuing a surety bond the surety needs to be fully satisfied, among other criteria, that the contractor is

- of good character
- has experience matching the requirements of the project
- has or can obtain the equipment necessary to do the work
- has the financial strength to support the desired work program
- has an excellent credit history
- has established a bank relationship and a line of credit

Benefits for a contractor

When a contractor provides a contract surety bond, other parties involved in the project are assured that he or she has met the surety company’s rigorous prequalification standards.

Other types of bonds

There are other types of bonds that may be associated with a job, depending on the location and owner requirements. Bonds may include, but are not limited to

- Maintenance
- Tax
- Compliance
- Subcontract performance and payment
- Union benefits

continued on the next page
Select a Construction Bonding Agent (continued)

Other types of bonds (continued)
- Environmental
- License
- Design/Build
- Efficiency
- Supply

Why do I need a construction bonding agent?

A professional bonding agent is a broker or go-between for an emerging contractor and several underwriting companies. The agent acts as a representative for the contractor in locating the most advantageous bonding arrangement with a underwriting company.

By the nature of their business, bonding agents have seen the best of times and the worst of times for many different contractors. They are valuable resources for business advice.

A bond agent keeps current on local legislation and the contractor’s trade area. This is important for both parties to work well together.

A bonding agent is not the same as an insurance agent. While a person may do both, these are very different jobs.

continued on the next page
Select a Construction Bonding Agent (continued)

What does this professional do for my business?

A good bonding agent is a value to your growing company. The agent

- Acts as a consultant in the selection process of other team members (e.g., banker, lawyer, accountant)
- Helps to establish a bond program. This program revolves around two numbers—largest single size project and total amount of bonded work outstanding at any one time.
- Helps the contractor with plans to grow the business, including discussions on
  - cash flow
  - long-term versus short-term debt
  - equipment financing
  - bank financing
  - reputable subcontractors and general contractors
  - possible working relationships with various owners and project managers
- Helps the contractor increase his or her bond program
- Supplies needed bonds in a timely manner

continued on the next page
Select a Construction Bonding Agent (continued)

What is the fair market value for this service?

A bonding agent is paid commission by the underwriting company. This commission is based on a percent of the bond premium. From the contractor’s perspective, all bonding agents cost the same. Agent’s commissions generally range from 10 to 40 percent of the total premium charged.

Bond rates are based on the contractor’s financial strength and experience. There are standard rates issued by surety companies; these rates can vary slightly between companies. The following is an example of a standard rate table.

<table>
<thead>
<tr>
<th>Contract Price</th>
<th>Rate per Thousand</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $100,000</td>
<td>$25.00</td>
</tr>
<tr>
<td>Next $400,000</td>
<td>$15.00</td>
</tr>
<tr>
<td>Next $2,000,000</td>
<td>$10.00</td>
</tr>
<tr>
<td>Next $2,500,000</td>
<td>$7.50</td>
</tr>
<tr>
<td>Next $7,500,000</td>
<td>$6.50</td>
</tr>
</tbody>
</table>

Using the above table, a bond for a $100,000 project would cost $2,500. A bond for a $500,000 project would cost $8,500 ($2,500 + $6,000). A bond for a $1 million project would cost $13,500 ($2,500 + $6,000 + $5,000). Large, stable contractors may qualify for a preferred rate that may be from 10 to 50 percent off standard rates. Some construction work of a lesser risk may be subject to a lesser rate (e.g., supplying carpet). Also, most surety rates are governed by the individual state insurance departments and can vary widely.

continued on the next page
Select a Construction Bonding Agent (continued)

How do I select this team member?

You must find someone you can work with easily. This relationship is vital to your success. The National Association of Surety Bond Producers can provide a listing of bonding agents in your area (call 202/686–3700).

Consider asking the following questions of prospective bonding agents:

- Are you a member of a construction trade association?
- Are you active in a professional surety association?
- Do you meet all agent licensing requirements in the states where I do business?
- Do you have professional liability insurance?
- What percent of your business is construction-related?
- Can you service my trade area?
- What references can you provide?
- Which surety companies do you work with? What are their ratings?
- May I review your personal financials as an example of your credit and risk positions?
- Do you work for any of my competitors?
- Do you work for any of my clients?

How do I decide between a small versus large agency?

Selection depends on the size of your company and where you expect to grow in the future.

Small agency

- As an owner, you should be able to meet with your counterpart
- Should be more flexible, with no large board of directors requirements
- Should receive more attention if you are a significant part of the agency's overall business
Select a Construction Bonding Agent (continued)

- May not get the service when the person in charge is out; may not be accessible when needed
- May not represent many competitive markets
- May not be able to service work outside the local area

Large agency
- Can service on a nationwide or worldwide basis
- Has more products available
- Has more markets to explore for best coverage at lowest rate
- May be difficult to meet with an owner, president, partner
- May be considered a lesser account if your company does not represent a significant part of overall book of business
- May practice market blocking
Select a Construction Insurance Agent

Introduction

Insurance is one of the single largest expenses of any construction firm. Having an uncovered loss is a sure way to quickly bankrupt your company. Most emerging contractors’ knowledge of insurance comes from their experience with their home and automobiles. Commercial insurance is much more complex.

Why do I need a construction insurance agent?

Insurance companies that look for construction business change constantly. Companies that offered competitive rates last year may not be offering good rates this year. Only insurance agents that work with contractors on a frequent basis are aware of which insurance companies to speak with to ensure that their clients are getting the best coverages at the best prices.

What does this professional do for my business?

Commercial insurance is a complex field. A construction insurance agent is familiar with the typical risks faced in the industry and is in a good position to advise you on both the types of insurance you should consider and the costs you will incur. The agent acts as your consultant to provide advice and information. The agent is your representative in dealings with insurance companies offering policies.

A good insurance agent is a value to your growing company. The agent

- May act as a consultant in the selection process of other team members (e.g., banker, lawyer, accountant)
- Helps to establish a comprehensive insurance program
- Helps the contractor with plans to grow the business, including discussions on risk management
- Helps the contractor increase his or her insurance program
- Supplies needed insurance in a timely manner

continued on the next page
Select a Construction Insurance Agent (continued)

Types of insurance

The following sections summarize recommended insurance coverages for contractors. Policies appear in bold italics, basic coverages within the policy appear in bold, desired additional coverages appear in regular type, and the optimal coverages appear in italics.

Business Auto Policy (BAP)

Contractors are exposed to the possibility of damage to roads from constant traveling by company vehicles going to and from the jobsite. Equipment transportation of this type often involves the hazards of low speeds and wide loads with an increased possibility of overturn. The merging in and out of flowing traffic by this heavy equipment can also present potential problems.

Business Auto Policy (BAP)

Liability Coverage

Owned

Drive other car coverage
Individual named insured
Employees as additional insureds
Delete fellow employee exclusion

Hired

Lessor as additional insured

Nonowned Autos

No Fault

Medical payments
Personal injury protection (PIP)

Uninsured Motorist

Uninsured motorist property damage
Underinsured motorist

Physical Damage Coverage

Loss payee

Specified Perils

Comprehensive

continued on the next page
Select a Construction Insurance Agent (continued)

Types of insurance (continued)

Physical Damage Coverage (continued)

Collision
Towing
Rental reimbursement
Citizens band radio coverage

Commercial General Liability (GCL)
Contractors are exposed to loss from bodily injury and property damage arising from their own torts as well as the actions of others for which they have assumed liability under a contract. Members of the general public and employees of other contractors or suppliers entering or working at the jobsite present a potential for bodily injury liability loss. This risk is heightened in areas where minors might have access to the jobsite during nonworking hours because of the “attractive nuisance” doctrine. Obviously, too, the location of a jobsite has an important effect on general liability exposures due to the varied legal climates, population densities, and property value concentrations.

Commercial General Liability (GCL)
Employee Benefits Liability
Waiver of Subrogation
Additional Insured
Damage to Insured’s Work (Completed Operations)
Delete:
Personal injury contractual exclusion
Fellow employee exclusion

Umbrella
Most construction contracts require limits that exceed what can normally be bought under primary policies (i.e., CGL, Auto, Employers Liability). The most effective way of purchasing higher limits is by means of an umbrella policy. Since umbrella policies have not been standardized, review these policies carefully to ensure that the coverage is properly arranged and coordinated with the primary policies.

From the Field
Don’t be afraid to voice your interests, goals, and beliefs to team members.

continued on the next page
Professional Liability
Contractors can generally cover the majority of their liability exposures through a well-structured automobile liability (BAP), general liability (CGL), workers compensation, and umbrella liability insurance program. However, certain contractors may have additional liability exposure due to the professional element of their business (i.e., design–build, construction management).

Workers Compensation
The coverage provided by workers compensation insurance applies only to claims made under the laws of the states designated on the policy information page.

It should be recognized that other states’ insurance is designed to cover incidental exposures. If operations begin in one of the states covered by other states’ insurance, the contractor should immediately inform the insurance agent so that the state can be added to the workers compensation insurance.

Workers Compensation and Employers Liability Policy

Statutory Coverage
- Executive officers, partners, sole proprietors
- Voluntary compensation

Other States Coverage
- USL&H
- Waiver of Subrogation
- Delayed notice of injury
- Alternate employer
- Foreign Workers Compensation

Employers Liability
- Stop gap endorsement

continued on the next page
Select a Construction Insurance Agent (continued)

Types of insurance (continued)

**Commercial Property Policy**

*Commercial Property Policy*

Building and Personal Property Coverage

**A. Building**

- Basic Causes of Loss Form
- Broad causes of loss form
- *Special causes of loss form*
- Blanket coverage
- Ordinance or law coverage
- Additional covered property—fences

**Actual Cash Value**

- Replacement cost
- *Agreed value*
- *Inflation Guard*
- Plate glass

**B. Business Personal Property**

- Basic Causes of Loss Form
- Broad causes of loss form
- *Special Causes of loss form*
- *Earthquake*
- *Flood*
- Earthquake sprinkler leakage

**Actual Cash Value**

- Replacement cost
- *Agreed value*
- *Functional replacement cost*
- Reporting

*continued on the next page*
Select a Construction Insurance Agent (continued)

Types of insurance (continued)

Commercial Property Policy (continued)

Extra Expense
  Basic Causes of Loss Form
  Broad causes of loss form
  Special causes of loss form
  Ordinance or law increased period of restoration

Difference-In-Condition (DIC)
  Earthquake
  Flood
  Collapse

Builders Risk/Installation Floater

During the course of construction, there is an exposure to direct property loss involving equipment and materials to be installed as well as work already put in place and any preexisting structures. Builders risk insurance is designed to cover these direct property damage risks. This policy is normally purchased by either the owner or general contractor and is designed to insure virtually all property that has been or is to be incorporated into the project. This coverage normally remains in effect until the entire job is completed.

An installation floater, which is normally purchased by trade contractors, is very similar to builders risk insurance. It is designed to cover direct property damage risks. However, an installation floater differs in that it normally covers property only during the period of installation. The purpose is to insure the materials and work put in place by the trade contractor before the work is completed and accepted by the owner. Most insurers use the exact same form to provide both builders risk coverage and installation coverage.

continued on the next page
Select a Construction Insurance Agent (continued)

Types of insurance (continued)

Builders Risk/Installation Floater

Completed Value
- Reporting form

Named Perils
- All risk

Specific
- Blanket
- Transit coverage
- Off-site storage coverage
- Scaffolding and forms coverage
- Plans, blueprints, and specs coverage
- Property of others
- Faulty workmanship
- Force Majeure
- Design error
- Testing coverage
- Performance guaranty (efficacy)
- Water damage
- Flood
- Collapse
- Mechanical breakdown
- Electrical apparatus breakdown
- Temperature extremes freezing or changes
- Debris removal
- Boiler explosion
- Loss of revenue
- Soft costs
- Waiver of subrogation
- Permissible occupancy

Actual Cash Value
- Replacement cost
- Agreed amount

continued on the next page
Select a **Construction Insurance Agent**  (continued)

**Types of insurance**  (continued)

*Difference-In-Condition (DIC)*

- Earthquake
- Subsidence

*Contractor's Equipment*

- **Scheduled Coverage**
  - Blanket coverage

- **Named Perils**
  - All risk
  - Replacement cost
  - Rented or leased equipment
  - Tools of employees
  - Waiver of subrogation
  - Loss payee
  - *Rental cost reimbursement*  
  - *Boom coverage*

Assess needs for other insurance for:

- **Valuable Papers**
- **Accounts Receivable**
- **Electronic Data Processing (EDP)**

[continued on the next page]
Select a Construction Insurance Agent (continued)

Types of insurance (continued)

**Crime**

*Employee Dishonesty*
  - Form A—Scheduled
  - Form B—Blanket
  - Forgery or alteration

*Office Burglary and Robbery*

*Theft, Disappearance, and Destruction*
  - Home of messenger

*Kidnap, Ransom, Extortion*
  - Transit
  - Extra Expense

What is the fair market value for this service?

An insurance agent is paid commission by the insurance company. This commission is based on a percent of the policy premium. From the contractor’s perspective, the owner must consider the intangibles—advice, promptness, support—when selecting an insurance agent.

*continued on the next page*
Select a Construction Insurance Agent (continued)

How do I select this team member?

Ask your peers and friendly competitors. Contact professional organizations (e.g., Independent Insurance Agents [IIA], Professional Insurance Agents [PIA], etc.) and your industry trade association for names of agents in your area.

Consider asking the following questions of prospective insurance agents:

- Are you a member of a construction trade association?
- Are you active in a professional insurance association?
- Do you meet all agent licensing requirements in the states where I do business?
- Do you have professional liability insurance?
- What percent of your business is construction industry specific?
- Do you have the resources to service my trade area?
- Which insurance markets do you work with?
- Do you have references?


Identify a Mentor

Introduction

Mentors can be valuable assets because of their experience with the ups and downs of their own successful business. A mentor is uniquely positioned to advise you on what does and doesn’t work. Why reinvent the wheel?

Why do I need a mentor?

A mentor should be someone with a proven track record. Look for a person with a history of success and profitability. A mentor is a skilled and trusted person teaching by example.

What does a mentor do for my business?

A mentor acts as a counselor on business matters. Areas where a mentor contributes to your company’s success include, but are not limited to:

- Setting standards and goals
- Providing hands-on opportunities
- Helping to design an implementation strategy and monitoring procedures
- Providing a sounding board for outside opinion and advice
- Contributing to
  - Marketing
  - Estimating
  - Contract negotiating
  - Job site management
  - Job costing, change orders, labor controls, requests-for-information, etc.
  - Internal controls and management information systems
  - Billings and collections
  - Financial reporting
  - Taxes

From the Field

Don’t be afraid to make your own decisions.

continued on the next page
Identify a Mentor (continued)

How do I find a mentor?

Most industry associations have members who will provide various levels of mentoring. In addition, you will hear from word-of-mouth of people who have demonstrated integrity and a willingness to “give back” to the industry.

Sources of mentors include

- Young executive programs
- Industry association programs
- Recommendations from attorneys, accountants, bonding agents, insurance agents

Should I have more than one mentor?

Multiple mentors can help you learn about the business on various fronts. You can develop a mentoring relationship with any of the following types of associates

- Insurance and bonding agents
- Banking professionals
- General contractors
- Equipment dealers
- Suppliers

The key is to not go to so many different people that you become ineffective in running your business. Do seek out people with both positive and negative experiences to get a balanced view of a particular issue.

Using the advice

Don’t expect a mentor to run your business for you. They are there for advice, which you should consider to the fullest extent when making a decision. Consider, also, that if you keep going against the advice of a mentor, the mentor will eventually find someone else more interested in taking the advice.
Select/Participate in Professional Associations

Introduction

A professional association represents your industry. It serves as a source of knowledge and experience to help you succeed. It also represents your interests through industry-related legislative activity. Professional associations are built by people who are interested in your type of business and each other.

Why do I need a professional association?

A professional association gives you access to
- Peers and mentors
- Networking with professional contacts
- Business development
- Training and education
- Leadership development
- Discounted services (insurance, purchasing)
- Business materials (forms, reports, marketing materials)
- Apprenticeship programs
- Craft training programs
- Social events
- Legislative representation
- Safety seminar classes
- Related businesses

What does a professional membership do for my business?

It enhances your image with business peers and clients. It provides you with opportunities to improve and grow your business through association with other successful business people. It improves you through training and education offerings.

From the Field

Get involved! Active members help other members.
Select/Participate in Professional Associations (continued)

How do I find a professional association?

To find state, regional, and local professional associations,
- Ask industry professionals
- Ask competitors and peers
- Search the Internet under “Construction” key word
- Look in the Yellow Pages, newspapers, construction publications
Be Involved in the Political Process

Introduction

As a matter of principle in a democratic society you should be involved in the processes that regulate and govern your livelihood.

Why should I be politically active?

No government has been able to successfully run a construction company. It has no incentive to succeed and be profitable.

Political involvement goes with your rights to own property and to seek redress. The War of Independence was waged over the issue of taxation without representation. By involving yourself in the process, you work toward having your interests represented and aired in the decision-making institutions that govern our country. You can influence current and new regulations as they are amended, repealed, modified, or updated. You can work to lessen the influence of special interest groups that works against your business.

What does political action do for my business?

Political action helps to

- Keep the United States competitive with other world players
- Bring fairness to issues dealing with
  - Taxes
  - Licenses
  - Tariffs
  - Fees
  - Unions

How do I become politically active?

Vote. Get involved with candidates and their issues. Join your industry political-action committees. Learn about what is happening in your county, city, and state.
Module C
Managing Business Operations
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C. Managing Business Operations

Overview

Introduction

Managing your business is comprised of financial, office, estimating/bidding, and quality control operations. There are benefits gained through the consistent, systematic handling of these aspects of your business. Relationships you build with owners, clients, contractors, and subcontractors enhance your ability to manage projects—and your company—for profit.

In this module

This module is divided into six broad categories with specific topics in each. Each topic identifies a basic business activity that is critical to your success as an emerging contractor. Each topic comprises specific tasks to enable you to perform the business activity.

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Financial business operations

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Financial Business Operations

Overview

Introduction

This first section of Module C covers basic financial business operations. The five business activities and their corresponding tasks covered are outlined below.

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Enforce Financial Policies

Introduction

As your business continues to expand, you should formalize your financial policies in writing and enforce them consistently. These policies cover operating issues such as invoicing, change orders, and signing checks.

Types of standard policies

The following is a list of typical standard financial policies.

- Check signing authority
- Contract signing authority
- Change order approvals
- Equipment and materials purchasing authority
- Lien release policy
- Field personnel signature authority

Check-signing authority

Most emerging businesses should limit the number of people who have check-signing authority. Typically, the owner(s) or designee in case of the owner(s) absence are the only people with the authority to sign disbursement checks and paychecks.

Contract-signing authority

Typically, only the company principals have the authority to sign a contract involving the commitment of the company’s resources. After the business begins to grow, additional individuals (e.g., estimator, project manager) are authorized to sign contractual agreements.

continued on the next page
Enforce Financial Policies (continued)

Change order approvals
In many companies, owners and project managers retain the authority to sign off on change orders. Without their approval, the change order cannot proceed. This policy should be reviewed with both clients and field personnel to eliminate misunderstandings.

Equipment and materials purchasing authority
Assigning the authority to approve equipment and materials purchases varies by company.

Lien release policy
Lien releases are a proactive approach to eliminating later problems with subcontractors, suppliers, and, in particular, second- and third-tier subcontractors and suppliers regarding amounts paid. It also addresses rights that are released once payment is received.

Signature authority in the field
Your policies should state clearly when, if ever, a field personnel signature is acceptable. Instances where this might be allowed include:

- Material purchases
- Subcontractor backcharges

Signature policy
A policy needs to be established with material suppliers regarding who within your company has the authority to purchase materials on credit.
Pay Suppliers and Subcontractors

Introduction

Sometimes the decision to pay a supplier or a subcontractor becomes an issue. Pay-if-paid clauses may exist in your state. In some states, these clauses do not stand up in court. Always check with your construction attorney regarding state laws that regulate payment obligations in contractual relationships.

Paying the supplier

In many instances, suppliers have a discount schedule that benefits the company. In this situation it is always advisable to pay the supplier first—unless the company must borrow funds to obtain a discount. This is counter productive.

Paying the subcontractor

Subcontractors are usually paid from funds paid by the owner. Typically, payment terms are specified in the subcontract agreement signed by the emerging contractor and the subcontractors. The following is an excerpt from a subcontractor agreement:

---

Section 1. Payment.

A. The Contractor agrees to pay the Subcontractor for the performance of this subcontract the sum of (Dollars and Cents) ($xx.00) subject to additions and deductions for changes agreed upon or determined as hereinafter provided.

B. Before the first application for payment, the Subcontractor shall submit a schedule of values allocated to the various portions of the work, prepared in a form specified by the Contractor, and supported by such data to substantiate its accuracy as the Contractor may require. This schedule, unless objected to by the Contractor, shall be used as a basis for reviewing the Subcontractor’s applications for payment.

C. Partial periodic payments will be made to the Subcontractor in an amount equal to XX% of the value allocated for such work requested for payment in subparagraph (B) above or as estimated by the Owner’s representative, less the aggregate of previous payments. Subcontractor shall submit request for payment on a Contractor’s Progress Billing form. Partial periodic payments shall become due to the Subcontractor ten (10) days after the Contractor receives payment for such work from the owner. No partial payment to the Subcontractor shall constitute approval or acceptance of work furnished hereunder, and all contract remedies are reserved by the Contractor. The Contractor may withhold from sums due the Subcontractor one-and-one-half times the costs anticipated as the result of any claim received from any unpaid entity with rights to claim a lien, or for other costs incurred or suffered by the Contractor and caused by the Subcontractor. ...

continued on the next page
Pay Suppliers and Subcontractors (continued)

Definition: Pay-if-paid clause

A pay-if-paid clause states the terms under which a subcontractor or supplier may be paid. For example,

"Partial periodic payments shall become due to the Subcontractor ten (10) days after the Contractor receives payment for such work from the owner."

These clauses may not be valid in your state. Check with your construction lawyer regarding the use of this type of clause.

Subcontractors paying suppliers

To ensure prompt and proper payment by subcontractors to their suppliers, many successful businesses require that subcontractors provide a notarized material release of lien from the supply companies.

In some situations, a subcontract bond may be required to minimize risk to the owner and the contractor.

Building good relationships with suppliers also allows you to monitor which subcontractors are paying their bills on time.

Sample contract language

Your subcontractor agreement form may contain specific language to govern the conditions of liens and claims. The following is an example.

Section 12. Liens and Claims.

Before issuing the Subcontract, the first payment by the Contractor, or at any time requested during the performance of this Subcontract, the Subcontractor agrees to submit to the Contractor, a list of all of its lower tier subcontractors, material suppliers, and any party furnishing labor, material, or other things in the performance of this contract and authorizes the Contractor to contact those listed directly to ascertain status of material delivery and payments made by the Subcontractor,

A. This list shall contain: name, address, and phone numbers of the above parties, contact person, and the dollar amount of their portion of the Subcontract.
**Pay Suppliers and Subcontractors (continued)**

B. Subcontractor shall, when required, furnish evidence satisfactory to the Contractor and Owner that claims for labor and material furnished the Subcontractor in connection with performance of this Subcontract have been paid, including claims for union health, welfare and pension fund payments, and all payroll taxes. Such evidence shall be furnished in such form and manner as required by Contractor, and all statements relative thereto shall, if called for by the Contractor, be made by sworn affidavit. The Subcontractor shall furnish to the Contractor releases to bond rights and lien rights by persons who have furnished labor, material, or other things in the performance of this Subcontract, it being agreed that payment may be held until such releases are furnished. Subcontractor shall deliver his or her labor and materials free from all claims, encumbrances, or liens.

C. If the Prime Contract requires that the Contractor waive his or her right to place liens on the Project or any part thereof, the Subcontractor hereby waives his or her rights to place liens on the Project and will cause suppliers, materialmen, mechanics, and subcontractors to waive their rights to place liens on this project.

**Definition: Subcontract bond**

A subcontract bond is a risk transfer mechanism where one party (surety company) guarantees to another (owner/contractor) that a third party (subcontractor) will perform a contract, including paying suppliers. It provides financial security and construction assurance.

For detailed information, see Module B *Selecting a Construction Bonding Agent*.

**Definition: Partial (interim) lien release**

A partial conditional lien release is a document signed by the subcontractor (or contractor) wherein the subcontractor (or contractor) waives his or her right to claim a lien against the property for payment for work performed or materials supplied through a specified date.

**Using partial (interim) lien releases**

You may require partial (interim) releases from the subcontractors as the project progresses. A sample progress billing form with partial lien release language follows.
Pay Suppliers and Subcontractors (continued)

Sample partial lien release form and subcontractor progress billing form

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<th>Subcontractor:</th>
<th>VID</th>
<th>Job:</th>
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<td>«Address»</td>
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<td></td>
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<tr>
<td>«CityStateZIP»</td>
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<td>«Telephone»</td>
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<tr>
<td>Job #:</td>
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<table>
<thead>
<tr>
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<th>$</th>
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<td>%</td>
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<td>$</td>
<td>%</td>
<td>$</td>
<td></td>
</tr>
</tbody>
</table>

1. Original Contract:
2. Approved Change Orders:
   1. Submod #
   2. Submod #
   3. Submod #
   4. Submod #
   5. Submod #
   6. Submod #

No changes to the contract amount can be billed without prior approval and/or a subcontract modification (submod) issued.

3. Revised Contract Amount To-Date:
4. Amount Completed To-Date:
5. Amount Previously Billed:
6. Total This Request:
7. Less: Retainage @ 0 %:
8. Amount Due This Payment:

(Line 4 from previous billing)
(Line 4 less line 5)
(Line 6 times retainage percent)
(Line 6 less line 7)

Upon receipt of the payment request on this billing, the undersigned does hereby release any and all mechanic's lien, stop notice, equitable lien, and labor and material bond rights against the above described property, for any labor service, etc., purchased, acquired or furnished for use on said premises. This release is for the benefit of, and may be relied upon, by the owner, prime contractor, construction lender, and/or the principal and surety on any labor and material bond posted for the project.

For all work shown in the above completed to-date, the undersigned does hereby represent and warrant that the undersigned has or will fully pay for all labor and materials, any and all welfare, pension, vacation, and other contributions required to be made on account of the employment of such laborers or mechanics so provided by the undersigned and does hereby agree to indemnify and hold each of the foregoing, the project, work of improvement and real property, free and harmless from any and all claims or liens for work completed through the above date.

By: ____________________________  Title: ____________________________  Date: ____________________________
Sample interim lien release

INTERIM LIEN/CLAIM WAIVER

FROM: 
ADDRESS: 
CITY, STATE, ZIP: 

PROJECT: 
PROJECT ADDRESS: 
CITY, STATE, ZIP: 

CONDITIONAL RELEASE

The undersigned does hereby acknowledge that upon receipt by the undersigned of a check from, “Company Name” in the amount of $<RetainAmp> and after proper endorsement and payment by the bank upon which it was drawn, this document shall become effective to release pro tanto any and all claims and rights of lien which the undersigned has on the above referenced project. This release covers a progress payment for labor, services, equipment, materials furnished and/or claims through «Date» only and does not cover any retention or item furnished after that date. Before any recipient of this document relies on it, said party should verify evidence of payment to the undersigned.

UNCONDITIONAL RELEASE

The undersigned does hereby acknowledge that the undersigned has been paid and has received progress payments in the sum of $<PaidtoDate> for labor, services, equipment or materials furnished to the above referenced project and does hereby release pro tanto any and all claims and rights of lien which the undersigned has on the above referenced project. This release covers payment for labor, services, equipment, materials furnished and/or claims through «Date» only and does not cover any retention items furnished after that date.

NOTICE: This document waives rights unconditionally and states that you have been paid for giving up those rights. This document is enforceable against you if you sign it, even if you have not been paid. If you have not been paid, use a conditional release form.

I CERTIFY UNDER PENALTY OF PERJURY UNDER LAWS OF THE STATE OF WASHINGTON THAT THE ABOVE IS A TRUE AND CORRECT STATEMENT.

SIGNATURE: (authorized corporate officer/partner/owner)

Notary: 
Dated this ___ day of ____ , 199___
My Commission Expires:

I CERTIFY UNDER PENALTY OF PERJURY UNDER LAWS OF THE STATE OF WASHINGTON THAT THE ABOVE IS A TRUE AND CORRECT STATEMENT.

SIGNATURE: (authorized corporate officer/partner/owner)

Notary: 
Dated this ___ day of ____ , 199___
My Commission Expires:
Pay Suppliers and Subcontractors (continued)

Definition: Final lien release

A final lien release is a document signed by the subcontractor (or contractor) at the completion of the job, wherein the subcontractor (or contractor) waives his or her right to claim a lien against the property for payment for work performed or materials provided.

Using a final lien release

Every business should have a financial policy that dictates the use of a final lien release.

continued on the next page
Pay Suppliers and Subcontractors (continued)

Sample final lien release

Subcontractor:  
«Contractor»  
«Address»  
«CityStateZIP»  
«Telephone»

VID  
«VID»

Job:  

Acct #:  
Job #:  
Phase #:  
«Phase»

Progress Billing #:  
Invoice #:  
Invoice Date:  
Billing Period From:  
To:

1. Original Contract:

2. Approved Change Orders:
   1. Submod #
   2. Submod #
   3. Submod #
   4. Submod #
   5. Submod #
   6. Submod #

   No changes to the contract amount can be billed without prior approval and/or a subcontract modification (submod) issued.

3. Revised Contract Amount To-Date:
4. Amount Completed To-Date:
5. Amount Previously Billed:
6. Total This Request:
7. Less: Retainage @ ____%:
8. Amount Due This Payment:

   (Line 4 from previous billing) ______________________________________
   (Line 4 less line 5) ______________________________________
   (Line 6 times retainage percent) ______________________________________
   (Line 6 less line 7) ______________________________________

Upon receipt of the payment request on this billing, the undersigned does hereby release any and all mechanic’s lien, stop notice, equitable lien, and labor and material bond rights against the above described property, for any labor service, etc., purchased, acquired or furnished for use on said premises. This release is for the benefit of, and may be relied upon, by the owner, prime contractor, construction lender, and/or the principal and surety on any labor and material bond posted for the project.

For all work shown in the above completed to-date, the undersigned does hereby represent and warrant that the undersigned has or will fully pay for all labor and materials, any and all welfare, pension, vacation, and other contributions required to be made on account of the employment of such laborers or mechanics so provided by the undersigned and does hereby agree to indemnify and hold each of the foregoing, the project, work of improvement and real property, free and harmless from any and all claims or liens for work completed through the above date.

By: ______________________________________
Title: ______________________________________
Date: ______________________________________
Pay Suppliers and Subcontractors (continued)

Using draw schedules to pay subcontractors

You can negotiate draw schedules with your subcontractors. In some instances, using a discount system for prompt payment can work to your advantage.

Types of draw schedules

In large part, whatever draw schedule you negotiate with your subcontractors depends on when the owner has agreed to pay. Although it would be convenient for all owners to agree to pay out at the same time each month, in reality, you will have some owners who want to have draws in the middle of the month, others that require a set up for the end of the month, and even some that request draws in the middle that are projections for month’s end.

Types of draw schedules include

- Payment by the 10th of the month
- Deposit upon order of product; full payment upon receipt of product
- Payment by general contractor when general contractor is paid by owner
- Discounts upon payment when work is completed

Using a cash flow forecast

A cash flow forecast enables your company to predict future cash needs by examining past and future project billings, cost, overhead expenses, and the like. The forecast can be prepared on a project-by-project basis and then combined to produce a company-wide forecast. Additionally, a cash flow forecast will help identify those periods when surplus cash is available for investment.

continued on the next page
Pay Suppliers and Subcontractors (continued)

Sample cash flow forecast

![Cash Flow Forecast Graph]

continued on the next page

From the Field

Establish a payment policy as part of your bid/contract.
Pay Suppliers and Subcontractors (continued)

Advantages and disadvantages of draw schedules

Advantages and disadvantages of using draw schedules include the following.

**Advantages**
- Periodic, predictable payments

**Disadvantages**
- After paying your suppliers up front (e.g., net 10 days), you act as a banking institution for the owner until the owner pays your draw to cover the expense.
Check References

Introduction

Checking references is an easy risk management tool. It protects you and your company from insolvent, poorly managed, and/or unscrupulous companies.

Definition: References

A reference is any type of referral given on behalf of a company by its associates, bank or lending institution, insurance and bonding company, and/or clients. A reference answers the questions:

- Does this company operate lawfully?
- Does this company pay its bills?
- Does this company have good credit and an unblemished history of financial dealings?
- Has this company experienced unusual or unsafe conditions that involve increased insurance risk?
- What do past and present clients have to say about quality workmanship and service of this company?
- Does the company perform their work on time?
- Does the company have good work ethics—are they honest and do they get along with other trades?

Check references

Request a list with the following information and follow up with each.

- Bank name, address, telephone number, and contact person
- Bonding agent name, address, and telephone number
- Insurance agent name, address, and telephone number
- Supplier names, addresses, telephone numbers, and contact people
- List of recent jobs, addresses, telephone numbers, and contact people
Control Overhead Expense

Introduction

Overhead can be an invisible cost if owners focus only on the familiar job costs associated with each project. Overhead expense can eat up profit in no time. Uncontrolled expenses jeopardize the success of any size company but are especially dangerous during the growth period of an emerging contractor.

Definition: Overhead

Overhead (general and administrative) is the category of expense that describes non-job specific costs such as office rent, computer, printer, and fax equipment, paper and other office supplies, telephone costs, and office personnel salaries.

Overhead can be figured as a percent of operating costs and revenue. Ask your accountant to work with you to determine where you are and where you need to be to improve profitability.

Track job cost expense

Job cost expenses are line items on a budget. You should have a systematic approach to monitoring and analyzing your operating costs on a monthly basis. Variances from budget projections are a first clue that you have cost control issues.

Control any expense

You should be reviewing all invoices and payables systematically to have a sense of where the company’s money is going each month. Until your operations are large enough to assign a financial operations officer—and even then—you must monitor expenses consistently and periodically to control expenses.
Collect and Analyze Data

Introduction

Produce a profit-and-loss statement monthly. This is a cornerstone to successful business operations. Compare where you are with where you should be or thought you would be. Determine why there are differences and take corrective action quickly.

Types of business data

You should have ready access to the following types of business data:

- Job costs, including
  - labor
  - materials
  - equipment
  - subcontractors
- Overhead
- Estimate and budgets
- Draws, payables, receivables

Collect and analyze different types of data

There are many types of forms and computer programs designed to collect business data.

Paper-based systems

For paper-based systems, using a systematic and consistent method to collect and record data is worth its weight in gold. Standard forms are the basis of effective paper-based systems.

continued on the next page
Collect and Analyze Data *(continued)*

**Computer-based systems**

Computer programs are designed not only to collect data but also to analyze the collected information. Programs range from stand-alone packages to fully integrated systems that tie in all aspects of a business for complete analysis.

Ask friends and competitors about their systems. Find out what works and doesn’t.

**Sample data collection form**

On the following pages is a sample of a form that can be used with a paper-based system or generated by a computer program.

*continued on the next page*
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<th>Phase Description</th>
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<th>Equipment Cost</th>
<th>Subcontractor Cost</th>
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**Collect and Analyze Data (continued)**

**When to collect data**

Start collecting data the day you get your business license. Keeping accurate data on your company’s operations is an effective and efficient method—and only reliable method—to monitor success or failure. Guessing does not work. Historical data are vital for accurate estimates and productivity ratios.

**What does it all mean?**

Collecting data is one task; understanding what the data show is another. By gathering current data and comparing it to your proposed budget, you are able to determine

- if unplanned expenses are influencing your profitability
- if planned expenses exceed estimates and why
- if contingencies are influencing your profitability

You must have accurate, reliable data at hand to gauge how well you are meeting your business goals. An accountant can help you plan how to collect and analyze your business data (see Module B Selecting a Construction Accountant).
Office Management Operations

Overview

Introduction

The second section of Module C covers basic office management tasks. The five business activities and their corresponding tasks covered are outlined below.

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Manage Office Operations

Introduction

A successful company is equal to more than the sum of its parts. Each part or division contributes to success, but it is the pulling together of those parts that creates a greater whole. Your ability to manage these parts begins in the office or nerve center of your operations.

What tasks need daily attention?

Tasks that require daily attention include:

- Appointment confirmation and/or cancellation
- Telephone messages and follow-up calls
- Schedule updates
- Paperwork routing and filing
- Marketing
- Project to bid search
- Estimates and bids for new jobs
- Manpower scheduling
- Receivables review

Who manages daily operations?

Depending on the size of your operations, you may have a receptionist, a secretary, or an office manager. Whatever your office operations staff may be, it is essential that you have clearly defined tasks. Each task can then be assigned to a particular person or staff position. This lessens the likelihood of important jobs falling through the cracks.

continued on the next page
Manage Office Operations (continued)

What tasks need weekly attention?

Tasks that require weekly attention include:

- Safety meetings
- Payroll
- Office supplies
- Payables

Who manages weekly operations?

Assign clearly defined tasks to specific staff. As the owner, you will still have to review what has been done. Depending on the size of your company, you may have superintendents and project managers performing some of the tasks.

What tasks need monthly attention?

Tasks that require monthly attention include:

- Profit and loss statement
- Budget versus actual job cost report and review
- Budget analysis
- Schedule updates
- Supervisory staff meetings
- Quality control review
- Progress draws
- Financial reports (e.g., cash flow, balance sheet)
- Progress draws
- Subcontractor invoicing
- Accounting summaries
- Schedule updates

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Manage Office Operations (continued)

Who manages monthly operations?

Your accounting functions are performed by the bookkeeper and reviewed by your accountant. Assign all clearly defined tasks to specific staff. As the owner, you will still have to review what has been done.

What tasks need quarterly attention?

Tasks that require quarterly attention include:

- Federal and state taxes

Who manages quarterly operations?

Tax issues must be completed by a qualified bookkeeper/accountant and reviewed by you. The taxes must be filed on time to prevent stiff penalties.
Review Workforce/Manpower Needs

Introduction

National and state-specific workforce data are available through national and state-level associations. Figures from these studies help you plan for long-term needs. Your local market manpower supply is determined by speaking with colleagues and competitors, watching the newspaper want ads, and working with your area school-to-work programs.

Review workforce/manpower needs

The science of reviewing workforce/manpower needs occurs during your estimating phase when you project the level of support needed to carry a project to completion. This step helps you plan how to assign current staff and when to hire additional personnel, if necessary. This is a vital step in planning for any size job. It is a matter of mathematics.

The art of reviewing workforce/manpower needs comes when you mold the estimate into your current and projected schedule. Figuring in contingencies such as materials shortages, bad weather, sickness, or other delaying variables is, at best, a guesstimate. Historical data may help you plan for this activity.

Definition: Multitasking

Multitasking in a merit shop situation is a term applied to describe an individual staff person’s ability to perform in more than one job area. Whether as a result of a need for increased efficiency or of a labor shortage, companies are discovering that the traditional division of job tasks can be modified. A worker in the field can also come into the office and assist in returning phone calls, completing paperwork, or filing forms. A craftsperson who is trained in various trades can perform varied work where the need for his or her skill is required.

continued on the next page
**Review Workforce/Manpower Needs (continued)**

**Use multitasking to satisfy workforce/manpower needs**

People have many talents and skills. By working with your staff, you may be able to develop an individual’s ability to perform multiple tasks—related and unrelated—as part of the company solution to increase efficiency or deal with workforce shortages.

Meet with your staff to discuss the possibilities. This type of effort draws your team together and strengthens rapport among staff. People gain a better understanding of what it takes to make the company successful by walking a mile in someone else’s occupational shoes.

**Establish multitasking**

The first step in multitasking is clearly identifying the tasks. You must be able to describe and explain what needs to be done. Undefined, vague descriptions lead to frustration that will ultimately undercut any hoped for efficiency in manpower scheduling.

Next is to work with your staff to identify areas of interest. Does someone in the field want to learn more about office operations? Is there a hidden talent among your crew?

If getting the job done means getting it done poorly, then there is no benefit to multitasking. If someone is not immediately able to perform new and different tasks, is training that person less expensive than hiring in a new person?
Delegate Job Responsibilities and Authority

Introduction

Maybe when you started out, you were doing all the jobs it takes to run a company. As an emerging contractor, you may still wear many hats, but you are now in the position to get some help. This help comes in the form of employees to whom you delegate responsibility and authority to get the task done.

Delegating

Delegating is a lot like reading a map. You have to have the big picture view of where you are and where you want to go. For your company, you must understand what has to get done and who is available to get it finished. Surround yourself with good, solid individuals when delegating.

Delegating job responsibilities and authority

Use the following steps to delegate job responsibilities and authority.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>List tasks and responsibilities.</td>
</tr>
<tr>
<td>2</td>
<td>Determine levels of authority associated with different tasks.</td>
</tr>
<tr>
<td>3</td>
<td>Determine if any tasks precede, follow, or overlap other tasks where authority may become an issue.</td>
</tr>
<tr>
<td>4</td>
<td>Assign tasks and corresponding authority to appropriate staff, subcontractor, engineer, architect, etc.</td>
</tr>
<tr>
<td>5</td>
<td>Follow up and evaluate success of delegation by monitoring the progress of those individuals to whom you delegated responsibilities.</td>
</tr>
</tbody>
</table>

continued on the next page
Delegate Job Responsibilities and Authority (continued)

Differences between office and field

Delegating tasks in the office and out in the field is consistent in that tasks are established with measures to ensure that they get completed.

Communication capability

All human endeavor requires communication. Whether you are a long distance runner checking with your coach or a space shuttle crew speaking with mission control, you must report progress, troubles, and successes.

Communication has never been easier or more complicated than now. Everyone has a fax machine, a cell phone, and a mail box. But, email may be down, your contact may be out of range, or your copier might be broken. You have to plan how to communicate important information and have a backup system ready. Typical communication methods include:

- Electronic and digital (telephone, fax, radio, cell, email, voice mail, etc.)
- Written (letters, forms, notices, etc.)

Whichever method you decide to use, be consistent and always follow up. Always follow up important voice communications with a written confirmation.

continued on the next page
Delegate Job Responsibilities and Authority (continued)

What if communication breaks down?

Inevitably, in any business, something will fall through the cracks. Someone will forget to return a phone call or to fax over estimate figures or check with a supplier. It can happen to the best of companies—just not very often!

What do seasoned contractors advise?

- Correct what is wrong as quickly as possible—damage control is critical to prevent the situation from getting out of hand.
- Determine how it happened and put preventive measures into place.
- If it was your fault, acknowledge it and make apologies.
Conduct Staff/Job Site Meetings

Introduction

Meetings provide a venue for a variety of operational objectives. Whatever you want to accomplish, make sure you plan ahead, use an agenda, and make it short and to the point—don’t waste valuable time and effort.

Types of meetings

You can anticipate any of the following types of meetings.

<table>
<thead>
<tr>
<th>Type of meeting</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preconstruction</td>
<td>Once per project</td>
</tr>
<tr>
<td>Subcontractor</td>
<td>As needed</td>
</tr>
<tr>
<td>Planning for crew and superintendents</td>
<td>Weekly</td>
</tr>
<tr>
<td>Staff</td>
<td>Monthly</td>
</tr>
<tr>
<td>Vendors</td>
<td>As needed</td>
</tr>
<tr>
<td>Safety</td>
<td>Weekly/as required</td>
</tr>
<tr>
<td>Training and education</td>
<td>As needed/required</td>
</tr>
<tr>
<td>Owner/owner representative</td>
<td>Weekly/monthly</td>
</tr>
<tr>
<td>Customer</td>
<td>As needed</td>
</tr>
</tbody>
</table>

Preparing for and conducting meetings

Use the following basic steps to prepare for and conduct meetings on any topic.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Create an agenda.</td>
</tr>
<tr>
<td>2</td>
<td>Notify participants of meeting time and location.</td>
</tr>
<tr>
<td>3</td>
<td>Document meeting notes.</td>
</tr>
<tr>
<td>4</td>
<td>Obtain necessary approvals.</td>
</tr>
<tr>
<td>5</td>
<td>Follow up.</td>
</tr>
</tbody>
</table>

continued on the next page
Conduct Staff/Job Site Meetings (continued)

Guidelines for meetings

Use the following guidelines to conduct effective meetings.

- Determine
  - who needs to be at the meeting
  - what topics will be covered
  - when the meeting should be scheduled
  - where the meeting will be held
- Prepare an agenda
- Summarize observations and/or suggestions
- Agree on action items at the end of the meeting

Sample agenda:
Preconstruction meeting

A preconstruction meeting is essential to start the project off right. The following is a sample preconstruction meeting checklist.

1. Introduce the parties (sales, staff, subcontractors)
2. Define responsibilities and general procedures of day-to-day operations
3. Explain access needed (limitations)
4. Discuss and agree on working hours (e.g., start times)
5. Establish job site message center
6. Set times for meetings with clients (if job size dictates)
7. Explain and post schedule
8. Cover special issues

continued on the next page
**Conduct Staff/Job Site Meetings** *(continued)*

**Sample agenda: Customer meeting**

The following is a sample agenda to prepare for a customer meeting.

- Review production schedule
- Deadlines for selections
- Change order approvals
- Payments
- Questions and concerns

**Sample agenda: Planning and staff**

The following is a sample agenda to prepare for a weekly planning meeting with crew and superintendents.

- Safety issues
- Customer feedback
- Scheduling
- Manpower requirements
- Material and equipment flow to the site
- Questions and concerns relating to subcontractors, scheduling, etc.

For project meetings, prepare an updated job package with enough copies of any changes for each meeting participant scheduled to attend. Changes may include:

- Job schedules
- Budget overruns
- Change orders

**Sample agenda: Safety meetings**

The following is a sample agenda for weekly safety meetings.

*continued on the next page*
HAZARD COMMUNICATION

Chemicals are everywhere and many things that we do today would be impossible without them. OSHA defines a hazardous chemical as any chemical that presents a physical hazard or a health hazard. Some are poisonous, others can cause serious chemical burns. Some may affect the respiratory system, still others can cause cancer and long term health problems. This is just a partial list of the hazards you may face. We have to identify these hazardous chemicals and know how to use them correctly or we may end up suffering dire consequences.

The key to chemical safety is following the written Hazard Communication Program. The Hazard Communication Standard requires that every employer who uses hazardous chemicals develop, implement, and maintain a written Hazard Communication Program. This program must include: a list of all hazardous chemicals that are in use with a reference to the appropriate Material Safety Data Sheet (MSDS); the method to be used to inform employees of the hazards associated with non-routine tasks; the method to be used to inform other employers of chemical hazards if a multi-employer workplace exists; a detailed explanation of the labeling system in use; how to access and use the MSDS file; and complete details on how employees are informed and trained, including specific procedures, emergency procedures, and any personal protective equipment that may be required. In addition, employee training, as well as the program, must be updated whenever a new chemical is introduced into the workplace.

Hazard communication is really a joint effort between employer and employee. The employer must provide you with information and training, and you must truly pay attention and use the knowledge in the field to prevent accidents, injuries, illnesses, and deaths. Year after year the Hazard Communication Standard has been one of the standards most frequently cited by OSHA. Clearly, as an industry we have not learned our hazard communication lesson. Working together to comply with the standard will benefit both you and your employer.

Remember that just because something looks harmless, doesn't mean that it is. The only way to know for sure is to read the label and the MSDS. Knowing the identity and the associated hazards of the chemicals you work with is essential for your health and safety.

SAFETY REMINDER

Learn how to read and understand Material Safety Data Sheets. It could save your life!

Special Topics For Your Project

Employee Safety Recommendations

Reviewed MSDS # Subject

Meeting Attended By

Supervisor's Signature

These instructions do not supersede local, state, or federal regulations.
Conduct Staff/Job Site Meetings (continued)

Resources for safety meetings

The following resources produce ready-to-use safety meeting materials.

- Safety Meeting Outlines
  - Box 700
  - Frankfort, IL 60423
  - 815/464-0200

Sample agenda: Weekly jobsite meetings

The following is a sample agenda to prepare for a weekly jobsite meeting.

- Job name, date, weather conditions, temperature
- Attendees sign-in sheet
- Discuss old business
- Discuss new business
- Outstanding requests for information, proposal changes, change orders

Sample form

The following is a sample jobsite meeting form.

continued on the next page
☐ Sign-in sheet
☐ RFI log
☐ PR log
☐ Minutes note

Meeting
Minutes No. 1

Project No:
Project Name:
Date:
Weather/Temp:

Present:

Copies of these minutes provided to:
Name: Representing:

Corrections to previous minutes:

Old Business:
Item Action Notes/Description

New Business:
Item Action Notes/Description

Schedule Status:

Submittal Status:

RFI & CO Status:

Next Meeting:

This memorandum is considered a record of our project meetings. Please contact (Company Name) immediately if there are any questions or corrections to these minutes; otherwise these notes will be considered correct and complete as written.
Purchase Company Equipment and Supplies

Introduction

You should determine during the estimating phase of a project whether you will need to purchase a piece of equipment or specialized tool. Purchasing any item should be done in accordance with your established, written policy.

Purchasing policy

Regardless of company size, purchasing of equipment and supplies should require a purchase order form. This creates a paper trail that is useful when analyzing financial reports and evaluating profitability.

You may also require that purchases use comparative pricing from three vendors. This helps ensure that you receive the best price on equipment and supplies.

Profit-making tip

Always check deliveries against order tickets to verify shipment contents. You need to be sure you got what you paid for and that the product was received in good working order (not broken).

Track equipment and supplies

Whether you use a paper-based or computer-based system, inventory control is essential to making sound purchasing decisions. You must know what you have, the state is in, and where it is.

Establish a system that triggers a reorder request when supplies reach a certain level. Waiting until the last minute for routine supplies is a profit waster. Time spent dashing to the supplier or waiting on a shipment is time lost.

continued on the next page
Assign responsibility and authority

Earlier you determined which tasks should or could be delegated to another of your team members. Company equipment and supply control and ordering is one such task. You should consider a centralized system to prevent duplicate orders from field personnel who may not be in immediate contact with each other.
Estimating and Bidding Operations

Overview

Introduction

The third section of Module C covers basic estimating and bidding operations. The four business activities and their corresponding tasks covered are outlined below.

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Prepare Bids

Introduction

A bid proposal sets out the scope of the project by detailing what work is inclusive and any specific exclusions. It identifies aspects of the proposed job that may need further explanation. It is a blueprint or map for the project.

Components of a bid proposal

A bid proposal should contain the following components.

- Scope of work
- Inclusions and exclusions
- Special conditions
- Quoted price (lump sum, GMP, T&M, etc.)
- Timeframe to start and finish project
- Name of documents used in preparation of the quote
- Specific note indicating that the quote is preliminary or final

Definition: Scope of work

A scope of work is a definition of the project work; it outlines in detail all work expected to be completed for the project. It varies in length depending on the complexity of the project.

It is important to have both the contractor and the client initial each page. This encourages both parties to read carefully for correctness and understanding.

Sample scope of work form

It may be useful to standardize your scope of work description. The following form ensures that the necessary information is gathered at the onset of the project and can be updated as the project develops. Used properly, a scope of work description is an exhibit referenced by the contract.

continued on the next page
**Prepare Bids** *(continued)*

--

**Review scope of work and exclusions**

This provides an opportunity to clarify the scope of work between the office, field, and the client. It allows you to clarify both what is included and excluded from the work. You may want to ask for clarification using a request for information letter.

--

**Sample Scope of Work and Exclusions letter**

The following is a sample letter detailing the scope of work and the exclusions.

*continued on the next page*
Prepare Bids (continued)

Date

To: Company Name
Project: Name of Project
Re: Bid Proposal Letter

Dear:

(Company Name) is pleased to be invited to provide a quote on the referenced project. Our bid is based on the work shown on the plans prepared by (Architectural Firm), dated __________, labeled (Name of Project), sheets numbered ___ through ___ and specifications sections __, __, __, __, and ___ are also included.

Specific inclusions are as follows:

- Building permit fees
- Prevailing wage

Specific exclusions are as follows:

- Builders risk policy
- Performance & payment bond
- Asbestos removal of any kind

- Based on the above, our quote is $0,000.00
- State sales tax $0,000.00
- TOTAL $0,000.00

We appreciate the opportunity and look forward to hearing from you soon.

Sincerely,

---

continued on the next page
Prepare Bids (continued)

Definition: RFI and PR

Request for Information (RFI) is a formal request for information regarding a change or clarification on a project. A Proposal Request (PR) is a formal request for the cost associated with a change in the scope of work. Submit this form to an architect or owner for approval and signature.

RFI and PR

The following is a sample of an RFI and a PR.

continued on the next page
Prepare Bids (continued)

Request for Information

REQUEST NO.: ______

JOB NO: ______

JOB NAME: ____________________________

ITEM: ____________________________

REF. DWG. OR SPEC: ____________________________

DESCRIPTION: ____________________________

____________________________________

☐ This change may have a cost impact  ☐ This change WILL NOT have a cost impact

Reply required by: ____________________________

Originator: ____________________________

Project Manager: ____________________________

ARCHITECT RESPONSE

☐ Approved  ☐ Disapproved

Date: ____________________________

REMARKS: ____________________________

____________________________________

continued on the next page
## Proposal Request

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>P.R. No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Manager:</td>
<td></td>
</tr>
<tr>
<td>Architect:</td>
<td>Attn:</td>
</tr>
<tr>
<td>Owner:</td>
<td>Job No.:</td>
</tr>
</tbody>
</table>

Description of work to be performed that varies from the contract documents:

Subcontractor Cost Associated with the Proposal:

<table>
<thead>
<tr>
<th>Subcontractor</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1)</td>
<td></td>
</tr>
<tr>
<td>2)</td>
<td></td>
</tr>
<tr>
<td>3)</td>
<td></td>
</tr>
<tr>
<td>4)</td>
<td></td>
</tr>
<tr>
<td>5)</td>
<td></td>
</tr>
<tr>
<td>6)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name of Company Costs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor Hours  @ $/hr</td>
</tr>
<tr>
<td>Office Labor Hours @ $/hr</td>
</tr>
<tr>
<td>Materials</td>
</tr>
<tr>
<td>Overhead &amp; Profit @ %</td>
</tr>
<tr>
<td>Liability Insurance @ %</td>
</tr>
<tr>
<td>B&amp;O Tax @ %</td>
</tr>
<tr>
<td>Bond @ %</td>
</tr>
</tbody>
</table>

Subtotal $ 0.00

Subtotal $ 0.00

TOTAL $ 0.00

Note: Above prices exclude WA State Sales Tax.

Construction Schedule time frame adjustment decrease or increase by ___________ Days

Approval: ____________________________
Date: ________________________________

Name of Company _______________________

Owner or Architect _____________________

2/22/09
Prepare Bids (continued)

Definition: Exclusions

Exclusions are work items specifically excluded from the scope of work.

Example: landscaping, duct cleaning, appliance installation, removing wall coverings, etc.

Definition: Drawings

The drawings are a visual representation of the scope of work. Drawings must be referenced by the bid proposal and the contract. The drawings must include a date and the page number. If revisions have been made, drawings must reflect the date of the change and initials by authorized person.

Clarifying the scope of work and exclusions

Use the following steps to clarify the scope of work and identify exclusions.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Read the scope of work to understand the project.</td>
</tr>
<tr>
<td>2</td>
<td>Reference the drawings to the scope of work to find the location of the proposed work.</td>
</tr>
<tr>
<td>3</td>
<td>Review and clarify exclusions.</td>
</tr>
<tr>
<td>4</td>
<td>Follow up with an action plan if there are discrepancies between scope of work, exclusions, and drawings.</td>
</tr>
</tbody>
</table>

*continued on the next page*
Prepare Bids (continued)

Types of bid proposals

There are different types of bid proposals including

- Lump sum
- GMP (guaranteed maximum price)
- Time and materials (not to exceed)
- Labor and materials, plus percent of overhead
- Cost plus percent of overhead and profit
- Cost plus fixed overhead and profit

Prepare to bid

You must have specific information before you can prepare your bid. This information includes

- Project description by owner, engineer, or architect (scope of work)
- Specifications, drawings, and/or blueprints
- Schedules and materials lists
- Bonding requirements
- Submittal requirements
- Applicable government requirements or regulatory impact

Use software to estimate the bid

There are many software programs available for estimating. These vary from simple to fully integrated systems that tie into your ordering, scheduling, and invoicing software. Do not get an overly complex package if you are not willing to take the time to learn it. If the program is too difficult, you will not use it.

Refer to association literature regarding available software and reviews of different programs. Ask your industry peers, CPAs, bonding agents, etc. for their recommendations.

continued on the next page
**Prepare Bids (continued)**

**Check the bid estimates**

Assign responsibility for preparing the estimates to an estimator. Then ensure that there is someone else to review and double check the estimate. This read-behind technique is invaluable for catching omissions or mistakes. It will save your company money.

In some firms, the owner is the final reviewer of all bids and estimates.
Select Subcontractors and Suppliers

Introduction

Building a reliable network of subcontractors and suppliers will enhance your ability to succeed as an emerging contractor. Certain basic steps will help you select subcontractors and suppliers.

Guidelines for evaluating subcontractors and suppliers

Some general guidelines for evaluating subcontractors and suppliers include

- Ask for and check references (see section Check References)
- Speak to the prospective's own subcontractors and/or suppliers
- Speak with industry peers who have dealt with them
- Ask your colleagues for recommendations
- Create a comparative chart for the following factors
  - Response time
  - Quality of work
  - Safety record
  - Team player
  - Work ethics and honesty
- Ask prospective subcontractors and suppliers to submit bids on projects

Selecting subcontractors and suppliers

Use the following steps to select subcontractors and suppliers.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Evaluate prospective subcontractors and suppliers.</td>
</tr>
<tr>
<td>2</td>
<td>Send out request for proposals/bids.</td>
</tr>
<tr>
<td>3</td>
<td>Compare bid sheets and select best bidders.</td>
</tr>
</tbody>
</table>

continued on the next page
Select Subcontractors and Suppliers (continued)

Use a bid invitation

A bid invitation form may be a useful tool for alerting your prospective subcontractors and suppliers about an upcoming project.

continued on the next page
Sample bid invitation

The following is a sample bid invitation letter.

*** BID INVITATION ***

DATE:

ATTENTION: SUBCONTRACTORS & SUPPLIERS

**BID DATE:**

Bid Time:

(*Name of Company*) is pleased to invite you to submit a quote on the following project. We are an "Equal Opportunity Employer" and request bids from minority, women and emerging small business subcontractors and suppliers.

PROJECT:

LOCATION:

TYPE:

SIZE:

ARCHITECT:

REMARKS:

PLAN AVAILABILITY:

[ ] Plan Room

[ ] Local Plan Centers

RSVP FROM:

Company Name:

ESTIMATOR:

[ ] Yes, we plan to Bid the above mentioned project.

[ ] No, we will not be able to bid this project.

Please respond by faxing this back with one of the boxes marked and your company name.

Please stop by or call prior to the bid date to see if any addenda have been issued.

And company name filled in.

Thank You!

A BID PACKAGE.xls
Select Subcontractors and Suppliers (continued)

Qualifying bids

Use the following steps to qualify bids submitted by prospective subcontractors and suppliers.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Use a checklist to ensure that all necessary components are contained in each bid.</td>
</tr>
<tr>
<td>2</td>
<td>Eliminate incomplete or late bids from the consideration process.</td>
</tr>
<tr>
<td>3</td>
<td>Compare bids to verify scope of work included in the bid.</td>
</tr>
<tr>
<td>4</td>
<td>Identify any unclear information and ask for clarification.</td>
</tr>
<tr>
<td>5</td>
<td>Select best suited and best priced bidders.</td>
</tr>
<tr>
<td>6</td>
<td>File unsuccessful bids for reference.</td>
</tr>
</tbody>
</table>

From the Field
Don’t bid the competition, bid the job.
Identify Costs

Introduction
How well do you understand markup and margin? Can you identify your costs accurately? How much markup is enough? What margin are you earning?

Definition: Markup
Markup is a percent of cost needed to cover general and administrative costs and indirect costs. The percentage of markup varies from business to business. Talk to your CPA to better understand the percent of markup you should be using on projects.

Calculate markup
The following calculation should help you determine your markup on a project. The calculation may vary depending on your market and local conditions.

Types of costs
To apply the proper markup, you must first correctly identify your costs. The following are typical costs

- Supervision
- Testing
- Scheduling
- Building permits
- Development fees
- Job site office
- Subcontractor and supplier costs
- Loan and financing cost
- Bonding and insurance costs
- Taxes (payroll, corporate, etc.)

continued on the next page
Identify Costs (continued)

Accounting for waste

Waste is unavoidable. Controlling waste is critical. Each company will have set standards for acceptable levels of waste (e.g., cutoff scrap from 2x4s).

Whatever your tolerance for waste, you must account for the cost of the waste because it affects your profitability.

Accounting for seasonal affects

Seasonal conditions will directly affect your costs and profitability. Forgetting to calculate in winter protection can create a negative impact on your project.

Seasonal workforce adjustments may also be necessary. In this case, you must calculate the costs and include them in your equation of markup and margin.

Lack of skilled labor is a very real problem in today's marketplace. Adjust productivity rates if you need to hire new craftspeople who may not be familiar with your operations.
Collect and Analyze Data

**Introduction**

Just as you collected and analyzed data on financial operations, you should do the same for estimating and bidding operations. Your goal is to increase accuracy of bids and takeoffs, increase profitability, and streamline your estimating and bidding processes.

**Types of data**

Collect the following types of data to analyze your estimating and bidding operations.

- Budget to actual cost comparisons
- Historical data from past estimates and bids on similar projects
- Productivity rates

**Collect data**

You should be collecting and generating the required data throughout the course of your normal business operations. The information you are looking for is part of the budget, the estimate, the schedule, and so forth. You may want to design some specific forms for easier comparison, but avoid adding more paperwork if possible.

*continued on the next page*
Collect and Analyze Data (continued)

Analyze data

Line the numbers up side by side. Ask yourself questions like these.

- Are you consistently overestimating or underestimating certain portions of your bids? Why?
- Do you have repetitive cost overruns in certain areas? Why?
- Have you changed work processes? How has that affected your ability to meet projections?
- What information would add to your accuracy on future bids? How can you obtain it?

Compare your data to the competition

Another benefit to collecting and analyzing your estimating and bidding data is that it allows you to compare your company with your competitors. Use the data to determine if you are higher or lower than your competition and by how much. If you are within 10 percent of most of your competition, your company is in the running. If you are 50 percent higher than the others, you are no longer competitive. If you are 50 percent lower, you are probably going out of business.

Knowing where you are in relation to the competition is not enough. Use the data to determine where the variances come from. For example, determine whether

- your overhead is influencing your competitiveness
- you are getting the best subcontractor quotes
- your markup is within industry standards and what each project will bear in relation to the risk involved to complete the project

Collect and Analyze Data (continued)

Do I need outside advice or help?

It is possible that you are succeeding without knowing why. It is possible to fail without realizing what went wrong. Build strong relationships with colleagues whose advice you can trust. Find a mentor—a highly successful contractor—to help guide you.

There are many resources to tap into.
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Quality Control Operations

Overview

Introduction

The fourth section of Module C covers basic quality control operations. The two business activities and their corresponding tasks covered are outlined below.

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Evaluate Projects Critically

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Review Quality Control Standards

Introduction

There is a direct correlation between your quality control standards and your reputation. You can have a project that meets or exceeds industry standards that was still a failure. The success of your project is not only judged by the quality of your construction but also by the quality of your service.

Whose quality standards?

As the owner of a company, you create and enforce the quality standard that the employees work toward. The project work must meet or exceed your expectations.

The quality standard for service is ultimately set by your customers.

Quality control standards in the specifications

In many cases, the specifications and drawings will indicate the level of quality expected on the project. The architect or engineer may indicate specifically the level of finished work quality.

Quality, however, is more than building within acceptable tolerances and to specifications. It is an expectation on the owner’s part as well.

Quality control standard policy

Your company should have a written statement defining your quality control standards.

continued on the next page
Review Quality Control Standards (continued)

Who is responsible for quality control?
Every person who works for your company must be responsible for quality control. Achieving the desired level of quality is a team effort. Everyone has to commit to and enforce the quality control policy, which ultimately creates your reputation.

Instilling quality control expectations in employees
Use the following strategies to bring all employees on board with the idea of individual and company-wide quality control.

- Involve employees in the development or refinement of your quality control standards policy
- Recognize employees who exceed quality control standards at staff meetings or in your company publications
- Sponsor company-wide contests
- Include awards and commendations in company advertising literature for customers

What is customer-perceived quality?
Veteran contractors will tell you that the job isn’t successful unless the client believes he or she got more than was paid for. It is the ability to exceed expectations—while staying on time and within budget—that generates the “word of mouth” advertising and respect that a high-quality conscious company receives.

continued on the next page
Review Quality Control Standards (continued)

How does quality control vary from trade to trade?

Each trade has a unique set of circumstances to work within. A one-tenth of an inch tolerance when spreading gravel may be imperceptible. A plumbed wall with a one-tenth of an inch variance is defective. As a company owner, you become familiar with all the trades that function together to complete a project. It is up to you to recognize where quality control standards vary and to see that those standards are applied appropriately in each circumstance.

Keeping quality control issues under control

Use the following strategies to help keep quality control issues under control:

- Conduct job site visits
- Encourage trades to report unsatisfactory work they encounter before further work is completed
- Have periodic quality control meetings to reinforce expectations with new subcontractors and employees
- Survey owners, subcontractors, and architects after the completion of a project to verify if they agree or disagree on the quality of the final product
Evaluate Projects Critically

Introduction

Evaluating your successes and not-so-successes is a valuable business activity. How do you know when a particular type of project is better left to another contractor? Should you decline a project based on past experience?

Who needs to contribute to project evaluation?

Who within the company and its associates can provide input on the perceived success or failure of a project? Is it the accountant with the bottom line profit or loss? Is it the superintendent who managed daily operations? Is it the subcontractor you have worked with for years?

Everyone involved in a project can shed light on the effort it took to complete a project. So, why seek out this information? Careful and critical evaluation of a project is aimed at helping your repeat successes and avoid disappointment.

Ask veteran contractors. There are some types of jobs you may eventually decide—through experience—are better left to another.

continued on the next page
Guidelines for evaluating a project

Use the following guidelines to help you evaluate a project critically.

- Did the company show a profit or loss at completion?
- Was the activity similar to past projects or did it represent a move in a new direction?
- Does the new direction make sense for our company?
  - Do we have the qualified staff to move in this direction?
  - Do we need training?
  - Can we perform competitively in this new area?
  - What competitors are already in this area and how many years experience do they have?
- Was the project enjoyable for management and staff?
- Was the owner satisfied with the product and the personnel who managed the project?
Maintaining Relationships

Overview

Introduction

The fifth section of Module C covers the importance of maintaining professional relationships and networking to help your company thrive. It also addresses the need to stay current on competitors in the marketplace. The five business activities and their corresponding tasks covered are outlined below.

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Maintain Relationships with General Contractors

Introduction

Your relationships with contractors allow your company to thrive. Finding and keeping the best contractor-clients determines whether your subcontracting company stays in business. These relationships are built on trust and honesty. You want to build a client base you can rely on.

Importance of the contractor relationship

You can actively seek out contractors your company wants to do business with. Talk to colleagues, bankers, insurance and bonding agents, and construction attorneys to find out who they prefer to work with. This is the type of contractor client you want to develop. Your company will benefit by working with the most respected and successful general contractors.

Compromise and communication

Sometimes, to make a professional relationship work, you have to compromise. This is a two-way street, paved with straightforward, effective communication. You may be expected to change a work process for the sake of a project. In turn, the general contractor may compromise to integrate your company’s processes into his or her system. Strive for a give-and-take situation—that is balanced and fair—through discussions with the general contractor.

Determine ahead of time where you will not compromise. If you have certain issues or concerns you are not willing to let go, then you will be prepared to turn down a work opportunity if you are not comfortable with the compromise. Listen with an open mind and discuss the ramifications of compromise. You will be in a better position to decide.

continued on the next page
Maintain Relationships with General Contractors (continued)

Determine who you can work with

There are many different personality types. Some types you can work with easily; others may be difficult or next to impossible to get along with. Decisions about who you can work with are based on time and experience. Keep the following guidelines in mind when determining who you can work with.

- Be proactive; discuss potential conflicts at project onset
- Find personality matches within your staff that work well with the client contractor’s staff
- Decide who you will not work with and why; address the issues or don’t do business with them

Handshake or contract

Many lifelong contractors and subcontractors will reminisce about the days when business was done with a handshake. Those days are well past.

You need written agreements that detail

- What is to take place
- When it will happen and the timeframe for completion
- Costs
- Inclusions and exclusions
- Responsibility and authority for each task
Maintain Relationships with Subcontractors

Introduction

The general contractor who does not build relationships with subcontractors will not succeed in the industry marketplace. Relationships built on trust, honesty, and mutual benefit are critical for the continued growth and profitability of a general contractor’s business.

Importance of the subcontractor relationship

Building and maintaining subcontractor relationships over time provides you with a resource pool you can count on. You have the ability to turn to these subcontractors in difficult situations and ask for help. You can move forward on projects knowing who you are depending on and why. Your selection and development of valued subcontractors helps your company to work smoothly and profitably.

Without successful relationships with subcontractors, you will eventually operate at the mercy of the open market. You may be forced to work with companies whose reputations you do not know and may not be able to rely on. If that happens, your problems have just begun.
Maintain Relationships with Owners, Engineers, Architects, and Inspectors

Introduction

Good will, trust, and open communication are fundamental to maintain professional relationships. There are many benefits to all parties involved when you work together. Referrals, advice, assistance, and success are all by-products of productive professional relationships.

Relationships with owners

Getting along with the owner of a project will help keep the process smooth until completion. It is important to get some insight on dealing with a particular owner by talking to colleagues, bankers, and other professional contacts.

Check an owner’s references just as he or she will check out your company. You want to know if there have been any unsuccessful projects in the past and why that occurred. You should be confident that the owner has a history of paying bills and assisting in the completion of work.

Relationships with engineers

Specifications and plans contain a great deal of detail. You need a comfortable, professional relationship with the engineer to be able to draw on his or her experience and insight when you have questions.

Engineers can also be a source of information about upcoming projects. A professional relationship may get you on a short list of contractors and subcontractors recommended by the engineer to the owner.

continued on the next page
Maintain Relationships with Owners, Engineers, Architects, and Inspectors (continued)

Relationships with architects

You need a comfortable, professional relationship with the architect in cases of disagreement on plans and specifications. It is helpful to have good will between you and the architect to work out differences of opinion on how to construct certain parts of the project.

Architects can also be a source of information about upcoming projects. A professional relationship may get you on a short list of contractors and subcontractors recommended by the architect to the owner.

Relationships with inspectors

Inspectors, as a rule, will go out of their way to help businesses and companies in getting inspections completed on a timely basis that fits with the project flow. When you have a sound professional relationship with an inspector, you can feel confident in asking for consideration to best expedite construction.

Antagonistic and unproductive relationships may result in delays of scheduled inspections due to poor communication.

Compromise and communication

As before, all relationships require some amount of compromise. To feel good about the compromise, the communication must be straightforward, honest, and considerate of all parties involved.

Poor communication among any of the parties only serves to delay or hinder the progress of your project. Have planning meetings at the onset to set expectations for kinds of communication necessary to keep the project moving. Take a proactive stance and discuss potential bottlenecks before they occur. When communication breaks down, it is the beginning of a failed project/relationship.

continued on the next page
Maintain Relationships with Owners, Engineers, Architects, and Inspectors (continued)

Decide with whom you want to work

Not all owners are alike. The same can be said for architects and engineers. Time and experience will eventually teach you who are the easiest and most pleasant to deal with on a professional level. Another source of insight is the talk on the street; what do your colleagues and competitors say about working with these people? There is plenty to know about a potential working relationship.

**Does the owner...**
- pay on time?
- say one thing and expect another?
- work productively with the team?
- change plans often during a project?

**Does the engineer...**
- produce accurate data?
- work productively with the team?

**Does the architect...**
- produce accurate specifications and drawings?
- work productively with the team?
- say one thing and expect another?
Conduct Follow-Up with Customers

Introduction

A successful business always makes satisfying its customers the number one priority. To complete a project properly, you must follow up with your customers to get feedback on your product and service. Without this feedback, you can not accurately judge the quality of your work.

What is follow up?

Follow up is the active solicitation of feedback from your customers regarding the completed project. It can take the form of a postproject survey, an interview with customers, a letter, or a phone call. The main criteria is that you ask your customers for their opinions.

Using feedback from your customers allows you to improve both your work processes and your product.

Significance of follow up

Beyond improving your work processes and product, follow up also serves to strengthen customer relations. Use it as an active tool to promote referral and repeat business. Customers or owners who feel you have taken a professional and personal interest in their satisfaction is more likely to recommend you to others. They are more likely to specify to their architects and engineers that your services are what they want.

Nowadays, customers don’t feel the same level of loyalty as many did in the past. If dissatisfied with the level of attention and service, these customers will take their business elsewhere.

The scenario includes other professionals as well. If you don’t work to keep their customers satisfied, the engineer or architect may not recommend you to a prospective client.
Maintain Awareness of Competitors

Introduction

You have to know who else is in the marketplace offering competing products and services. It is a matter of survival to compare your operations critically and evaluate opportunities to improve.

Who are your competitors?

Who bids on the same projects as your company? These are your competitors. You may know who they are by hearing who gets contract awards; you may meet them at an association gathering; you may see them at the bank.

You can get names of competitors by looking at the Yellow Pages, calling the Better Business Bureau, or talking to your colleagues.

Compare yourself to your competitors

Find out what your competitors are doing. If you are consistently losing bids to a competitor, ask yourself why. Talk to your professional contacts such as bankers, accountants, architects, and engineers. Compare yourself to your competitors to evaluate if there are changes you should consider making to your work processes or pricing structure. Learn all you can.

Maintain an awareness of your competitors

Periodically review your operations in the light of what your competitors are doing. Are they introducing improved work processes or technological advancements? Have they changed the way they bid projects based on their experiences? Is there a way to increase your competitiveness?
Project Management

Overview

Introduction

The sixth section of Module C covers project management issues. The 11 business activities and their corresponding tasks covered are outlined below.

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Review Estimated Versus Actual Costs Weekly

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Manage Project Budget, Resources, and Materials

Introduction

You are managing relationships, budgets, personalities, timeframes, commitments, schedules, completion dates, subcontractor invoicing and payments. There is more, of course, to manage when taking a project forward. Each element is important to the final success of the project.

Key elements of a project budget

The key elements of a project budget that you must manage include

- Labor
- Materials and supplies
- Equipment
- Subcontractors
- Schedule
- Change orders

Types of resources

Types of resources required on a project include

- Financing
- Personnel
- Equipment and tools

continued on the next page
Manage Project Budget, Resources, and Materials (continued)

Types of materials

The types of materials required on a project include

- Office and administrative supplies
- Building materials

Request for information

A key factor to managing successfully is having the correct and current information on hand to make decisions. This may require that you submit a Request for Information (RFI) to another team member such as an architect or an engineer. (Refer to page 57 for a sample form.)

Change orders

Change orders are a fact of life. How you choose to deal with them can have a significant impact on your business. Successful contractors have a specific process that handles any alteration to the original scope of work by means of a change order.

Change order process

Typically, a change order process entails the following phases.

<table>
<thead>
<tr>
<th>Phase</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Customer/owner requests information regarding a change to the scope of work by submitting an RFI.</td>
</tr>
<tr>
<td>2</td>
<td>Contractor evaluates change for impact on schedule, budget, and work flow.</td>
</tr>
<tr>
<td>3</td>
<td>Based on contractor’s information, the contractor submits Proposal Request (PR) for the change to the architect and/or owner.</td>
</tr>
<tr>
<td>4</td>
<td>Architect and/or contractor initiates a change order.</td>
</tr>
</tbody>
</table>

continued on the next page
Sample change order evaluation

The following form is a sample change order evaluation.

![Change Order Form]

This contract is modified as follows:

1) Contract Sum
   1.1 Original Contract Sum.................................................................
   1.2 Net Changes by previous C.O. (s)....................................................
   1.3 Prior Adjusted Contract................................................................. $ -
   1.4 Contract Adjustment this C.O.
       a) INCREASE..............................................................................
       b) DECREASE............................................................................
   1.5 Net Contract including this C.O. (1.3 + 1.4).................................... $ -

2) Contract Time
   2.1 Original Date of Substantial Completion.........................................
   2.2 Revised Date by Previous C.O. (s)......................................................
   2.3 Contract Time Adjustment this C.O.
       a) INCREASE (Calendar Days).........................................................
       b) DECREASE (Calendar Days).........................................................
   2.4 Revised Date of Substantial Completion...........................................
   2.5 Revised Date of Final Completion...................................................

Name of Company Approval:                                           Owner Approval:
Date:                                                                 Date:

2/22/00

CO Proposal Metr.xls
Review Estimated Versus Actual Costs

Introduction

This is a basic business activity. There are numerous software programs available to help you review estimated costs in comparison to actual costs.

Sample job cost status report

The following is an excerpt of a job cost status report that compares estimated costs to actual costs.

```
<table>
<thead>
<tr>
<th>CODE</th>
<th>DESCRIPTION</th>
<th>ORIGINAL ESTIMATE</th>
<th>CURRENT ESTIMATE</th>
<th>TOTAL COST</th>
<th>% COMP</th>
<th>BALANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>01001</td>
<td>General Expenses</td>
<td>0.00</td>
<td>0.00</td>
<td>15.50</td>
<td>0.00X</td>
<td>-15.50</td>
</tr>
<tr>
<td>01010</td>
<td>Field Superintendent</td>
<td>2,000.00</td>
<td>1,200.00</td>
<td>1,329.74</td>
<td>99.98X</td>
<td>0.26</td>
</tr>
<tr>
<td>01203</td>
<td>Jobsite Tel/Pwr/etr</td>
<td>80.00</td>
<td>80.00</td>
<td>0.00</td>
<td>0.00X</td>
<td>80.00</td>
</tr>
<tr>
<td>01204</td>
<td>Port-a-Pot</td>
<td>75.00</td>
<td>75.00</td>
<td>140.00</td>
<td>100.00</td>
<td>65.00</td>
</tr>
<tr>
<td>01200</td>
<td>Equipment Rental</td>
<td>0.00</td>
<td>0.00</td>
<td>307.47</td>
<td>100.00</td>
<td>-307.47</td>
</tr>
<tr>
<td>01240</td>
<td>Current Cleanup</td>
<td>250.00</td>
<td>250.00</td>
<td>147.21</td>
<td>59.88X</td>
<td>102.79</td>
</tr>
<tr>
<td>01250</td>
<td>Dumpster</td>
<td>250.00</td>
<td>1.00</td>
<td>0.00</td>
<td>0.00X</td>
<td>1.00</td>
</tr>
<tr>
<td>01280</td>
<td>Surveying</td>
<td>250.00</td>
<td>1.00</td>
<td>0.00</td>
<td>0.00X</td>
<td>1.00</td>
</tr>
<tr>
<td>01300</td>
<td>Blue Prints</td>
<td>0.00</td>
<td>0.00</td>
<td>12.92</td>
<td>0.00X</td>
<td>-12.92</td>
</tr>
<tr>
<td>01310</td>
<td>Travel/Fuel</td>
<td>0.00</td>
<td>0.00</td>
<td>118.68</td>
<td>100.00</td>
<td>-118.68</td>
</tr>
<tr>
<td>01350</td>
<td>Building Permit</td>
<td>183.00</td>
<td>183.00</td>
<td>212.70</td>
<td>116.23X</td>
<td>-29.70</td>
</tr>
<tr>
<td>01402</td>
<td>Liability Insurance</td>
<td>152.00</td>
<td>1.00</td>
<td>0.00</td>
<td>0.00X</td>
<td>1.00</td>
</tr>
<tr>
<td>01510</td>
<td>Taxes</td>
<td>190.00</td>
<td>206.00</td>
<td>284.63</td>
<td>99.33X</td>
<td>1.37</td>
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<td>02050</td>
<td>Demolition</td>
<td>100.00</td>
<td>1.00</td>
<td>0.00</td>
<td>0.00X</td>
<td>1.00</td>
</tr>
<tr>
<td>02200</td>
<td>Earthwork</td>
<td>3,740.00</td>
<td>5,035.97</td>
<td>5,035.97</td>
<td>100.00</td>
<td>0.03</td>
</tr>
<tr>
<td>02500</td>
<td>Asphalt Paving</td>
<td>750.00</td>
<td>2,142.00</td>
<td>2,292.00</td>
<td>100.00</td>
<td>-151.00</td>
</tr>
<tr>
<td>03101</td>
<td>Conc Form- Footings</td>
<td>873.00</td>
<td>873.00</td>
<td>973.12</td>
<td>111.24X</td>
<td>-98.12</td>
</tr>
<tr>
<td>03102</td>
<td>Conc Form- Stem Wall</td>
<td>873.00</td>
<td>873.00</td>
<td>487.28</td>
<td>55.83X</td>
<td>365.72</td>
</tr>
<tr>
<td>03103</td>
<td>Conc Form- SOG</td>
<td>0.00</td>
<td>0.00</td>
<td>56.55</td>
<td>0.00X</td>
<td>-56.55</td>
</tr>
<tr>
<td>03200</td>
<td>Concrete Reinforce</td>
<td>150.00</td>
<td>150.00</td>
<td>28.50</td>
<td>19.00X</td>
<td>121.50</td>
</tr>
<tr>
<td>03201</td>
<td>Rebar Installation</td>
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<td>0.00</td>
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continued on the next page
**Review Estimated Versus Actual Costs (continued)**

**Accuracy of data**

The cost data you enter must be accurate if your comparisons are going to be of use. Ensure that figures are reviewed. If something looks way over or under budget by an unexpected amount, check that the data was entered correctly.

**Comparison results**

Evaluating the comparison is as simple as determining whether or not you are over budget on any line items. If you have a surplus in the balance column, you have performed better than expected. If you have a overrun in the balance column, you should determine what factors contributed to it.
Review/Verify Invoices

Introduction

Mistakes can happen to anyone. By reviewing and verifying your invoices, you can lessen the likelihood that those mistakes happen to you.

Types of mistakes

Typical mistakes made on invoices include
- Clerical error
- Cost posted from the wrong job
- Mathematical error
- Duplicate billing
- Overbilling
- Retainage overlooked

Review/verify invoices

Assign a staff person to review and verify all invoices received before they are paid. Errors are generally easy to spot. Determine a set procedure to ensure that all invoices are reviewed and verified consistently.
Ensure That Daily Reports Are Submitted

Introduction

Daily reports should be required for each job site. These reports have legal ramifications in the event of a dispute. It makes good business sense to ensure that they are completed correctly and turned in on time.

Assign responsibility

The project superintendent or foreman is most likely to be assigned the task of completing a daily report form. Depending on the contract documents, the superintendent may stay on site long enough to fill out the report and then go to the next site or he or she may be on the same site all day.

Whatever arrangement exists, it is important that the form be filled in, updated as necessary, and turned in weekly.

continued on the next page
Ensure That Daily Reports Are Turned In (continued)

Sample daily report form
A daily report form may look like this.

"Name of Company" Daily Report

<table>
<thead>
<tr>
<th>Job Name:</th>
<th>Job #:</th>
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<tbody>
<tr>
<td>Date:</td>
<td>Day:</td>
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<tr>
<td>Report #:</td>
<td></td>
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<td>Weather Condition:</td>
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Summary:

VISITORS:

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<tr>
<th>Men on the Job</th>
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<th>H</th>
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<tbody>
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<td>Superintendent</td>
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<tr>
<td>Inspection</td>
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<table>
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<tr>
<td>Electrical</td>
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</table>

Signature: ____________________________
Meet Contract Expectations Regarding Paperwork

Introduction

You must carefully review the contract documents to determine what—if any—specific paperwork is required. Oversight or misunderstanding does not relieve you of any obligations. When in doubt, ask your construction attorney about federal, state, or local requirements for paperwork.

Types of paperwork

A contract may specify that different types of paperwork be submitted during the course of a project. There may be federal, state, and local requirements as well. Typical paperwork may include

- Lien notices
- Bonding information
- Registration or licensing
- Permits
- Safety notices
- Prevailing wage rates
- Progress reports
- Daily log entries
- Submittal log (sample)
- Change order log
- Contract tracking sheet (sample)
- Proposal request (see page 55)
- Proposal request log (sample)

continued on the next page
Sample submittal log

The following is a sample submittal log.
The following is a sample contract tracking sheet.
Sample proposal request log

The following is a sample proposal request log.
Coordinate/Cooperate with All Project Participants

Introduction

Projects vary in size and complexity. An organizational chart is useful for keeping track of all project participants, even on smaller jobs.

Organizational chart

The organizational chart is a classic business tool that defines project participants and their relationships. You could include contact and emergency information for all people listed and distribute to team members.

Sample organizational chart

This is a typical organizational chart for a project.

continued on the next page
Coordinate/Cooperate with All Project Participants (continued)

Who's in charge?

Chain of command and levels of responsibility and authority must be discussed in the pre-construction phase of any project. This includes accounting for interaction with people outside the organization who are involved in the project such as inspectors.

Avoid disputes

By delineating who is responsible and has authority over different tasks, you can likely avoid disputes or misunderstandings. Communication is at the heart of every smooth flowing project.
Monitor and Minimize Job Costs

Introduction

There are a variety of techniques to minimize costs. Through careful monitoring of the on-going project costs, you will be able to implement adjustments as needed.

Types of costs to monitor

You should monitor the following costs on an on-going basis.

- Material
- Labor
- Subcontractor costs
- Temporary utilities
- Supplier cost
- General conditions

Minimize job costs

You can work to minimize job costs through

- Control of typical job costs
- Suggestions for value engineered solutions to a proposed project that results in cost savings
- Control of overhead costs
- Timely communication of potential problems and possible solutions
- Streamlined paperwork requirements

Effect of the schedule on job costs

Schedule overruns cause a series of cost overruns. For example, a delay may impact the project by costing

- Extra labor
- Extended temporary utilities and job site trailer rental
- Extended insurance premiums
- Additional finance charges on loans
Determine When to Spend Money to Make Money

Introduction

The old adage about “the right tools for the job” indicates that there is an appropriate time to spend money to make money. The right tool may refer to a technological improvement to a compression gauge or to a redesigned advertising brochure used to attract more clients.

When to spend money on tools and equipment

You will have to determine whether you should invest money into tools and equipment based on several factors, including

- Is the tool or equipment needed for a money-making facet of the company or is it for a one-time job?
- Is it less expensive to rent the particular item on a short-term basis rather than tie up the cash in a purchase?
- What maintenance costs are associated with the item?
- Is special training required for proper use and maintenance of the item?

When to spend money on advertising tools

How will you get clients if no one knows you are doing business? Advertising is not a luxury expense for your business. It is a basic cost of doing business. Refer to Module F on Developing and Implementing a Marketing Plan.
Expedite Project Flow

Introduction

There is software available that can ease the task of creating project flow charts. Procedural charts can eliminate the guesswork from many common routine task descriptions. Make use of the technology available.

Types of software

There are many types of software available for tracking project flow. Typical packages include the following features

- Cash flow forecasts
- Critical path method (CPM)
- Start and end date
- Duration of activities
- Schedule activities
- Bar graph

Project flow and communications

The most basic component for expediting project flow is ensuring that all players are in the communication loop. Make use of

- Email
- Fax machines
- Pagers and cell phones
- Intraoffice websites

continued on the next page
Expedite Project Flow (continued)

Use the schedule to expedite project flow

The schedule is the navigational diagram of your project. Use the schedule to monitor timeframes, avoid delays, increase efficiency, and more. Use the schedule to

- Review at weekly project meetings whether the project is ahead or behind schedule
- Project cash flow forecast for owner
- Schedule subcontractors/suppliers well in advance of time expected at jobsites

Sample project schedules

The following are two sample project schedules.

continued on the next page
Complete Project On Time

Introduction

You can complete the project on time by adhering to the proposed schedule—with its built-in float time. Planning ahead is the best way to ensure you meet your schedule projections.

Schedule review

Review the schedule daily to monitor project progress. Use the schedule to advise subcontractors and suppliers of upcoming deadlines and deliveries. The schedule is your tool for completing the project on time.
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Avoid Litigation

Introduction
Consistent, effective communication from the preconstruction phase to project completion is the best method for avoiding litigation. Arbitration is intended as a win-win approach to problem solving in the event that problems arise that the parties are unable to solve between themselves.

Contract language
Your contract should have specific language regarding disputes and remedies. This information is covered in detail in Module D Legal/Contractual Issues.

Use a complete contract
Make sure that the contract has a scope of work that specifically lists inclusions and exclusions. If everyone signs off on the contract, it helps to minimize disputes later.

Be proactive
Take a proactive approach to avoid litigation. Communication is key to preventing misunderstandings that may lead to litigation.

- Be sensitive to possible areas of disagreement and communicate with all parties concerned.
- Explore options and alternatives for problems; listen to other people’s opinions and views.
- Consider all disagreements as action items—follow up on them and make sure they are resolved.
- Work toward consensus as an approach to problem-solving.
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Module D

Legal and Contractual Issues
The information presented in this section is not legal advice and should not be construed to be legal advice or to form a lawyer/client relationship. You should seek independent counsel for advice regarding individual legal issues.

No representations or warranties are made as to the accuracy, completeness, or currency of the information provided.


D. Legal and Contractual Issues

Overview

Introduction

This module covers many legal and contractual issues a contractor is likely to encounter in the process of running his or her business. This information is general by necessity and does not replace your own attorney’s advice.

In this module

This module is divided into five broad categories with specific topics in each.

<table>
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<th>see page</th>
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</thead>
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<td></td>
</tr>
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<td>Introduction</td>
<td>D-7</td>
</tr>
<tr>
<td>Minimum requirements</td>
<td>D-7</td>
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<tr>
<td>Standard form contracts</td>
<td>D-8</td>
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<td>Flow-down and incorporation-by-reference clauses</td>
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<td>Liquidated damages clauses</td>
<td>D-10</td>
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<td>No-damages-for-delay clauses</td>
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<td>Force majeure clauses</td>
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<tr>
<td>Termination clauses</td>
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<tr>
<td>Waiver of lien clauses</td>
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<tr>
<td>Scope definition</td>
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Delay claim analysis D–107
Contract Provisions and Standard Forms

Overview

Introduction

This first section of Module D covers basic contract provisions and standard forms. The topics are outlined below.

In this section

For information on... see page

Contract Provisions and Standard Forms

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Flow-down and incorporation-by-reference clauses ...... D–9
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Waiver of lien clauses .......................................... D–17
Attorney's fees clauses ......................................... D–18
Scope definition .................................................. D–19
Contract Provisions and Standard Forms

Introduction

This section provides a general discussion of key issues related to contracts and standard forms. This is intended as an overview and not specific legal advice. You should always obtain legal advice when entering into a contract.

Minimum requirements

Nearly every relationship in the construction industry is defined by a contract. At a minimum, construction contracts consist of a mutual agreement of the contractor and owner expressing the work to be performed and the price to be paid for that work. This contract will include:

- a statement of the contractor’s and owner’s names and addresses,
- the date that the contract was executed,
- the name and address of the project,
- a detailed description of the work or brief description of the work and an incorporation of the plans and specifications that describe the work in detail,
- a statement of the start and finish dates for construction,
- a statement of the ability and procedure for incorporating changes in the work scope into the contract,
- a method of providing the construction work under changed conditions if any are encountered,
- an allocation of insurance coverage and the corresponding amounts,
- a statement of the amount to be paid by the owner for the work, and
- the dates the payments are to be made.

Also, in many states, particularly regarding residential construction, laws have been enacted that state specific information that must be included in every contract for construction.

continued on the next page
Contract Provisions and Standard Forms (continued)

Minimum requirements
(continued)

Given the complexity of construction projects, most owners, contractors, and architects rely on and use form contracts tailored for their specific type of project or contractual relationship. Form contracts will be made up from several parts that, in combination, form the entire agreement between owner and contractor. Parts of the owner and contractor agreement may also contain provisions governing the architect's or engineer's obligations under the contract.

Standard form contracts

Standard form contracts satisfy the need for written contracts that can be economically furnished and executed, generally without legal services. These contracts help to standardize construction relationships and practices. These contracts are produced by the major construction organizations such as the AIA, EJCDC, ASA, ASCE, and the AGC. One criticism of the contracts produced by these agencies is that they tend to slightly favor their constituents. Another criticism is that they are the product of committees and thus may not be particularly incisive. Form contracts exist for most types of construction contracting, be it a contract for a stipulated sum, a cost plus fee contract, a unit price contract, or others.

Parts of the standard contract

Standard contracts are generally made up from two parts. For example, AIA A101 represents the basic form of agreement, and incorporates by reference AIA A201 that contains the conditions of the contract. The conditions of the contract (A201) are the expanded and detailed statements setting forth the agreement of the contractor and owner.

continued on the next page
**Contract Provisions and Standard Forms (continued)**

**Standard form contracts**
(continued)

**Modifications**

Modifications are made to these documents in two ways. Some strike the language of the contract and insert new language directly on the form itself. In general, the correct way to modify the language of A201 is to provide a list of Supplementary Conditions. The Supplementary Conditions contain paragraphs of text numbered in accordance with the paragraph numbers contained in A201. When an existing A201 paragraph is modified or deleted, the same paragraph number is used. When additional text is added to the existing A201 text, a new paragraph number is generated that directly follows the last paragraph number in the A201 section being amended.

By modifying the text of the form document in this manner, those already familiar with the text of the form contract may readily review a proposed contract by focusing on the changes in the supplementary conditions.

**Flow-down and incorporation-by-reference clauses**

Flow-down and incorporation-by-reference clauses in subcontracts are used to bind the subcontractor to the terms and conditions of the prime contract entered by the general contractor and owner. Typically, the flow-down clause and the incorporation-by-reference clause are used to bind the subcontractor to the prime contract’s provisions regarding disputes procedures, lien waivers, delay damage provisions, and indemnity provisions.

**Flow-down**

The obligations and duties flow down to the subcontractor, and the subcontractor will generally enjoy the rights and remedies against the general contractor that the general contractor possesses against the owner.

*continued on the next page*
Flow-down and incorporation-by-reference clauses (continued)

Incorporation-by-reference
Incorporation-by-reference clauses operate similarly to flow-down clauses. These clauses are used to incorporate the provisions of the prime contract into the subcontract by expressly stating that the pertinent sections of the prime contract and plans and specifications are incorporated into the subcontract agreement.

Although these clauses attempt to bind the subcontractor to all of the provisions of the prime contract, if there is a direct conflict between an express provision of the subcontract and an express provision of the prime contract, the subcontract will likely control.

Exceptions
Generally, the subcontractor will be bound to follow the incorporated terms of the prime contract. In some contexts, however, such as Miller Act claims (Payment Bond in federal government contracts), courts have held that the subcontractor is not required to follow the disputes procedure in the prime contract when bringing a bond claim under the Miller Act.

Liquidated damages clauses
In construction contracts, time is generally of the essence. Late performance by the contractor will, in most cases, cause the owner to suffer financial loss because the building or structure they contracted for is not usable. Proving such damage or financial loss can be difficult, and therefore is normally advantageous to liquidate—or determine the amount of damages—in advance, at the time the contract is executed.

continued on the next page
Liquidated damages clauses (continued)

Set dollar value
The liquidated damages generally are stated in terms of a set dollar value per day of delay. Thus, if the liquidated damages clause states that the contractor shall pay to the owner $500.00 per day for every day the completion of the project is delayed, the contractor has an incentive to complete the project on time or else be liable to make payment to the owner for every day of delay. If the contractor delays completion of the project by 10 days, the contractor is obligated to make payment to the owner in the amount of $5,000.00. This sum may be deducted from money the owner owes the contractor for work billed. In some contracts, when it becomes evident that the contractor will not complete the project on time, the owner may be entitled to retain additional funds, beyond the contract retainage amount to cover the liquidated damage amount.

Not a penalty
Liquidated damages—to be enforceable in most locations—must be an approximation of actual damages and not serve as a mere penalty to the contractor for failure to complete the work on time. Further, if the owner causes a portion of delay, or if delays are caused by risks assumed by the owner and not the contractor, the contractor will likely be entitled to an extension of time for completion of the project, and the liquidated damages would not apply until the extended time period has run.

Substantial completion
Finally, liquidated damages generally apply to a delay of substantial completion of the project, not necessarily final completion. A building may be used by the owner for its intended purpose, that is, substantially complete, before completion of minor or punchlist items (final completion). Liquidated damages may not apply if substantial completion is met before the contractual deadline.
Pay-when-paid clauses

Pay-when-paid clauses make payment to the subcontractor dependent upon the owner paying the general contractor. These clauses will, at a minimum, delay payment to the subcontractor until the general subcontractor receives payment for the work. At the extreme, this clause may make payment to the subcontractor contingent upon the general contractor receiving payment from the owner.

The question of which extreme applies varies by jurisdiction. In some jurisdictions, the pay-when-paid clauses are interpreted as an unconditional promise to pay, and that payment is delayed until receipt of funds by the general contractor. Thus, the general contractor is not obligated to make payment to the subcontractor until the general actually receives payment from the owner. In other jurisdictions, the pay-when-paid clause is held to control merely the timing of the payment, and is not a condition for payment. In those jurisdictions, the clause—absent clear language stating that it operates as a condition precedent to payment—does not remove the general contractor’s obligation to make payment to the subcontractor in the event the general contractor fails to receive payment from the owner.

In cases where the owner’s failure to make payment to the general contractor is based on a breach of contract or default of the general contractor, courts may not enforce the pay-when-paid clause and may allow payment to the subcontractor. This rule bars the general contractor from receiving a benefit from its own breach or default.

continued on the next page
Contract Provisions and Standard Forms (continued)

No-damages-for-delay clauses

When a construction project is delayed, the general contractor and subcontractors will likely suffer monetary damage. This damage will include increased unabsorbed home office overhead expenses because the overhead expenses incurred by the contractor are not absorbed by billings on the construction work of the delayed project, and—for the same reason—increased field overhead expenses. To avoid liability for these costs, parties include a no-damages-for-delay clause in the contract. Thus, if the contractor suffers a delay, there will be no recovery for increased expenses. In some no-damages-for-delay clauses, the contractor is limited to an noncompensable extension of the contract time as the only available remedy for project delays. This allows the contractor an extension of time, and avoidance of any liquidated damages, but denies the contractor monetary compensation for expenses such as unabsorbed home office overhead and extended field overhead.

In most jurisdictions these clauses are valid and enforceable. However, in some contexts, the state law may hold the clause unenforceable. Because of the harsh consequences worked by the clause, courts typically construe them narrowly and have developed several exceptions to the no-damages-for-delay clause.

Not contemplated

If the delay encountered is not a delay contemplated by the parties, the clause may not be effective. An example is when a owner fails to obtain the rights of way for entry upon land for construction.

Active interference

Another exception is the active interference exception. This exception requires some affirmative act that causes an unreasonable interference with the construction of the project, and cannot be just a simple mistake or error in judgment. In a case such as where another contractor is using the site area, interfering with the work of the delayed contractor, active interference has likely occurred

continued on the next page
Contract Provisions and Standard Forms (continued)

No-damages-for-delay clauses
(continued)

Fraud or bad faith
The fraud or bad faith exception will bar use of the no-damages-for-delay clause if the delay is caused by a misrepresentation of a party. There are also exceptions to the no damage for delay clause based on wrongful or willful conduct, encountering unreasonable delays, and in cases where a party has breached a material provision of the contract.

Force majeure clauses
Not all risks inherent in a specific job can be evaluated before executing the construction contract. Contractors may be able to predict normal weather patterns but not unusually severe weather, storms, and floods. Also, events such as national emergencies, wars, and government actions precluding or affecting work on the project cannot be effectively evaluated. Force majeure clauses attribute the risk of encountering these forces to one party or allocate the risk to each party by providing a specific remedy in the event the force is encountered. If an unexpected force is encountered and work on the project is affected, the parties may provide for termination of the contract, extra compensation for down time and unabsorbed expenses, or limit remedy to an extension of time only.

continued on the next page
Contract Provisions and Standard Forms (continued)

Termination clauses

There are two main types of termination clauses contained in construction contracts: termination-for-default clause and termination-for-convenience clause.

Termination-for-default

The termination for default clause allows one party to terminate the contract when the other party has materially breached the contract. A minor deviation from the terms of the contract will not be considered a substantial breach sufficient to allow a termination of the contract for default. Examples of a contractor’s substantial breaches of contract sufficient to allow termination are

- persistent failure to provide enough skilled workman or proper materials to the project,
- failure to make payment to subcontractors,
- persistent failure to follow laws, ordinances, or rules,
- failure to complete the work of the project on time, or
- other material breach of the construction contract.

When the contractor is terminated for default, the owner is entitled to certain remedies. The owner may generally

- complete the work of the contract itself,
- hire another contractor to complete the work, or
- call upon the original contractor’s surety to complete the project.

The owner may also be entitled to recover other damages such as delay damages and reprocurement costs.

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Contract Provisions and Standard Forms (continued)

Termination clauses (continued)

Termination-for-convenience by owner
If the contractor is not in default or has not breached a material provision of the contract, the owner may still terminate the contractor for convenience. In private construction projects, this provision must be expressly made in the contract itself or the power to terminate for convenience will not exist. When terminated for convenience, the contractor will be entitled to remedies including

- payment for work provided to date,
- costs incurred by the contractor due to termination,
- fair and reasonable profit on work performed,
- but generally no recovery of overhead or profit on work that remains unperformed.

However, under the 1997 AIA documents, the contractor may recover reasonable overhead and profit on work not performed, though this is not the general rule in other contexts.

Termination-for-convenience by contractor
Under certain contracts the contractor may be entitled to terminate the contract. This right may accrue under the contract, if the contractor does not contribute to the cause(s), when

- the owner stops the work for more than 30 consecutive days,
- a court or agency of the government orders the work to stop,
- act of government such as a national emergency requires the work to stop,
- the owner fails to make payment on a Certificate for Payment certified by the architect, or
- if the owner has failed to furnish reasonable evidence of its ability to pay for the work if the contract requires such evidence.

continued on the next page
Contract Provisions and Standard Forms (continued)

Termination clauses (continued)

Generally, the contractor’s right to terminate must be expressly stated in the contract.

Waiver of lien clauses

One of the most powerful payment remedies of a contractor is the mechanic’s lien. Given the power of the remedy, owner’s typically incorporate a clause in the contract

- prohibiting the contractor from filing a mechanic’s lien,
- requiring that any liens be removed from the property by filing a bond to discharge the lien, and/or
- requiring the contractor to indemnify the owner when a lien is filed.

By waiving all lien rights at the commencement of the project, the contractor has relinquished a significant tool in obtaining payment for his or her work. This should be carefully considered before executing the contract. In some states, a contractual waiver of mechanic’s lien rights is invalid, but in others it is enforceable and operates to preclude the filing of mechanic’s liens.

Other portions of the contract may require furnishing full or partial lien releases for payments already received when submitting an application for payment or submitting the application for final payment. In the case of a partial lien release, this means that the contractor waives his or her lien rights for the work actually paid for under previous applications for payment from the owner.

These partial lien waivers should be carefully reviewed to make certain that they do not purport to waive all lien rights. The partial lien waiver should apply to payments actually received from the owner. The contract may also provide that the contractor must file a complete release of all liens and claims with its application for final payment. The contractor should make certain that all claims and payment issues have been resolved before furnishing a complete release.

continued on the next page
Contract Provisions and Standard Forms (continued)

Attorney’s fees clauses

In the absence of a provision in the contract for recovery of attorney’s fees, parties will generally not be entitled to recovery of their attorney’s fees if they prevail in a lawsuit. Also, when negotiating to resolve lawsuits, legal fees may also be incurred, and—without a clause in the contract providing for recovery of legal fees in a lawsuit—it may prove difficult to negotiate for recovery of attorney’s fees incurred in negotiating a resolution. Therefore, construction contracts may include attorney’s fee provisions by which a party who prevails in the lawsuit will be entitled to recovery its attorney’s fees. There may be several variants of this clause. The clause may limit the party to recovery of its reasonable attorney’s fees. In this case, the reasonableness of the fee’s will be a factual issue for resolution by the court. Other attorney’s fee clauses seek to limit recovery of attorney’s fees to the “substantially prevailing party.”

Other clauses in the contract may include recovery of attorney’s fees separate from a distinct attorney’s fee clause. Typically, indemnification clauses will provide for recovery of attorney’s fees by the party who is indemnified. Mechanic’s lien clauses may provide for attorney’s fees associated with discharging the lien, and hazardous materials clauses may provide for indemnification of the owner, including indemnification for attorney’s fees incurred when hazardous materials are encountered and damage or injury occurs.

continued on the next page
Scope definition

Scope definition in the contract can either be broad or specific.

**Broad scope definition**

Clauses in the contract may state that the drawings and plans are diagrammatic and that the contractor or subcontractor’s scope of work includes any and all items necessary for a complete finished product. This catchall type of scope definition requires careful review of the contract documents for gaps in the drawings and specifications. With this type of clause, any gaps will be filled by the contractor regardless of whether the item was actually included in the contractor’s takeoff or bid.

**Specific scope definition**

Another method of stating the scope of work in the contract is to specifically recite the specification sections and specific plan sections for the work provided under the contract. In this manner of stating the scope of work, the contractor may be entitled to extra compensation for completing work that is not described in the recited plan and specification sections. Contractor’s may also seek to include their proposals for a project in the contract documents so that the language they know and understand, as well as the scope of work statement they drafted is included in the contract.
Government Contracts

Overview

Introduction

This second section of Module D covers government contracting process. The four topics are outlined below.

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Competitive Sealed Bidding

Introduction

In private contracting, an owner is free to use whatever contracting scheme best suits his or her needs. Typically, an owner is free to encourage the submission of competitive bids, but nonetheless award the contract to someone other than the low bidder.

The bidding process

In contrast to the private contracting, most federal, state, and local construction contracts can be awarded only by a process known as "competitive sealed bidding." This process is generally mandated by federal and state procurement statutes. Competitive sealed bidding ordinarily must include the following elements.

- Issuance of a written Invitation to Bid ("IFB") containing or incorporating by reference detailed specifications and contractual terms and conditions
- Public notice of the Invitation to Bid by posting, mail, or otherwise so that any interested contractor may learn about the proposed contract and evaluate the feasibility of submitting a bid
- A formal, public opening and announcement of all bids received at which the bidders and others may be present and examine the bids
- Evaluation of the bids based upon the requirements set forth in the Invitation to Bid
- Award of the contract to the "lowest responsive and responsible bidder"

continued on the next page
Competitive Sealed Bidding (continued)

Contractor Responsiveness

Ordinarily, to qualify for an award of a government contract, the bidder must submit a bid that conforms to the Invitation to Bid. Otherwise, a bid is regarded as nonresponsive, and it ordinarily must be rejected. On the other hand, a minor defect or variation of a bid proposal from the exact requirements of the Invitation to Bid that does not affect the price, quality, quantity, or delivery schedule may be treated as a mere informality and waived.

Thus, a bid containing nonconformities may still qualify as a “responsive” bid as long as the nonconformities do not affect price, quality, quantity or the delivery schedule.

Contractor Responsibility

Ordinarily, to qualify for the award of a government contract, the bidder must qualify as a “responsible bidder.” This term is commonly defined as a company that has the capability to perform fully the contract requirements and the moral and business integrity and reliability that will assure good faith performance. Thus, the criteria of “responsibility”—unlike the criteria of “responsiveness”—involves consideration of factors that go to a bidder’s ability to perform. These criteria customarily permit the government to make a reasoned judgment that a contractor can satisfy the requirements of the contract.

Issues that have resulted in a determination that a bidder does not qualify as a “responsible” bidder include:

- Criminal violations
- Insufficient financial resources
- Record of unsatisfactory performance
- Insufficient equipment or facilities
- Lack of experience
The Federal Acquisition Regulations (FARs)

Introduction

The federal government has adopted a single, unified regulation known as the federal acquisition regulations (FARs) that implement and expand on the federal statutes that govern all federal construction contracts.

Authority of the FARs

The FARs have the force and effect of law, and the mandatory clauses required by the FAR may apply even when they are not expressly included in the contract. The FARs are published in the Code of Federal Regulations at 48 C.F.R. Chapter 1. The FARs may also be found at www.arnet.gov/far.

Use of FARs

The FARs represent the cornerstone of the federal government’s regulation of public construction contracts. The FARs set forth the exact wording of clauses that must be used in government contracts such as changes clauses, differing site conditions clauses, termination clauses, and clauses addressing disputes. The FARs also detail the procedures that the government’s contracting officer must follow in administering a construction contract.
Socioeconomic Programs

Introduction

It is the federal government’s policy to place a fair proportion of its construction contracts with small business concerns and small disadvantaged business concerns. It is also the policy to give these business concerns the maximum practicable opportunity to participate as subcontractors in contracts that are awarded consistent with efficient contract performance. To accomplish this goal, the government has enacted a number of statutes and regulations that apply in most government construction contracts.

Size standards

The Small Business Administration (SBA) has established small business standards. Certain construction contracts are set aside for businesses that qualify as “small businesses” under the SBA size standards. In the building construction industry, in general, a business is considered small if its average annual receipts for its preceding fiscal year did not exceed $17,000,000.

Subcontracting

Certain government contracts require the successful bidder to submit a subcontracting plan that includes separate percentage goals for using

▫ small business concerns
▫ small disadvantaged business concerns
▫ women-owned small business concerns

The subcontracting plan must also recite the types of records that will be maintained to demonstrate the adoption of procedures aimed at complying with the requirements and goals of the plan.

continued on the next page
**Socioeconomic Programs** (continued)

**Subcontracting** (continued)

In general, a "small disadvantaged business concern" means a small business concern that is at least 51 percent unconditionally owned by one or more individuals who are both socially and economically disadvantaged. Individuals who qualify as "socially disadvantaged" and "economically disadvantaged" are defined in the federal acquisition regulations (FARs).

**The 8(a) Program**

Section 8(a) of the Small Business Act establishes a program that authorizes the Small Business Administration (SBA) to enter into construction contracts with other federal agencies and then let subcontracts for performing those contracts to eligible socially and economically disadvantaged small business concerns, commonly referred to as "8(a) contractors." Detailed regulations governing 8(a) contracts are set forth in the FARs.
State and Local Procurement Laws

Introduction

Generally, state statutes and local ordinances contain competitive bidding requirements requiring the advertising of a contract award in a designated manner. However, as a general rule, the state and local statutes are not as extensive or rigorous as those that apply to federal construction contracts.

Public protection

Generally, the courts have held that the state and local statutory requirements are for the benefit and protection of the public, not the individual bidders, and that the lowest bidder has no fixed absolute rights. Likewise, administrative procedures for handling claims under state and local contracts vary widely from the rigid procedures required for federal contracts.

Claims

Typically, however, state and local procurement laws do provide for some kind of administrative procedure for addressing construction claims. In some jurisdictions the administrative procedure is as simple as requiring an informal proceeding before the contracting agency. In other jurisdictions, a board of contract appeals exists for the purposes of hearing construction claims. Usually, an appeal to court is available following exhaustion of the administrative remedies. In every instance, the governing state or local procurement law and regulations should be consulted.
Government Regulations

Overview

Introduction

State and federal laws establish many requirements for operating any business, and construction contractors face additional regulatory requirements as the following section summarizes. The detailed requirements governing contractors could fill libraries. What follows is a brief summary of the types of issues that apply to new contractors.

This third section of Module D covers government regulations. The four topics are outlined below.

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State and Local Regulations

Introduction

Contractors who plan to engage in any activity regulated by state/county building codes are generally required to register and become licensed before beginning to do business. Many states require license applicants to pass an examination on construction law, business organization, and the skills of their occupation. Applicants may also have to present letters of reference from previous employers, customers, banks, architects, or engineers, as well as proof of on-the-job experience and evidence of financial ability to operate a contracting business.

Basic requirements for a contractor’s license

Nearly all states have some form of the following basic requirements for contractor license applicants.

- At least 18 years of age with a high school diploma or equivalent
- Proof of US citizenship or legal residency
- Documentation of any current occupational licenses
- Photograph of applicant
- Description of any citations, violations, or liens resulting from construction work

Licensure examination

A prospective contractor may also have to demonstrate competence in his or her trade to obtain a license. For example, to perform electrical work, a contractor must have a master electrician’s license from a state board or master electricians.

continued on the next page
State and Local Regulations (continued)

Licensure examination (continued)

Before obtaining an application for licensure, a prospective contractor must pass an exam. To qualify for the exam, the prospect may have to meet certain work experience requirements under the supervision of a master electrician or similarly-qualified person, or have board-approved professional training. The subjects on the exam include general theory, wiring and protection, wiring methods, materials, equipment for general use, special occupancies, and special equipment, conditions, applications, and calculations.

Licensure fees

There are fees charged to apply for an exam or a masters license. Licenses must be renewed periodically. Holders of out-of-state master licenses may be eligible for a masters license without taking another exam. Holding a license in one state usually does not extend the right to do construction work in other states.

Fines

There are usually fines for performing any significant work without a license, and often, an unlicensed contractor may not have the right to sue to collect unpaid amounts under a construction contract.

Structuring the business

There are various legal structures that any business may take. The most common are sole proprietorship, general and limited partnerships, C and S corporations, and limited liability companies. Each structure offers options that are appropriate for different situations and that affect tax and liability issues.

If a contractor plans to operate in a corporate form, it will be necessary to conform with generally applicable requirements for corporations doing business in that state.

continued on the next page
**State and Local Regulations (continued)**

**Naming the business**

Contractors should also determine whether it is necessary to register the name of the business with the state under a trade name registration law.

**Trademarks, patents, copyrights**

The contractor must consider the need to apply for trademarks, patents, and/or copyrights. Trademarks are names or symbols used in a business and may be registered in a state and/or the federal Trademark Office.

New and useful inventions can be patented. This requires compliance with detailed and technical procedures. Copyrights prevent unauthorized copying of written matter, works of art, and computer programs.

**Business occupation license**

Counties and cities often require a business or occupation license, too. If there are plans for the business to occupy a new or used building, a certificate of occupancy may be necessary.

**Bonding and insurance requirements**

Licensed contractors may also have to post a state license bond. Construction contractors that will employ any workers need liability and workers compensation coverage in each state where they do business.

**Tax liabilities**

Income taxes are levied by federal and state governments on all business revenue. Consequently, every business must file annual income tax returns and pay quarterly estimated taxes.

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State and Local Regulations (continued)

Tax liabilities (continued)

Many states impose a sales and use tax on retail purchase, retail sale, rental, storage, use or consumption of tangible personal property, and certain services, which must be collected on just about every tangible item sold. A sales tax number may be required for each business before opening. Contractors should obtain the number plus instructions for collecting, reporting, and remitting the money from the state government.

Tax laws also require businesses to withhold from employee wages federal income taxes, state income taxes, and FICA (social security) insurance. The Internal Revenue Service (IRS) publishes guides concerning tax compliance for small businesses. The Business Tax Kit includes data and forms for a Federal Employer Identification Number (EIN) and a tax guide for small business.

Employer obligations

All businesses with employees are required to comply with state and federal regulations governing the employment relationship, such as union management relations laws, occupational safety and health laws, minimum wage and overtime regulations, unemployment insurance, employee benefits, workers compensation, etc.

Unemployment

States typically require businesses to pay unemployment insurance tax if the company has one or more employees for 20 weeks in a calendar year, or it has paid gross wages of $1,500 or more in a calendar year. The taxes are payable at a rate of 2.7 percent on the first $8,500 in annual wages of an employee. Unemployment insurance must be reported and returns made to the state.

OSHA

The Federal Occupational Safety and Health Administration (OSHA) outlines specific health and safety standards that employers must provide for the protection of employees. Many states have similar standards.

continued on the next page
INS
The Federal Immigration Reform and Control Act of 1986 requires all employers to verify the employment eligibility of new employees. The law obligates an employer to process Employment Eligibility Verification Form I-9. The Immigration and Naturalization Service (INS), Office of Business Liaison offers a selection of information bulletins and live assistance for this process.
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OSHA Requirements

Introduction

For employers in the construction industry, occupational safety and avoiding workplace injuries are critical elements not only of a company's legal compliance program, but also for employee relations and financial success. Under the federal Occupational Safety and Health Act (OSHA), employers have a general duty to provide both work and a workplace that are free from recognized hazards.

Legal obligation to inform

Employers have a legal obligation to inform employees of safety and health standards that apply to their workplace. The employer must also display in a prominent place the official OSHA poster describing rights and responsibilities under the OSH Act.

If the employer has more than 10 employees, the employer must maintain records of all work-related injuries and illnesses, and must post a summary of injuries every year in February. OSHA regulations provide that an employee may refuse to work when faced with imminent danger of death or serious injury.

Retaliation

Employers are prohibited from punishing or discriminating against employees for exercising such rights as complaining to an employer, union, OSHA, or any other government agency about job safety and health hazards, or for participating in OSHA inspections, conferences, hearings, or other OSHA-related activities.

continued on the next page
OSHA Requirements (continued)

State plans

States with their own occupational safety and health programs conduct inspections. There are currently 25 states administering their own occupational safety and health programs through plans approved by OSHA. These states must adopt standards and enforce requirements that are at least as effective as the federal requirements. Most states adopt standards identical to the federal standards and have similar inspection procedures—including citations and penalties, employer and employee rights and responsibilities.

OSHA inspections

OSHA safety and health compliance officers are authorized to conduct workplace inspections to determine whether employers are complying with standards issued by the agency for safe and healthful workplaces. OSHA usually may not conduct warrantless inspections without valid consent. The agency may, however, inspect after obtaining a judicially authorized search warrant. An OSHA inspector may conduct a comprehensive inspection of the entire workplace or a partial inspection limited to certain areas or aspects of the operations. Inspections are usually conducted without advance notice; alerting an employer without proper authorization in advance of an OSHA inspection can bring a fine of up to $1,000 and/or a 6-month jail term.

A compliance officer will explain the purpose of the visit, the scope of the inspection, and the standards that apply. The employer will be given a copy of any employee complaint that may be involved (with the employee’s name deleted, if the requested). The employer is asked to select an employer representative to accompany the compliance officer during the inspection, and an authorized employee representative is also permitted to attend the opening conference and participate in the inspection.

continued on the next page
OSHA Requirements (continued)

OSHA inspections (continued)

At the end of the inspection, the OSHA inspector will meet with the employer and the employee representatives in a closing conference to discuss abatement of any hazards that may have been found. Citations may be issued when violations of standards are found and for violations of the general duty clause, even if no OSHA standard applies to the particular hazard.

Resources

OSHA standards, interpretations, directives, and additional information are on the internet at www.osha.gov.

Types of citations

There are four types of citations.

Serious violation

A serious violation is one where there is a substantial probability that death or serious physical harm could result. The penalty for a serious violation is assessed from $1,500 to a maximum of $7,000, depending on the gravity of the violation. A penalty for a serious violation may be adjusted downward based on the employer’s good faith, history of previous violations, and size of business.

Willful violation

A willful violation is one that the employer intentionally and knowingly commits. The employer must have been aware that a hazardous condition existed and that that condition violated a standard or other obligation of the Act and made no reasonable effort to eliminate it. Penalties of up to $70,000 may be proposed for each willful violation. The minimum willful penalty is $5,000. An employer that committed a willful violation that has resulted in the death of an employee may also be subject to criminal penalties of up to $250,000 (or $500,00 if the employer is a corporation) and up to six months’ imprisonment, or both. A second conviction doubles the possible term of imprisonment.

continued on the next page
OSHA Requirements (continued)

Types of citations (continued)

Repeated violation
A repeated violation is a violation of any standard, regulation, rule, or order where, upon subsequent inspection, a substantially similar violation is found and the original citation has become a final order. Violations can bring a fine of up to $70,000 for each such violation. To calculate repeated violations, the initial penalty is adjusted for the size and then multiplied by a factor of 2, 5, or 10, depending on the size of the employer.

Failure to abate
Failure to abate a prior violation may bring a civil penalty of up to $7,000 for each day that the violation continues beyond the prescribed abatement date.

Notice of contest
A citation and proposed penalty become a final order unless an employer contests the citation, abatement period, or proposed penalty. A Notice of Contest must be given to the OSHA area director in writing within 15 days of the citation. An orally expressed disagreement will not suffice. A copy of the notice must be posted in a prominent location in the workplace.
Wage and Hour Requirements

Introduction

This is a brief summary of wage and hour requirements. For an in-depth discussion on this issue, refer to Module E Managing Human Resources.

Labor standards legislation

The federal government and many state and local jurisdictions have adopted laws that require employers to compensate their employees in accordance with certain minimum standards. The federal Fair Labor Standards Act (FLSA) covers employers with revenues in excess of $350,000 per year, and requires such employers to pay non-exempt employees at least $5.25 per hour for all hours worked. The FLSA also requires covered employers to pay premium compensation of one and one-half an employee’s rate for all hours worked in excess of 40 in a single work week.

These minimum wage and overtime requirements are enforced by the Employment Standards Administration of the US Department of Labor. Individual employees also have the right to file suit in federal court on their own behalf. Many states have similar labor standards laws that cover employers that might not be covered by the federal law.

Davis-Bacon Act

Contractors who perform work on public contracts face an additional array of labor standard requirements under laws like the federal Davis-Bacon Act, which requires contractors on all federally funded construction projects to pay the rate of wages and benefits prevailing in the community in which the project is being built.

The prevailing rates are determined by the Employment Standards Administration. Many states have Little Davis-Bacon Acts imposing prevailing rate obligations in connection with state public works projects. Additionally, contractors on federal projects may have to adopt affirmative action plans and comply with myriad regulations governing equal opportunity for minorities, women, individuals with disabilities, and veterans.
Worker's Compensation Requirements

Introduction

The risk of injury on the job is a constant concern on construction sites. Worker’s compensation is the state law response to this exposure, ensuring that any employee who is injured at work will receive all reasonably necessary medical treatment, as well as certain temporary and permanent disability benefits if the injury results in significant disability from working.

State requirements

State laws uniformly require contractors to procure a worker’s compensation insurance policy protecting all employees against the risk of injury on the job. Failure to have effective coverage in place before commencing operations may be the basis for fines, criminal liability, and loss of certain defenses in the event of a claim by an employee.

Effect on the company

If an on-the-job injury occurs at a time when no insurance is in effect, the impact on a company’s financial profile and insurability can be disastrous.

Sources of coverage

Coverage may be available from a business insurance broker, a state operated insurance fund, an industry insurance association, or through state-approved self-insurance.
Disputes and Remedies

Overview

Introduction

This fourth section of Module D covers disputes and remedies. The five topics are outlined below.

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Mechanic's Liens

Introduction
Mechanic's lien laws provide monetary protection to contractors, subcontractors, and suppliers. The laws vary greatly from state to state. This section provides an overview of this type of law. Be sure to consult with your attorney.

Definition: mechanic's lien
A mechanic's lien is a type of security interest created by statute to protect those who provide labor and materials to improve real estate. The term “mechanic's lien” is somewhat misleading because it ordinarily applies to claims by general contractors, subcontractors, and suppliers, not mechanics.

Purpose of mechanic's liens
The purpose of the law is to give contractors, subcontractors, and materialman who have enhanced the value of a building or structure the security of a lien on the building or structure to the extent that they have added to its value. After a lien is created, a lien claimant can force the sale of the building or structure to collect its debt.

Variations in mechanic's lien laws
Each of the 50 states and the District of Columbia has its own mechanic's lien statute. Mechanic's lien statutes are generally divided into two classes:
- The “New York” or “derivative lien” system, and
- The “Pennsylvania” or “direct lien” system

New York or derivative lien system
Under the New York or derivative lien system, the amount that a lien claimant may recover is limited to the amount that the owner owes to the general contractor. In states using this system, an owner ordinarily has a complete defense to a mechanic's lien if the owner is not indebted to the general contractor.

continued on the next page
Variations in mechanic’s lien laws (continued)

Pennsylvania or direct lien system
In contrast, under the Pennsylvania or direct lien system, the right of subcontractors, materialman, and laborers to a lien does not depend on the existence of any indebtedness of the owner to the general contractor, and the fact that the owner has already paid the general contractor is no defense.

Variations
The mechanic’s lien statutes of the various states are notorious for the extent to which they vary from each other. Consequently, familiarity with the procedures for obtaining and perfecting a mechanic’s lien in one state is of limited usefulness when attempting to obtain or perfect a mechanic’s lien in another state. Among other things, notice requirements, time limits for filing, and the people entitled to claim a lien vary widely from state to state.

In all instances where a mechanic’s lien may be necessary, an attorney familiar with the specific state’s statutory requirement should be consulted.

Property subject to a lien
Although the rules vary from state to state, ordinarily buildings, structures, condominiums, and site development improvements are all subject to mechanic’s liens. This ordinarily includes excavation, paving, landscaping, and storm water and sanitary sewer improvements. It is also common for mechanic’s lien statutes to allow a mechanic’s lien to be filed against a tenant’s leasehold interest in a building or structure when the tenant rather than the owner contracts for improvements.

continued on the next page
Mechanic’s Liens (continued)

Property subject to a lien (continued)
People supplying labor, materials, and equipment for improvements to public property are generally not entitled to a mechanic’s lien. Such people are usually protected by a payment bond posted according to the requirements of the Miller Act—the statute requiring payment bonds on federal projects. Likewise, individual states have “Little Miller Acts”—the state’s statutes requiring payment bonds on state and local construction projects.

People entitled to a lien
Ordinarily general contractors (customarily defined to mean anyone who has a direct contract with the owner) and subcontractors (customarily defined as people who have a contract with the general contractor) are protected by mechanic’s lien statutes. Many statutes—but not all—allow sub-subcontractors (people having a contract with a subcontractor) to file mechanic’s liens.

Pre-lien notice requirements
In some states, as a prerequisite to asserting a mechanic’s lien, a claimant must first give written notice to the owner setting forth the lienor’s name, address and describing the property and nature of services or materials furnished or to be furnished. Ordinarily, this “pre-lien” notice must be filed before commencing any work or within a certain number of days after commencing work. If the notice is not provided, the right to assert a mechanic’s lien is forfeited.

Post-lien notice requirements
In some states, written notice must be furnished to the owner, sometimes in addition to the pre-lien notice, informing the owner of the lienor’s name, address, nature of labor or materials furnished, person to whom the materials were furnished and amount due. Failure to furnish this notice within the required time limits invalidates the lien.

continued on the next page
Mechanic's Liens (continued)

Requirements for filing a lien

To obtain a lien, it's ordinarily essential that a written statement be filed, usually in the courthouse in the county where the property is located, within the time required by statute. This written statement, commonly referred to as a mechanic's lien, places the owners and prospective purchasers of the property on notice of the amount and nature of the mechanic's lien claim. Ordinarily, the statutes require that the written statement

- name the owner,
- describe the real property,
- describe the work performed or materials furnished,
- state the amount due,
- identify the party who owes the debt, and
- state the name and address of the lien claimant.

A lien statement that does not comply with the statutory requirements is generally invalid, and the lien claimant loses the right to assert the mechanic's lien.

Enforcement of the lien

Ordinarily, after a mechanic's lien is filed, the mechanic's lien must then be enforced within certain time limits required by statute or the mechanic's lien is forfeited. Usually, a lawsuit must be filed in the court where the project is located to enforce the lien by forcing a sale of the property to satisfy the debt.

Waivers

In most states, a lien claimant may voluntarily waive his or her right to claim a mechanic's lien by agreeing to a waiver provision in the contract. In some states, however, such waiver provisions are void and unenforceable. Partial lien releases given in exchange for each progress payment are usually enforceable in all the states.

continued on the next page
**Mechanic's Liens (continued)**

**Bonding off the lien**

In most states, the owner, general contractor, or other parties in interest may apply to the court where the mechanic's lien is filed to "bond off" the mechanic's lien. This procedure allows a bond—usually backed by a corporate surety company—or cash to be posted with the court in place of the property as security for the payment of the mechanic's lien claim. After the bond is approved and filed, the property affected by the lien is ordinarily released from the lien, and the bond or cash takes the place of the property as security for payment of the lien.

**Priorities**

The statutes vary from state to state as to whether mortgages or encumbrances created before the work is commenced have priority over mechanic's liens. In many states, mortgages created before the work is commenced have priority, and when the owner defaults, foreclosure by the mortgage holder wipes out all mechanic's liens. On the other hand, in some states a mechanic's lien has priority as to the value of any improvements, and the mortgage has priority as to the value of the underlying land.
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Miller Act Payment Bonds

Introduction

The Miller Act was enacted by Congress in 1935 and requires prime contractors for federal construction projects exceeding $25,000 in value to furnish the government with a performance and payment bond. The payment bond must be executed by a surety company, and subcontractors, suppliers, and materialman have a right to sue on the bond if they are not paid.

Government property only

Mechanic’s liens cannot attach to government property. The Miller Act, therefore, was designed to provide an alternative remedy to the mechanic’s liens that are available on private construction projects.

Where to obtain copies

The Miller Act requires the department secretary or agency head of the contracting agency to provide a copy of the bond (and the contract for which it was given) to any person who submits an affidavit that he or she has supplied labor or material to the project covered by the bond and for which payment has not been made. In most cases, a copy of the bond can be secured from the Owner’s Contracting Officer or Project Manager. The bond itself is a two-page standard form document.

Claimants covered by the Act

The Miller Act protects only people who

- have a contract with the prime contractor (all first-tier subcontractors, suppliers, materialmen, etc.) and
- have a direct contractual relationship with a “subcontractor.”

Third-tier subcontractors and others who have a more remote relationship from the prime contractor and his or her subcontractors are not covered. Similarly, second-tier subcontractors or suppliers who have a contract with a first-tier materialman, as distinguished from a “subcontractor,” are not covered.

continued on the next page
Miller Act Payment Bonds (continued)

Claimants covered by the Act (continued)

Whether a party with a direct contract with the prime contractor is a “subcontractor,” as distinguished from a materialman, depends on the facts of each case. In reaching a decision, the courts have considered the following factors:

- Whether the person takes on responsibility for a specific part of the original contract
- Whether the material or labor furnished is a substantial part of the work
- Whether the material furnished is custom manufactured
- Whether a payment or performance bond was required
- Whether retainage was withheld
- Whether shop drawings were submitted

The Act’s three limitation periods

The Act has three limitation periods that claimants must satisfy in order to recover.

90-Day Waiting Period

You must wait 90 days from the date you last furnished the labor or material for which you are claiming. If you sue before 90 days elapse, your suit is premature and subject to dismissal.

90 Days Written Notice

If you have a direct contract with a subcontractor, but no contract with the prime contractor, you can recover on the bond only if you give the prime contractor written notice within 90 days from the date you last furnished the labor and materials for which you are claiming. The notice requirement is intended for the benefit of the general contractor by making it possible for him or her to protect himself or herself against the claims of unpaid second-tier subcontractors and suppliers by withholding payment for 90 days. After 90 days elapses without notice, the prime contractor is free to pay his or her subcontractors without risk of liability to suppliers. No written notice is required of a first-tier subcontractor.

continued on the next page
Miller Act Payment Bonds (continued)

The Act’s three limitation period (continued)

One Year Outside Limitation for Suing
You must file suit on the bond before one year elapses from the date you last furnished labor and material to the project. This limitation applies to all claimants under the Act. The suit can be filed only in the federal court where the project is located.

Type of notice required
The Act gives second-tier claimants the right to sue on the bond only after they have first given the following written notice to the prime contractor:

... upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be serviced by any means which provides written, third-party verification of delivery to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

Strict 90-day notice requirement
The requirement that the 90-day notice be provided in writing and that oral notice will not suffice is considered by most courts to be a strict condition before filing a suit. Further, because the notice provisions are intended to benefit the prime contractor, most court decisions require that the notice be sent by the claimant and that it notify the prime contractor that the claimant is looking to the prime contractor for payment.
Miller Act Payment Bonds (continued)

Strict 90-day notice requirement (continued)

Thus, claimants who have merely asked the prime contractor to pressure the subcontractor to make payment, merely copied the prime contractor with letters to the subcontractor, merely relied upon requests made on his or her behalf by the subcontractor, or otherwise have not made it clear that the claimant was looking to the prime contractor for payment have not qualified.

Nonwaiver of rights

The Miller Act provides that the right to sue on a Miller Act payment bond cannot be waived unless the waiver is in writing, signed by the person whose right is waived, and executed after such person has first furnished labor or material for use in the performance of the contract.

Little Miller Act payment bonds

Each state has enacted a statute that requires prime contractors on state projects to furnish a payment bond guaranteeing payment to subcontractors and others who perform work at the project. These statutes are commonly referred to as “Little Miller Acts” because they are modeled on the federal Miller Act, which requires payment bonds to be posted on federal government projects. As in the case with the federal Miller Act, most state “Little Miller Acts” require the payment bond to be executed by a surety company, and subcontractors, suppliers, and materialman have the right to sue on the bond if they are not paid.

Mechanic’s liens cannot attach to government property. State “Little Miller Acts,” therefore, are intended to provide an alternative remedy to the mechanic’s liens that are available on private construction projects.

continued on the next page
Miller Act Payment Bonds (continued)

State projects that qualify

State “Little Miller Acts” ordinarily apply to all state and local government projects. This commonly includes construction projects undertaken by counties, cities, towns, park authorities, sanitation districts, and state and local departments of transportation.

Variations in state Little Miller Acts

Although “Little Miller Acts” are customarily modeled after the federal Miller Act, the statutes nonetheless differ widely from state-to-state. For example, the state statutes frequently differ as to whether second- and third-tier subcontractors and suppliers are protected by the bond. Likewise, state statutes frequently differ as to the requirements for giving written notice of a claim and the timing for such a notice. The specific requirements of each state “Little Miller Act” should be consulted before taking any action.
Arbitration

Introduction

Arbitration is the voluntary submission of a dispute to a disinterested person or people for final and binding determination. Arbitration is voluntary and therefore must be based on a mandatory arbitration provision in the contract between the parties or the mutual consent of the parties to submit a pending controversy to arbitration.

The agreement to arbitrate

The standard form construction contracts published by the American Institute of Architects (AIA), the most widely used standard form construction contracts in the United States, require all disputes arising out of or related to the contract to be resolved by arbitration. After such an agreement to resolve disputes by arbitration is made, the parties give up their right to go to court to resolve any dispute arising under the contract. If one of the parties declines to participate in an arbitration, the opposing party may obtain a court order compelling arbitration.

The American Arbitration Association

Most agreements to arbitrate provide that the arbitration must be conducted according to the rules of the American Arbitration Association (AAA). The AAA is a public service, not-for-profit organization offering a broad range of dispute resolution services, including arbitration of construction industry disputes. The AAA has headquarters in New York City and offices located in major cities throughout the United States. Arbitration hearings are customarily held at locations convenient for the parties. The AAA publishes Construction Industry Arbitration Rules that set forth the procedures to be followed in construction industry arbitrations. Copies of these rules may be obtained from the AAA's web site at www.adr.org/.

continued on the next page
Arbitration (continued)

Initiation of an arbitration

A party to a contract requiring arbitration according to the rules of the AAA can ordinarily initiate an arbitration proceeding by

- filing a copy of a demand for arbitration with the appropriate regional office of the AAA,
- enclosing a copy of the arbitration provisions of the contract, and
- paying appropriate AAA filing fees.

The original of the demand should ordinarily be sent to the other party to the contract.

Parties to an existing dispute may also initiate an arbitration proceeding irrespective of whether arbitration is required by their contract. In such cases, the parties can simply file a joint written submission to arbitrate with the appropriate regional office of the AAA.

Selection of the arbitrators

The AAA maintains a roster of contractors, subcontractors, architects, engineers, attorneys, and other people with experience in construction matters who serve as arbitrators. If the parties have not agreed to a different method of appointment and the AAA rules apply, the AAA sends a list of prospective arbitrators to each party. The list ordinarily contains a brief biographical description of each proposed arbitrator. The parties may strike from the list any arbitrators who are unacceptable, and if the parties fail to agree, the AAA will unilaterally appoint an arbitrator or arbitrators.

Number of arbitrators

Unless the parties otherwise agree, a panel of three arbitrators is ordinarily selected for large and complex cases; otherwise, one arbitrator is selected. The arbitrator or arbitrators then set the date, time, and place for the arbitration proceeding.

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Arbitration (continued)

Costs and fees

The AAA charges administrative fees based on the amount of the claim or counterclaim. Currently, filing fees range from $500 on claims below $10,000 to a maximum of $7,000 for claims in excess of $1,000,000. Additionally, the parties must compensate the arbitrator or arbitrators for each day they serve at daily rates suggested by the AAA. There may also be fees for the rental of a hearing room and other miscellaneous fees.

Time

One of the principal attractions of arbitration is that it proceeds relatively quickly compared to a court proceeding. For example, under the current AAA Construction Industry Arbitration Rules, cases involving claims of less than $50,000 are supposed to be completely resolved in 60 days. Larger, more complex cases ordinarily take longer than 60 days to resolve. Arbitration proceedings are nonetheless ordinarily concluded in substantially less time than would be the case in a court proceeding.

Discovery procedures

Before the trial in a court proceeding, as distinguished from an arbitration proceeding, the parties are permitted to question witnesses and other people under oath in depositions and subpoena and to examine documents in their opponent’s possession. This procedure is known as “discovery.” In contrast, in an arbitration proceeding, discovery is generally much more restrictive. For example, under the AAA Construction Industry Arbitration Rules, an arbitrator may direct the parties to produce documents and other information and to identify any witnesses to be called, but ordinarily there is to be no other discovery. This is frequently cited as a disadvantage of arbitration.

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Arbitration (continued)

Evidence at the hearing

In an arbitration proceeding, the rules of evidence that govern court proceedings do not apply. Consequently, a party may prove his or her case with affidavits and other secondhand information that would not be allowed in a court proceeding. This generally makes it easier for claimants to prove their claims and more difficult for defendants to defend against claims.

The arbitration award

Arbitrators are generally not bound to decide disputes according to the principles of law that apply in a court proceeding. Ordinarily, an arbitrator is not required to state the reasons for his or her decision. The arbitrator is generally free to grant any remedy or relief he or she deems just and equitable and within the scope of the agreement of the parties. Under the AAA rules, unless otherwise agreed by the parties, the award must be made no later than 30 days from the date of closing of the hearing.

An award may include an assessment of the administrative fees and costs of the arbitration proceeding, but these costs ordinarily do not include attorney’s fees.

Appeal of an award

A party seeking to overturn an arbitration award has a heavy burden of proof. In most states, an arbitration award may not be successfully appealed to court unless

- the award was procured by corruption, fraud, or other undue means,
- there was evident partiality or misconduct by an arbitrator,
- the arbitrator exceeded his powers,
- the arbitrator improperly refused to postpone the hearing or hear evidence, or
- there was no arbitration agreement.

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Enforcing an arbitration award

In most states, the prevailing party in an arbitration proceeding may apply to court to have the arbitration award confirmed. Unless the opposing party provides grounds for overturning the award, the court will confirm the award and enter a judgment that can be enforced just as any other court judgment can be enforced.
Mediation

Introduction

Mediation consists of an effort by an impartial person to assist the parties in reaching the settlement of a controversy or claim by direct negotiations. The mediator participates impartially in the negotiations and advises and consults with the parties in an effort to reach an agreement that both parties find acceptable. A mediator cannot impose a settlement, but can only guide the parties toward achieving a settlement.

The agreement to mediate

The standard form construction contracts published by the American Institute of Architects (AIA), the most widely used standard form construction contracts in the United States, require the parties to first try to resolve their claims by mediation before proceeding to arbitration or litigation.

Mediation services

There are a variety of mediation services available. These mediation services are usually private businesses that, for a fee, maintain rosters of trained mediators who are available to mediate disputes. One of the most widely recognized mediation services are those offered by the American Arbitration Association (AAA). The AAA is a public service, not-for-profit organization offering a broad range of dispute resolution services, including mediation of construction industry disputes. The AAA has headquarters in New York City and offices located in major cities throughout the United States. The AAA publishes Construction Industry Mediation Rules that set forth the procedures to be followed in construction industry mediations. Copies of these rules may be obtained from the AAA’s web site at www.adr.org/.

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Mediation (continued)

Initiation of a mediation
If mediation is pursued through the AAA, a party may initiate a mediation by filing a request for mediation with the AAA together with an appropriate administrative fee. Alternatively, if there is no contract requirement for mediation, the parties may nonetheless request the AAA to mediate a dispute by filing an appropriate request for mediation with the AAA.

A request for mediation need only contain a brief statement of the nature of the dispute and the names and addresses of the other parties to the dispute.

Selection of the mediator
If mediation is sought under the auspices of the AAA, following receipt of a request for mediation, the AAA appoints a qualified mediator to serve. If the contract between the parties already names a mediator or specifies a method of appointing a mediator, the AAA will follow the procedure specified in the contract. Following appointment of the mediator, the mediator fixes the date and time of each mediation session. The mediation is ordinarily held at a local office of the AAA or at any other convenient location agreeable to the mediator and the parties.

Authority of the mediator
A mediator does not have the authority to impose a settlement on the parties. However, the mediator customarily conducts both joint and separate meetings with the parties and makes oral and written recommendations for settlement.

continued on the next page
Mediation (continued)

Privacy

Mediation sessions are ordinarily private. The parties and their representatives may attend mediation sessions, but other people may attend only with the permission of the parties and with the consent of the mediator.

Confidential information disclosed to a mediator by the parties or by witnesses in the course of the mediation cannot be divulged by the mediator. All records, reports, or other documents received by a mediator while serving in that capacity remain confidential.

Costs and fees

Most mediation services, including the AAA, charge administrative fees for their services. Additionally, mediators ordinarily charge an hourly or daily fee for the time spent serving as a mediator.
Federal Government Contract Claims

Introduction

Doing business with the federal government is markedly different than working in the private sector. As such, the claims process is unique to the government. This section provides an overview of the federal government contract claims process.

The Contract Disputes Act of 1978


Claims

All claims by a contractor against the government must be in writing and must be submitted to the contracting officer for a decision. The contracting officer must issue his decision in writing and mail (or otherwise furnish) a copy of the decision to the contractor.

$50,000 or less

For claims of $50,000 or less, the contracting officer must issue his or her decision within 60 days from receipt of a written request from the contractor that a decision be rendered within that period.

More than $50,000

The contracting officer must issue a decision on a certified claim of more than $50,000 within 60 days or notify the contractor of the time within which a decision will be issued. If a claim for more than $50,000 is not certified, it is not considered valid.

continued on the next page
Federal Government Contract Claims (continued)

Claims (continued)

More than $50,000 (continued)

For claims of more than $50,000, the contractor must certify that

- the claim is made in good faith,
- the supporting data are accurate and complete to the best of his or her knowledge and belief, and
- the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable.

Appeals to the board of contract appeals

The contracting officer’s decision on a contractor’s claim is final and conclusive and not subject to review unless the contractor files a timely appeal. A contractor may appeal the contracting officer’s decision to the appropriate agency board of contract appeals within 90 days from the date of receipt of the decision. There are presently 12 agency board of contract appeals consisting of:

- Armed Services Board of Contract Appeals (ASBCA)
- National Aeronautics and Space Administration Board of Contract Appeals (NASABCA)
- Department of Energy Board of Contract Appeals (EBCA)
- Postal Service Board of Contract Appeals (PSBCA)
- Department of Agriculture Board of Contract Appeals (AGBCA)
- Veterans Administration Board of Contract Appeals (VABCA)
- Department of Interior Board of Contract Appeals (IBCA)
- Department of Labor Board of Contract Appeals (LBBCA)
- Department of Transportation Contract Appeals Board (DOTCAB)
- Department of Housing and Urban Development Board of Contract Appeals (HUDBCA)

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**Federal Government Contract Claims (continued)**

**Appeals to the board of contract appeals (continued)**

- General Services Administration Board of Contract Appeals (GSBCA)
- United States Army Corps of Engineers Board of Contract Appeals (ENGBCA)

Agency boards consist of at least three people who have experience in public contract law. An appeal to an agency board is less formal than a court proceeding, and it is not necessary for the contractor to be represented by an attorney. The decision of an agency board is final, except that the contractor may appeal a decision to the United States Court of Appeals for the Federal Circuit within 120 days after the date of receipt of a copy of the decision. On appeal, the Court of Appeals will fully evaluate all legal issues, but the Court will treat the board’s findings of fact as final and conclusive unless proven to be “fraudulent, or arbitrary, or capricious, or so grossly erroneous as to necessarily imply bad faith, or if such decision is not supported by substantial evidence.”

**Appeals to the US Claims Court**

In lieu of appealing a contracting officer’s decision to an agency board of contract appeals, a contractor may bring an action directly to the US Claims Court—unless there is any contract provision, regulation, or rule of law to the contrary. Any such action must be filed within 12 months of the date of the receipt by the contractor of the decision of the contracting officer. However, once a contractor elects to appeal to an agency board of contract appeals, he is bound by the election and may not appeal to the Claims Court.

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Federal Government Contract Claims (continued)

Government appeal

The government may appeal a board decision to the United States Court of Appeals for the Federal Circuit within 120 days of the decision, subject to the same standards of legal and factual review that apply to a contractor's appeal.

Accelerated procedure

All agency boards of contract appeals must provide for an accelerated disposition of any appeal from a decision of a contracting officer where the amount in dispute is $50,000 or less. The accelerated procedure applies at the sole election of the contractor. If the accelerated procedure is selected by the contractor, the appeal must be resolved "whenever possible" within 180 days from the date the contractor elects to use the procedure.

Small claims

Each agency board of contract appeals must provide simplified rules of procedure for claims of $10,000 or less. These small claims procedures apply at the sole election of the contractor, and appeals must be resolved "whenever possible" within 120 days from the date on which the contractor elects to use the procedure. A decision reached under the small claims procedure is final and conclusive and cannot be set aside except in cases of fraud.

Interest on claims

Contractors with successful claims are entitled to receive interest from the date the contracting officer receives the claim payable at a rate set periodically by the Secretary of the Treasury.
Changes and Claims

Overview

Introduction

Virtually all construction disputes relate to the concepts of either scope, price, or time. The contract documents for a construction project may be lengthy and detailed. These documents merely reflect the “rules” by which all parties agree to abide. Like all rules, the meaning and scope of the contractual provisions are open to interpretation. It is vital for you to have a clear understanding of how the most common construction claims relate to the concepts of scope, price, or time. You should understand the importance courts give to related concepts such as notice, implied duties, and others. If you wish to increase your chance of success on future contract claims, take steps to manage existing claims and to avoid claims being asserted against you.

In all situations, consultation with your attorney is highly advisable as it is the safest way to ensure that your contractual rights are preserved and protected.

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Change Orders

Introduction

During the progress of any construction project, changes in the scope of the work will occur. Most construction contracts anticipate these changes and include a “changes” clause. The purpose of a contractual changes clause is to allow the owner to direct the contractor to make changes in the work without invalidating the contract. The clause also avoids forcing the contractor to sue for breach of contract if he or she believes that a given change is beyond the scope of the original agreement. The changes clause provides a means for orderly administration of the inevitable changes that occur in the scope of the contractor’s work.

Contractor’s duty to perform changes

A contractor generally has a duty to perform all owner-mandated changes because owners typically reserve the right (through a “changes” clause in the contract) to make changes in the work.

Refusal to perform changes

If the contract contains a changes clause of the type described above, the contractor cannot refuse to perform the additional work even if there is a disagreement on entitlement and/or cost. The only situation where a contractor may confidently refuse to complete the change is when (and if) the contractor can demonstrate that the extra work amounts to a “cardinal” change. (Cardinal changes are discussed in more detail below.) Courts, however, are generally unwilling to find “cardinal changes.” Thus, there are only a few circumstances under which a subcontractor can refuse to perform change order work.

continued on the next page
Change Orders (continued)

Undisputed part of a change

Apart from the “construction change directive” procedure in the AIA General Conditions, most changes clauses do not allow the contractor to be paid for the undisputed part of the change. This holds true unless the contractor waives his or her right to perform the work under protest (thereby foregoing the right to recover any of the disputed portion of the cost of the change).

Amending the change clause

Prudent contractors should amend the changes clause to provide that the work will proceed without disruption but that the contractor has the right to

- be paid for the undisputed portion of the change; and
- recover, if possible, the balance of the cost of the change at the conclusion of the project.

At minimum, changes clauses should provide for the parties to “agree to disagree” on disputed portions of the change. For example, the parties can agree to disagree on issues of entitlement and direct and indirect costs. This will ensure that the progress will not be disrupted due to a disagreement about the existence or scope of an alleged “change.”

Who has authority to order changes?

One problem associated with change orders is who has authority to issue changes to the project. Occasionally, courts must decide whether a given party in the construction process—owner, construction manager, architect, or contractor—had the authority to issue a change order. In general, most changes clauses specifically limit the authority to issue a change order to the owner.

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Change Orders (continued)

Ambiguous situations

In some instances, however, such as where the contract language is ambiguous, the architect may direct the contractor to perform a change. Although owners may argue that the architect did not have authority to order the change, courts sometimes find that in certain circumstances the architect had the authority to bind the owner.

Such a finding, however, is rare because most construction contracts expressly limit the authority of the architect with respect to initiating changes. Therefore, to limit the possibility of a later dispute, contractors should insist that change orders be issued by either

- the owner or
- an agent of the owner who has clear authority to issue change orders.

Change order “Notice” requirements

The requirement of written notice for change orders is another issue that is widely litigated. The typical changes clause requires that the contractor only perform changes upon the issuance of a “written change order,” and only after the contractor has given the owner “written” notice of the claim and/or the events giving rise to the claim.

Despite these requirements, it is not uncommon for contractors to perform additional work with only verbal authorization from the owner. This practice of proceeding without written authorization is a risky proposition as the failure to adhere to a contractual notice requirement has doomed many a claim.

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Change Orders (continued)

Less costly alternative

The purpose of requiring an owner be given notice is to allow the owner the ability to analyze the situation and, if necessary or possible, proceed with a less costly alternative. If the contractor fails to provide the owner with notice, performs the change order work, and later bills the owner for the extra work, the owner may claim that he or she was denied the ability to seek a less costly alternative to the work performed by the contractor.

Acting as a volunteer with ambiguities and errors

From a contractor’s perspective, the importance of obtaining a written directive to perform change order work is amplified when the contractor believes that the additional work results from ambiguities or errors in the project’s plans or specifications.

For example, if the contractor is aware of an ambiguity in the specifications and nevertheless performs the additional work without first obtaining a written directive resolving the error or ambiguity, courts may later find that the contractor has acted as a “volunteer.” In such a case, the contractor has forfeited the right to be compensated in any way for the additional work that he or she voluntarily undertook.

Protest and progress

Obviously, situations occur where strict enforcement of contract provisions calling for written authorization before payment is made for extra work may result in injustice to the contractor.

For instance, the contractor might be required to perform substantial extra work to correct a clear error in the contract documents. However, if the owner is unwilling to acknowledge the change as a legitimate extra, the contractor often has little choice but to proceed with the work under protest to maintain the project’s progress.

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Change Orders (continued)

Document the claim

Contractual notice requirements will often be strictly construed by the courts. In situations where the failure to give formal written notice of a change is not held to bar a contractor’s recovery of the resultant additional costs, the contractor must demonstrate to the court that the owner was aware of the change. Thus, a prudent contractor will give the owner detailed written notice of a claim, as required by the contract, as soon as the claim is discovered. By giving such notice within the requirements established by the contract, the contractor will remove a large obstacle on the road of recovering on his or her claim.

Contractor recovery for changes without a “Formal Notice”

To protect contractors, courts recognize several theories that allow the contractor to recover even where the contract requires written notice/authorization for change order work before payment is made.

Actual notice

One theory permits the contractor to rely on “actual notice” to demonstrate that the owner was aware of and authorized the change order work. This theory allows the court to conclude that the purpose of a contract provision calling for written authorization—to give the owner notice—was satisfied. For example, where the owner is informed of the change (or need for a change) either in a progress meeting, or by reviewing minutes of a progress meeting, or in a telephone call, and does not deny receiving notice, courts may conclude that the purpose of the changes clause has been satisfied and separate written notice was not necessary.

continued on the next page
Change Orders (continued)

Contractor recovery (continued)

Constructive notice
Another theory that contractors may rely on to recover costs (or additional time) related to a change is to establish that the owner had “constructive notice” of the change. This means that the owner knew or should have known of either

- the existence of the change;
- facts giving rise to the change; or
- that the change was necessary to correct a defect in the contract documents.

One example of where a court would likely find the owner had “constructive notice” (and was, therefore, obligated to pay for a change order), is the situation where an owner deliberately makes a change to the project that the owner and contractor believe is a “zero dollar” change—a change that will not impose any additional costs to perform. If it turns out that the contractor in fact incurred additional costs in implementing the change, the a court would probably conclude that the owner had constructive notice that the change would occur and that the contractor was entitled to be reasonably compensated for his or her work to effect the change.

Waiver
The theory of “waiver” affords contractors another way to recover the costs of extra work where no written change order exists. Waivers may occur where the parties to a contract regularly ignore the provisions requiring written change orders or written notice and proceed with the work. In this situation, the owner is said to have “waived” the contract’s written change order notice requirements.

However, to establish such a waiver, the contractor or subcontractor must demonstrate sufficient or continuing conduct to demonstrate the requirement was truly waived. It is often difficult to prove that a party waived the right to be notified in writing of any change. Thus, contractors should not rely upon waiver as a substitute for providing the required notice.

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Types of changes

There are three basic types of changes.

**Owner-generated change orders**

Where the owner makes changes in the design of the project after the contract with the contractor has been made, the resulting change is an owner-generated change. Owner-generated change orders can also come about as the result of changes—additions, deletions, substitutions, etc.—made by the owner’s design team during the course of the project. Although owner-generated changes may lead to entitlement issues of whether the change is actually a change in the scope of the work, the bulk of the disputes (if there are any at all) tend to cluster around the pricing of such change order work.

**Contractor-generated change orders—constructive changes**

Often on a job, change orders arise when the contractor recognizes that as the result of either the field conditions, the contractor’s interpretation of the contract documents, or some other reason, work required to complete the project is outside the contractor’s original scope of work. If this occurs and a change is not recognized by the owner, the contractor must push for a change order on the theory of “constructive changes.” In other words, although no formal change order was issued, project conditions effectively required the contractor to perform additional work to complete the contract.

Courts have endorsed the constructive change doctrine under the rationale that allowing contractors to recover for constructive changes provides an incentive for contractors to continue to work pending resolution of any dispute involving the work at issue.

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Change Orders (continued)

Types of changes (continued)

- Generally, under the doctrine, a contractor can recover for five types of constructive changes.
  - Disputes over contract interpretation during performance
  - Owner interference or failure to cooperate
  - Defective specifications
  - Owner’s misrepresentation and nondisclosure of superior knowledge
  - Acceleration

Cardinal changes

A cardinal change is a change that, by its magnitude, is beyond the scope of the contract. As such, cardinal changes are not governed by contractual “change” provisions because changes clauses only govern changes that are within the scope of the contract. The “cardinal change” can be a potential tool that a contractor can use, albeit in rare circumstances, to obtain payment or extra time despite failing to adhere to the requirements of a changes clauses.

If a court finds that cardinal change has occurred, the owner has breached its contract and the contractor does not need to perform the additional work. However, courts rarely find cardinal changes and there is no rule to determine whether or when a cardinal change has occurred. As a result, an allegation of a cardinal change will be analyzed on its own facts and circumstances, with primary consideration given to the magnitude and quality of the changes ordered and their cumulative effect upon the project as a whole.

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Bilateral modifications

The contractor walks a fine line between fulfilling his or her duty to perform changes and refusing to perform since entering into bilateral modifications of the contract can effectively waive the contractor’s right to claim cardinal changes.

Courts may likely view a bilateral modification to a contract as evidencing a “meeting of the minds” that creates an enforceable contract and replaces any parallel provisions of the original contract. Additionally, by making the changes, a contractor may be found to have implicitly agreed that the changes were within the changes clause of the contract. Because there can only be a cardinal change where an owner requires its contractor to perform materially different duties from those bargained for in the contract as modified, the bilateral modification can undercut any attempt to claim a cardinal change.

Consult your attorney

Consultation with your attorney is highly advisable as it is the safest way to ensure that your contractual rights are preserved and protected.
Differing Site Conditions

Introduction

The term "differing site conditions" describes any on-site physical condition that is substantially different from what the contractor reasonably expected to encounter and increases the amount of time or money required to complete the project. The most common differing site conditions claim involves subsurface soil.

Subsurface conditions

Possibly one of the greatest risks a contractor accepts in performing any substantial project is that the soil conditions or project site will vary from what the contractor expected when he or she bid the job. Although sophisticated analysis of soil conditions may be performed in preparation of bid documents, most contractors can state from experience that geotechnical information often is misleading or plainly erroneous. These unexpected findings often lead to claims for increased costs and delays as work is suspended until soil-related problems are solved. For example, foundation work is redesigned; more suitable materials are obtained from an off-site source, etc.

Project delays

The impact of soil-related problems is also significant because it usually occurs at the very outset of a project, thus delaying progress early in construction. Further, as many large projects are scheduled to make good progress during favorable weather conditions, an early and significant delay can throw the entire schedule into periods of bad weather, with resultant loss of efficiency.

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Differing Site Conditions *(continued)*

Types of changed conditions

In dealing with changed conditions, the courts have traditionally grouped differing site conditions claims into the following two categories:

- "Type I" conditions are subsurface conditions at the site that differ materially from the conditions indicated in the contract.
- "Type II" conditions are unknown and unusual physical conditions at the site that differ materially from those ordinarily expected to be found in work of the character shown in the contract.

"Type I" site conditions

A Type I condition depends on representations made in the contract documents about the conditions the contractor is likely to encounter. The focus of a Type I site conditions dispute is whether the contract contains an *affirmative statement* as to what type of conditions the contractor can expect to encounter on the project site. Having made an affirmative representation, the owner then naturally assumes the responsibility and risk for any damages that may result if the contractor relied upon that representation when bidding.

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Differing Site Conditions (continued)

"Type II" site conditions
A Type II site condition occurs when the contract does not purport to detail the conditions the contractor will encounter in excavation (or elsewhere) and unexpected materials are discovered in the course of the work. In such a situation, if the contractor is to recover for a differing site condition, the courts will attempt to determine what the contractor could have reasonably expected when bidding or beginning the project. In general, a contractor should have a valid claim for a Type II differing condition if two conditions are met. If the two factors are met, a court might find that a Type II changed condition exists and that the contractor is entitled to an equitable adjustment of the contract.

- Subsurface conditions at the construction site differ substantially from those ordinarily encountered and generally recognized as inherent in the work being performed; and
- that difference in conditions causes a change in the construction methods required for the performance of the work, which results in an increase in the cost of the work.

Differing site conditions clauses
Differing site conditions clauses are contractual clauses that shift the risk of unforeseen conditions from the contractor, who usually bears them, to the owner. Under these clauses, the contractor is able to recover the costs incurred as a result of differing site conditions without having to establish misrepresentation, deceit, or breach of warranty by the owner.

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Differing Site Conditions (continued)

Contractor requirements

Site conditions clauses set forth specific procedures to follow when a differing site condition is encountered and impose certain requirements on the contractor. For instance, most changed conditions clauses require that the contractor provide the owner with written notice within a stated period of time once a changed condition is found. Written notice is extremely important, and the contractor risks losing a claim if proper notice is not given.

The theory behind the notice requirement is that the owner should have an opportunity to investigate the situation before the changed condition is disturbed and before additional work is performed. Notice is necessary so the owner, at minimum, has the opportunity to verify whether the changed condition exists and the extent to which it has affected the contractor’s work.

Burden of proof without a clause

Contractors negotiating with an owner should be sure that their contract includes a “changed conditions” clause. If it does not, the contractor will have a much more difficult burden of proving entitlement to recover increased costs if changed conditions are encountered. For example, if the contract does not have a changed conditions clause, the contractor will have to demonstrate that the owner either

- is guilty of misrepresentation regarding soil conditions, or
- has breached an implied warranty that the contract documents are accurate and correct.

If the owner made no representation in the contract documents regarding soil conditions, the contractor will not be able to establish a misrepresentation. As to the possible breach of an implied warranty, a court may conclude that because the contract documents made no reference to soil conditions, or the boring logs were expressly excluded from the contract documents, no warranty was breached. Thus, the absence of a “changed conditions” clause makes recovering for such extra costs much less likely.
Delays, Disruption, and Acceleration

Introduction

Historically, project scheduling was governed by the implied duties and obligations found in every contract. However, as project scheduling has become more complex, construction contracts have started requiring specific provisions dealing with the project schedule. These express scheduling provisions have enabled courts to move beyond the concept of implied warranties (with their concomitant rights and obligations), to the express warranties of the specific contract provisions dealing with scheduling.

Owner's scheduling responsibilities

Traditionally, owners have not been very involved in the project schedule and would become involved only after a dispute developed regarding time extensions, excusable delays, or the like. However, owners now are more involved in scheduling the project. The owner who prepares and issues a project schedule assumes a substantial risk. Courts tend to view owner-issued schedules as analogous to specifications and consider the owner to have warranted that a particular project can be completed according to that schedule.

Contractor's assumed risk

Where the owner issues a schedule, the owner may attempt to limit its liability by means of contract provisions. The provisions may require the contractor to verify the reasonableness and feasibility of the schedule. If the contractor examines the schedule and discovers a serious error in the sequence or duration of activities but nevertheless begins construction according to the schedule, the contractor may be held to have “assumed the risk” of meeting the schedule.

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Contractor’s assumed risk

This is similar to the situation where the contractor discovers a patent error or ambiguity in the plans or specifications. The contractor should immediately report the error to the owner in writing and obtain from the owner a written statement as to whether the error is real and, if so, what steps to take to correct the error. If the owner informs the contractor that there is no error and/or issues corrections, the contractor would then be entitled to rely on the corrections and/or statement of no error. If the contractor later incurs increased costs as a result of the scheduling defect, the contractor has the right to rely on the owner’s representations contained in the project schedule.

Additional owner obligations

In addition to warranting that the project can be completed as scheduled, the owner has a number of additional obligations. First, the owner and its design team must promptly approve shop drawings to avoid adversely affecting the project schedule. Second, where the contract requires that the owner furnish certain equipment for use on the project or supply samples or conduct tests, the owner must do so in a timely manner. These owner obligations make it clear that the owner undertakes substantial risk when its actions or inactions result in project delays. Therefore, careful attention to execution of the progress schedule is as significant to the owner as it is to the contractor.

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Delays, Disruption, and Acceleration (continued)

Preliminary schedule

General contractors on construction projects are frequently required by the contract to prepare and issue a preliminary schedule revealing how he or she plans to execute the project in a timely manner. Although the parties to the contract certainly should be thinking about the progress schedule even before mobilization, preliminary schedules are often inaccurate and are issued more as a means of complying with contract provisions than to actually set the work schedule. As such, the assumptions, logic, and manpower and equipment needs shown on a preliminary schedule often are not well-reasoned, may be based on inaccurate or sketchy information, and may ultimately prove unreliable.

Contractor’s scheduling rights and responsibilities

Because of the potentially unreliable nature of preliminary schedules, the owner can use them to defeat a contractor’s delay or acceleration claim. Therefore, if a preliminary schedule is required, the contractor should make it clear to the owner that the schedule is preliminary and is based only upon the reliable information known to the contractor at that time.

If the contractor does not do this, the contractor should take particular care to ensure that the preliminary schedule submitted actually reflects the plan for executing the work. The schedule should never be submitted merely to comply with a contract provision since once the contractor has submitted this schedule, he or she is bound by its details.

Changes to the schedule

Regardless of the care and hard work that go into the preparation of a project schedule, few projects are built precisely according to schedule. Inevitably, there are variations in the productivity of the labor force, adverse weather, critical components are not delivered to the job site as anticipated, and many other expectations fail to develop as the parties reasonably expected.

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**Changes to the schedule**

The immediate consequence of such deviations is that the project is not built according to the plan. Because some deviations are inevitable, the contractor must properly update the project schedule to account for unforeseen events. Without updating, the schedule will not be an accurate portrayal of the likely work progress and instead merely reflect what the contractor intended to do.

**Failing to update**

Failing to update the schedule can affect the general contractor’s relations with both the owner and subcontractors. If the contractor abandons the detailed schedule and adopts a more flexible, *ad hoc* schedule (which essentially states that the work will be done when it is done), the contractor may find himself or herself in a dispute with subcontractors whose work was planned on the basis of the initial progress schedule. The subcontractors may have incurred increased costs as a result of the delays caused by the contractor’s abandoning the schedule.

**Subcontractor’s scheduling rights and responsibilities**

Subcontractors often neglect their rights with regard to the project schedule and adopt a reactive position rather than attempting to control events. Part of this attitude reflects the subcontractors’ failure to recognize that they have rights corresponding to the contractor’s responsibilities under a project schedule. By asserting these rights, a subcontractor can successfully reduce the risk of delays in the performance of his or her work.

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Delays, Disruption, and Acceleration (continued)

Subcontractor review and comment

The first way a subcontractor can protect himself or herself is by reviewing and commenting on the general contractor’s schedule. Any errors, faulty assumptions, or objections should be pointed out by the subcontractor.

Subcontractor job coordination meetings

Another way a subcontractor can participate in the scheduling process on a direct project level is in job coordination meetings with the general contractor and other subcontractors. These meetings—whether conducted daily, weekly, or on some other basis—are an effective means of resolving disputes and settling issues involved in scheduling the work. Using the job coordination meetings to obtain a full airing of differences among the parties is thus a valuable management tool that can produce many rewards in terms of both fewer delay claims and overall project efficiency.

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Implied duties and the project schedule

The rights and obligations of the parties under a construction contract are not determined solely by the express provisions of the contract.

**Implied obligations**

A party’s express rights are generally supplemented and modified by certain *implied obligations*. Often, these implied obligations help the contractor recover on his or her claim against the owner on the basis that certain obligations are constructively imposed on the owner (e.g., duty to cooperate, duty not to hinder, etc.). The implied obligations, however, potentially run to all contracting parties. Implied duties include:

- Duty to schedule and coordinate the work (owner and general contractor’s duty)
- Duty not to delay, hinder, or interfere with the work (all parties’ [e.g. owner, design professional, general contractor, and subcontractors’] duties)
- Duty to cooperate (all parties)
- Duty to grant reasonable time extensions (owner’s duty)

In negotiating the construction contract, the contractor should recognize his or her implied obligations and rights, but should also seek to have express language inserted into the agreement that protects his or her rights. Such proactive action in the negotiation stage will preclude the necessity (and uncertainty) of relying upon what a court may later read into the contract.

**Duty to schedule and coordinate work**

Every construction contract contains an implied duty on the part of the owner or contractor to schedule and execute work on the project in a “normal and reasonable” sequence. Thus, a general contractor cannot schedule the work in a manner that favors his or her own performance over that of the subcontractors. Doing so would violate the obligation of the contractor to schedule the work of the various trades in a reasonable manner.

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Delays, Disruption, and Acceleration (continued)

Implied duties and the project schedule (continued)

Frequently, contracts will require the subcontractor to “follow the progress of work” or “commence work when notified by the general contractor.” However, because of the general contractor’s implied responsibility to reasonably direct and coordinate the work of all trades, such clauses are generally viewed as requiring the general contractor to keep the work moving in a logical and economical sequence. The fact that the general contractor prepared a schedule for approval by the owner does not necessarily impose on the contractor the obligation of ensuring that all work will be completed in the time specified in the schedule.

Courts have held that a progress schedule, absent contractual language to the contrary, is nothing more than a serious estimate and calendar to be revised from time to time. As such, if a general contractor acts within reason and takes steps to create conditions wherein subcontractors can comply with the schedule, the contractor should not be liable for breach of the implied obligations to schedule and execute the work.

Duty not to delay, hinder, or interfere with work

Every construction contract contains an implied promise that the contracting parties will do nothing to prevent, interfere, or hinder the other party in his or her performance of the work. This duty not to delay, hinder, or interfere with the work applies to any number of acts or omissions during the course of construction. A contractor’s breaches of the duty include, but are not limited to, such diverse breaches as

- failing to provide an enclosed workplace
- failing to make progress payments as required
- failing to supply information needed in the performance of the work

In general, recovery under the duty will occur if the defendant’s conduct constituted a substantial interference with and hindrance to the plaintiff in the contemplated “normal” performance of the its contract work.

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Duty to cooperate

Every construction contract contains an implied duty that all parties will cooperate with each other in rendering their performance. The duty to cooperate, therefore, is similar to the implied duty not to delay, hinder, or interfere with another party’s work in that both duties address what the courts perceive to be the fundamental relations between parties to a contract. If a court finds that the breaching party has in fact violated the duty of cooperation, the injured party is entitled to recover the extra costs it incurred which were reasonably attributable to the party’s breach.

Essentially, such duty is one of “reasonable cooperation” and support in assisting each party in the completion of its portion of the work. Examples of where a breach of the duty of cooperation may occur include, but are certainly not limited to, situations where the breaching party

- causes delays,
- radically resequences the entire project,
- provides work piecemeal,
- causes or fails to alleviate site access problems,
- fails to expedite the flow of information to the contractors so as to minimize delay in their performance; and
- fails to coordinate the work properly.

In sum, the duty to cooperate may take a variety of forms, particularly, because the performance of one party is likely to depend on any number of acts to be performed by another party to the contract. Without the cooperation of the other party, the contractor’s performance cannot occur or, if it does, is apt to be much more expensive than originally anticipated. Therefore, it is important that owners, contractors, and subcontractors be familiar with the concept of an implied duty to cooperate.

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Duty to grant reasonable time extensions

Construction contracts often require that the owner grant a time extension in the event the project experiences certain delays. This obligation ensures that the contractor can effectively schedule and coordinate the remaining work by incorporating the extra time into the progress schedule. Although the owner may believe the time extension is “giving something” to the contractor because it precludes the owner’s ability to assess liquidated damages, the extension also benefits the owner.

For example, if the owner did not grant the time extension, the contractor would likely have a good claim for acceleration as well as both the extra time and increased costs (which are not generally recoverable under a ‘no damages for delay’ clause). If proven, this claim by the contractor would, for example, defeat the owner’s entitlement to liquidated damages. As such, both parties to the contract benefit from the owner’s prompt action in granting reasonable time extensions.

In addition, if the owner does not grant a reasonable time extension, courts may find constructive acceleration entitling the contractor to recovery for extra costs. Take, for example, the situation where it is obvious that there was a project delay well before the extension was granted. Under these circumstances a court may conclude that, by failing to grant the extension within a reasonable time (and refusing to promptly adjust the project schedule), the owner effectively forced the contractor to accelerate his or her work in order to meet the owner’s original pre-extension contract deadlines. As such, the contractor would be entitled to compensation for extra costs incurred in accelerating his or her performance because, although the owner may not have explicitly ordered the contractor to accelerate work, it constructively ordered such acceleration.
The project schedule and contract claims

Many contract claims are generated by deviations from the project schedule. Effects on the project schedule can result in issues of

- abandonment of the schedule,
- concurrent delay,
- acceleration and disruption, and
- suspension of work.

Abandonment of the project schedule

All parties to the construction contract are susceptible to the charge that they have “abandoned the project schedule.” When a project is delayed, given the amount of work remaining on the project, it may not appear likely that the project will be complete by the contractually-specified completion date. This situation is usually compounded by the probability of future delays. For an owner this situation may mean substantially increased costs such as increased financing expenses, temporary accommodations for employees, and extended rental of manufacturing facilities until the project is completed. In such circumstances, the owner may believe it is justified in casting aside the project schedule and insisting on a revised schedule that will provide occupancy and help reduce costs. Doing so, however, must be done with caution.

If the owner or general contractor concludes that the project schedule has become so inadequate that it must be abandoned, the best way to proceed is by means of a change order. The change order should be executed by all parties to the contract with the agreement that

- the schedule will be abandoned,
- an alternative scheduling method will be adopted for the remainder of the work, and
- no claims will be made by any party arising out of or resulting from the abandoned project schedule.

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Delays, Disruption, and Acceleration (continued)

The project schedule and contract claims (continued)

Occasionally, the failure of one party to comply with the project schedule can amount to a material breach of the other party’s contract, thereby justifying the abandonment of the entire project. The basis for abandonment begins with the fundamental principle that a breach that deprives one party of the essential performance for which it bargained will release that party from performing its undertaking.

For example, if a general contractor fails to follow its critical path method (CPM) schedule and begins scheduling certain trades to begin work at earlier stages than originally planned, this may make the work of certain subcontractors responsible for more preliminary work much more difficult. In fact, in such a situation, the courts may well find that the contractor’s breach—failing to schedule the work properly—resulted in conditions that made the subcontractor’s work impossible and thus justified the subcontractor abandoning the project.

Concurrent delay

Often, a construction project will be delayed for reasons attributable to more than one party—for example, both the owner and contractor. This situation may occur where there is a liquidated damages clause. The owner seeks to recover liquidated damages for the total amount of the delay, whereas the contractor seeks to avoid full liability for the liquidated damages by contending that the owner is responsible for at least some delay.

Historically, courts were reluctant to apportion delay, on the belief that if the party seeking damages was at all responsible for any of the delay, it had forfeited the right to recover any damages. However, the modern view is that damages will be apportioned where there is “concurrent” delay, i.e., a delay attributable to both parties.

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The project schedule and contract claims (continued)

Acceleration

“Acceleration” is an increase in the speed of the contractor’s performance beyond that anticipated or scheduled at the time the contract was bid. Acceleration typically occurs as the result of either

- an explicit order from the owner to the contractor to accelerate, or
- a directive from the owner to the contractor that requires the work to be completed on time, despite the contractor’s entitlement to a time extension.

The latter is termed a “constructive acceleration” and allows the contractor to recover his or her acceleration costs. Finally, a third type of acceleration occurs when the contractor voluntarily undertakes to accelerate the project to take advantage of a contractual bonus for early completion or to make up for its own inexcusable delays.

Disruption

Acceleration claims frequently include claims for disruption or loss of efficiency. In such case, the theory is that by accelerating the work to meet the contract completion date, the contractor’s forces could not work as efficiently as anticipated. In other words, the work required a greater number of less efficient man-hours than would normally be necessary to perform the same work. This situation is often referred to as “disruption.”

Additionally, a disruption/loss of efficiency claim can also result from other changes in the work or changes that disrupt the manner by which the contractor planned to perform his or her work. Thus, although the contractor may not have encountered acceleration, he or she has suffered a loss of efficiency due to change in its scope of work. In this case, although the contractor may not be able to recover under the “cardinal change” doctrine, the disruption/loss of efficiency claim should entitle him or her to compensation for the extra costs if he or she can show that the changes negatively affected the progress of the work.

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Suspension of work

If the owner or general contractor suspends another party’s work—assuming the contract does not have a “no damages for delay” clause—that party is entitled to recover delay damages. Occasionally, even in the face of a no damages for delay clause, certain suspensions of work have been deemed not covered by the clause. This happens based on the theory that the suspensions were not within the contemplation of the parties at the time the contract was signed.

For example, where the owner has failed to obtain the necessary public approvals to begin construction, but does not communicate this to the contractor who mobilizes upon receipt of a notice to proceed, courts have allowed the contractor to recover delay damages notwithstanding a “no damages for delay” clause. Additionally, some courts have held that where the suspension is of such a duration as to be beyond contemplation of the parties, the suspension is a material breach of contract that permits the contractor to refuse to perform unless the owner grants an equitable adjustment.
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Delay Claims Analysis

Introduction

There are several factors used in analyzing the validity of delay claims. The following is a general discussion of elements used in the legal determination of those claims.

Use of schedules in the delay analysis

Different types of project scheduling methods affect the determination of delay claims.

CPM and computer-generated schedules

Construction schedules are a key element to protect a contractor against a delay claim. Construction schedules, particularly Critical Path Method (CPM) schedules or schedules using similar computer-generated techniques, are now well-established tools to help prove or disprove delay claims. Although any construction schedule, whether a bar chart or a CPM schedule, can document and establish a delay claim, computer-generated schedules are more readily adaptable to this purpose.

For example, such scheduling programs can perform an impact analysis of individual delays to the construction project and factor such delays into the original schedule. In this way, the computer generated schedule can enable the fact finder to determine the overall delay incurred on the project.

The typical approach to using a CPM schedule in proving a construction delay claim is to prepare the following:

- A reasonable as-planned schedule to show that the original planned schedule was reasonable;
- An as-built schedule that reflects the actual construction activity;
- An as-built schedule reflecting all delays that highlights what activity on the critical path was delayed; and
- An adjusted schedule that establishes completion of the project absent delays for which the other party is responsible such as an as-planned versus as-built schedule reflecting the duration and reason for each delay.

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Delay Claims Analysis (continued)

Use of schedules in the delay analysis (continued)

**CPM and computer-generated schedules (continued)**

These four components can help prove or disprove claims relating to loss of productivity and efficiency. These same four components can (with some modifications) be used for proving or disproving acceleration claims.

**As-planned schedules**

The “as-planned schedule” demonstrates the time in which the project would have been completed if not for any project delays. Ideally, the as-planned schedule is the initial schedule prepared by the contractor and submitted to the owner for review and/or approval. However, it may be important to adjust this schedule to reflect events that later occur on during the project that enabled the contractor to save time (or to adjust the schedule to eliminate incorrect or unreasonable assumptions made by the contractor), which could not be anticipated when the contractor prepared and submitted the as-planned schedule. Any such adjustments should be properly documented and explained. The goal is to establish a reasonable and reliable yardstick for measuring delays.

**As-built schedule**

The next schedule required for a delay claim analysis is an “as-built schedule.” This schedule indicates the actual manner in which the project was built. It should reflect the actual sequence and durations of the work activities of the project and should be based upon project documentation relating to the schedule generated by the contractor and his or her forces during the project.

**As-built schedule including delays**

The third key schedule in a delay claim analysis is the “as-built schedule including all delays”—whether caused by the contractor or owner. The purpose of this schedule is to identify specifically the delays that affected the project, the activities affected by the delays, and the effect of such delays on the project’s completion date.

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Delay Claims Analysis (continued)

Use of schedules in the delay analysis (continued)

A major step in preparing this particular schedule is to identify precisely those delays that affected the critical path of the project and the duration of each such delay. If the contractor has maintained good job records, the documentation of change orders, submittal delays, errors and omissions, and other job impacts, it should not be difficult to identify precisely where the contractor’s work was delayed and the extent of each such delay.

However, this type of analysis should be taken one step further to ensure that in preparing this schedule, the contractor does not lose sight of changes in sequence and other disruptions that result from changes issued by the owner, errors and omissions, or similar problems. In other words, the contractor should be sure that critical delays to the project resulting from changes in sequence are not ignored in the effort to document the more visible and obvious delays that affected the project schedule. Again, accuracy in the preparation of this schedule is essential because an error in the analysis—found only when the schedule is used in litigation—can prove fatal to the credibility of the entire claim.

Adjusted schedule reflecting completion absent delays

The final scheduling analysis prepared as part of the overall delay claim is an “adjusted schedule” that reflects completion of the project absent delays for which the owner is responsible. This schedule essentially details what the contractor realistically would have done on the project had his or her performance not been affected by the owner-caused delays. This schedule is then compared to the as-built schedule to determine precisely the amount of time the owner delayed the project.

continued on the next page
Delay Claims Analysis (continued)

No damages for delay clauses
When used in a construction contract, a “no damages for delay” clause prohibits a contractor (or those claiming under or through the contractor) from asserting claims, regardless of the cause, for time-related damages associated with those delays.

Sample no damage for delay clause
The following is typical of many no damages for delay clauses.

Notwithstanding anything to the contrary in the Contract Documents, an extension in the Contract Time shall be the sole remedy of the Contractor for: (1) delay in the commencement, prosecution or completion of the Work; (2) hindrance or obstruction in the performance of the Work; and/or (3) other similar claims (collectively referred to as Delays) whether or not such Delays are foreseeable, unless a Delay is caused by acts of the Owner constituting active interference with the Contractor’s performance of the Work, and only to the extent such acts continue after the Contractor furnishes the Owner with notice of such interference. In no event shall the Contractor be entitled to any compensation or recovery or any damages, in connection with any Delay, including, without limitation, consequential damages, lost opportunity costs, impact damages or other similar remuneration.

Even though clauses like the above may produce harsh results, they are valid and enforceable and will generally preclude an action for delay damages. Nonetheless, courts construe such clauses very strictly because of the potentially extreme severity of results flowing from their enforcement.

continued on the next page
Exceptions to the clause

There are at least four widely recognized exceptions to the enforcement of no damage for delay clauses.

- Delays not within the contemplation of the parties
- Active interference by the owner
- Owner fraud, concealment, or misrepresentation
- Delays of extreme length

Each of these exceptions is discussed in greater detail below. Obviously, the application of an exception to a no damages clause is a fact-driven exercise. Thus, a contractor should not rely that a court will allow a delay claim to proceed even though a contract has a clause precluding such a claim.

Uncontemplated delays exception

Exactly what kind of delays are “not within the contemplation of the parties” depends on the facts and circumstances of each case. Courts will consider such things as

- what delays were reasonably foreseeable by the parties when they signed the contract,
- the specific terms of the no damage for delay clause, and
- what delays, if any, were specifically mentioned in the contract.

The rationale for allowing “uncontemplated delays” to trump a no damages for delay clause is the idea that a contractor cannot bargain away his rights to bring a claim for damages resulting from delays which the parties did not contemplate at the time. Thus, even broadly worded no damages clauses will generally only encompass those delays that are reasonably foreseeable.

continued on the next page
Exceptions to the clause
(continued)

Owner “active interference” exception
The second exception to a no damages for delay clause is triggered when the delays arise from the owner’s active interference. The “active interference” exception arises from the notion that, in a contract where time is of the essence, the owner has an implied obligation to refrain from doing anything that would unreasonably interfere with the contractor’s opportunity to proceed with his or her work with reasonable economy and dispatch.

The no damages for delay clause, however, will not be waived merely because the owner made a simple mistake, error in judgment, or lacked diligence. As the name implies, active interference requires a finding that defendant committed some affirmative, willful act in bad faith that unreasonably interfered with the contractor’s compliance with the terms of the construction contract.

Owner fraud, concealment, misrepresentation, or bad faith exception
The third and most widely recognized exception to the enforcement of a no damages for delay clause is in the case of fraud, concealment, misrepresentation, or bad faith on the part of the owner. One example would be a situation where an owner issues a Notice to Proceed, but denies the contractor access to the site until a separate contractor—working on a different project on the same grounds—completed his or her contract. In such a situation, a court may well hold that the owner must pay the contractor increased delay costs because it knew and failed to disclose that access to the construction site would be limited while the other contractor completed his or her project.
Delay Claims Analysis (continued)

Exceptions to the clause (continued)

Extremely long delay exception
Delays of extreme or unreasonable length can amount to an “abandonment of the original contract” for which the contractor may recover delay damages in spite of a no damages for delay clause. As with the other exceptions, there is no single determining factor that establishes exactly what length of time is the same as abandonment, and the individual facts and circumstances in each case are of critical importance.

Delay damages
Delays may be compensable or noncompensable. Generally, for compensable delays, such as differing site conditions, owner-caused delays, and changes in the scope of work, the contractor is (unless prevented by its contract) entitled to both an extension of time and compensation for the delay. Conversely, for noncompensable delays, the contractor may, at best, be only entitled to a time extension resulting from the delay.

Noncompensable delays
Although construction contracts normally are clear on what delays will justify an extension of time (typically referred to as “excusable delays”), the contracts are usually silent on which delays are compensable and which are not. In general, if a cause of delay is not the result of the owner’s actions or owner-directed changes in the scope of the contractor’s work, it will typically be noncompensable.

Typical examples of generally noncompensable delay include, but are not limited to, labor disputes, fire, delays solely caused by the contractors, its suppliers and subcontractors, and adverse weather conditions not reasonably anticipated. Thus, in order for the contractor to recover delay-related damages and a time extension, the delays must be both excusable and compensable.

continued on the next page
Delay Claims Analysis (continued)

Delay damages (continued)

Compensable delays
Other causes of delay, however, entitle the contractor to compensation as well as an extension of time. As a general rule, if the owner (or some entity working for the owner) has breached the contract and caused a delay or has made changes in the scope of the contractor’s work that cannot be accomplished within the original schedule, the contractor, in the absence of a “no-damages for delay” clause, may recover additional time and the reasonable expenses incurred due to the delay. In the event compensable delays occur, it is critical for contractors to understand the type of delay damages that are compensable and how those delay damages are best calculated and documented.

Typical delay costs
Regardless of whether they are compensable or noncompensable, there are seven basic costs the contractor normally incurs as the result of delay. These seven basic costs are as follows:

1. Extended field overhead expenses
2. Home office overhead expense
3. Extended equipment cost
4. Escalated material cost
5. Escalated wages
6. Extended insurance costs and bond premiums
7. Costs of disruption

For each additional day a contractor is on the job as a result of owner-caused delays, the contractor incurs fixed field overhead costs. These field costs, often referred to as “general conditions”, may include:

- Superintendent’s salary
- Foreman’s salary
- Storage trailer
- Electricity
- Office supplies
- Watchman’s salary
- Office trailer
- Telephone
- Sanitary facilities
- Drinking water
Delay Claims Analysis (continued)

Delay damages (continued)

Through accounting records, a contractor can establish field overhead costs. These costs may be determined in one of two ways.

- Take all the field office expenses incurred for the time spent at the end of a job that represents the delay period
- Take the field office expense for the entire job, divide by the number of days to complete the project, and multiply the daily cost by the number of days delayed.

Calculating typical delay costs

There are several factors to consider when calculating typical delay costs.

**Recoverable home office expenses**

Most contractors reflect in their bid on each project a portion of their home office overhead expense either in a “general conditions” figure or an overhead figure expressed as a percentage of the actual construction costs. This category of expense ordinarily includes the project manager’s salary, officers’ salaries, rent, electricity, telephone, and other general and administrative expenses associated with the operation of the home office. Thus, when the duration of a project exceeds what the contractor expected, the contractor’s home office overhead costs continue to be incurred although the contractor can no longer recover those costs from the project. Often, this home office overhead is referred to as “unabsorbed overhead.” This means that there’s no project that is designated to absorb or account for these costs. Because identifying the portion of the home office overhead expense attributable to a specific project is usually difficult, courts have recognized a method commonly referred to as the “Eichleay” formula, after the case in which the formula was first employed.

*continued on the next page*
**Calculating typical delay costs (continued)**

The Eichleay formula, shown below, basically proportions the delayed contract to all contracts of the contractor over a specific period of time. By applying the same proportion to the home office expense, the formula allows the contractor to obtain the home office expense allocable to the delayed contract.

**THE EICHLEAY FORMULA**

\[
\begin{align*}
(1) \quad & \text{Total Contract Billings} \\
& \text{for this job, including} \\
& \text{change orders during} \\
& \text{Contract Period (from} \\
& \text{Notice to Proceed to} \\
& \text{Substantial Completion)} \\
& \text{Total Contract Billings} \\
& \text{for all jobs during} \\
& \text{Contract Period} \\
& \times \quad \text{Total Company} \\
& \text{Overhead during} \\
& \text{Contract Period} \\
& = \quad \text{Overhead} \\
& \text{allocable to} \\
& \text{the Contract} \\
(2) \quad & \text{Allocable overhead} \\
& \text{Days of Performance} \\
& = \quad \text{Daily contract} \\
& \text{overhead} \\
(3) \quad & \text{Daily contract overhead} \\
& \times \quad \text{No. days delay} = \quad \text{Amount claimed}
\end{align*}
\]

To use the Eichleay formula, the contractor must first prove he or she has been delayed by the owner and that an excusable and compensable delay has occurred.

*continued on the next page*
Calculating typical delay costs (continued)

**Extended equipment rental**

Another recognized element of delay damages is extended equipment rental costs incurred when the contractor must rent equipment to perform the work on the project. Even when the contractor owns the equipment, he or she may recover these costs. However, the measure of damages for contractor owned equipment is the "fair rental value" of the equipment based on published rental rates. In the event the equipment involved is idle by virtue of the delays, the courts have generally reduced the fair rental value by 50 percent to compensate for the absence of wear and tear. In addition, if the cost of materials has increased during the delays on the project, the contractor may recover the escalated costs of the material.

**Additional labor and material costs**

Extended project performance periods can and often result in an increase in the contractor’s material and labor costs to complete the contract work. For example, if the project takes longer than anticipated, the contractor’s material costs may increase due to shortages of materials, seasonal price fluctuations, or the inability of subcontractors and suppliers to obtain the materials at the price originally quoted. Further, weather-related work such as the placement of concrete can (and often does) cost more to perform in the winter months. Thus, delays carry the potential for a claim resulting from the increased materials costs that may be experienced by the contractor.

*continued on the next page*
Calculating typical delay costs (continued)

Extended project periods can also result in higher labor costs. The wages of unionized construction workers, for example, are set by union agreement. If the project period runs longer than anticipated, the prevailing wage rates may increase during the construction of a project, thereby increasing the contractor’s cost of performance. Similarly, for nonunion workers, if the labor market is tight and competition for available workers is high, an extended project duration could result in greater labor costs. In both situations (union and nonunion workforce), if the contractor is to recover the costs of the additional wage expenses, he or she must first prove that the bulk of the labor costs would have been incurred in the time period before such costs increased.

Extra insurance costs

If, as the result of delay, the contractor incurs additional insurance costs or bond premiums, the contractor may recover these additional costs.

Lost efficiency

One of the largest costs incurred by a contractor, and certainly the most difficult to prove, is lost efficiency resulting from delays and disruption to his or her work. Courts have recognized claims for lost efficiency where a contractor is forced to accelerate, is suspended, or is required to change his or her sequence of operation and is disrupted or delayed in his or her performance or completion of the work. The challenge in recovering disruption costs, however, is accurately computing the damages.

There is no standard method for determining disruption costs, and ordinarily such costs must be established by an estimate prepared by an expert. Alternatively, a comparison of historical costs with actual costs can be used. For example, if a subcontractor can show a significant increase of labor costs after the date in which the delay occurred, such comparison of the cost of performing work in different periods is a well-established method of proving damages.

continued on the next page
The total cost approach

Perhaps the method least favored by courts to prove delayed disruption damages is the "total cost" method. The total cost approach calculates the difference between the contractor's total cost for the work performed and his or her original bid for the work. This method is less favored because of the implied assumption that (1) there were no errors in the contractor's bid; and (2) that the defendant's breach of contract was responsible for all of the additional costs.

Because of its flaws, the total cost method is ordinarily employed only when no other method of proof is available to the parties, the contractor's bid is realistic, the actual costs incurred by the contractor are reasonable, and the contractor is not responsible for the added expenses.

Liquidated damages

In anticipation of delays on the project, the parties often agree to a liquidated damages provision. Liquidated damages are a substitute for actual damages where the owner's delay damages would be difficult to identify or prove. A liquidated damages clause usually provides that the contractor is to pay the owner a certain dollar amount for each day the project is delayed beyond the stipulated completion date. A typical liquidated damages clause provides that if the contractor fails to so achieve substantial completion by a set date, then owner's sole and exclusive remedy for such failure shall be to recover from the contractor a set sum of money for each calendar day the substantial completion is delayed by the contractor. Note, if the liquidated damages clause fails to state that it is the sole remedy for delay, the owner may be able to collect both liquidated damages and actual damages.

Liquidated damages clauses are enforceable as long as they represent a reasonable estimate of the damages that the owner will incur in the event of delay. However, a liquidated damages clause will not be enforced if the court determines the clause is a disguised penalty or creates a forfeiture.
Calculated typical delay costs *(continued)*

Whether a court construes the clause is a disguised penalty primarily turns on two major questions.

- Does the liquidated damages clause provide for payment that reasonably approximates the probable actual damages?
- Are the probable damages, by their nature, unascertainable with exactness at the time the contract was formed?

If, at the time of contracting, damages were clearly ascertainable, then a clause providing for payment in excess of the actual amount may not be upheld. In most cases, the liquidated damages clause meets the second criteria in that delay damages are not easily ascertainable at the time of contracting. Thus, ordinarily, the only real issue in a dispute over the validity of a liquidated damages clause is whether the clause provides for payment in excess of the probable actual damages and, therefore, is void as a penalty.

Importance of prompt notice

One of the most important things a contractor can do to ensure recovery on a delay claim is to give immediate notice of the delays and keep detailed and accurate records of his or her increased costs. Most construction contracts have a “notice of costs” provision that requires the contractor to provide the owner with prompt notice of the claim and the costs associated with the claim. Most typical notice provisions require the contractor to give the required statement in writing and follow such statement with an itemized statement of the details and amounts of such damage that the contractor has verified. Unless such statements are made and delivered within the times required by the provisions, the claims may be forfeited.

For that reason, it is prudent practice for a contractor who encounters owner-caused delays to immediately assess his or her daily field overhead costs (together with any other delay costs) and inform the owner—in writing—of the nature and extent of these costs. Thereafter, the contractor need only inform the owner that he or she has been delayed a certain number of days and simply refer the owner to the previous letter outlining the costs involved.
Module E
Managing Human Resources
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E. Managing Human Resources

Overview

Introduction

Your people are your most important asset. How to attract and retain qualified personnel is challenging in today's job market. Your company should have a written document that conveys your policies, procedures, expectations, requirements, practices, and benefits to both provide your employees with guidance and protect your company. There are legal requirements with which you must comply affecting hiring, absences, discipline, compensation, and almost every other area of your operations related to employees. Protecting your company demands that you observe these requirements and incorporate defenses which also call for legal knowledge. Always consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer for specifics that apply to your state and locality.

In this module

This module is divided into four topics. Each topic identifies a basic business activity that is critical to your success as an emerging contractor. Each topic comprises specific tasks to enable you to perform the business activity.

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Hire/Fire Employees

Overview

Introduction

The first section of Module E covers issues concerning hiring and firing employees. The four business activities and their corresponding tasks covered are outlined below.

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Recruit Personnel

Introduction

Advertising for employees must be done carefully, no matter which medium you use. Advertisements must be worded in such a way as to comply with all equal employment opportunity guidelines. If you use agencies to help with recruitment, your company is legally responsible for ensuring that the agency or service uses lawful recruiting techniques.

As with all issues dealing with regulatory compliance, consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer for specific advice.

Company policy on recruitment

You should develop a written policy that states how your recruitment process functions. Consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer to ensure that it complies with all equal opportunity employment opportunity guidelines.

General guidelines on recruitment procedures

Use the following general guidelines as a starting point to prepare a company policy on recruitment procedures. Some of the items that should be stated specifically include:

- Only official company application forms are accepted
- Applications are valid for a specified length of time after which the application expires
- Only applications for specific, advertised positions will be accepted
- Unsolicited applications and/or resumes will not be accepted
- Information provided on the application may be investigated to confirm accuracy and completeness
- Other necessary requirements and procedures, as well as hiring criteria, should be specified in your written policy

continued on the next page
Recruit Personnel (continued)

Government employment regulations

Depending on the size of your workforce and the nature of your contracts, different federal and state laws apply to your company. The following are some examples of federal laws that may apply.

- Civil Rights Act of 1964
- Federal Rehabilitations Act of 1973
- Vietnam Era Veterans Readjustment Assistance Act of 1974
- Immigration Reform and Control Act of 1986
- The Worker Adjustment and Retraining Notification Act of 1988
- Drug Free Workplace Act of 1988
- Americans with Disabilities Act of 1990
- Executive Order 11246 (Affirmative Action)
- Family Medical Leave Act
- National Labor Relations Act
- Fair Labor Standards Act

Affirmative obligation

Federal contractors have an affirmative obligation to hire and promote workers with disabilities, disabled veterans, and Vietnam Era veterans. You should post the official statement provided by the Office of Federal Contract Compliance (OFCCP) and distribute it to all applicants with a form requesting voluntary identification.

In addition, federal contractors are obligated under Executive Order 11246 to take affirmative action to employ applicants of various protected classes. All job postings and advertisements must prominently display the Equal Employment Opportunity Employer logo and statement. It should also include a reference to the Americans with Disabilities Act (ADA).

continued on the next page
Recruit Personnel (continued)

Consistency of procedures

It is of utmost importance that the recruitment procedures be applied consistently for each applicant. Variation of any procedures can lead to discriminatory allegations. If possible, assign one person to handle all recruitment activities to help ensure consistency.

The company management team should review recruitment and hiring practices at least once per year, and more often if there is a high degree of turnover. Everyone who is involved with recruiting and interviewing should follow the exact same outline and procedures.

Sources of potential employees

You may use any of the following sources to recruit potential employees.

- State employment agencies
- Private employment agencies
- Networking resources
- School-to-work programs
- Advertising (see below)

Advertising for employees

Advertisements are usually written as concisely as possible to save space. List the key elements/skills for the job, contact person, whether applications/resumes will be taken by mail only, email or fax, and company name if desired. Make sure that the advertisement has “Equal Opportunity Employer” at the end.

It is recommend that copies of the ads be kept either in a folder or a notebook with number of resumes/applications received and hire rates noted for each ad. On investigation or audit it is possible that government field agents will ask to see copies of all ads. It is best to have only one person in charge of placing ads for control and to avoid duplication and unnecessary advertising.

continued on the next page
Recruit Personnel (continued)

High risk recruitment practices

The following are examples of high risk recruitment practices.

- Word of mouth recruiting
- Giving preference to applicants related to current or former employees
- Giving preference to applicants referred by current or former employees

Although these have traditionally been great sources for qualified employees, these sources may unintentionally perpetuate under representation of protected classes and thus be illegal and should not be exclusively relied on.

Company application form

Your company should have a standard, official application form. The form ensures consistency in the recruitment process by having all applicants respond to identical information requests. Although there are several commercial providers of human resource forms that produce standardized forms including applications, you should use customized, attorney-designed forms to minimize the risks of employment and labor related claims.

Use an expiration time period

Your company application should state in bold letters that the application is only valid for a limited period of time. For example,

Please note that this application shall be considered valid for a period of not more than thirty days from the date the application was received.

It should indicate that the applicant must reapply for a position at the end of that time period if he or she still wishes to be considered for employment.

continued on the next page
Recruit Personnel (continued)

Use an expiration time period (continued)

When you have a job opening, every application for that job classification that has not expired must be reviewed. At the end of the time period, all applications must be treated as having expired and no further action taken on them. This must be done consistently.

The application itself must be kept on file for two years, but this does not affect how long you consider the application viable. For information on record retention get “Guide to Record Retention Requirements” available from the Superintendent of Documents, Government Printing Office, Washington, DC. Their web site is www.access.gpo.gov/su_docs. You may also obtain the Summary Guide to Record Retention Requirements prepared by the Minnesota Chapter Labor and Employment Law Counsel, Doug Seaton of Burk & Seaton, PA (612/896-1700 or 612/896-1704 fax).

EEO record retention rules

The EEO and other legal retention rules require that all accepted applications be kept on file for two years. In addition, unless the application has an express expiration date, you are obligated to review each application on file whenever a position becomes available for at least two years.

If you accept unsolicited applications and / or resumes, you create a corresponding legal liability for your company under the record retention rules. You do not have to accept unsolicited applications or resumes.

If you receive material through the mail and you are not hiring at that time, respond with a letter stating that you are currently not accepting applications. The letter should not mention that resumes were “reviewed” or “considered.” The response should not mention that the resume was processed or promise that the resume will be kept on file for later consideration. Doing so creates an retention rule obligation.

continued on the next page
Recruit Personnel (continued)

Notifying unsuccessful applicants

All applicants that are considered but not hired should be informed of the fact that they have not been hired but should not be provided with any reason for the rejection. Make sure, however, you can support the decision not to hire and that the decision is free from discriminatory bias. Make sure that your record of why you do not offer employment to an individual—such as notations on the application form—matches what you tell the applicant. Keep applications of unsuccessful applicants for two years.

Recruiting family members

If you allow spouses or relatives to work for your firm, check to make sure you have not established a preference in hiring or promoting that perpetuates a disproportionate effect by gender or other protected class status.

Consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer in this and all other matters related to recruitment.

Application packets

For consistency, establish a standard application packet for distribution to bonafide applicants. It should include but is not limited to the following:

- Company application form with express expiration date
- References and contact information request form and release
- Demographic and veteran status disclosure form, if required, for nondiscriminatory practices compliance information
- INS Form I-9
- Notice and/or permission form for checking driver's record, credit history, criminal record
- Notification of drug testing policy
- Notification of physical examination, if required
- Company statements regarding sexual harassment in the workplace, drug-free workplace, equal employment opportunity and affirmative action practices

continued on the next page
Recruit Personnel (continued)

Application requirements

Require applicants to allow photocopies of their original documentation that establishes identity and employment eligibility.

To establish identify, require a

- Current state-issued driver’s license,
- State-issued identification card,
- School identification card with photograph,
- Voter registration card, or
- Military service record.

To establish employment eligibility, require a

- Social security card,
- Birth certificate, or
- Immigration document.
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Interview Applicants

Introduction

Interviewing is as much a process of what not to ask as a process of asking the right questions to determine a person’s ability to work for your company.

Consult with your ABC chapter, labor and employment counsel, or another experienced labor lawyer.

Consistency

It is critical that the interviewing procedures be applied consistently for each applicant. Variation of any procedures can lead to discriminatory allegations. If possible, assign one person to handle all interviewing activities to help ensure consistency.

The company management team should review interviewing and hiring practices at least once per year, and more often if there is a high degree of turnover. Everyone who is involved with interviewing should follow the exact same outline, ask the same questions, and use the same procedures.

What to ask

Confine your interviewing questions to past employment history and technical skills proficiency. For example, ask questions such as

- What was your specific job title?
- Can you describe your job duties?
- What was the name of your past immediate supervisor?
- What was your salary for position held?
- What were your reasons for leaving?
- Have you ever been convicted of a crime?
- Our work sometimes requires overtime and/or travel, can you work such a schedule?
- Can you perform the essential duties of this position (provide a job description)?

continued on the next page
Interview Applicants (continued)

What to ask (continued)

- Do you want to provide any additional information that relates to your ability to perform the job?
- Is there any additional information we need about your name to verify employment/education information?

You can ask questions about any information supplied on the official company application.

What not to ask

You must not ask questions related to

- Age—but you can ask if they meet the requirement of the state minimum age
- Religion
- Marital status
- Economic status
- Union membership or support
- Physical or medical conditions
- National origin

Ask for references

Ask for references for all prospective employees that you hire directly. Remember to include a sheet for contact information and an authorization release of claims as part of your application packet. Make every effort to get references for any employee coming through a temporary agency as well.

Check references

Do a reference check on any individual offered full-time employment even if he or she first comes to you through an agency. When completing a reference check, try to contact at least the last three employers. Any gaps in employment should be noted and investigated during the interview process.

continued on the next page
Interview Applicants (continued)

Check references (continued)

Telephone contact with previous employers is an efficient way to check references. Offer to fax a copy of your authorization release document if the employer is reluctant to provide information. If you are dissatisfied with the response, follow up with a written request for information.

It may be difficult to obtain information from previous employers. It is best to have a written release from the applicant authorizing you to request information.

A sample release might state that the applicant

- understands that consideration for employment is conditioned upon the results of reference checks;
- authorizes the employer to investigate all statements made by the applicant and to contact former employers and references;
- releases all previous employers and other references from liability for any information supplied to you.

Even this may not help get answers from former employers except for the responses to dates of employment, job title, and maybe the stated reason for leaving. The question “Is the applicant eligible for rehire?” may get an answer and if it is NO, the decision not to hire is justified.

Arrests/Convictions

The question “Have you ever been arrested?” is not allowed. You may ask “Have you ever been convicted of a crime?” Inquiring about felony or gross misdemeanor convictions is a wise practice and is not prohibited by law. You may inquire as to the

- length of time since conviction,
- circumstances of the offense,
- number of convictions,
- applicant’s employment record since the conviction, and
- rehabilitation.

continued on the next page
Interview Applicants (continued)

Arrests/Convictions (continued)

It is also wise to state that this statement of conviction will not necessarily be a bar to employment but facts related to when it occurred and rehabilitation will be considered.

It is wise to do background checks if this information is really needed. Be sure to follow the legal guidelines. This information will be more reliable than what can be obtained on application forms.

Using a temp agency

There are advantages to using a temporary agency for finding employees needed for short term. These agencies provide quick help when needed. Many agencies require a demonstrated level of skill by the workers they choose to represent, but not always. In some cases, an employee coming from an agency will have limited insurance coverage provided by the agency. The worker is an employee of the agency and they provide the worker’s compensation, and unemployment insurance premiums.

The disadvantage of using agencies is your possible inability to verify employees’ work history and trade skill level.

Using a leasing agency

Leasing employees is a big business. The leasing company markets its ability to take over the financial aspects of employment. These agencies

- issue the payroll,
- pay the related payroll taxes (FICA, Medicare, state and federal taxes, state and federal unemployment, and workers compensation),
- have the employees under their umbrella of benefits (although some leasing firms will allow your employees to maintain their current benefits or do not cover the benefits), and
- issue the W-2.

continued on the next page
Using a leasing agency

The hiring, firing, and disciplinary actions and other related employee functions are maintained by the company. This method in some cases can save a company money especially if workers comp rates are high. There is a fee for this service that must be weighed carefully for financial reasons. It almost operates similar to outsourcing your payroll function.

These firms may also provide workers on a temporary basis but usually they are of a more permanent nature. In fact, there are agencies that will lease your employees back to you. These agencies should be considered as an outsourcing arrangement.

For a set fee plus the payroll costs and benefits, the agencies take over the responsibility of the payroll department including providing of benefits. Small employers are using this type of arrangement to get the most out of benefits packages and save on administrative costs. Usually the employer has more control over these leased employees because he or she can perform the hiring, firing, and disciplinary functions.

Legal issues

These temporary leased employee arrangements can expose the real “employer” to liability as a joint employer despite representations by the provider. Your chapter labor and employment law counsel or other experienced labor counsel should review your plans and proposed agreements in these areas.

Conducting a field interview

It is not recommended that you conduct an interview in the field and offer on-the-spot employment. Have all potential candidates come to the office. Conduct the same procedures for applying, interviewing, and verifying information for all potential employees.
Hire Employees

Introduction

When you have completed the interviewing process and checked references, you are ready to offer employment to the most qualified applicants. You should have a company policy regarding types of employees and whether or not you offer signed contracts.

Employment contracts

Employment contracts are usually reserved for top executives but, at times, maybe used for those positions that are in high demand such as engineers, scientists, and those in specialized computer positions. These contracts should be tailored specifically for the individual and the job being performed. The contracts can be one paragraph or several pages. Key elements that the contract should include are

- names of the parties to the agreement,
- duration of the agreement,
- what happens upon expiration of the agreement,
- description of the job,
- employer’s option to change the status of the employee at will and change the duties,
- salary and handling of increases,
- dismissal arrangements,
- noncompete clauses, and
- secrecy clauses specifically spelled out.

As with any contract, it should be reviewed by legal counsel.

For most employees the relationship is considered "employment at will." This means that unless there is a true employment contract, the employee has the right to end the relationship at any time for any reason—or no reason—and the employer may discharge the employee whenever the discharge does not violate an accepted public policy.

continued on the next page
A handbook as a contract

The employee handbook has been held to create binding contractual obligations in some cases. Therefore, a written disclaimer should be placed prominently in the handbook stating that the handbook is not a contract and that employees are "at-will employees." This will usually invalidate anything in the handbook that could be viewed as creating a contractual relationship.

The ADA and hiring

You must see that you do not unintentionally discriminate against a applicant with a disability in every aspect of the employment relationship from the job application procedure to job training and performance.

The decision to hire a individual with a disability should be based on whether or not an individual can perform the essential functions of a job, placing the emphasis on what the employee can do rather than on what he or she cannot do. Written job descriptions have become more important as a result of the ADA and should be used in identifying and establishing a job's essential functions.

Employment status

It is advisable to include a disclaimer regarding employment status. For example,

*Neither the company nor any of its managers, supervisors, or other employees guarantee any specific duration of employment. Employees may leave employment at any time without cause. Likewise, the company reserves the right to terminate any employee at any time, within the provisions of the law.*

continued on the next page
Hire Employees (continued)

Model employee handbook

Available from ABC National, the *ABC Model Employee Handbook* is a compendium of policies and procedures on various workplace subjects. The *ABC Model Employee Handbook* can help you draft your own handbook tailored to nonunion employees in your firm.

The manual is a general guide to the types of provisions that are frequently included in handbooks. It includes legal disclaimers and caveats that have been approved and enforced by federal and state courts in actual cases involving defense of ABC members.

Definitions of employees

Job descriptions and the employee handbook should use a consistent definition for employees. Categories include, but are not limited to

- Regular full time—those employees working more than 30 hours per week on a regular basis (this is usually the minimum but it can be set by the company.)
- Regular part time—those employees working 30 hours or less on a regular basis.
- Temporary or casual part time—those that work less than 30 hours per week but not on a regular basis
- Exempt—those full-time regular employees that work in administrative/supervisory, executive, sales, or professional areas.
- Nonexempt—those full time regular employees that do not work in the exempt areas (i.e., clerical or field personnel).

Sample language used to define each of these categories may be found in the *ABC Model Employee Handbook*.

*continued on the next page*
Hire Employees (continued)

New employee orientation
Each and every new employee should experience an orientation. This helps set expectations regarding the environment and atmosphere associated with working for your company. It is a chance to meet co-workers and to see the big picture related to working for your company.

This is your opportunity to help the employees adjust to the work environment and become oriented to the company policies and procedures that apply. Most firms use a mandatory, signed acknowledgment sheet to verify that each employee received the orientation and an employee handbook. This can prevent an employee from later claiming that he or she was not fully informed about your policies and procedures.

Consistency
It is crucial that each and every employee receive the same orientation information. Consistency can be achieved by assigning a single person to conduct all orientations and employee handbook presentations.
Evaluate Employee Performance

Introduction

There are both formal and informal performance procedures you can use to evaluate employee performance. The objective of either is to measure, improve, and maintain job performance. Performance evaluation is a way to provide a standard framework for goals and measurement. It can be used as a tool to determine salary increases, develop actions necessary to correct performance problems, enhance training, create career development, and obtain employee feedback about what the employee perceives as his/her job duties and how he feels he/she is doing.

Like other aspects of employment, this area is also subject to legal proceedings.

Resources

There are many organizations that have model performance and appraisal forms. These are just a few.

- Business and Legal Reports (www.blr.com)
- American Compensation Association (www.acaonline.org)
- Auxillium West (www.auxillium.com)
- Society for Human Resource Managers (www.shrm.org)

Using a formal evaluation

A formal evaluation usually focuses on a fixed period of time such as six months or the yearly anniversary. Approaches to a formal system vary widely. A firm may use just a few paragraphs describing how good a job is being done, noting absenteeism or other problems, or have long detailed documents.

continued on the next page
Evaluate Employee Performance (continued)

Types of formal evaluations
Formal evaluations can be used to measure employee performance and knowledge in a wide range of areas. For example, you may wish to evaluate an employee’s

- Safety knowledge
- Skill improvement
- Job performance

Sample evaluation form
Formal evaluations are developed to provide consistency, objectivity, and to require supervisors to evaluate employees in specific areas. The rating system whether it is just “good,” “excellent,” “fair” or “poor,” or ratings on numerical values should be conveyed to everyone so that its values are fully understood. The formal evaluation is performance measured against the standards of the job (job description), and goals set during the prior period. Some companies have instituted the self-appraisal system whereby the employee is given a blank copy of the formal appraisal and rates himself or herself. Then at the formal meeting the two are compared and discussed.

The following is a sample formal evaluation form for nonexempt employees.

continued on the next page
Superior Construction Co., Inc.
Nonexempt Level Performance Appraisal and Evaluation

Employee name: ________________________________

Job title: __________________________ Date employed: ________________

Rating period: From ________________ To ________________________

Current rate: __________________________ Date of last raise: ________________

Requested raise: ________________ Approved rate increase: ________________

Using a performance appraisal and evaluation system allows the supervisor and employee to review performance over the last rating period; to set goals and to measure task achievement, and; to identify areas for development and to track progress.

There are three sections to this performance appraisal and evaluation form: Section 1. Work Performance Evaluation; Section 2. Goal-Setting and Task Achievement, and; Section 3. General Evaluation. For Section 1, the following definitions may be helpful as guidelines.

T = Trainee

Employee is still learning key job responsibilities and, therefore, cannot be completely evaluated in this area.

1 = Below expectations

Performance is consistently below job standards.

2 = Fair

Performance occasionally falls short in this key job area.

3 = Good

Performance is consistent, competent, and reliable, and occasionally may exceed standards for the job.

4 = Above average

Performance meets all criteria for "Good" category, plus often exceeds standards in this job area.

5 = Excellent

Performance meets all criteria for "Above average" plus always exceeds job standards and assumes additional duties, which are completed in a like manner.
# Section 1: Work Performance Evaluation

Instructions: Mark applicable rating column and support with comments, as appropriate on attached sheet.

## Rating Scale

- T = Trainee
- 1 = Below expectations
- 2 = Fair
- 3 = Good
- 4 = Above average
- 5 = Excellent

<p>| 1. Knowledge: The combination of education, skills, and experience |  |  |  |  |  | T |
| 2. Conduct: Behavior that is professional and courteous in dealing with clients, coworkers, and outside vendors |  |  |  |  |  |  |
| 3. Judgment: Ability to use sound reasoning to reach correct decisions in standard, job-related areas. |  |  |  |  |  |  |
| 4. Initiative: Voluntarily beginning work or new tasks without direction. Eagerness and willingness to do more. |  |  |  |  |  |  |
| 5. Attendance: Absences and punctuality compared to the company standards. |  |  |  |  |  |  |
| 6. Flexibility: Ability to adapt to new or high-pressure situations without hindering performance. |  |  |  |  |  |  |
| 7. Teamwork: Works willingly, cooperatively, and courteously with others to accomplish tasks. |  |  |  |  |  |  |
| 8. Communication: Ability to convey ideas clearly and effectively either orally or in writing. |  |  |  |  |  |  |
| 9. Quality of work: Level of accuracy and thoroughness of work completed. |  |  |  |  |  |  |
| 10. Quantity of work: Amount of work completed. |  |  |  |  |  |  |
| 11. Time management: Plans and prioritizes work schedule to best accomplish tasks within required time frame. |  |  |  |  |  |  |
| 12. Interpersonal relations: Ability to achieve and maintain cooperation and a positive working relationship with other employees, clients, and vendors. |  |  |  |  |  |  |</p>
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<td>13. Results: Ability to achieve goals on time, as well as maintain efficiency with capital and human resources.</td>
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<td>14. Technical skills: The knowledge and proficiency level of technical aspects of the job.</td>
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<td>15. Problem-solving: Ability to grasp and apply proper solutions to work situations.</td>
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<td>16. Dependability: Ability to complete work on time and in manner expected.</td>
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<td>17. Responsiveness to supervision: Ability to accept work/project assignments willingly and feedback (positive and negative) constructively.</td>
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<td>18. Leadership: Motivates others to work toward objectives while inspiring confidence, loyalty, and teamwork.</td>
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<td>19. Customer relations: Maintains a courteous, responsive, professional, and knowledgeable attitude in all customer interactions.</td>
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<td>20. Vendor relations: Maintains a courteous, professional, and knowledgeable attitude in all vendor interactions.</td>
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### Section 2: Goal Setting and Task Achievement

A. Major goals or tasks for current review period:                      Date achieved/comments

B. Major goals or tasks for next review period:                      Target date for achievement
### Section 2: Goal Setting and Task Achievement

C. Individual development plan: employee and supervisor should mutually discuss potential developmental activities that can become part of a realistic, useful development plan. Development activities might include formal training, cross training professional conferences, project assignments, self-study, etc.

### Section 3: General Evaluation

Instructions: Comment on each of the areas below, attaching additional information if necessary.

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<tr>
<td>A. Areas of strength</td>
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<tr>
<td>B. Areas for improvement or development</td>
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<tr>
<td>C. Overall evaluation (indicate overall performance level from cover page and support rating with specific job-related examples of performance behaviors)</td>
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### Section 3: General Evaluation

D. Employee's comments

E. Supervisor's comments

F. Department Head's comments

---

I have reviewed this performance appraisal with my supervisor and I understand its contents. I also understand that my signature only means that I have seen this document, but not necessarily indicate agreement. I understand I have the right to respond in writing to any disagreement and this will be attached and placed in my personnel file.

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Evaluate Employee Performance (continued)

Using an informal evaluation

The informal evaluation is an ongoing process rather than an isolated event/time period. This is the ideal situation. Positive, constructive feedback on a regular basis can help avoid serious problems and redirect employees at an early stage. This informal process is more communicative and verbal, but at the same time, a quick handwritten note should be kept. The informal can cover any area that is in the formal but in a more specific event time frame.

Guidelines for writing

Use the following guidelines when writing the appraisal.

- Use concrete, concise terms to describe performance.
- Be objective and use job-related data.
- Use examples both positive and negative when talking about accomplishments.
- List specific ways to improve on the negatives as well as specific compliments for the positives.

Evaluation meeting

Use the following guidelines when conducting an evaluation meeting.

- Hold the meeting in private and allow plenty of time.
- Do not allow interruptions.
- Complete the evaluation within a week of the official review date.
- Relate the employee's performance to the department and company as a whole.
- Let the employee know that you have confidence that he or she can improve in areas that need it.
- Allow employees to voice their opinions—do not interrupt them unless they are asking you a specific question.
- Work with the employee on setting his or her goals for the next year including those areas that need improvement.

continued on the next page
Evaluate Employee Performance (continued)

Evaluation meeting (continued)

▷ Write the goals on the appraisal form.
▷ If the employee disagrees with anything on the appraisal form, he/she should have the opportunity to write a response and it should be placed with the appraisal.
▷ Require that the employee sign the appraisal and receive a copy with the original placed in the personnel file.
Counsel Employees

Introduction

There are times when someone needs more than just help using a new tool. In situations where your employee’s performance may be affected by issues not directly related to the work at hand, you should be aware of employee counseling programs and employee assistance programs. At one time certain types of counseling was done informally by many human resource professionals but now help has become more formalized through the use of employee assistance programs (EAPs).

ABC does not recommend that an employer counsel individuals on any issue other than absenteeism and discipline because the liability/risk is too great.

Situations requiring counseling

Typical situations that may demand your attention include:

- Apparent drug or alcohol use
- Emotional problems
- Personal finance/taxes
- Outplacement
- AIDS
- Other physical illness
- Absenteeism
- Discipline

How EAPs work

Large firms may have in-house, trained counselors but many use services on a contract basis. The program typically provides diagnosis, referral and at times treatment.

The employee may call for an appointment directly if choosing to seek help on his or her own or when management recommends or mandates that the employee see a counselor because of job performance problems that may be related to a personal problem. Absenteeism and discipline may be handled by the employer directly.

continued on the next page
Counsel Employees (continued)

How EAPs work (continued)
Confidentiality is key in the success of this program in both the self referral or the employer mandated.

If the employee is concerned over cost, benefits such as the health insurance may cover some of the costs of certain types counseling such as drug/alcohol abuse and emotional issues. Some employers provided this type of service as a separate benefit.

Resource

For more information contact
Employee Assistance Professionals Association, Inc.
1012 Wilson Boulevard, Suite 500
Arlington, Virginia 22201 U.S.A.
Phone: 703-387-1000
Fax: 703-522-4585
www.eap-association.com

Legal considerations
There is much you can say and there is much that you cannot say to an employee. Consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer for specific advice.
Discipline Employees

Introduction

On the basis of a clearly and understandable written disciplinary policy, you will be able to take steps to discipline employees. Absent a legally defensible policy, you may encounter problems when trying to take steps to protect an employee and your company. At times you may wish to consult your legal counsel regarding disciplinary action.

Disciplinary policy

When writing the disciplinary policy, make sure that the employee’s rights are protected from discharge whenever the discharge violates an accepted public policy. Avoid restrictive discipline and discharge policies. Keep the statements short, flexible, and general rather than detailed.

Progressive discipline

You may want to consider a progressive discipline policy that is an effective means of protecting against wrongful discharge. This type of procedure imposes a light punishment for the first offense with increasingly harsher forms of punishment for subsequent offences. This type of policy gives the employee time to adjust his or her behavior and it allows the supervisor to help the employee by advising him or her which steps are needed to avoid further action.

For an example

- First offense—verbal warning or counseling. Make sure that the date and subject is briefly recorded.
- Second offense—a written warning. This can be a form that states the date of the warning and details
  - the reason for the warning,
  - section of the disciplinary policy violated, and
  - steps to be taken to avoid further action.

This should be signed by the employee and the person filing the report and placed in the employee’s personnel record.

continued on the next page
**Discipline Employees** (continued)

**Progressive discipline** (continued)
- Third offense—suspension or unpaid leave ranging from a few days to a few weeks.
- Fourth offense—discharge

**Immediate discharge**

When using a progressive discipline policy, a provision should be included that allows management to summarily fire employees. It is impossible to list all the reasons why an employee may be fired abruptly.

Even though you have this type of policy, it does not preclude skipping steps for more serious violations such as violence, intoxication on the job, or vandalism, which may lead to immediate dismissal or right to suspension.

**Legal considerations**

There are legal considerations you must keep in mind when creating and enforcing a disciplinary policy. These include
- Document all discipline and discharge cases thoroughly
- Avoid exhaustive lists of rules and regulations and indicate that the list is not all encompassing.
- Use a disclaimer stating that the employer may adjust the disciplinary procedures or policy at any time

**Types of documentation**

The following are types of documentation you may be required to keep regarding disciplinary actions.
- Written warnings using a form or letter, plus written documentation on verbal warnings
- If timesheet fraud, make sure you have all the time sheets in question.

*continued on the next page*
Discipline Employees (continued)

Types of documentation (continued)

- If a witness is needed to document the activity and have the witness sign the document.
- If the employee denies the charge, have the reasons documented in writing with the employee's signature.
- If the incident is investigated, make sure the person investigating is objective and documents the findings.

Motivation with discipline

You should never leave an employee feeling like there is no hope for improvement or redemption.
Terminate Employment Using Documentation

Introduction

Despite all efforts, sometimes an employee may not work out well for your company. Documenting your actions is very important to head off discriminatory or wrongful termination complaints.

Reasons for termination

Employees may be separated from the company for a variety of reasons, including

- Voluntary resignation
- Retirement
- Lack of work
- Felony conviction
- Falsification of employment application
- Falsification of timesheet
- Poor job performance
- Discharge

Sample language for policy statements regarding types of separation may be found in the ABC Model Employee Handbook.

Policy statement

Your employee handbook must contain specific language defining the company’s policy for terminations and the procedures followed.

Consult with your attorney to verify that the language used is legally correct.

continued on the next page
Terminate Employment Using Documentation (continued)

Types of documentation for involuntary separation or discharge

You should collect and file the following types of documentation to substantiate an involuntary separation or discharge.

- Performance reviews
- Written note of any verbal counseling sessions
- Written warning or reprimand
- Probation letter or notice

Reasons made clear

It is important that you have a clear idea of why an employee is being terminated. You should be in a position to express the reasons in writing. Do not use a shotgun approach, hoping one of the reasons given will be supportable. Reasons for termination should correspond to what you have in your employee handbook or can be encompassed under some general catch-all language justifying termination.

On-the-spot termination

It is strongly suggested that you not terminate employment on the spot. Always allow a cooling off period and give yourself time to talk with managers and supervisors (as necessary) before making a final firing decision.

In the case of a flagrant violation of company policies and procedures, a suspension may function as an intermediate step to firing. Always investigate an incident even if the employee was caught red-handed.

continued on the next page
Terminate Employment Using Documentation (continued)

Exit interview

Whenever possible, conduct an exit interview. This is a method for you to gain valuable feedback on what the separating employee liked and disliked about working for your company. You can improve your workplace by getting information on the impression of the company your employees take away with them.

Maintaining a positive relationship with former employees can be an excellent way of ensuring that those former workers recommend your business to others, and may even return to your employ after they have experience elsewhere.

Discharge recommendations

Discharges can become emotional. It is wise to require that at least two members of management review any discharge. Use the following guidelines when discharging an employee.

- All pay questions should be resolved in advance of termination
- Caution interviewers against making broad statements such as “you can stay here as long as you do your job.”
- Review personnel policies and handbooks to be certain they don’t imply something beyond what they are intended to state.
- Make sure that all supervisors are aware of the discipline policy and its procedures and are trained accordingly.

Beware of what is considered retaliatory discharge. For example, discharging whistleblowers, personnel with criminal records, and workers who have filed OSHA complaints and/or worker’s compensation filings.

Even though this is considered an unfriendly discharge, try doing an exit interview and having at least two members of management in the meeting.

continued on the next page
**Terminate Employment Using Documentation (continued)**

**Notification of benefits**

The former employee may be entitled to benefits such as unemployment claims, COBRA, or unpaid vacation or leave. Use the exit interview as the occasion to explain and clarify any benefits due the employee.

**Final paycheck**

Review your company policy regarding settling accounts, returning company property, and issuing the final paycheck. Check the state laws that affect the distribution of the final paycheck; there are no federal laws governing issuance of final paychecks. The W-2 form may be issued at any time after termination but no later than January 31 of the following calendar year. If the employee requests issuance of the W-2 either verbally or in writing and there is no chance of rehire, you must issue the W-2 within 30 days of the request or 30 days after the final paycheck, whichever is latest.
Training/Education

Overview

Introduction

The second section of Module E covers issues concerning your company's training and education efforts. The three business activities and their corresponding tasks covered are outlined below.

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Establish an Employee Training Program

Introduction
Training benefits new and veteran workers alike. Developing employees' skills benefits your company. Some types of training—such as safety—are required by law. There are many different ways to establish a training program for your company.

Types of training
There is a wide range of training options available in most regions. These include, but are not limited to, the following:

- Association-sponsored programs
- Company-sponsored programs
- Programs in conjunction with local technical college
- State-sponsored programs
- Federally mandated training
- Online courses
- Off-the-shelf training packages
- Trade school courses
- Apprenticeship programs
- Adult continuing education classes through counties or states

Company policy
Prepare a clearly worded policy(s) that outlines the type of plan your company will offer. Participation may depend on:

- Employee status
- Time with the company
- Job requirements
- Length of time with the company after the course is taken

continued on the next page
Establish an Employee Training Program (continued)

Reflect your company philosophy

Your employee handbook should state your company’s philosophy regarding employee development. For example, "The company encourages all regular full-time employees to further develop and improve themselves through education and training. The company feels employee development is an advantage to both the company and the employee."

Job training

Your company may decide to provide job training to employees. This can be done through a local accredited training program or by conducting your own training. The training may be limited in nature. For example, introduction of a new technique and/or equipment may call for training sessions to acquaint employees with the changes.

Your company may decide to provide more extensive employee training through a long-term program such as apprenticeship. The next section Train Employees covers information for setting up an apprenticeship training program.

Certificate training

Some types of training are federally-mandated such as safety. Check with your state and local authorities for further requirements for certified employees on job sites.

Mandated training includes but is not limited to

- OSHA 10-hour
- OSHA 30-hour
- CPR
- Safety
- First aid

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Establish an Employee Training Program (continued)

Continuing education

Many companies encourage their employees to seek additional education through continuing education courses related to their jobs. While improving profitability for the company, this opportunity also increases an employee’s ability to progress and succeed within the company.

Career mobility is a motivational factor for many people. The new and improved skills learned through continuing education can also make the employee more efficient, thus improving profitability.

Educational assistance

Programs that assist employees by paying the costs of continuing education are varied. General guidelines include:

- Employees must submit a written request for educational assistance that describes:
  - Name of the school
  - Course description; relationship to job
  - Costs
  - Schedule
  - Degree program, if applicable
  - Approval by his or her supervisor

- Employees must continue with full-time employment for a given length of time following course completion

- Employees submit receipts and final grade report (grade C or better required) for reimbursement consideration

Sample language for policy statements regarding types of training may be found in the ABC Model Employee Handbook.

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Establish an Employee Training Program (continued)

Resources for established programs

Contact the ABC office serving your region. You will find information on locally and nationally sponsored programs. In addition, investigate the following resources.

- Community colleges
- University extension programs
- Craft training centers
- Technical schools or colleges
- NCCER partnering associations

Co-op work

Co-op work describes a program that transitions students completing college education programs into company management positions.

Management training improves a company’s profitability by increasing the efficiency, understanding, and buy-in of future management personnel.

School-to-work

School-to-work describes a program that transitions students completing high school studies into accredited apprenticeship programs and a company’s workforce. If the high school program uses the Wheels of Learning curriculum, the juniors and seniors can join the apprenticeship program while still completing their studies.

School-to-work programs are currently working across the nation with great success.
Train Employees

Introduction

Apprenticeship has been in existence since before the Middle Ages when highly skilled workers recognized the benefits of passing on their knowledge in the work environment. Today’s programs combine on-the-job training with classroom learning to better prepare the apprentice.

What is apprenticeship?

Apprenticeship is a combination of on-the-job training (OJT) and related instruction in which workers learn the practical and theoretical aspects of a highly skilled occupation. Apprenticeship programs are sponsored by employer groups, individual employers, and/or employer associations. Refer to the Labor Standards for the Registration of Apprenticeship Programs (CFR 29 part 29).

ABC apprenticeship training

ABC sponsors apprenticeship training in the following areas.

- Electrical
- Carpentry
- Concrete
- HVAC
- Welding

Contact your ABC chapter to see what apprenticeship training is provided. If not provided, contact the chapter for information on starting a program.

For more information, also contact the Bureau of Apprenticeship and Training (BAT), US Department of Labor, Washington, DC (www.doleta.gov/atels_bat/index.htm) and the Employment and Training Administration (www.doleta.gov/).

continued on the next page
Train Employees (continued)

Setting up apprenticeship training

Registered apprenticeship is a voluntary industry-driven training program. The registered apprenticeship program can be implemented by employers or employer associations. Government plays a support role. BAT provides technical consultation services on the development of the apprenticeship standards.

Employers or groups of employers design, organize, manage, and finance registered apprenticeship programs under a set of apprenticeship standards, which include an on-the-job training outline, related classroom instruction curriculum and the apprenticeship operating procedures. These standards are then registered with the Bureau of Apprenticeship and Training (BAT) or a BAT-recognized State Apprenticeship Council (SAC) or Agency.

BAT provides apprenticeship services in all states, and registers programs and apprentices in the 23 states where there is no SAC or Agency.

The SACs in 27 states, the District of Columbia, the Virgin Islands, and Puerto Rico have been delegated authority by the Secretary of the US Department of Labor to register apprenticeship programs for federal purposes.

Finding apprentices

The following are some methods of finding apprentices.

- Contact the Bureau of Apprenticeship and Training (BAT) or the State Apprenticeship Council or Agency.
- Advertise apprenticeship openings for individuals that live within commuting distance in the newspaper.
- Disseminate apprenticeship opening announcements to local secondary/post secondary schools, women's centers, outreach programs, and community organizations, one-stop centers, etc.

continued on the next page
Train Employees (continued)

Finding apprentices (continued)

- Contact the America's Job Bank.
- Use your home page on the Internet to list apprenticeship openings.
- Advertise in newspapers including all the requirements for applying.
- Participate in annual workshops conducted by one-stop centers for the purpose of familiarizing school, one-stop center personnel, and other appropriate personnel of your apprenticeship opportunities.
- Cooperate with local school boards and vocational education systems to develop programs for preparing students to meet the minimum qualifications to qualify for entry into the program.
- Establish preapprenticeship or preparatory training designed to afford related work experience to prepare candidates for apprenticeship.
- Actively work with local community organizations to assist them in better preparing applicants.
Provide Safety Training

Introduction

All employees have the right to work in a safe and healthy environment and every employer has a legal duty to provide a workplace free from safety and health hazards. It takes commitment, preparation, training, education, and motivation by both the employees and the employer.

Company policy

The company policy statement should
- address the company’s commitment to safety,
- make a specific and concrete statement of supervisor and employee responsibilities,
- provide detailed and specific procedures for accident reporting and investigation, and
- provide detailed and specific procedures for correcting hazardous conditions.

Resources

It is vital that the employees know that the company is serious about expecting employees to do their part. There are sample safety programs for the construction industry written by various commercial sources. Contacting your workers compensation provider may also be a resource for policies and training.

continued on the next page
Provide Safety Training (continued)

Legal requirements for safety training

Construction is covered under Standard 1926.65. Under the guidelines set by OSHA are the Training Curriculum Guidelines—Non Mandatory. These guidelines would meet or exceed the requirements set forth by the Hazardous Waste Operations and Emergency Response requirements. The training curriculum guidelines state that other approaches could meet the regulatory guidelines as set forth in the Hazardous Waste Operations and Emergency Response requirements.

Suggested core criteria include:

- Training facility—sufficient resources, equipment, support staff
- Training director—responsible for the program
- Instructors—competent
- Course materials (audiovisual, written, skill testing when appropriate)
- Ratios of student to teacher—no more than 30 students per instructor
- Proficiency assessment—testing by written questions or skill testing
- Course certificate
- Recordkeeping
- Program quality control—review of program periodically

Safety topics

The standards fall into the following areas: General, industry, maritime, construction, and agriculture. The OSHA regulations cover these specific areas:

- Personal protective equipment
- Walking and working surfaces: Ladders, scaffolds, power lifts; fall protection
- Electrical wiring and electrical equipment
- Hazard communication
- Hazardous materials
- Environmental controls

continued on the next page
Provide Safety Training (continued)

Safety topics (continued)

- Training and operation in welding, cutting, glazing
- Exits
- Fire protection
- Material handling and storage
- Guarding and operating machinery
- Operating hand-held equipment

Delivering training

A safety professional or competent person should oversee all training efforts performed by the company. As defined by OSHA, a competent person is one possessing the skills, knowledge, experience, and judgment to perform assigned tasks or activities satisfactorily as determined by the employer.

Tracking safety training

Safety training sessions should be documented. An agenda and attendance list for any training should be filed for company records.

Guidelines for documenting safety training

The following is required for safety training.

- Date of course
- Name of instructor
- Subject of course
- Test used in course (written test minimum of 50 questions, 25 questions if skills tested)
- Names of individual course participants
- Names of those successfully completing course
- Number of training certificates issued to each participant
- Maintenance of training records for 5 years
- Records should be available and provided upon the attendees request or as mandated by law
Policy and Compliance

Overview

Introduction

The third section of Module E covers issues concerning your company’s policies and procedures. The 10 business activities and their corresponding tasks covered are outlined below.

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Promote Employee Feedback/Input

Introduction
Positive employer/employee relations is a cornerstone for effective business operations. Building positive employee relations requires commitment from top management and should be given the same priority as the production and sales side of the business.

Benefits of employee feedback/input
Having a work force that is motivated to achieve short-term objectives in support of long-term business goals creates a formidable partnership. In addition, such an environment results in lower employee absenteeism, turnover, decreased disciplinary problems, and increased efficiency. Supervisors are a critical link in maintaining positive employee relations.

Encourage the practice of keeping management visible. Open communication needs to be maintained. Every employee should be made to feel that their contribution to the company’s success has not gone unnoticed.

Types of feedback
The following are types of feedback you can solicit from your employees.

- Process improvement suggestions
- Value engineering suggestions
- Company sponsored events
- Improving benefits
- Cost savings/reduction measures
- Client relations

continued on the next page
Promote Employee Feedback/Input (continued)

Getting the feedback

There are many ways to promote employee feedback and input on the company. For example,

- Chairman’s Night: Everyone invited, but no supervisors attend
- Suggestion box
- Recognition for good suggestions that work
- Recognition for cost savings/reduction measures
- Newsletter

Guidelines for feedback

Be specific about the kinds of feedback you want the employees to contribute. Establish guidelines for feedback. The following are sample guidelines for promoting feedback.

- Do suggest any improvements or changes you think necessary or beneficial for the company and its employees.
- Do not air personal grievances as feedback; use the company’s established grievance procedure.
- Management should respond openly.
Enforce Safety Policy

Introduction

Companies must be committed to the safety of their employees and the general public. To accomplish this goal, a company must implement and enforce the safety program in daily activities.

Establish lines of responsibility

Be sure that every employee understands the extent of his or her responsibility for safety. Regularly review the reporting process for all safety issues with employees during scheduled safety meetings. Be sure to include office staff as well as field staff in these safety updates.

Guidelines for enforcement

Use the following guidelines to enforce your company's safety policy.

- Incorporate a safety training component into new employee orientation.
- Each employee should have a copy of the company safety manual.
- Have employees read and sign a company safety policy awareness form.
- Have disciplinary procedures relating specifically to safety violations.
- Convey safety information to employees on a regular basis through payroll stuffers, safety alerts, tool box talks, etc.
- Provide safety videos for their use at work and at home.
- Designate a person to receive all safety violations or concerns and respond to them.
Develop Job Descriptions (if required)

Introduction

It is important for a company to establish roles and responsibilities of various jobs within the company. These roles and responsibilities are necessary to avoid duplication of effort and to ensure work flows smoothly and efficiently from one area to another. The job description is the document that provides this information.

Purpose of job descriptions

Job description are designed to

- Establish the basis on which staffing decisions can be made
- Establish a standard for each type of job
- Minimize liability under the Fair Labor Standards Act and American Disabilities Act
- Provide a measurement tool for job evaluations
- Ensure proper classification of jobs
- Support the salary/wage structure
- Support the organization structure

Positions requiring job descriptions

Every job in the organization should be thoroughly analyzed and described.

continued on the next page
Develop Job Descriptions (if required) (continued)

Elements of a job description
Job descriptions should contain the following elements

- Job title
- Department
- Job level
- Job category (exempt, nonexempt)
- Compensation level (salaried, hourly)
- Reporting to
- Job location
- Job summary
- Principal duties (essential functions and related duties)
- Required skills, experience and educational requirements

Analysis of job descriptions
Answers to the following questions will help identify critical data elements that point to the nature and level of the job.

- Why does the job exist?
- Why is it being performed?
- What duties and responsibilities does this job have?
- What are the essential requirements or components of the job?
- What type of knowledge and thinking requirements is required?
- What are the mental and physical demands of the job?
- What requirements or qualifications are necessary to perform these functions competently?
- What level of supervision is given and/or received?

Resources for job descriptions
You may obtain model construction industry job descriptions from various commercial sources and bookstores. You should tailor these to meet the requirements of your company. Another source is through networking with others in the construction industry.
Comply with State and Federal Employment Laws

Introduction

When you hire even one employee, you bring a new level of complexity to your company operations. There are numerous state and federal employment laws that will affect your company.

Federal employment laws

The following federal employment laws may affect your company. Refer to the resources listed for more information covering each law.

Fair Labor Standards Act (FLSA)

Any employer engaged in interstate or foreign commerce with gross yearly sales of at least $500,000, you are subject to FLSA. Issues addressed by FLSA include

- Minimum wage
- Equal pay
- Overtime pay
- Child labor

For more information, contact the US Department of Labor, Employment Standards Administration, Wage and Hour Division (www.dol.gov/dol/esa).

Social Security and Medicare (FICA) taxes

The Federal Insurance Contributions Act (FICA) is a federal law that requires you to withhold two separate taxes from the wages you pay your employees: A social security tax and a Medicare tax. The law also requires you to pay the employer's portion of these taxes. Unless you have employees who receive tips, the employer's portion will be the same as the amount that you're required to withhold from your employees' wages.

For more information, contact the Social Security Administration (www.ssa.gov) or your accountant.

continued on the next page
Comply with State and Federal Employment Laws (continued)

OSHA

Your legal obligations to provide a safe work environment for your employees arise primarily from a federal law known as the Occupational Safety and Health Act (OSHA). OSHA was enacted in 1970 to address the uneven patchwork of state laws regarding workplace safety, and to respond to the growing number of serious injuries and deaths occurring in the workplace.

For more information, contact the Department of Labor, OSHA (www.osha.gov/index.html) and your state OSHA agency.

Federal Unemployment Tax Act (FUTA)

The Federal Unemployment Tax Act (FUTA) imposes a payroll tax on employers, based on the wages they pay to their employees. You don’t withhold the FUTA tax from an employee’s wages; the business itself must pay this tax.

The FUTA tax is imposed at a single flat rate on the first $7,000 of wages that you pay each employee. After an employee’s wages for the calendar year exceed $7,000, you have no further FUTA liability for that employee for the year. The FUTA tax rate is a flat 6.2 percent. However, you can generally claim credits against your gross FUTA tax to reflect the state unemployment taxes you pay.

For more information, contact the Internal Revenue Service (www.irs.gov).

continued on the next page
Comply with State and Federal Employment Laws (continued)

**Employee Retirement Income Security Act (ERISA)**

The Employee Retirement Income Security Act, better known as ERISA, is a federal law that affects certain administrative aspects of employee benefit and retirement plans.

If you offer an employee welfare benefit plan, such as health insurance or a retirement plan, you are subject to certain requirements under ERISA. Although your administrator or insurance company may take care of most of your ERISA obligations, you should have some familiarity with the requirements of the law so that you can make sure the administrator is performing adequately.

For more information, contact your accountant, firms that provide services for implementing benefits, or the Internal Revenue Service (www.irs.gov).

**Equal Pay Act**

The Equal Pay Act (a part of the federal wage and hour laws) says you cannot pay a person of one gender, who is doing the same or substantially the same work as another employee of the opposite gender, less money.

It's important to understand that the Equal Pay Act applies only to pay differences between men and women. It does not address pay inequities motivated by race, color, religion, or national origin. Pay inequities related to protected groups other than gender groups are covered by federal antidiscrimination law.

For more information, contact the US Department of Labor, Employment Standards Administration, Wage and Hour Division (www.dol.gov/dol/esa) or the Equal Employment Opportunity Commission (www.eeoc.gov).

*continued on the next page*
Comply with State and Federal Employment Laws (continued)

Title VII of the Civil Rights Act

Title VII of the Civil Rights Act of 1964, also known as Equal Employment Opportunity (EEO) mandates, prohibits employers with 15 or more employees from discriminating against applicants and employees in all aspects of employment—including recruiting, hiring, pay, promotion, training and termination—on the basis of race, color, national origin, religion or gender.

Employment decisions, therefore, must be made on the basis of business necessity, not on an employee's or applicant's membership in a protected class. There are exceptions to Title VII that allow you to require that an applicant be a certain race, color, religion, or gender. These exceptions are known as bona fide occupational qualifications (BFOQs). BFOQs are rarely used because they are exceedingly difficult to justify.

Areas most affected by Title VII include job advertisements, job qualifications, hiring decisions, job applications, interviews, discipline, and termination.

For more information, contact the Equal Employment Opportunity Commission (www.eeoc.gov).

Age Discrimination Employment Act (ADEA)

The Age Discrimination in Employment Act, also known as the ADEA, applies to employers with 20 or more employees and is geared toward protecting individuals over the age of 40 against employment discrimination. Specifically, you cannot discriminate on the basis of age by hiring younger employees because they are younger, paying an older person less because the employee is older, or terminating an older employee before a younger employee because the older employee is older. The ADEA does say, however, that it is not unlawful for you to observe the terms of a bona fide seniority system.

There are exceptions to the ADEA that allow you to require that an applicant be of a certain age. These exceptions are known as bona fide occupational qualifications (BFOQs). BFOQs are rarely used because they are exceedingly difficult to justify.
Comply with State and Federal Employment Laws (continued)

**Age Discrimination Employment Act (ADEA) (continued)**
The ADEA affects the following areas of employment specifically: job advertisements, job qualifications, hiring decisions, job applications, interviews, discipline, and termination.

For more information, contact the the Equal Employment Opportunity Commission (www.eeoc.gov).

**Americans with Disabilities Act (ADA)**
The American with Disabilities Act, also known as the ADA, is actually a part of Title VII legislation and also applies only to employers with 15 or more employees. The ADA covers those who:

- have a long-term physical or mental impairment that substantially limits one or more life activities
- have a history of such impairment
- are regarded as having such an impairment

As an employer, you must reasonably accommodate all individuals covered by the law, and you cannot do any of the following:

- adopt different pay scales, benefits programs, or promotion opportunities for the protected group (assuming the differences harm the protected group)
- enter into contracts with other companies that would have the effect of discriminating against your employees
- discriminate against an employee in any term and condition of employment because a family member or friend was covered under the protection of the ADA
- make employment decisions based on generalizations about a disability rather than the facts of a specific case

*continued on the next page*
Comply with State and Federal Employment Laws (continued)

Americans with Disabilities Act (ADA) (continued)

The ADA also affects such areas of employment as pre-employment medical exams, pre-employment inquiries about physical ability, job descriptions, job qualifications, absenteeism, and worker safety.

For more information, contact the US Department of Justice, Civil Rights Division, Disability Rights Section (www.usdoj.gov/crt/ada).

COBRA

If you have 20 or more employees, you are subject to a law known as the Consolidated Omnibus Budget Reconciliation Act of 1985, better known as COBRA. COBRA requires employers to offer individuals who would otherwise lose benefit protection the option of continuing to have group health care plan coverage.

For more information, contact your health insurance provider or your third-party administrator, if self-insured.

Family Medical Leave Act (FMLA)

Family leave is now mandated under the federal Family and Medical Leave Act. Only employers with 50 or more employees are subject to this law. It requires that covered employers allow employees to take the equivalent of 12 weeks of unpaid leave each year due either to a birth or adoption of a child, or to attend to the serious health condition of an immediate family member or to the employee's own serious health condition.

For more information, contact the US Department of Labor, Employment Standards Administration, Wage and Hour Division (www.dol.gov/dol/esa).

continued on the next page
Comply with State and Federal Employment Laws (continued)

Definition: Employee

An employee is any individual who performs services subject to the will and control of the employer both as to what shall be done and how it shall be done. It does not matter that the employee has considerable discretion and freedom of action, so long as the employer has the legal right to control both the method and the result of the services. The title that an individual has (such as partner, agent, or independent contractor) nor how payments for services are measured or paid or what they are termed affects the individual’s being an employee. A person not treated as an employee for tax purposes cannot be covered under employee benefit plans.

Definition: Independent contractor

The IRS has a 20-factor test to determine employee or independent contractor status. These factors help determine whether the employer has sufficient control to establish the employee-employer relationship. Basically, if the individual offers his or her services to the general public on a regular consistent basis and is free to work when and for whom he or she chooses using methods not directed or controlled by the employer, he or she is an independent contractor.

The 20-rule test (IRS Reg. 31.3401)

1. A worker required to comply with others instruction on when, where, and how to work is usually an employee.
2. Training a worker indicates that services are to be performed in a particular manner/method.
3. Integration of a worker’s services into the business operation indicates control.
4. Services to rendered personally indicates an employment relationship.
5. The right to hire, supervise and pay assistants show control.
6. A continuing relationship indicates an employment relationship.
7. Set hours of work for the worker indicates control.

continued on the next page
Comply with State and Federal Employment Laws (continued)

The 20 rule test (IRS Reg. 31.3401) (continued)

8. Full-time work indicates control.
9. Work performed on a business’s premises suggest control.
10. Requiring work be performed in a set order indicates control.
11. A requirement that the worker submit regular or written reports indicates control.
12. Payment by the hour, week, or month indicates an employment relationship.
13. Payment of business expenses indicates an employment relationship.
14. Furnishing tools and equipment indicates an employment relationship.
15. The right to discharge a worker indicates an employment relationship.
16. The worker’s right to terminate his relationship without liability indicates an employment relationship.
17. Investment by the worker in facilities indicates an independent contractor.
18. The ability to realize a profit or loss from services indicates an independent contractor.
19. Working for more than one firm at a time indicates an independent contractor.
20. Services available to the general public on a regular and consistent basis indicates an independent contractor.

continued on the next page
Comply with State and Federal Employment Laws (continued)

Definition: Exempt employee

Exempt employees are exempt from the overtime provisions of the Fair Labor Standards Acts. The Act has broad categories of “white collar” positions that must meet special criteria established by the US Department of Labor. These exempt employees must perform certain types of work that must be performed a certain percentage of the time. Generally they must be paid on a salary basis and receive a minimum salary. Generally, the exempt position must use consistent exercise of discretion, may supervise two or more employees, have the authority to hire or fire or effectively recommend such decision, and work that is primarily intellectual and varied in character.

Attaching a title to a nonexempt position and paying a fixed salary will not transform a nonexempt position into an exempt position. Exempt positions include:

- Administrative
- Executive
- Professional—engineer, accountant, scientist
- Outside sales
- Computer-related (falls under professional)

Time and Salary Requirement

<table>
<thead>
<tr>
<th>Short Test</th>
<th>Minimum Wkly Salary</th>
<th>% of work that must be exempt activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>$250</td>
<td>50%</td>
</tr>
<tr>
<td>Executive</td>
<td>$250</td>
<td>50%</td>
</tr>
<tr>
<td>Professional*</td>
<td>$250</td>
<td>50%</td>
</tr>
<tr>
<td>Outside sales</td>
<td>None</td>
<td>NA</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Long Test</th>
<th>Minimum Wkly Salary</th>
<th>% of work that must be exempt activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>$155</td>
<td>80% retail, service establishment, hospital 60%</td>
</tr>
<tr>
<td>Executive</td>
<td>$155</td>
<td>80% (retail, service establishment, hospital 60%</td>
</tr>
<tr>
<td>Professional*</td>
<td>$155</td>
<td>80%</td>
</tr>
<tr>
<td>Outside sales</td>
<td>None</td>
<td>80%</td>
</tr>
</tbody>
</table>

*data processing professionals paid an hourly wage must be paid 6.5 x minimum wage

continued on the next
Comply with State and Federal Employment Laws (continued)

Definition: Nonexempt employee

Nonexempt employee is any other employee that does not meet the qualifications of the exempt employee. The classifications would be clerical, secretarial, field personnel, etc. The nonexempt status could be paid on a fixed salary basis or by the hour. Whether the employee is paid hourly or fixed salary and qualifies under the nonexempt category, they are entitled to be paid for overtime hours at one and one-half their hourly rate. Under the Fair Labor Standards Act, covered employers must pay nonexempt employees at least the minimum wage per hour of work.

Recording keeping requirements

Employers must keep and make available certain records concerning a covered employee’s position, wages, hours, sex, and other information. Records must be kept for both exempt and non-exempt employees. Most records must be kept for at least two years and pay records must be kept for three years.*

The following is a listing of records that must be maintained according the Wage and Hour Division.

- W-2, W-4
- Hours worked for employees nonexempt from overtime
- Overtime paid
- Employee’s name, address, date of birth
- Occupation
- Grade of pay
- Weekly compensation
- Deductions from compensation
- Training wage certificates

*continued on the next
Comply with State and Federal Employment Laws (continued)

Recording keeping requirements (continued)

Time sheets and time cards for both exempt and nonexempt employees are part of good record keeping. Exempt employees may or may not turn in time sheets or time cards. Time sheets are not a means for recording pay for the exempt employee but for the recording of hours and properly charging projects, vacation and sick leave, or other leave granted by means of your benefit policy.

*Note: Social Security Act requires four years of retention.

Salary basis requirement for pay

Salary basis requirements

- Must be paid a predetermined amount at least the minimum weekly required by the regulations
- Amount may not be reduced because of variations in the quality or quantity of work performed
- Must receive full salary for any week in which work is performed without regard to the number of days or hours worked
- Need not be paid for any work week in which no work was performed
- Absences of a day or more for personal reasons other than sick or accident may be made without loss of status as exempt
- Absences of less than a day, exempt employee must be paid for the full day. (As a condition of employment, the employer may require the employee to make up the lost time. Even if required and the time is not made up you cannot deduct it.)
- Deductions for time off after exceeding the company sick leave or vacation policy may be made for time off of a day or more without affecting the exempt status.

continued on the next page
Comply with State and Federal Employment Laws (continued)

Your rights regarding the unions

In some parts of the country, unions use techniques such as salting to disrupt merit shop contractors' business. You can take a proactive stance regarding union activities meant to harass you and your employees. Some general guidelines

- Do not talk with a union representative without a witness
- Do not examine or accept the presentation of alleged membership cards
- Suggest that everything be presented in writing
- Limit comments but at least formally express doubt
- Seek counsel and guidance from an experienced consultant or attorney
- Never accept an offer to look at the cards
- Do dictate a memo immediately for your own record of any conversation with a union representative seeking recognition
- Do instruct your employees or staff on what to do and not to do regarding unions
Review Payroll Policy

Introduction

It is necessary to comply with state and federal government requirements for wages and fair pay. A payroll policy gives you a basic management tool to ensure that you satisfy your employees and maintain both external and internal equity. It also is a means of some degree of control over the cost of labor. This policy should be reviewed at least annually to ensure that legal requirements are being followed and that the structure is competitive.

What must be considered

Certain issues must be addressed in your company’s employment policy. These include, but are not limited to

- Americans With Disabilities Act
- Title VII of the Civil Rights Act
- Equal Pay Act
- The Age Discrimination In Employment Act
- Rehabilitation Act of 1973
- Fair Labor Standards Act
- ERISA (Employee Retirement Income Security Act)

Sample payroll policy

The ABC Model Employee Handbook has a sample policy statement that can be tailored to your company’s needs.

continued on the next page
**Review Payroll Policy (continued)**

**Procedures to support the policy**

Detailed procedures are necessary to support your company payroll policy. The procedures should cover (this is not a comprehensive list)

- Job analysis/evaluation
  - When are these reviewed
  - The procedure for review
- Employee classification
- Salary increases
  - Percentage of increase determination
- Job pricing (salary/wage structure)
  - When it is updated
  - How it is updated
  - What guidelines or survey to use
- Pay periods
- Pay dates
- Overtime policy
- Inclement weather policy for pay
- Direct deposit/pay check
- Bonuses
- Longevity increases
- Holiday pay
- Vacation/sick pay

**Competitors' wage**

You want to offer a competitive wage to make sure you attract the best prospects and retain the best employees, but you'll want to do it without running the company out of business. The best way to find out what a competitive wage is in your area is to find out what others are paying for the same type of work.

*continued on the next page*
Review Payroll Policy (continued)

Competitors' wage (continued)

The best way to find out is by using salary surveys for the construction industry. The Department of Labor also has wage and salary surveys by metropolitan areas. There are various commercial firms that provide surveys for a fee.

PAS, Inc., in Saline, Michigan (www.building.com/texis) deals specifically with the construction industry and provides not only surveys but job descriptions and other resources for the human resource area. The American Compensation Association (www.acaonline.org) and Society of Human Resource Managers (www.shrm.org) can also give you guidance.

Market factors

You should review market factors that affect wages such as:

Inflation

Inflation causes the buying power of your employees' salary to decrease, when the dollar amount remains the same. Since many employers adjust for inflation each year, maintaining competitive pay may require you to adjust every 12 months. Some may adjust for cost of living increases rather than inflation or use the CPI index indicator as a means of adjustment.

Workforce mobility

As the educational level of your employees rises, more will change jobs and change employers more frequently. At the lower end of the pay scale, turnover can be high and makes it necessary to keep on top of who's getting paid what in the field where your employees work.

Unionization

As your business grows and you gain more employees, you need to be aware that some unions have targeted small businesses for organization activity. If your pay is highly competitive, you reduce the likelihood that your workers will consider joining a union.

continued on the next page
Review Payroll Policy (continued)

Putting a raise in perspective

When giving raises, realize the limitations that your company faces and what has been budgeted in your financial plan. You do not have to give everyone the specified budgeted percentage but maintain the overall budgeted percentage. Increases should be based on the person's contribution to the company, how they have improved, and the level of competency in their position.

You should also consider—as part of their compensation—the cost of provided benefits. These costs would be for medical, dental, vision, use of a company vehicle, etc. When giving a review, prepare a benefit statement to allow employees to see what their true compensation is.
Review Employment Policy

Introduction

In complying with state and federal government requirements for employment, you will have developed an employment policy that is detailed in your personnel manual. Periodically review this policy to be sure that you are adhering to legal requirements.

What must be covered

Certain issues must be addressed in your company’s employment Consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer for specific advice.

Sample procedures

The ABC Model Employee Handbook has many of these basic policies that can be tailored to meet your specific company’s needs.
Review Employee Benefits

Introduction

Employee benefits are one of the most important advantages you have in keeping good employees. Benefits became a popular way of attracting and keeping good workers after World War II, but with increases in collective bargaining and the advantageous treatment of benefits under federal laws, certain benefits are now almost universally being taken for granted. Benefit costs now account for more than one-third of payroll costs. They may be costly but are attractive to employees and well worth the cost in moral and retention.

Types of benefits

There are a variety of benefits that you can offer to your employees. Most benefits are offered at the discretion of the company and law mandates some. These benefits include but are not limited to the following:

Time-off benefits

There are certain time off benefits that you may be required to offer such as jury duty and military leave, but federal law does not require employers to pay employees while on either type of service but some states may make the requirement. There is no federal law that mandates time of to vote but some states may have that law. The types you can provided at your discretion are vacation, sick leave, personal leave, pregnancy leave, and death leave.

Worker’s compensation

Every state has enacted worker’s compensation laws to protect employees against loss of income and medical payments due to a work-related injury, accident, illness, or disease. Depending on the state it may be a state controlled plan whereby the employer makes payments to the state insurance fund or is required to carry insurance acquired through commercial insurance.

continued on the next page
Review Employee Benefits (continued)

Health/medical insurance
Health insurance is a valuable benefit, but it can be expensive for small groups. There are many options, however, that are tailored to meet a growing business's needs. There are legal mandates to be aware of regarding health care such as Civil Rights Act, Age Discrimination in Employment Act, COBRA, Family Medical Leave Act, and ERISA. Some states have their own mandates.

Types of plans include HMO (health maintenance organization), PPO (preferred provider organization), self insurance, managed care, and the fully coverage policies.

Employees may be asked to help pay for the medical benefit thereby reducing the employer cost for either family coverage or single coverage or the employer may offer only the employee coverage and charge the employee for the difference in the family portion of the coverage.

Flexible spending accounts
Covered under the Cafeteria Plan or Section 125 Plans, this type of benefit is one that can cost the employer very little. It allows the set up of accounts to cover qualified medical expenses under the medical account and dependent care costs under that account. The employee contributes pretax dollars to one or both of the accounts and is reimbursed for the eligible expenses by the submission of proper documentation. The employee must be warned that this is a use-it-or-lose-it benefit, whereby the employee must use the funds by the end of the plan year. The employee must also be advised that expenses paid under this plan are not deductible on their federal tax return and should consult their accountant for further information.

Disability insurance
Disability insurance can also be a valuable benefit. You will have to investigate the difference between short-term policies and long-term policies. In addition, there are federal and state programs that interact with these plans.

continued on the next page
Life insurance
Life insurance is a great benefit to provide because it offers employees with a family some security at a fairly low cost. You can work with your insurance agent to choose the different types of life insurance you can purchase and learn how to handle day-to-day administration.

Retirement plans
As an employer you may wish to provide your employees with a type of retirement plan. These can included a pension plan, profit sharing, or stock bonus plan that qualifies for preferential tax treatment.

Pension plans can be costly and time consuming to administer. There are basically two types of pension plans: Defined benefit (promises specified benefits) and defined contribution (employer promises a specific contribution on behalf of each employee).

The 401(k) plan generally must be part of a profit sharing or stock bonus plan and meet general requirements of a qualified plan as well as special requirements.

Seek the advice of your accountant or benefit specialist when considering this benefit.

Miscellaneous benefits
You have the freedom to offer almost any miscellaneous benefit to your employees. Many owners find that offering some unusual, special benefits can help to improve employees' job satisfaction and to increase employees' sense of identity with the business. You may also find that a certain type of benefit can be valuable to the business, such as a company vehicle that advertises your company everywhere it goes.

Be aware that the benefit of providing a vehicle may increase the employee's income for tax purposes. Check the IRS guidelines and make certain this benefit is well documented and the employee understands the costs involved for personal use. Other benefits are tuition reimbursement, uniforms, sporting event tickets, and company-sponsored events.

continued on the next page
Review Employee Benefits (continued)

**Employee qualification**

Benefits can be phased in over specific time periods, but be aware that some are mandated by law such as the medical benefits under the Health Insurance Portability Act. The length of employment is the governing factor. You can usually phase in the vacation, sick leave, personal time, or other time off policies. There are regulations on the time of eligibility on a various types of retirement plans.
Prepare an Employee Handbook

Introduction

The employee handbook is a tool used by human resources and is the basic tool for communicating information to employees concerning the company. It is probably the most read book that the employee has. These books may be just a few pages stapled together or designed as ring binders to promote updating of the handbook periodically.

Contents

The handbook summarizes the relationship between the employer and the employee. It describes what the employer expects of the employee and generally captures the employee relations culture of the company.

It also provides the rules, regulations, policies, and procedures that employees need to know to be successful in their positions. It should also provide information on issues such as pay, employee services, and benefits of the company. The benefits (such as medical, dental, or the Sec 125 [Cafeteria Plan]) may, because of its detail and size, be contained in a special employee benefit book titled *The Health Plan of Emerging Contractor* to distinguish it from the employee handbook.

Benefits of the employee handbook

There are no rules or laws—federal or state—that require you to have an employee handbook. But it is something that will benefit your company.

Knowledge

It pays to sell your company—this is where the employer provides the information on what he or she offers to employees. It gives the employee the knowledge of what the employer can do for him or her whether he or she uses the benefit or not.

*continued on the next page*
Benefits of the employee handbook (continued)

**Motivation**
The employee handbook can be a motivator and an effective tool for reducing turnover. The employee has something to compare to other offers—it may be the one thing you offer your employee in benefits that makes all the difference. If he or she is unaware of this benefit you may find yourself looking for employees.

**Efficiency**
The employee handbook can save you time and money. By having a well-prepared handbook and easily indexed to find things, about 75 percent of the questions employees may ask will be answered by reading the handbook. These are the routine questions that would otherwise wind up on your desk or the supervisor’s desk. It saves management time.

**Fairness**
The employee handbook can affect morale. The published rules and policies help reinforce to the employee that everyone is being treated consistently and fairly. It eliminates the confusion about various issues that may arise.

**Compliance**
The employee handbook can help meet legal requirements. There are certain things that the law requires be communicated to the employees. Some of these legal requirements have been mentioned in previous sections such as Title VII of the Civil Rights Act, Equal Pay Act, Affirmation Action under the Rehabilitation Act of 1973, Americans with Disabilities Act, and others.

**Legal concerns**
Policies must be written within the context of various federal and state laws governing employment. (See above in meet legal requirements.)

*continued on the next page*
Prepare an Employee Handbook (continued)

Does the manual create a contractual obligation in any way?

In some states laws have been passed that make employment practices and procedures contractually binding on the employer—such as wages, vacation pay, sick leave and health benefits.

Are there any guarantees or items stated in such a way as to imply a guarantee in your handbook? If you don’t mean intend for it to be a guarantee, write it in such a way that allows you to deviate from the statement.

There is way to guarantee legal pitfalls but you may be able to avoid some in the creation of the employee handbook.

Implied contract

To avoid creating the impression of an employment contract, place a disclaimer prominently in the handbook—bold lettering is best—indicating that this document and anything contained in the book should not be construed as a contract.

Do not use the term “PROBATIONARY PERIOD” for new hires, instead refer to them as “newly hired.”

Do not use the term “PERMANENT EMPLOYEE,” which can denote lifetime employment and can conflict with the “employment at will” concept.

Avoid the use of restrictive discipline and discharge policies as mentioned under the section on hiring and firing employees

Review your handbook and keep it current—the laws are constantly evolving

continued on the next page
Prepare an Employee Handbook (continued)

Contents of an employee handbook

Although the following list is not comprehensive and provides only the broad categories, it will give you an idea of what can be contained in the handbook.

- Overview
  - Introduction
  - Company history and services
- General office policies and procedures
  - AIDS/ARC/HIV policies
  - Company vehicles and responsibilities
  - Conduct
  - Dress code (office and field)
  - Drug and alcohol policy
  - Employee classification
  - Employee purchases
  - Hours of work
  - Housekeeping and the kitchen area
  - Inclement weather
  - Orientation
  - Parking
  - Paydays
  - Reference checks and rehires
  - Smoking in the workplace
  - Social events
  - Solicitation and distribution
  - Telephone courtesy and usage
  - Training, education, and professional development
  - Travel and expense reimbursement
  - Workplace safety and health

continued on the next page
Prepare an Employee Handbook (continued)

Contents of an employee handbook (continued)

- General employment policies and procedures
  - Age limits (work-related)
  - Attendance, absenteeism, and tardiness
  - Career opportunities
  - Corrective action and discipline
  - Employee referral bonus program
  - Exit interviews
  - Grievance procedure
  - Hiring of relatives
  - Initial review period
  - Lunch period
  - Moonlighting/conflict of interest
  - Overtime compensation
  - Performance evaluations
  - Personnel files and information
  - Resignation and termination
  - Salary reviews
  - Suggestion system
  - Timesheets
  - Tools, equipment, property, and supplies

continued on the next page
Prepare an Employee Handbook *(continued)*

**Contents of an employee handbook (continued)**

- Benefits
  - Bereavement leave
  - Dental insurance
  - Health insurance
  - Holidays
  - Incentive compensation (bonus) program
  - Jury duty
  - Leave of absence
  - Life insurance
  - Military leave
  - Notary public
  - Sick leave
  - Vacation leave

- Compliance
  - EEOC/affirmative action
  - Sexual harassment and discrimination
  - Other compliance areas

*ABC Model Employee Handbook* has many of these basic policies that can be tailored to meet your specific company's needs.

**Resources**

There are already established policies and procedures prepared by several commercial firms, from various associations that provide resources in the area of human resource management and in books that can be purchased.
Prepare a Personnel Policies Manual

Introduction

This manual is not generally designed to be used or read by employees but is designed to give management and supervisors guides on daily employee relations. It may be additional sections attached to the employee handbook providing more in-depth discussion. It contains procedures, rules, and practices in what may be called a supervisor’s and manager’s policies and procedures.

Legal concerns

As with the employee handbook, the personnel policies written may be construed as a contract. States have passed laws that make the employment practices and procedures contractually binding on the employer, such as wages, vacation pay, sick leave and health benefits. At a minimum, the employer should always reserve the right to make changes:

- Its sole discretion
- Interpret and administer the policies in light of changing circumstances and events
- The reason is to make it your right to be flexible.

Is a personnel policies manual necessary?

As with the employee handbook, there is no federal or state law mandating that this type of manual be written. Even though it is a good idea, it won’t shield an employer from legal problems.

Advantages

By not writing down policies, misunderstandings and poor morale or charges of discrimination or favoritism may occur. One manager may allow one employee to do something while another manager may not allow the behavior. Remember, even written policies may be challenged.
Prepare a Personnel Policies Manual (continued)

Is a personnel policies manual necessary? (continued)

Writing policies will cut down on the number of redundant, simple questions that are asked such as allowing of vacation or what the supervisor can allow or not allow.

This manual can help develop good managers and supervisors by vesting them with the responsibility for their own actions.

It can provide material that can be used in supervisory training for new supervisors and as a refresher course for others.

What does the manual contain?

The manual should contain all the usual personnel information and activities. It can be added to as the need arises. The manual should include payroll, benefits—but not necessarily the medical/health plan but the vacation, holiday, personal leave, leave of absence, and other employee perks. It may contain an introduction from the president, an index, employee relations statement, employment disclaimer, professional conduct, and noncompete agreement.

Some examples of items would be

▷ Purpose of manual
▷ How to use the manual
▷ Authority of the manual
▷ Responsibilities of supervisors and managers
▷ Employee relations policy
▷ Hiring policy
▷ Job training
▷ Pay policies and procedures
▷ Rules of conduct
▷ Safety rules
▷ Cost control
▷ Grievance and complaint procedure
▷ Communications
▷ Termination

continued on the next page
Prepare a Personnel Policies Manual (continued)

Writing a manual

Use the following steps to write a manual.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gather all written communications regarding human resource procedures and policies distributed to supervisors, managers, and employees.</td>
</tr>
<tr>
<td>2</td>
<td>Organize them into various categories.</td>
</tr>
<tr>
<td>3</td>
<td>Review and add to these and write the first draft.</td>
</tr>
<tr>
<td>4</td>
<td>Review with senior management and discuss changes that may be made.</td>
</tr>
</tbody>
</table>

Writing tips

Keep the following tips in mind.

- Keep the language readable, avoid technical jargon, use short simple sentences.
- Be clear—say what you mean.
- Use active verbs as much as possible.
- Ensure consistency. For example, don’t say that one level of management has an “open door policy” and then in another instance say the employee must go to his or her immediate supervisor.

Resources

As with the employee handbook, various sources are available: Books on personnel manuals, associations that have already prepared guides to writing, and commercial firms that can help you write your own. Networking is another good source of this type of information.

continued on the next page
Prepare a Personnel Policies Manual (continued)

Periodic updating

Even after the manual is finalized and distributed, it will need to be updated and periodically reviewed. To be sure that the manual is useful, an evaluation of the manual should be undertaken between six months and a year after initial distribution. All managers and supervisors should provide feedback on whether any of the policies are unclear, changed, modified, or added.

Training

Training is an integral part of any process and this area is not an exception. The key to any manual is effective training in its use. Make sure that all parts of the manual are covered and that all supervisors and managers understand its use and authority. Those managers and supervisors that are leaving should turn in their manuals. New managers and supervisors should be instructed in the manual as part of their orientation.
Develop Policies and Procedures

Introduction

You are required by law to have certain policies and procedures in place. In addition, you may want to develop a broad range of policies and procedures to support your company’s smooth operations.

Types of policies and procedures

The following is a general outline of typical policies and procedures. Consult your ABC chapter, labor and employment counsel, or another experienced labor lawyer for specific advice to determine which of these you require for your business.

- Communications
  - Orientation
  - Notices
  - Company representatives
  - Bulletin boards
  - Suggestion boxes
  - Meetings

- Employment
  - Performance reviews
  - Job classifications/employee categories
  - Work hours/work week
  - Pay week/period
  - Pay/wage
  - Hire/fire
  - Disciplinary actions

continued on the next page
Develop Policies and Procedures (continued)

Types of policies and procedures (continued)

- Benefits
  - Time off
  - Insurance
  - Training/education
  - Retirement/pension
  - Company vehicle
- Regulatory
  - EEOC
  - Harassment
  - Drug free
  - Unemployment
- Work rules
  - Safety
  - Security
  - Tools and equipment
  - Smoking, language, radios on job site
  - Conflict of interest
Create Awareness of Company Goals and Expectations

Introduction
You have worked hard to create a company that you are proud of owning. Now, it is time to create and maintain an awareness in the minds of the employees that keep the company going of who you are and why you are in business.

Mission statement
The mission statement can be just a few paragraphs or several pages. You will find mission statements in the annual reports of publicly traded companies. It is basically the statement of why the company exists and its broad-based goals. For an example,

...providing quality installation of ..... on a cost-effective basis for our customers, to ensure that we service and provide our customers current technology in our field ...... that we put our customers first and listen to their suggestions..... and that we do this on a profitable basis to ensure the growth and continuance of our company.

Why company goals are important
Your goals are, in large part, the driving force behind your company’s operations.

The detailed goals—whether they are short or long term and the procedures for their implementation—are developed from the mission statement. For example, details about how you will provide the “customer is first” approach.

continued on the next page
Create Awareness of Company Goals and Expectations (continued)

Employee buy-in

To have employees buy into the company goals, they must be made to feel a part of the goal-setting process. People will only buy into something if they feel that they have a stake in the process. Forming a committee for the strategic goal setting is one way. This committee should be formed of managers, first-line supervisors, and employees. Other employees can filter their suggestions to the committee. Let everyone know that this committee is looking at improving customer relations and are requesting suggestions which will be reviewed by the committee.

Employee support—buy-in—of company goals is crucial for success. Having the commitment of employees helps to

- Create and maintain a strong company image in the marketplace
- Project a unified purpose
- Support company operations

Communicating the goals and expectations

The best time to communicate your company goals and expectations is at

- new employee orientation,
- three-month review (when benefits may be taking effect),
- performance reviews, and
- regularly scheduled company meetings.

continued on the next page
Create Awareness of Company Goals and Expectations (continued)

Top-to-bottom management

If management has already set the goals, the approach is called top-to-bottom management. You must take different approaches in conveying the message. It is hard to make employees accountable for supporting goals and expectation unless you can get them to buy into the goal. Use short ideas such as “Quality is everyone’s concern,” “Do it Right the First Time,” “Remember you are a customer, too!” It is best to keep goals in front of all employees, not just new employees or at reviews—stress it throughout the year. Use posters and payroll inserts and stress that management is behind the goals. Use suggestion boxes for any new ideas for improving on the goals.
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# Motivation

## Overview

### Introduction

The fourth section of Module E covers ways to motivate your employees. Employer/employee relations is a cornerstone of any business operation. The four business activities and their corresponding tasks covered are outlined below.

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Develop Employee Incentive Programs

Introduction

The establishment of incentive programs supports the motivation effort; it results in quality work, safety, and attendance. A program that rewards and recognizes people goes a long way toward building employee spirit and commitment to the company.

Purpose of incentive programs

Incentive programs in themselves do little good. It’s their application as individual recognition that enhances motivation. Everybody likes to have his or her achievements recognized by others. Even though personal satisfaction may come from meeting a predetermined goal, it is always more meaningful if someone else is there to recognize the success.

Motivated workers are willing to extend the extra effort when the business needs help in overcoming a problem or meeting a production deadline. But if the extra effort goes unnoticed, employees will wonder why they should bother.

Reasons to recognize and reward

Common reasons for recognition and reward include:

- Length of service (usually landmark anniversaries like one, five, 10, and 20 years of service)
- Retirement
- Safety (achieving a certain number of days without an incident)
- Attendance (six months or a year without an absence)
- Productivity
- Customer service
- Superior performance awards (usually for outstanding effort and achievement on a specific project)
- Employee-of-the-month programs

continued on the next page
Develop Employee Incentive Programs (continued)

Types of incentives

There are many types of incentives, including

- certificates
- plaques
- trophies or ribbons
- jewelry (pins, pendants)
- pens or desk accessories
- watches and clocks
- cash bonuses
- savings bonds
- tickets to sporting or cultural events
- personal note from the president
- posting names on a bulletin board
Encourage a Sense of Loyalty

Introduction

Every employer wants supportive, committed employees. How to foster that in your employees takes effective communication and sharing of success and power.

Effective communication

Company goals and expectations must be clearly conveyed to employees. Your first step in fostering an environment where employees actively support and strive for the success of the company begins with clear communications.

Close communication

When employees realize that they have your ear, they will provide feedback that will enhance general operation and identify issues that detract from effective operations.

Why employees participate

There is great truth in simple phrase “pride in a job well done.” Your most valuable resources are the people who work for you. As people, they have some basic needs for self-esteem and accomplishment. Employees actively participate in a company when they
- believe that they can make a difference
- feel that their contributions are valued by management
- see that their ideas are implemented
- reach a level of selfActualization in their work

Types of company events

Typical company events include
- Family picnics
- Holiday parties for couples
- Departmental meetings
- Sports activities
Maintain Company Morale

Introduction
Motivation of an employee does not just happen. Management must have a coordinated and well thought-out program of employee recognition. It can not be for selected personnel but must encompass all employees.

What is company morale?
Company morale is the general feeling of belonging to a select group; an employee of the firm. It is an individual's feeling that his or her personal interest may be secondary to the needs and objectives of the firm.

Signs of low morale
Low morale may exist among your employees, but you may not realize it. There are some obvious signs that you can watch for, though, including:

- excessive absenteeism or tardiness
- high turnover
- poor work quality
- increasing number of errors in work
- necessity to redo work frequently
- lack of enthusiasm about work
- jealousy or fighting among staff members
- complaints from customers about service

Having some of these present in your business may or may not be indicative of a morale problem. In the case of errors in work and poor work quality, there may or may not be training issues to address. If work quality is poor, don't make the immediate assumption that the employee hates his or her job. It's important to recognize that if an employee has not been adequately trained for the work he or she is expected to perform, morale can suffer.

continued on the next page
Maintain Company Morale (continued)

Maintain company morale

Use the following guidelines to maintain and improve company morale.

- Create a genuine "We Care" attitude from management
- Provide appropriate training opportunities
- Ensure proper and accurate communication at all levels of the company
- Resolve issues/problems promptly
- Understand that an employee’s need cannot be met at all times
Increase Productivity

Introduction

There is a direct correlation between morale, motivation, and productivity. It is your task to figure out how best to motivate your employees, strengthen and maintain company morale, and then reap the rewards of increased productivity.

Increase motivation

Increasing employees' motivation can be as simple as recognizing accomplishments. Incentive programs play a big role in employee motivation. Other methods of increasing motivation include

- Provide on-the-job training
- Provide programs that support continued technical education
- Job enrichment through greater responsibility
- Supervisor recognition of employee at staff meetings

Effect of motivation on the bottom line

Motivation can directly affect productivity and increase operating margins through cost reductions in all areas. Create employees who work with greater effort and willingness to support the organizational goals.

Increase productivity

Use the following guidelines to help increase productivity in your company.

- Salary that is in line with industry standards
- Selectively reward those identifiably good employees
- Incentive programs consistent and open to all
- Continued education and technical support
- Providing the tools they need to do their job
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Module F
Marketing
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F. Marketing

Overview

Introduction

Too many construction companies survive from sale to sale. This module presents basic information about designing a strategy that provides for continued growth over the long term. In any industry, this is referred to as the marketing and sales plan. Use of targeted marketing will generate a steady stream of customers to a business. This stream is essential to any company’s prosperity and growth.

In this module

This module is divided into two broad categories with specific topics in each. Each topic identifies a basic business activity that is critical to your success as an emerging contractor. Each topic comprises specific tasks to enable you to perform the business activity.

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# Develop a Marketing Plan

## Overview

### Introduction

This first section of Module F covers basic marketing plan development. The eight business activities and their corresponding tasks covered are outlined below.

## In this section

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Determine the Target Market

Introduction

Who wants or needs your company’s product(s) or service(s)? By identifying who is most likely to buy your product/service, you can design a marketing and sales approach that appeals to that specific audience—the target market. With your target market defined, you can make changes to your product/service, if necessary, to meet the needs and wants of those buyers. You can also plan how best to reach your audience through focused advertising and promotions.

Business plan tie-in

During the development of your business plan, you described your company from a customer point of view. The approach focused on the perspective of what your customers expect and want from you. You described

- What you are selling
- How your product or service benefits the customer
- What sets your company apart from your competitors
- Which products are in demand and will likely remain popular into the future

Your customers

As part of the business plan, you also defined who you want to get and keep as a customer. You defined your customer by identifying

- Your current customer base
- How your customers learn about your product or service
- Patterns or habits your customers and potential customers share
- Qualities your customers value most about your product or service
- Qualities your customers like least about your product or service
- Prospective customers whom you aren’t currently reaching

*continued on the next page*
Determine the Target Market (continued)

Methods to gather information

You may use a variety of methods to gather specific information about your customers' wants and needs. Information gathering methods include

- Customer surveys
- Focus groups
- Advisory board
- Industry association data
- Data collection agencies
- Buyer/user interviews

Demographics

After you have specified who your customers are, you use demographic data to determine

- Where the customers are located
- How large the market is geographically
- How many consumers compose this market
- Any cyclical factors that influence this market

Marketplace data

In Module A, Reassessing the Business, there is a list of resources for demographic information, including

- The Statistical Abstract of the United States (US Census Bureau)
- State and Metropolitan Area Data Book (US Census Bureau)
- County and City Data Book (US Census Bureau)
- County Business Patterns (US Census Bureau)
- The Survey of Current Business (US Bureau of Economic Analysis)

continued on the next page
Determine the Target Market (continued)

Sources of demographic data
Sources available for market research include

- Small Business Administration (www.sba.gov/regions/states.html)
- US Department of Commerce, Bureau of Economic Analysis (www.bea.doc.gov)

Customized research
You may choose to hire a research firm to gather and analyze market data for you. Much of the information the firm will gather for you comes from the sources listed above. If your business has a high financial risk factor, it may be worth hiring a professional research firm.

Potential niche
Through your research and analysis, you may identify a particularly heavy consumer segment. This presents a potential opportunity to direct your marketing efforts more precisely at these users, thereby creating a niche market for your company.
Establish the Marketing/Advertising Budget

Introduction

Too many companies use “leftover” monies to fund the marketing effort. This is a mistake. Effective marketing generates leads and sales. It cannot be an afterthought of the budgeting process.

Definition: Marketing

Marketing is an umbrella term that describes a company’s efforts to identify customer wants and needs and then sell itself, its products, and its services to customers.

Elements of marketing

The elements of marketing include

- Customer identification (market research)
- Market positioning (unique benefits or advantages)
- Marketing mix (price, product, promotion, place)
- Public relations

Definition: Advertising

Advertising is paid publicity using any of a variety of methods to promote a company’s products/services in support of the company’s marketing plan. Advertising provides reasons for customers to buy your product/service instead of the competition’s offerings.

continued on the next page
Establish the Marketing/Advertising Budget (continued)

Elements of advertising

Elements of advertising include
- Yellow Pages
- Brochures
- Trade shows and conventions
- Newspaper advertisements
- Direct mail
- Radio and television

Definition: Publicity

Publicity is free advertising generated through public relations efforts to promote a favorable public opinion of the company. It is considered the "art of furnishing or creating news." Publicity is often in the form of features, consumer news, and hard news.

Definition: Promotion

Promotion is the marketing tactic that covers all phases of the communication between your company and its customers. It requires a written plan to address your goals and objectives. Any promotional activities must be tailored to a specific target audience. A major component of promotion is advertising and it requires its own budget.

Definition: Marketing plan

A marketing plan is the business management tool that details how you will reach your target market through advertising, promotion, and public relations efforts.

The marketing plan should reflect the company’s philosophy and goal—who you are, what you are, what you want to be, and how you are going to get there. It should be in place before work on the marketing budget begins.

continued on the next page
Establish the Marketing/Advertising Budget (continued)

Definition: Advertising plan

An advertising plan is the determination of how your marketing dollars will be spent to achieve your goals. This includes such information as:

- Type of advertising (radio, TV, newspaper, truck signs, uniforms)
- Frequency of advertisements (daily, weekly, monthly)
- Timing of advertising (seasonal, quarterly, continual)
- Promotional events
- Public relations activities
- Weighted dollars spent toward most profitable product lines

Marketing budget

One method for establishing a marketing budget is to assign a fixed percent of the projected sales volume. Typically, marketing budgets range anywhere from 1 to 5 percent of projected sales volume. Most full service companies spend between (??) to (??) percent. Most specialty companies spend between (??) to (??) percent. A showroom will add xx percent to the marketing budget.

Sample marketing budget

On the following two pages is a sample marketing budget.

Level of sophistication

Depending on the size of your company, you may have a simple marketing/advertising budget or a complex one drawn up by experienced marketers.

continued on the next page
## Master Marketing Budget/Schedule Sample

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Establish Customer Service Policies and Procedures

Introduction
Without your customers, you would be out of business. Satisfied customers are the lifeblood of a successful company. They provide continuing business and referrals. Your policies and procedures must promote your company's philosophy regarding your customers.

Company philosophy
Effective customer relations begin with a customer philosophy that outlines expectations for service by company personnel and all associates working with your company. Without this framework, each employee or subcontractor operates on his or her own customer philosophy. You must require that everyone associated with your company support your customer philosophy. Consistent behaviors are achieved when all team members work from the same philosophy.

Customer service
Think about what image you want customers to get when they hear your company name. Create a positive statement that appeals to buyers. Your philosophy should be realistic and attainable. You will have to balance available resources with the commitment you make to customers.

Based on this statement of customer service, design your company policies according to your philosophy. Develop procedures to achieve your goals and identify performance items to measure. In hiring, look for personnel and trades who are comfortable working within your customer philosophy.

continued on the next page
Establish Customer Service Policies and Procedures (continued)

Establish procedures

Written procedures provide a framework for making changes. When the current methods are clearly defined, adjustments can be made to fine tune them. Think of your written procedures as a living document.

Developing written procedures clarifies company thinking. The process involves discussing and describing how things get done. When complete, your written procedures provide an excellent starting point for orienting new personnel and cross training veterans. Reviewing the procedures helps everyone understand his or her assignment as well as what others in the company do. They provide a useful reference for activities that are seldom needed.

Components of a procedure

A procedure has four basic components.

- Objective—Describe what the procedure accomplishes for the customer.
- Procedures—List the steps required to perform the task in the order they should be done. Each step should show who would perform that step. Limit each step to no more than two actions.
- Materials—List the forms or other items needed to perform the steps.
- Evaluation—Describe how you will measure success.

continued on the next page
Establish Customer Service Policies and Procedures (continued)

Sample procedure

The following is a sample customer service procedure.

Objective
- The buyers/owners can customize the construction process to meet their specific need through the use of change orders.

Procedure
1. Project manager documents the requested change in detail.
2. Project manager explains the process for approval and pricing to the buyers/owners.
3. Project manager immediately submits the change request for review by the superintendent and the purchasing manager for approval and pricing.
4. Superintendent approves or rejects the requested change based on review of all circumstances.
5. Project manager reviews decision with buyers/owners.

Materials
- Change order schedule
- Change order form

Evaluation
1. Buyers/owners are satisfied with the results of changes they order.
2. Every change from the original contract is documented.
3. Product(s)/service(s) are completed and delivered as ordered.

continued on the next page
Establish Customer Service Policies and Procedures (continued)

Topics to cover

When it comes to customers, specific service procedures vary widely from one contractor to the next. Topics needing procedures include but are not limited to the following:

- Contract
- Selections
- Preconstruction conference
- Change orders
- Site visits
- Delivery dates
- Project expectations
- Terminology
- Definition of team members and their roles
- Warranty

Internal customer service

A healthy service culture recognizes and values internal customer service. The way management treats employees and employees treat each other will be reflected in the way the company treats its buying customers. This begins with respectful treatment of every employee and continues through daily routines.

Benefits of customer satisfaction

The overall objective of the marketing plan is to have satisfied customers. If your marketing plan is effective, your company should enjoy the benefits of 50 to 75 percent repeat and referral business. If at least half of your business is not repeat or referred, you must reevaluate your marketing plan and contact management system.

continued on the next page
Establish Customer Service Policies and Procedures (continued)

Cost of poor customer service

Lost opportunities, missed sales, or difficulty conducting business due to poor reputation—hesitant land owners, zoning, community resistance to intended development—all can result from a poor reputation for quality and service.
Develop Company Image and Communications Materials

Introduction

You must communicate your company's image effectively to generate leads and sales. The image should illustrate the company's message and style. A company logo is a first step toward building an image in the public's eye. This logo should then appear on every business element that comes in contact with potential customers.

Quality, appearance, and content

The quality, appearance, and content of your company's letters, proposals, and marketing pieces effect the quality, workmanship, and thoroughness of your construction. If there are errors, poor preparation, or the like in these communication materials, prospective customers assume your work is the same.

continued on the next page
**Develop Company Image and Communications Materials (continued)**

**Pick an image**

What do you want to convey to your customers? What image do you want to bring to mind when people think about your company? How will you differentiate your company from the competition? With the assistance of a professional designer, your company image can convey a variety of qualities:

- Innovative
- Traditional
- Speed
- Quality
- Customer-oriented
- Exclusiveness
- Reliability
- Affordable
- Convenient
- On-time performance
- Trustworthy
- Successful
- Solid

**Business positioning**

In the creation of your business plan, you determined the features and benefits that make your product(s)/service(s) unique compared to those of your competitors. These differences allow you to position your product/service in the marketplace and draw customers to you. Your ability to communicate important differences is the basis for a successful positioning strategy.

Correct positioning of your product/service is the solution of the question regarding the marketing mix—product, price, promotion, and place. The marketing mix was discussed in Module A, *Reassessing the Business.*

*continued on the next page*
Develop Company Image and Communications Materials (continued)

Meaningful differences

The differences you emphasize must be meaningful enough to a potential customer to influence his or her buying decision. These meaningful differences (i.e., features and benefits) should be created and conveyed to your customers through a comprehensive strategy that includes your

- Pricing structure
- Product/service design
- Advertising and promotion activities
- Public relations events
- Customer service standards
- Follow-up procedures
- Ability to remove risk from the customers’ buying decision

Consistency

Everything you do to bring your product/service to the customer must work together to promote a consistent image of your company. This image—perhaps embodied by your logo—is indispensable to your success.

continued on the next page
Develop Company Image and Communications Materials (continued)

Communication materials

The company image must be conveyed successfully throughout a variety of communication materials. These include, but are not limited to, the following:

- Logo
- Signage (e.g., truck signs, job signs, billboards)
- Business cards
- Business stationery (e.g., letterhead, envelopes, faxes, memos, email)
- Forms (e.g., contracts, change orders, invoices, receipts, notices)
- Advertisements (e.g., newspaper, magazine, TV, radio)
- Promotional materials (e.g., brochures, flyers, newsletters)
- Displays (e.g., trade shows, conventions, association meetings)
- Uniforms and hardhats
- Telephone answering machine message
- Fax cover page

Design considerations

There are a series of questions to answer that result in decisions regarding the design of your communication piece (e.g., newsletter for customers, magazine advertisement, brochure, company form, etc.). For example,

- What is the communication piece about?
  - Product/service
  - Opportunity
- What is the purpose of the communication?
  - Goal and objective for communication of this information is to persuade, inform, move to action, etc.
- What image should the communication convey?
  - Support the company image created earlier

continued on the next page
Develop Company Image and Communications Materials (continued)

Design considerations (continued)

- How much time is available to produce the communication piece?
  - Unlimited time
  - Printer’s deadline
  - Radio station’s deadline
- What is the budget for the communication piece?
- Who will be reading, using, or listening to this communication piece?
  - Target audience preferences
- Where will the communication piece be used?
  - Local or national newspaper
  - Local or national television
  - Billboard
  - Direct mail
- How long will the communication piece be kept?
  - Indefinitely: Company forms, letterhead, business cards
  - Finite: Radio, TV, newspaper
  - Long-term: Pricing schedules, product catalogs
- Will customers be photocopying or faxing the communication piece?
- Will there be any specific requirements for color?
  - Company colors
- Must the communication piece conform to a company style or fit into an ongoing communication program?
- What kind of communication piece works best to support goal and objectives of information?
  - Printed
  - TV
  - Radio
  - World Wide Web
- How will the communication piece be distributed?

continued on the next page
Develop Company Image and Communications Materials (continued)

Measuring effectiveness

Create a tracking system to measure the effectiveness of your communications. For example, have a chart that lists the different advertising options your company uses. Track the cost of the advertisement and the number of qualified leads and sales produced by the advertisement.

Sample tracking sheet

The following is a sample tracking sheet for measuring the effectiveness of various advertising options.

<table>
<thead>
<tr>
<th>Origin of Lead</th>
<th>Leads</th>
<th>Sales</th>
<th>% conversion lead to sale</th>
<th>% of Total Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Referral from previous customer</td>
<td>110</td>
<td>27</td>
<td>25</td>
<td>45</td>
</tr>
<tr>
<td>Referral from company friend</td>
<td>46</td>
<td>10</td>
<td>22</td>
<td>16</td>
</tr>
<tr>
<td>Employee referral</td>
<td>13</td>
<td>4</td>
<td>31</td>
<td>7</td>
</tr>
<tr>
<td>Truck signs</td>
<td>12</td>
<td>2</td>
<td>16</td>
<td>3</td>
</tr>
<tr>
<td>Jobsite signs</td>
<td>14</td>
<td>3</td>
<td>21</td>
<td>5</td>
</tr>
<tr>
<td>Yellow Pages</td>
<td>35</td>
<td>4</td>
<td>11</td>
<td>7</td>
</tr>
<tr>
<td>Newspaper ads</td>
<td>11</td>
<td>2</td>
<td>18</td>
<td>3</td>
</tr>
<tr>
<td>Brochures</td>
<td>4</td>
<td>1</td>
<td>15</td>
<td>2</td>
</tr>
<tr>
<td>Trade show</td>
<td>52</td>
<td>7</td>
<td>13</td>
<td>12</td>
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<tr>
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<td>3</td>
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<td>0</td>
</tr>
<tr>
<td>TOTAL</td>
<td>300</td>
<td>60</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>
Select Resources to Help Promote Company Image

Introduction

Building on your decisions regarding company image, target market, product/service positioning, marketing plan, and pricing, you must select the distribution (place) method and sales representation necessary to make your marketing strategy a success.

Distribution decision

It is easier to change your product, pricing, and promotion decisions than to change your place or distribution choice. The distribution choice—how you will get your product/service to the customer—affects the subsequent selection and use of all other marketing tools. Distribution choices include

- Sales force
- Direct mail
- Telemarketing
- Internet
- TV and cable channels
- Subcontracting
- Networking
- Partnership and co-op programs

Distribution criteria

When evaluating which distribution channels best suit your marketing and sales plan, consider the following criteria

- Ease or difficulty of entry in the marketplace against the competition
- Lowest costs of entry compared to the competition
- Least financial risk and commitment
- Sufficient potential volume to achieve short-term financial goals
- Pricing levels required to generate required revenue and profit margin

continued on the next page
**Select Resources to Help Promote Company Image** (continued)

**Competitors products/services**

In your business plan, you identified and analyzed your primary and secondary competitors. You must now find out how they bring their products/services to the marketplace. Find out what distribution channels work for them and decide if similar methods fit into your overall marketing and sales plan.
Develop Special Promotional Events

Introduction

You must promote your company to attract customers. These may be new customers or those that are currently using a competitor’s product/service. Your promotional event needs to be unique and communicate the right message about your company.

Definition: Promotion

Promotion is a planned event or offering used to draw attention to a company’s product/service. Promotional programs provide an incentive for a customer to try out your product/service. A promotional event attracts potential customers and encourages them to consider using your company’s product/service in exchange for a discount, possible prize, rebate, or similar reward.

Types of promotional events

Promotional events can be as imaginative and innovative as you can dream up. The objective of the event is to attract publicity to your company and encourage consumers to take notice of your products/services. Traditional promotional events include

- Grand opening (e.g., showroom, new location, finished building)
- Drawings (e.g., leave a business card for the possibility to win a gift certificate to a local restaurant)
- Premiums and gifts (e.g., magnets, T-shirts, coffee mugs, and weekly agendas with your company logo)
- Coupons/rebates (e.g., 10 percent discount on next service call)
- Demonstration (e.g., trade show, open house, seminar)

continued on the next page
Develop Special Promotional Events (continued)

Special events

Another type of promotional activity is a special event. These are typically performed in conjunction with a charity or community organization. Examples of special events include:

- Sponsoring a sports team for a youth organization
- Donating to a charity
- Sponsoring a community service award, program, or event
- Sponsoring a fix-up day at a community center, place of worship, or public facility (e.g., homeless shelter)
- Sponsoring trade association events
- Sponsoring “think tank” workshops in your industry

Cost of promotion

You must analyze your promotion to determine if the costs of the event, premiums, or gifts will be recovered through increased business. If new customers are not generated by the promotion, it is not cost effective to continue.

Planning a promotion or special event

Use the following steps to plan a promotion or special event.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Set up an event calendar and mark major holidays, community events, and seasonal opportunities for promotional events.</td>
</tr>
<tr>
<td>2</td>
<td>Establish a theme for the event.</td>
</tr>
<tr>
<td>3</td>
<td>Set up a project team including key vendors.</td>
</tr>
<tr>
<td>4</td>
<td>Develop a schedule complete with milestones.</td>
</tr>
<tr>
<td>5</td>
<td>Develop a budget including direct mail, PR, and favors.</td>
</tr>
<tr>
<td>6</td>
<td>Develop a recap procedure to establish the effectiveness of the event.</td>
</tr>
</tbody>
</table>

continued on the next page
Develop Special Promotional Events (continued)

Role of publicity in promotional events

Publicity reaches people in the same manner as news stories but has more credibility than advertising. Whenever possible, try to get publicity for your promotional events. This involves notifying local newspapers and television/cable news crews well in advance of the event.

Consumer news

Invite reporters to cover a seminar or community service event. Encourage the media to do a consumer news story to educate readers/listeners. These stories are typically produced as a public service. Examples of consumer-oriented stories include

- Sick buildings and clean air remedies
- Impact of a project on the community
- Industry trends and new technology

Feature stories

Feature stories are personal interest articles or reports. They describe you or your company and appeal to a wide range of audiences because they are informative and interesting. Examples of feature stories include

- Reasons for success
- Interviews
- Third-party endorsements
- New products and services

Hard news

Hard news reports cover significant events and public functions as a matter of public record. Examples of hard news publicity stories include

- Award recognitions
- Grand openings
- Impact of disaster
- Key hires
- Major project awards (e.g., ABC Safety Program, etc.)
Select Media for Advertising

Introduction
There seems to be an explosion of advertising reaching consumers today. How do you know which media will be most effective for your product/service? Researching the possibilities and analyzing the results is the best method to evaluate media for advertising.

Types of advertising media
Advertising dollars are spent on
- Newspapers
- Television and radio
- Telemarketing
- Internet/electronic
- Direct mail and catalogs
- Magazines
- Telephone directories and 800 numbers
- Signs and other outdoor advertising

Advantages/disadvantages
There are pros and cons for using any type of advertising media.

Newspaper
The advantages to using newspaper advertising include
- Good way to reach local target market
- Provide media kits to help you develop your ad
- Large numbers of people buy and read newspapers
- Production changes are made easily and quickly
- Offers great exposure for a modest cost

continued on the next page
Select Media for Advertising (continued)

Advantages/disadvantages (continued)

Newspaper (continued)
The disadvantages to using newspaper advertising include
- Placement with competitor’s ads
- Photographs do not reproduce well
- Small ads can look “lost” on a page

Television and radio
The advantages to using television and radio advertising include
- Good way to reach local target market
- Frequent placement reinforces the advertising message
- May add credibility to company image
- Everyone has a radio
The disadvantages to using television and radio advertising include
- Television ads can be expensive
- Requires professional development
- Requires frequent listening or viewing for message to “sink in”

Internet/electronic
The advantages to using Internet/electronic advertising include
- Good way to reach a target market
- Creates an air of sophistication for company
- Reduces time for customers to reach you
- Expands your prospect base
- Reduces marketing costs

continued on the next page
Select Media for Advertising (continued)

Advantages/disadvantages (continued)

Internet/electronic (continued)
The disadvantages to using Internet/electronic advertising include

- Competition with huge quantities of information on the Web
- Require professional development
- Requires constant updating

Direct mail and catalogs
The advantages to using direct mail and catalog advertising include

- Targeted mailing lists
- Can be highly personalized
- Easy to track response rate compared to advertising dollars
The disadvantages to using direct mail and catalog advertising include

- Per-piece cost is higher than most forms of print
- Require professional development
- Piece becomes dated quickly

Magazines
The advantages to using magazine advertising include

- Wide circulation to a specific group of consumers
- Ads can create a company image
- Quality of photographs is excellent
- Color is generally used for more impact

continued on the next page
Select Media for Advertising (continued)

Advantages/disadvantages (continued)

Magazine (continued)
The disadvantages to using magazine advertising include

- Long lead time between ad preparation and publication
- Expensive
- Require professional development

Telephone directories and 800 numbers
The advantages to using telephone directories and 800 numbers include

- Wide circulation to consumers
- Most callers are ready to buy
- One ad works all year long
- Pay by the month
- Helps you describe advantages of your company

The disadvantages to using telephone directories and 800 numbers include

- Adequate staffing to handle 800 calls
- Expensive for color listings and bold type
- Listed alongside your competitors by classification

Signs and other outdoor advertising
The advantages to using signs and other outdoor advertising include

- High visibility
- Truck and job-site signs are relatively inexpensive
- Viewed frequently when placed on a busy travel path
- Reinforces your other advertising efforts

continued on the next page
Select Media for Advertising (continued)

Advantages/disadvantages (continued)

Signs and other outdoor advertising (continued)

The disadvantages to using signs and other outdoor advertising include

- Require professional development
- Only split-second exposure as cars drive past
- Message must be brief based on 2-3 seconds of driver’s time
- Committed for 3-month periods

Low-cost advertising

The purpose of advertising is to get more people to buy your product/service. Although you can spend thousands of dollars on television or national magazine advertising, there are other low-cost advertising options, including

- Business cards
- Brochures and flyers
- Doorhangers
- Truck signs
- Calendars, key chains
- Bumper stickers
- T-shirts
- Pens, pencils
- Email promotions

Word-of-mouth advertising

Ask customers for referrals. This is considered the most effective type of advertising. Satisfied customers are your best advertisements. They will pass along product/service information for free.

continued on the next page
**Select Media for Advertising** (continued)

**Websites**

Today it seems that everyone has a website. How do you know if you should go this route? First, find out if your competitors have websites. Make sure whatever you decide to put on the web is prepared and maintained professionally. It is your image and your calling card.

**Summary chart**

Use the following chart to summarize media and their advantages.

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Media</th>
<th>Cost</th>
<th>Reach</th>
<th>Shelf life</th>
<th>Ease of use</th>
<th>Lead time</th>
<th>Image quality</th>
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<tbody>
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<td></td>
<td>Brochures</td>
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<tr>
<td></td>
<td>Telemarketing</td>
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</tr>
</tbody>
</table>
Generate New Business

Introduction

The best way to generate new business is to expand. This may constitute adding or changing your current product/service offerings or finding new customers for your existing business.

New product/service

Adding or changing your business product(s)/service(s) is one way to generate new business. A move in this direction must be accompanied by thorough planning and research. This option should require you to produce a new or updated business plan in preparation to generate new business.

New geographic market

When deciding to look for new geographic markets to generate business, you should create a business plan to detail your expansion. Entering a new geographic market is the same as starting a new business. Small businesses find that the move to multiple locations offers a great opportunity to generate new business.

Be aware that opening up in a new geographic market requires the same in-depth market research and demographic analysis as when you started your primary location. You cannot simply copy your existing operations to a new site.

New customers

A third means of generating new business is to attract new customers to your existing business. Again, expansion of this type requires some new business planning to ensure a feasible result. You will have to discern what adjustments you need to make to your product/service and/or marketing and sales plan to capture these new customers.

continued on the next page
Going public

A classic method for generating new business is to explore the opportunity of work outside of your traditional market. If you have always worked in the private sector, you can generate new business by obtaining publicly funded projects.

Advantages of public work

There are many reasons to consider doing public work, including

- Reliable payment
- Higher wages paid
- High-profile projects increase public visibility of your company
- Many projects available in the marketplace
- Natural promotion of projects by government
- Larger market than private clients

Disadvantages of public work

Entering a new arena is not without its risks. Some disadvantages to entering into public work include

- More competition
- Lower margins
- More scrutiny
- More politics involved in selection
- Lowest bidder
- Additional paperwork
- Bonding required

continued on the next page
Generate New Business (continued)

Going private
The reverse may be true for your company. You may have functioned primarily in the public area and now want to generate new business through private work.

Advantages of private work
There are many reasons to consider doing private work, including
- Better margins
- Greater ability to establish a relationship with the customer
- Greater ability to negotiate work versus bid

Disadvantages of private work
Some disadvantages to entering into private work include
- Private customers go out of business
- More dependent on market conditions for work

Subcontractors
Subcontractors should keep the following guidelines and hints in mind when generating new business.
- Service is key
- Price is only part of the buying decision
- Follow-up is key
- Always finish! The last 10 percent of the project affects customers’ perceptions of your service

continued on the next page
Generate New Business (continued)

Involving employees in generating new business

Regardless of the size of your company, you can involve your employees in generating new business. Use the following guidelines when considering how to involve employees in your marketing efforts.

- How good are employees’ communication skills?
- How strong is their work experience?
- Have they sold products or services in the past?
- Are they able to get to the decision-maker in the sales process?
- What authority do they have to make an agreement on behalf of the company?
Implement a Marketing Plan

Overview

Introduction

This second section of Module F covers the implementation of your marketing plan. The five business activities and their corresponding tasks covered are outlined below.

In this section

For information on... see page

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**Prepare a press release and ads in selected media**

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<td>Introduction</td>
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<td>Media kits</td>
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<td>Definition: press release</td>
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<td>General hints about press releases</td>
<td>F-59</td>
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<td>Tips to make press releases an effective means of promotion</td>
<td>F-59</td>
</tr>
</tbody>
</table>

**Participate in business activities**

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
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<tr>
<td>Participate in job-related education</td>
<td>F-61</td>
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<td>Participate in trade shows and conventions</td>
<td>F-62</td>
</tr>
<tr>
<td>Resources for business activities</td>
<td>F-62</td>
</tr>
</tbody>
</table>
Make Sales Calls and Visits

Introduction

Through your marketing plan and strategies, you have generated qualified leads. Now it is time to make a sales call to close the deal with your customer for the product/service they need.

The right person

The single most important factor for a successful sales call is getting to speak to the right person. The right person must

- Be a decision maker in the company
- Be influential if the decision is made by a group
- Be able to help you navigate the sales process

Get to the right person

Some strategies for getting to the right person include

- Understand the company structure and hierarchy
- Ask for names from other department personnel
- Ask "point blank" who will authorize the purchase
- Float trial balloons by offering "what if" scenarios

Types of sales calls

How you approach the sales call or visit varies depending on what you are selling and the level of previous contact with the customer. Types of sales calls include

- Cold call: when you don’t know the person
- Referral call: when you respond to a referral
- Warm call: when you have something in common with the prospect
- Follow-up call: when you respond to an information request

continued on the next page
Make Sales Calls and Visits (continued)

Elements of a successful sales call

Successful sales calls share some general characteristics. These characteristics include:

- Enthusiasm: you must want to make the call
- Clear objective: know what you want the call to accomplish
- Contact person: have a way of speaking to the decision-maker
- Valid offer
- Customer knowledge: you must understand about the company and the person you are calling

Preparation checklist

When preparing for a sales call or visit, use the following checklist to ensure an organized and efficient presentation.

- All audiovisual aids are working and clean
- Offer is clearly stated
- Prepared answers to most common objections
- Various terms determined to facilitate purchase
- Enough time planned to arrive early and set up the presentation

Influence of company marketing efforts on a sales call

The money and effort your company has put into marketing the product/service effects the success of your sales call. In general, the marketing strategy effects:

- The image of your company
- The rate of product sales
- The percentage of products sold
- Your staffing requirements as sales pick up
- Cash flow
Overcome Customer Objections

Introduction

It is classic sales wisdom that an objection is merely an opportunity to sell the product/service more effectively. Knowing what kind of objections to expect will help you prepare yourself to overcome those objections to the satisfaction of the customer and the benefit of your company.

Types of objections

An objection signals an area where you have failed to identify and meet a customer’s need or desire. Types of objections you are likely to encounter include

- The price is too high
- The terms are not flexible
- Timing is off
- Delivery is a problem
- Selection is poor

Negotiating

Negotiating is a skill. It can be learned and it must be practiced. Resources for learning negotiating skills include

- *How to Win Friends and Influence People* by Dale Carnegie
- *How to Master the Art of Selling* by Tom Hopkins
- *The Power of Positive Thinking* by Norman Vincent Peale
- *Success Through a Positive Mental Attitude* by Napoleon Hill

continued on the next page
Overcome Customer Objections (continued)

Presentation skills

To make effective sales calls and overcome objections, you must remember some basic presentation skills.

- Listen to the customer objection carefully
  “This design is not going to work in our space.”
- Find an area of agreement
  “We agree that an access ramp is essential to the project.”
- Convert the objection into a question
  “Can the facility layout be changed to factor in this element?”
- Answer the question
  “We can rearrange this space to incorporate the ramp in this location.”
- Ask a closing question
  “Given the feasibility of this design change, will you proceed with the project?”

Make yourself invaluable

Establishing your company’s credibility is essential to becoming invaluable to a customer. You must prove to the customer that

- You put his or her best interests ahead of a sale
- You are a source of unbiased information
- You are an expert in your product/service area
- You are honest beyond reproach
- You represent the best source of up-to-date information
- You can deliver the product or service on time
- You are accessible after the sale
- You will honor your warranties
Stimulate Repeat Business

Introduction

After you have successfully attracted and gotten a customer, how do you keep that customer’s repeat business?

Role of customer satisfaction

Unless you have a satisfied customer, you cannot expect repeat business. If you know you have the best product/service available on the market, what else can you do to ensure repeat business? You must provide excellent customer service to guarantee your customer’s long-term satisfaction.

Strategies

Use the following strategies to stimulate repeat business.

- Follow-up offers on products related to the initial sale.
- Correspond with the customer at least once a month via direct mail or letter.
- Send educational pieces on your company’s products and services.
Prepare a Press Release and Ads in Selected Media

Introduction

You must let the media know when something newsworthy happens at your company or as a result of your work. The most effective way to do this is to prepare a press release and send it to the media.

Media kits

Many newspapers and magazines provide interested contributors with a media kit. This kit identifies all the requirements for submitting a press release for an article or guidelines for an advertisement. A media kit typically includes

- Demographic information about the audience
- Reach information
- Current rate card
- Sample publication
- Ad preparation guidelines

Definition: Press release

A press release is a specifically formatted communication sent to media (newspapers, TV stations) detailing the facts about a particular event or story.

A well-written press release is more likely to be printed and generally will get more attention from readers. Used effectively, press releases can be an inexpensive way to build a positive perception of your company.

Uses of a press release

Even businesses whose services are not normally available to the general public (like many in the construction industry) can increase goodwill and name-recognition of their products. In addition, press releases are an excellent way for you to present your expert opinions about your business, and to present a view of how innovative and exciting your industry is.

continued on the next page
Prepare a Press Release and Ads in Selected Media (continued)

Press Release
Media Release
Contact: Company Owner
    Company Name
    Company Address
    Phone:
    FAX:
    E-Mail:
DATE

FOR IMMEDIATE RELEASE

The Headline
(In about 10 words—or less—you need to grab the attention of the editor. The headline should summarize
the information in the press release, but in a way that is exciting and dynamic.)

Opening Paragraph
(Sometimes called a summary lead, your first paragraph is critical. This paragraph must explain “the five
Ws and one H” of the story—the who, what, when, where, why, and how. This paragraph must
summarize the press release, with the following paragraphs providing the detail.)

The Body
(Using a strategy called the inverted pyramid, the body of the press release should be written with the
most important information and quotes first. This inverted pyramid technique is used so that if editors
need to cut the story to fit space constraints, they can cut from the end without losing critical
information.)

Closing Paragraph
(Repeat the critical contact information, including the name of the person, his or her phone number and/
or email address.)
Prepare a Press Release and Ads in Selected Media (continued)

Topics for a press release

Make sure your press release is newsworthy and has broad, general interest. Some examples of topics that publications are likely to cover are:

- Announcements of new products or services, or of sweeping changes to existing ones
- Expert opinions about legislation or current events
- Exceptionally good news about a company
- Personnel additions
- Project awards, started, finished
- Interesting tidbits of information or trivia, such as noteworthy statistics or unusual events

Remember, a clear, concise statement of the news is more easily written into an article or brief.

continued on the next page
Prepare a Press Release and Ads in Selected Media (continued)

Writing a press release

To write a press release to generate media interest for a feature or public interest story, follow these steps.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
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</table>
| 1    | Write a two-sentence abstract  
      (This is what editors use to evaluate the press release. The abstract should clearly state the news and explain why it is important.) |
| 2    | Provide detailed explanation.  
      (Give all the details of the news, and explain its implications. It helps to offer your interpretation of the news, especially if it may be hard to understand. Explain how this compares to other happenings in the field. Provide some history, if possible.) |
| 3    | Provide background information.  
      (Provide information that nonspecialists need to know to understand the news. Remember, the press release will eventually be presented to the general public. Also, the editor may not be familiar with the topic and may need background information to evaluate the news. Offer to provide more information if you can. The easier it is to write about your news, the more likely it will be published.) |
| 4    | Provide company information.  
      (Give a brief description of your business, and include corporate background or history if it is available. This helps editors understand your business so they can write about it.) |

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Prepare a Press Release and Ads in Selected Media (continued)

General hints about press releases

Editors really do like publicizing the information they receive in press releases. Sometimes, though, a press release has been so poorly written that it is difficult to use. This can happen when the author of the press release is trying to sell his or her product or service rather than provide information about it.

Remember to stick to the current news. Don't try to impress an editor by listing everything your company has ever done. Your accomplishments may be astounding, but if they're not timely and relevant they won't be published.

Provide the facts so that editors have something to report. Don't fill your press release with puffery and hype.

Tips to make press releases an effective means of promotion

Don't expect every press release you send to be written up. It may take time and persistence to make the news.

Send press releases regularly, every two months, every month, or every week.

You can increase your chances by focusing on the media that covers your type of news. Call their offices to find out who receives press releases. Follow up: Offer more information if you have it. Remember, you are working with the editor to provide interesting and useful content for publication. Any information you can send may be helpful.

When your press release does make it into publication make the most of it. Ask for reprints to use in your promotions or show to your customers, use quotes from the article in your literature.
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Participate in Business Activities

Introduction

There are a variety of business activities that will strengthen your company. All of the activities increase your knowledge base and generate exposure for your company in the public eye.

Participate in job-related education

The construction industry is experiencing unprecedented changes because of technological advancements and product and materials development. The only way to stay in front is to stay informed about the newest developments in your field.

Job-related education gives you and your employees the ability to keep up with industry advancements so that you can offer the highest quality and most effective products/services to your customers. Examples of job-related education include:

- Trade association education
- Manufacturer seminars and training
- Small Business Administration programs
- Small Business Development Center (SBDC) training
- Small Business Institute (SBI) counseling
- US Environmental Protection Agency publications

Participate in community activities and charitable organizations

Public service is a commendable way to build good public relations while getting free publicity for your company. Think about ways to donate your time, talent, and expertise to community organizations that operate in your area. Participate in service organizations and business clubs. This allows you to work with seniors, homeless citizens, youth groups, and others while promoting good will for your company.

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Participate in Business Activities (continued)

Participate in networking activities

The days of the handshake contract may be over, but now more than ever, it is who you know that helps your business thrive. Networking is a time-honored activity whereby you increase your contacts within your industry for the mutual benefit of all parties.

Examples of networking opportunities include
- Association chapter meetings
- Trade shows and conventions
- Public and community events
- Chamber of commerce events
- Sporting events

Participate in trade shows and conventions

Trade shows and conventions are great venues to publicize who and what you are. Your industry association can provide you with guidelines for creating a display or booth.

Emerging contractors find it more economical to attend trade shows for the networking opportunities rather than to produce an exhibit.

Resources for business activities

First and foremost, contact your trade association for help in locating appropriate business activities that you can join. In addition, the following resources exist in almost all business communities
- Chambers of commerce
- Small business associations
- Rotary clubs