



**PROCTOR, CROOK,  
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TODD J. LAYCOCK, CPA

## Are You a Good Contractor?

In today's economy, going out of business is a threat for some contractors, yet others are thriving.


How do you measure up? What are your chances for success? Can you recognize and avert problems that could cause you to go broke? Can you handle those crises that cannot be averted?

Review the following factors and see—are you a good contractor?

### The Organization:

- Focus on training—formal or on-the-job—at all levels of the company.
- Implement a logical, incentive-based compensation plan that meets company and individual needs.
- Keep tenured, proven field superintendents motivated, and they will keep revenue flowing.
- Promote from within and maintain a high level of excitement.
- Develop a succession plan—one that will take 8 to 10 years to implement—well before it's time to sell the business. It will allow the company to continue to grow and prosper.
- Create an organizational chart and distribute to employees. Update it whenever someone leaves, new opportunities present themselves, the market changes or your current structure is no longer productive.
- Cultivate a culture that communicates a sense of loyalty, ownership and urgency. Culture is the soul of your business.

**2nd  
Edition  
2010  
INSIDE**

 **Identify Problem Areas to Increase Your Profit Margin**

 **Is an ESOP Right for You?**

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## Are You a Good Contractor?

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- Employ a full-time leader to define your company's vision and direction.
- Calculate rates annually for each level within your organization to reduce expensive high employee turnover.

**Finances:** Making a profit is critical to your organization; it is why you are in business. Most contractors do not go broke due to lack of work but because of improperly managed cash flow. Manage your overhead and make sure it is appropriate for your level of revenue and profit. Develop a detailed monthly operating budget, a 12-month cash flow projection and have adequate cash flow available.

**Marketing:** Customers are your means for generating profit. Employees must understand their value and be prepared to keep the customer happy at all costs. Find a well-defined market niche and combine it with a great marketing strategy.

### Project Control:

- Implement an early warning system to signal potential problems. The more you manage a project the more successful it will be.
- Avoid litigation at all costs; contractors rarely win in court.
- Allow field managers to find, analyze, implement and measure ways to improve productivity.

**Planning:** Design a crisis management plan and practice it regularly. Do what is necessary to ensure that your successful contracting firm continues to be a success.

For more information, contact our office today.

## Identify Problem Areas to Increase Your Profit Margin

It seems improbable that an industry responsible for building an entire nation could have low profit margins – but it is true. Contractors' profit margins are considerably low for such a high-risk business. There are numerous circumstances that can be attributed to the low profits; however, two of the strongest theories that are thought to cause low profit margins are fee structures and a lack of technological advancement in the industry.

Many industry experts believe that low fees are the main contributor to the lack of high profits. Contractors have an extremely difficult time translating the service they provide into fees to potential buyers. One reason for this is that clients



believe they are buying a commodity – not a service. Competition is so great that if buyers are not pleased with the fee structure of one contractor, they will simply go to another and the sale is lost.

Another contributing factor to low profits in the construction industry is slow technological advancement



with regard to the methods and systems used. While other industries are utilizing advanced technologies to expedite processes, replace staff and reduce expenses, contractors, unfortunately, have not been able to reap the benefits of many innovative technologies that could result in faster job completions.

Additionally, contractors are not cross-trained to understand the accounting methods the company uses and, therefore, are not able to identify and, in turn, prevent any costs from being lost.

All hope is not gone. There are steps that contractors can follow to help improve low margins. Contractors need to offer design services, in addition to standard construction services, to stay competitive in the industry. More importantly, a contractor that offers design/build services will have stronger ground to stand on when charging higher fees because it will become apparent to buyers that they are purchasing a service, not a commodity.

Contractors should also survey previous customers for feedback to determine strengths and weaknesses and use that information to improve skill set. In addition, while technology is not available to replace the installation of electrical wiring, for example, it is available to help contractors increase their efficiency in completing a job. Contractors should better utilize computers and other technology to track

the day-to-day activities of jobs. This will organize projects and will allow contractors to:

- Plan ahead for upcoming projects

# "Building Profits Through Planning"

- Create more timely schedules
- Organize and track work orders
- Easily place and track orders for supplies/inventory

Contractors can also improve efficiency by using only qualified subcontractors and trained craftspeople and personnel.

Lastly, contractors should consult with their professional advisor to gain an understanding of the accounting methods being used. In this way, contractors can become more aware of their cash flow, accounts receivables/payables and assist in identifying areas in which costs can be recovered.

We understand the construction industry and can help you identify issues that will increase your profit margin. If we can be of assistance, please call our office today.

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## Is an ESOP Right for You?

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There has been a recent trend where contractors have been choosing to sell their companies to an employee stock option plan (ESOP). The main drive behind this trend is the numerous tax advantages available to business owners who participate in an ESOP. This, however, should not be your only consideration when choosing to sell your business to such a plan. There are a number of issues that could change your decision to participate in an ESOP arrangement.

An ESOP is a qualified defined benefits plan in which employees contribute monies toward purchasing company stock. Just as other defined benefits plans, such as a 401(k), ESOPs are bound by sections of the Internal Revenue Code and the

Employee Retirement Income Security Act and therefore typically require the assistance of a professional to implement.

The tax benefits for employees are similar to other defined benefit plans as tax is not paid on money contributed to the plan. Instead, employees begin paying tax on their contributions when they begin to take distributions from the plan, which can begin when an employee reaches 59.5 years old. Also, employees can roll the balance in the ESOP over to another type of retirement plan at the termination of employment. Sellers of their stock in an ESOP can avoid capital gains taxes on any gains if they reinvest the money in what the IRS terms "qualified replacement property." The benefit applies only if an ESOP acquires 30 percent or more of a C-Corporation. This is generally stocks or bonds of domestic operating companies, so check with your tax professional before taking part in this benefit.

Employers' contributions to an ESOP can be fully deductible in many situations. Generally, the deductible is limited to 25 percent of compensation. Also, deductible contributions can be made to pay off any debt that was incurred to create the ESOP. S-Corporations also can be owned by an ESOP and can provide significant income tax savings for the corporation.

In order to understand whether an ESOP is right for your company, you should consider several issues.

1. **How are you going to exit your business?** If you do not plan on selling your company to your employees as your exit strategy, you should be aware that having

an ESOP may affect the value of your company to a third party. The value of an ESOP is generally calculated on a very conservative basis – typically far more conservative than other investments would be calculated. This could affect the price of your business if you plan to sell it to a third party.

2. **How will an ESOP affect your company's finances?** There are both ongoing and start-up costs that could affect your profitability. These costs can be significant for some companies due to the amount of oversight the government requires. You will have to keep tabs on employees' contributions and other plan details, keep your plan current with regulatory changes and ensure that your plan has a significant amount of oversight. Oftentimes companies hire outside companies, such as a bank or trust company to oversee the plan.

3. **Will your business environment affect your plan?** Typically, the environment in which your company does business has a significant effect on your company's likelihood of being able to successfully implement an ESOP. Many companies that seek to use an ESOP as a means of ownership transition seek to pay off the debt associated with creating the ESOP as soon as possible. This may be very difficult to do for companies in the construction trade as income can be cyclical, leading to an unforeseen inability to pay off the debt quickly. Also, because construction companies are in highly competitive environments, making failure more likely than in



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## Is an ESOP Right for You?

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other fields, an ESOP may not be a good choice. The number one purpose of an ESOP is to provide your employees a retirement vehicle. Companies that are in unstable markets or on tenuous footing probably should not adopt these plans.

4. **How can demographics affect your plan's success?** The most successful companies who administer ESOPs have a diverse employee base on which to draw. Diversity in age on all employment levels can have a profound effect on a company's ability to

remain stable and successful. As previously mentioned, ESOPs are a retirement vehicle. Stability in ownership and management are the best ways to ensure that your employees have a comfortable retirement when they have invested in an ESOP. Having highly-skilled employees with diverse ages will help to overcome any gaps in management when key employees leave the company. Furthermore, companies typically want to have more than 30 employees to help maintain the company. Finally, as owners are effectively transferring their ownership to employees, it is vital that the owners of a company divest their knowledge of how the company operates and be sure that

successors know the company's key contacts and have built their own relationships.

5. **Will having an ESOP affect your ability to be bonded?** ESOPs may negatively affect your ability to be bonded. Bonding lines are strongly tied to tangible assets, and the funds that you must divert toward the ESOP will reduce your tangible assets. This could affect your ability to be bonded in certain conditions.

Our professionals can assist you in instituting an ESOP for your company. We are also well-versed in advising contractors of their best options for defined benefit plans and exit strategies. Please call one of our professionals today.