**The Business of Petroleum Contracting**
**Determining your bottom line and planning for your future**
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This article illustrates the general opinions based on observing petroleum contractors from a supplier's point of view. We've watched construction companies grow, downsize, sell, purchase or maintain their operations over the years. We share the observations through offering a business modeling tool for service technicians and recommendations regarding Business Planning.

On the service side of your petroleum contracting business, labour costs are one of the major operating expenses. To maximize operating performance and overall profitability, every business owner or manager must be able to measure the true cost of labour and how it relates proportionately to the labour rates billed to clients. The margin after deducting the full labour burden, must be sufficient to cover the balance of expenses such as equipment & tooling, indirect labour, administrative expenses and last but most importantly profit.

**Labour**

Labor costs generally refer to wages paid for mental or physical effort exerted to accomplish a task however, in business accounting, labour cost includes the cost of wages, medical insurance, life insurance, workers' compensation insurance, pension contributions and taxes on those wages, as well as other benefits shouldered by the company. These costs are classified as direct or indirect labor. Direct labor costs are those paid to employees directly involved in the production of goods or performance of services while wages of workers not directly engaged in the production of goods or rendering services to customers, such as an office assistant, are considered indirect labor. A description of labour burdens set as a percentage for service technicians, is outlined below:

| **Description:** | |
|---|---|
| EI/ QPIP | 4.49% |
| EHT | 1.95% |
| CPP/ QPP | 4.95% |
| Workers Compensation | 4.20% |
| Life Insurance | .28% |
| Accidental Death | .08% |
| LTD | 1.28% |
| EHC | 1.28% |
| Dental | 1.52% |
| Pension Plan | 1.84% |
| Training | 2.36% |
| Stat Holidays | 1.76% |
| Vacation | 7.76% |




C.P.C.A.

| | |
|---|---|
| Sick Days | 1.00% |
| Licenses | .20% |
| Communication | 3.88% |
| Uniforms/Safety | 3.70% |
| **Total** | **42.46%** |

If the base labour rate is $ 25.00 per hour with the above burdens factored in, the actual cost would be $ 35.50. We encourage you to develop a schedule of labour burdens specific to your operation.

As a contractor, you constantly receive pressure from employees for raises and from customers to lower labour rates. It is recommended that the above information is shared with your employees and customers. With employees, it is quite common to include with their pay notification a total rewards statement. The statement includes a schedule of the base wage and lists all the additional labour costs paid by the employee and employer. This can hopefully provide insight and appreciation to the employee as to the actual costs of running a business.

With respect to clients, the full labour burdens as a percentage can be shared through a marketing sheet. The marketing sheet should demonstrate your company as a differentiator to those unapproved or casual contractors that move in and out of the industry. The sheet that lists the associated costs of maintaining skilled, educated and safety conscious employees can assist in justifying your labour rate. And more specifically with field technicians, the contractor can also list vehicle and equipment costs related to providing a service technician to a site.

**Full labour burden vs. labour rates;**

On the CPCA website, a business model template is available for download. The model is specific to the service technician side of the business (time and material) as opposed to construction station builds. The template allows you to input various operational data to determine how labour billing rates and hourly wages impacts the bottom line. The template is set up in an excel workbook with 3 working tabs to enter information. The first tab is the income statement summary and revenue assumptions. The revenue assumptions take into account average billable hours and actual paid hours of direct labour. The remuneration tab calculates the direct and indirect labour costs. The last tab includes the equipment costs and G&A expenses. Both the remuneration and the operating tabs pull the inputs into the revenue tab which summarizes your financials by actual dollar and cost ratios to revenue. It is recommended that you start with actual data and assumptions to calibrate it to your profit margin. Then you can manipulate rates and hourly wages to determine bottom line impact. It can also be used as a planning model to determine the bottom line affect of adding direct or indirect labour. Also, the workbook does not contain any input limitation so it can be the base to customize to your company. Below is a sample of the contractor with 3 service technicians.

Note, the model is specific to the profit margin of direct and indirect labour costs with associated equipment costs and G&A expenses. The model does not factor revenue and profit associated to parts and material, billed into the service calls.

Revenue/Summary:

**Petroleum Mechanic Rate Determination Model**

***Revenue/Summary:***

**Summary of Variables**

| | | |
|---|---|---|
| Number of billable employees: | 3 | |
| Wage of billable employee | $25.00 | |
| Number of office admin. | 1 | |
| Wage of office staff | $18.00 | |
| Management salaries | $ - | |
| No. of vehicles | 3 | |
| PM hourly rate | $75.00 | |
| Total revenue: | | $324,000.00 |
| Remuneration costs: | 70% | $225,603.00 |
| Operating costs: | 27% | $ 86,918.00 |
| Total costs: | | $312,521.00 |
| Profit (before tax) | 4% | $ 11,479.00 |

***Productivity Assumptions:***

| | |
|---|---|
| Labour cost hours per day | 7 |
| Daily billable hours | 6 |
| Billable days per week | 5 |
| Billable weeks | 48 |
| Annual billable hours | 1,440 |

Input Information

Automatic Calculations

Remuneration tab:

**Petroleum Mechanic Rate Determination Model**
***Remuneration***

**Labour Costs**

**Billable Employees**

| | | |
|---|---|---|
| Base wage | $25.00 | |
| Statutory deductions | 11.39% | |
| WC | 4.20% | |
| Employee benefits | 5.00% | |
| Vacation,holidays,sick days | 10.50% | |
| Safety Equipment | 3.70% | |
| Training | 2.56% | |
| Communication | 3.88% | |
| Cost per employee | $35.31 | |
| Number of billable employees | 3 | |
| Total Cost of billable employees | | $177,950 |

**Office Administrators**

| | | |
|---|---|---|
| Base wage | $18.00 | |
| Statutory deductions | 11.39% | |
| Employee benefits | 6.28% | |
| WC | 4.20% | |
| Vacation,holidays,sick days | 10.50% | |
| Cost per hour | $23.83 | |
| Number of employees | 1 | |
| Total Cost | | $47,653 |

| | |
|---|---|
| **Total Remuneration Costs** | **$225,603** |

**Input**

| | |
|---|---|
| Vacation Pay (incl. holidays/sick days) | 10.50% |
| Statutory deductions | 11.39% |
| WC | 4.20% |
| Employee benefits | 6.28% |
| Safety Equipment | 3.70% |
| Training | 2.56% |
| Communication | 3.88% |

**Automatic Calculations**

Operating costs:

| Petroleum Mechanic Rate Determination Model | | | |
|---|---|---|---|
| ***Operating Costs*** | | | |
| **General Expenses** | | | |
| **Vehicle costs** | | | |
| Number of vehicles | 3 | | |
| Lease/Loan | $ 600 | monthly | |
| Maintenance | $ 100 | monthly | |
| Repair | $1,500 | annual | |
| Fuel | $ 480 | monthly | |
| Insurance | $1,000 | annual | |
| **Annual cost per vehicle** | | | **$16,600** |
| **Total cost per vehicle** | | | **$49,980** |
| **Equipment Costs** | | | |
| Small tools | $3,500 | annual | |
| Equipment mtce/supplies | $1,500 | annual | |
| Equipment rentals | $2,000 | annual | |
| Other | | annual | |
| **Total Equipment Costs** | | | **$ 7,000** |
| **Occupancy Costs** | | | |
| Rent/Mortgage | $ 300 | monthly | |
| Taxes | $ 250 | monthly | |
| Maintenance | $ 100 | monthly | |
| Utilities | $ 200 | monthly | |
| **Total Occupancy Costs** | | | **$10,200** |
| **General & Administrative Expenses** | | | |
| Insurance | $3,888 | annual | |
| Bad Debt Expense | $ 300 | annual | |
| Bank Charges | $ 500 | annual | |
| Advertising | $ 300 | annual | |
| Travel | $1,500 | annual | |
| Licenses | $ 600 | annual | |
| Business Tax | $ 750 | annual | |
| Postage | $ 500 | annual | |
| Telephone | $2,400 | annual | |
| Office Supplies | $2,000 | annual | |
| Interest Expense | $2,500 | annual | |
| Professional Fees | $1,500 | annual | |
| IT | $3,000 | annual | |
| Other | | | |
| **Total Gen & Admin Expenses** | | | **$19,738** |
| **Total Operating Costs** | | | **$86,918** |

**Input Information**

**Automatic Calculations**

**The need to plan:**

If you have been a member of the Petroleum Contractors Association from the beginning, congratulations you've been in business for over 20 years. Although the industry has seen significant change and yet in some aspects remains the same, the thought on many contractors' minds is the transition to retirement.

Have you set a date? More important to the date, do you have a retirement plan? Hopefully you've followed your investment advisor's advice throughout your tenure and paid yourself first. Hopefully, you have an asset base that will fund your retirement and the sale or closure of your business is not your key financial support. But, like many, if you've continued to put everything you have into the business, a sale regardless of assets or shares will affect your retirement lifestyle.

As principals of a small to medium sized construction company, retirement is a very complicated task. Do you close the business down by selling the tangible and intangible assets or do you find a successor(s) to purchase your shares to continue on?

Whichever your method, the value of the business is as unique as the individuals and circumstances that are involved. What is a fair market value, would it not be the amount that 2 parties would pay if they were not forced to buy or sell? The reality is usually one of the 2 parties is leading the process which reverts back to the old law of supply and demand resulting in either a lower or high selling price.

So how does one prepare for selling your business? How do you formulate a retirement plan? Often it is a bit of a shocker when you make the decision and you ask an advisor to put a value on business.

In preparing your business for sale, metaphorically you have to look at your business as a unit or entity that provides utility…usefulness. On your income statement, revenue is an indicator of productivity or in other words, utility. In smaller companies, the principal's productivity/work ethic/ business acumen/ motivation/capacity or whatever you choose to call it, determines utility. The principal is the company. What happens to the company's utility when you leave? How can you transfer the usefulness through a sale? This is fundamental notion that will determine the businesses value, if the new owner is comfortable that the utility transferred will support the sale price of the business and a decent operational return, then you'll probably sell the business.

On the other hand, if the selling principal represents the only utility in the company most likely a sale will not occur, unless you can identify a potential candidate, family member or key employee to take over the business that will assume your utility over time. Otherwise you'll probably be getting into an arrangement to transfer your client calls to a competing contractor and selling your asset base. This route is particularly tough because you want to take care of your client's so you refer them to competition and your contractor equipment generally does not hold its value on resale.

For those that have family in the business, your succession plan is probably already determined years before you've considered retiring. While some days it might be difficult working with parents or siblings, you are the fortunate ones. Again, metaphorically speaking, the transference of your utility is a natural process that starts the day your successor comes to work. In the valuation process, usually concessions are made on both sides to ensure the business continues on maintaining and growing utility as the company changes hands.

Many other variables or circumstances on both the vendor's and purchaser's side will drive a sale. Examples such as health issues, larger corporations entering a new marketplace, or the need to acquire complementing services or expertise will directly affect the market value of the business.

Business planning:

If you're the principal contractor and your retirement is not in your immediate future or if it's a few years away, the importance of annual business planning is the key to your eventual retirement. Your business planning will involve getting your business saleable or in other words setting up to transfer your utility. Simple statement, but easier said than done.

They say that everyone always achieves the goals in life they set out to do. The problem is that only 10% of the population set goals. Business planning and goal setting is difficult for a small business because you are focused 24/7 on customer service, employees, regulators and subcontractors and you are constantly making critical decisions that effect your day to day operations. Business planning involves critical decisions for the long term and are generally less urgent therefore taking a back seat to those critical daily decisions. Literally, years can go by without stepping back and going through the exercise of reviewing your corporate direction. It's usually when something sudden and unexpected happens that forces stop and set a direction. Time is the commodity in business planning especially around the topic of retirement. If you make formal business planning a behavior early, then less urgency and more options will be available in the latter years.

A few simple guidelines to business planning:

It's important that you make it a formal annual event away from you work environment. It's not a long drawn out process, as you've most likely been doing it on the fly for years. Arrange to be away a few days offsite with your shareholders, directors or spouse.

Some of the information you want to include in your planning meetings are current financial statements, client lists, accounts receivable reports and notes on internal and external issues.

Business planning can be a simple process which involves taking a step outside of the operation and taking an honest look in as well as surveying the external environment. The review of your company strengths and weaknesses, plus current trends in the industry and local economies that might positively or negatively affect you business, is the basics to reviewing your operation.

From you analysis, develop goals then actionable items to get to that point. Assign the items then monitor the results. Again easier said then done, so often at year end, companies fail to review results; this actual should be the first part of you planning process.

Examples of action items that come out of planning are:

- Identify a successor, family member or key employee to communicate your retirement plan and start the process.
- Review buildings, lands and equipment to maintain or enhance value
- Engage a professional to value the business.
- Review expenses towards regulating spending.
- Evaluate or grade your clients based on revenue generation, technical/professional competencies and payment habits.
- Employ an appropriate billing rate for the above.
- Review equipment purchases for alignment with overall goals.
- Investigate training issues/costs for product or service expansion.
- Make a list of new clients to be contacted.
- Review technology that will improve productivity, i.e. GPS software in fleets
- Develop relationship management plan around suppliers and regulators.

A note for larger contractors with middle/ department managers or regional operations, annual business planning and budgeting are standard procedure. Obviously one would consider annual budgeting and planning as 2 different exercises, but often these processes get blended together, due to the fact that revenue projection and expense allocation are key elements to budgeting which turn into “the business plan for the year”. The problem with budgeting/planning as one exercise, the negotiation of budget numbers are usually based on historical performance drives the business plan. To capture a meaningful budget, the business plan has to drive the budget which should be completed before the budget process. With larger corporations, the business plan should include the input from the front line staff that can point out the opportunities and areas of improvement that are evident on a daily basis. The front line input also generates motivation as the solutions are driven from the bottom up. The managers/owners business acumen can determine a meaningful path and goals from the input. For larger contractors, whichever format of budgeting and business planning you follow, just make sure it's meaningful as opposed to just going through the motions of completing the annual task.

Whether you are a large or small contractor, goal setting through established business planning is a key to success. And, if retirement is in the picture, you're realizing the value of time as a commodity and the importance of planning, setting goals and meaningful execution played throughout your career and into the transition to retirement.