

Chronicle Profile

Going Into Business Construction

GUIDANCE IN STARTING A CONSTRUCTION BUSINESS

A. Growth Ladder for Contract Construction

The nature of the contracting business within the construction industry implies a series of steps by which an individual would logically start and grow in the industry. These are as follows:

1. Craftsman
2. Subcontractor-craftsman
3. Subcontractor
4. Contractor-subcontractor
5. Contractor
6. Developer-contractor
7. Developer

While entrance into the industry can be and is made from without (from other forms of business, architecture, law, finance, etc.), this series of steps represents a continuum for growth wholly within the construction field. As the individual establishing a contracting business progresses from one function to a higher one, he generally will play a dual role, assuming both the function from which he is progressing and that to which he aspires. Thus, the craftsman turned sub-contractor will continue to perform as a craftsman as he builds his business as a subcontractor. Likewise, the smaller contractor will perform more as his own subcontractor than will the larger. Often a higher function on the continuum is assumed to increase the level (or assure an even level) of business or activity at the lower level. For example, the contractor develops a subdivision in order to increase or assure business for his contracting operation. For each function, a volume level is reached where it makes better business sense to assign lower level functions to other firms or individuals.

It is significant that as one progresses through this continuum, the degree of responsibility for project completion and the potential for financial gain (or loss) increases. Also, the need for technical construction skills decreases as the need for business skills increases.

B. Starting a Contracting Business

For the skilled craftsman desirous of becoming a contractor, a logical first step is to establish himself as a small subcontractor in his construction specialty. As such, his technical knowledge would be of value. As his business grows, he should be able to pick up the more sophisticated business skills that would be required. With a thorough knowledge of his technical specialty and a familiarity with the construction "community" in the geographic area of operation, the new contractor would be in a fair position to secure business. Geographic identity is important because working friends and acquaintances will serve as primary sources of contacts and leads from which contracts are secured. This is often a necessity since the new contractor has only his skill and reputation as a craftsman to recommend him for higher levels and types of work.

Establishment as a small subcontractor need not be a "formal" event. Extensive investment in offices and equipment is not necessary to begin in business and might obligate the new businessman to a level of business which may not be obtainable. Because an individual starting a subcontracting business will often continue to work for others as a skilled craftsman while building up his own business, he may be able to begin his own contracting firm more deliberately by working for himself only when real opportunities appear.

General contracting requires more business skill than technical skill (although technical skill is needed to determine if subcontractors are performing as specified by contract, and also to oversee any of the specialty work which the contractor performs for himself rather than by hiring a subcontractor.) Estimating is less critical to the degree that the contractor uses estimates prepared by subcontractors (to which they may be contractually bound). Scheduling, however, is a major responsibility for the contractor. Keeping to a schedule is crucial to completing a job at the predetermined contractual cost, and a delay by any one of the many subcontractors, suppliers, and others whom the contractor is co-ordinating can force a major reorganization of the job schedule with a concomitant loss in time and money. Subcontractors branching out into general contracting should be aware of the additional managerial requirements which such a venture entails. Just as the successful skilled craftsman does not necessarily make a successful subcontractor because of the difference in required skills, the successful subcontractor is not necessarily ready to become a general contractor.

Similarly, expanding one's operation from contracting to developing requires a number of new skills. Principal among these are finance and marketing. A contractor is relatively certain of payment for his work. If his estimate is well-prepared and his bid allows for a safe margin, barring any unforeseen circumstances, the contractor can be somewhat sure of his profit. The developer, on the other hand, is taking a greater risk. He operates on a profit margin that is based on an assumed product price. The developer is vulnerable on two counts: cost overrun and forced sale at a discount. Also, he must invest substantial amounts of capital, either his own or that of investors or of a lending institution.

The contractor will encounter jobs which he feels are attractive but which are clearly beyond his capacity. Beyond the obvious attractions of additional work and profitability, the larger job offers the contractor an opportunity to learn, to broaden his experience, and to prepare himself for even larger jobs in the future. When confronted with an attractive job opportunity beyond his capacity, the contractor

should be wise enough to seek a joint venture with other firms. Firms band together for a specific job because they are unable, as individual units, to handle it. Together they may possess the financial, technical, and managerial resources and experience to compete for the job. By participating in such joint ventures (which usually dissolve at completion of the job), the smaller contractor gains exposure to larger jobs. Building upon this, he may develop the experience and, equally important, the credibility to progress to larger jobs on his own.

2. Equipment Requirements

At a minimum level, little in the way of expensive equipment is required, especially for the general contractor. A truck will be the major expense, although small operators may get by with a station wagon which doubles as a family car. Skilled craftsmen who will be hired for contract execution provide their own tools. Major pieces of equipment need not be purchased, as they may be rented until such time as the volume of business warrants purchase. Specialty contracting, on the other hand, has greater equipment requirements, although the needs vary from field to field. A small carpentry contractor may get by with a few hundred dollars in hand and some power tools, whereas excavating or demolition work requires expensive heavy machinery.

3. Physical Space Requirements

For general contracting at a smaller operating level, little physical space is required. As stated, many smaller general contractors operate out of their own homes. For the specialty trades, physical space is needed to the degree that equipment and supplies must be stored. Many smaller specialty contractors will also operate from a private residence using a garage for storage of supplies and a driveway for vehicle parking.

4. Licensing Requirements

Licensing requirements vary greatly among the States. Massachusetts, for example, has no licensing requirement, and New Jersey requires no license except in the case of certain types of electrical contracting. Delaware and New Mexico, on the other hand, require a license of all contractors for both public

and private work. Many States require a license for only contracts above a certain dollar value (varying from \$100 to \$30,000). Maryland requires a license based on an annual dollar volume of work. The State of Washington requires both a license and a surety bond of contractors. A summation of the licensing requirements by State appears in the appendix.

Although a license may not be required, many States require "prequalification" of contractors bidding on public works above a certain dollar value. This will usually involve completion of a form that requires information about the contractor's financial resources and liabilities, equipment, past record, personnel, and experience. It is generally limited to highway work, but may be required for larger public jobs.

Detailed information about licensing and prequalification requirements, as well as tax information, may be found in Summary of State Regulations and Taxes Affecting General Contractors, published annually by the American Insurance Association, 85 John Street, New York, New York, 10038.

5. Labor Requirements

The availability of construction labor varies from skill to skill and from one geographic area to another. Steamfitters, carpenters, electricians, and plumbers are most in demand, and the potential entrepreneur would do well to review the availability of local skilled labor in those fields prior to selecting a site for his business.

A key decision for a contractor is whether to use union or non-union labor. There are advantages either way. Union labor is available on relatively short notice, and by virtue of union membership, a certain level of proficiency is assured. Furthermore, training is not the responsibility of the contractor, but the union. The contractor need not carry a full-time crew for fear of losing good men as he might with nonunion labor. However, for these advantages, the contractor pays the price of higher wages (nonunion wages are about 85 percent of union wages) and the possibility of union disputes. For example, with a crew of a certain size, the union business agent may insist on a foreman that the contractor considers unnecessary. These kinds of problems do not arise

with nonunion labor.

Many contractors come from the skilled trade unions and because of their loyalty and personal experience will use exclusively union labor. In some areas of the country, particularly the Northeast, the West Coast, and major metropolitan areas, the unions are strong, and union labor is used for virtually all construction. In such areas, the contractor has no choice but to use union labor.

A similar aid to growth for the homebuilder is an arrangement with a prefabricator. Prefabricated homes simplify the other complex homebuilding process, and suppliers of prefabricated homes, having a stake in their builders, offer valuable advice and assistance in marketing, management, and financial matters.

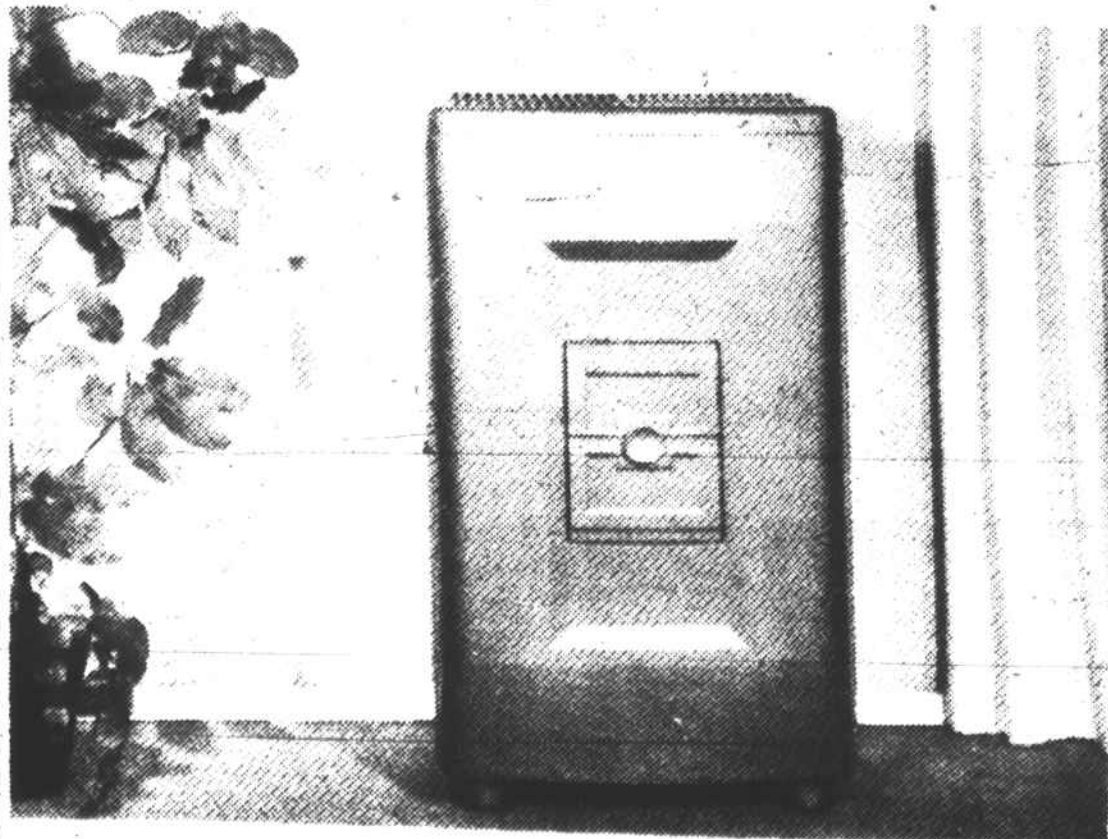
C. Requirements for Establishment of a Contracting Business

1. Capital Requirements

Compared with other types of business, capital requirements for construction contracting are not great. Many a small contractor will operate out of his own home, possibly with a separate room as an office and with a separate telephone (though even this is not a necessity). The degree of capitalization required to begin in business is primarily based on the size of anticipated contracts. Approximately one-tenth to one-third of the value of a contract is sufficient to carry the contractor until payment begins and a cash flow can be established. For financing, however, some evidence of a personal stake by the contractor is necessary. An official of the National Institute of Home Builders suggested that \$20,000 would be sufficient to establish oneself in business. The skilled craftsman with a good reputation in the field, however, may be able to start as a part-time subcontractor with even less capital, slowly building a capital reserve with his reputation as a competent subcontractor.

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