

Setting up a contracting business

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BUSINESS GUIDE

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Contracting can be an excellent form of diversification that tacks on well to a farming business, be it arable operations, niche crop contracting, snow clearing, gritting, hedge cutting. Because it's a relatively straightforward business to start, it can sometimes be too easy to fall into the trap of being too general or not doing your costings properly and not charging enough.

Identifying opportunities in contracting

The first step in identifying an opportunity is to know your region. Regions will have criteria that dictate what farming enterprises are suitable and therefore, what contracting opportunities may be present. The second step is to look at the issues that are affecting businesses or farms in your area, and find a solution to their problems that they cannot solve.

Ideally, find a niche. Niche markets are good. You might not be driving around in a 230 hp tractor that can be heard in the next county but how smug could you be in the pub when the penny drops that the kit you are using is earning twice or three times the margin of the big stuff at a third of the capital cost.

Opportunity comes in many forms. Watch for an emerging market – a large company offering contracts to farmers for example, or a new raft of grant aided projects.

Get yourself informed. Be aware of all on-farm grants, schemes and regulations. Not only could they present an opportunity, but conversely, they could also be a threat to a service you currently offer.

Decreasing 'on farm' margins is not always bad news for the contractor. Some farm enterprises may historically have earned good money leaving farmers with a tax problem, often solved by the farmer buying new machinery and thereby not needing a contractor. So, when times in farming are tight then farmers will consider alternative arrangements, and of course this presents an opportunity.

Be innovative, adaptive and flexible. Most successful contractors are able to think outside the box and never see a problem, only a solution. If you are not of this disposition you may be in the wrong profession. You will certainly struggle to be successful when the margins tighten.

Look at it from the grower's point of view. Always ask the question 'Would I be prepared to pay for the service on offer' or 'Would I like a job done in that way or is it best doing it differently.' Also, what might seem like a good idea to you may not have relevance to growers so put yourself in their shoes. Do this continually, even with your long-term customers. Never cease to question what you are providing and how.



"The first step to identifying contracting opportunities is to know your region."



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Over the past 30 years contractors have had their best earning periods when a revolution in machine design hit the marketplace. One example is when self-propelled forage harvesters first appeared. It created a situation where the contractor could charge less per acre than trailed harvesters, but could cover a great deal more area, plus silage quality improved because clamps were filled covered and sealed much more quickly. It is a deal that worked for all, and everyone was a winner. Look for these revolutions as they will always come along.

So many times, people go contracting with no clear objective and end up doing the same as everyone else. The end result is an oversupply to the market which drives the price down. We've often seen potato farms hiring in tractor plus trailer plus driver combos for less money than they can run the kit themselves – there's only one winner in that scenario, and it's not the contractor.

Budgeting to start a business

Never talk yourself into a job just because it's there. Do your figures and work out your margin. The difficulty can be quantifying how much work you will do, therefore how much revenue that job will generate.

Start by knowing your cost per hour to run just the power unit (tractor in most cases) and then work out what your breakeven point is with the attachment and ask, 'Is this amount of work definitely out there?'

Contracting revenues will fluctuate annually but there is always a level you need to get to, to make ends meet. Plenty of work does not mean plenty of money. Make sure you know and have your margin. Whatever you do, especially starting out as a one-man band please cost in your own time. Far too many times we see costs with no allowance for owner's time. You wouldn't work for someone else for free so why would you for yourself?

The objective of doing your figures is to work out what it costs to run the machine and implement on a per unit basis – normally per hour, sometimes this can be per acre. If you are on an acre rate don't forget to account for the time it takes you to get to and from the job.

Examples of unit costs to include in your budgets:

- Labour
- Fuel and oils
- Depreciation
- Tyres
- Repairs
- Insurance
- Material costs of attached implement
- Wearing parts of attached implement

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Working out a unit cost, include:

- Labour – if PAYE don't forget tax, national insurance and holiday pay
- Fuel and oils
- Depreciation (check second-hand market at 5 years old compared to new (less discount) and divide the difference by the hours)
- Tyres
- Repairs
- Insurance
- Material costs of attached implement e.g. baler twine
- Wearing parts of attached implement e.g. plough shares

These are generally the costs when the machine is working i.e. the variable costs. You have to remember you also have overhead costs which are the costs of running your business regardless of how many machines/how many hours they are working etc.

Typical overhead costs include:

- Yard/building rent
- Rates
- Utilities e.g. heat, water, electric
- Professional fees and bookkeeping
- Running support vehicles
- Phones

Work out your costs, put your margin on and then compare to industry standards through the [NAAC](#).

Operating profit should be between 20% and 40% from turnover.

Net profit (once you've taken overheads off) should aim to be around 20% or above. If, once you have done your budgets and it is realistically significantly less than 20% you should think carefully about starting this business.

Remember your profit is not cash you take away, you will need a large proportion of it to reinvest into the business.



Don't forget to calculate extra capital costs, other than the machine itself:

- Workshop equipment
- Fuel tank/bowser
- Pressure washers/wash bays
- Support vehicles/personal vehicle

Spending money in a start-up business

Spend wisely. In the early stages, spend money on the things that earn money. A flash truck might look good, but it won't earn any money sat in the corner of a field while you're running the kit.

Manage your overheads. As before, things like an office are important, but in the early stages a chair, desk and laptop is all you need. The same applies to a workshop. It's surprising what you can achieve with an inverter welder, basic tools and a hammer.

Finance

A contracting business typically uses three different types of finance:

- 1) Hire purchase/lease hire
- 2) Loan
- 3) Overdraft

If you use a loan to purchase your machinery, be sure your project can pay back the full interest and capital. It's not an overdraft.

Loans should be taken over as short a period as you can manage - the average would be three years. In every case make sure that the machine is only two thirds worn out by the time the finance is paid. If this isn't the case the project is most likely not viable so walk away.

An overdraft should only be used for costs occurred by the running of the business. Do not be tempted to buy capital items with it as the interest will be painfully high. A great deal of farm businesses will run most of the year on their overdraft - contracting businesses are generally the same but always try to bring it into a plus position at some stage in the year as the banks will look for that.

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"Never talk yourself into a job just because it's there. Do your figures and work out your margin to see if it's feasible."

In short:

Use a bank loan for long-term investments like a workshop or a machinery shed, finance for equipment or machinery that generates immediate revenue, and an overdraft for the running costs, fuels oils labour etc.

Finally, three things I've learnt:

1) Don't chase work through price

Good customers will pay a fair price for a very good/exceptional service. If you know your margin and you are not ripping off your customers and someone is doing the job for less, don't be afraid to hold your position. Undercutting breeds a customer base of ruthless cost driven customers with little appreciation for quality in the form of service and efficiency.

For example, a competitor who is a few pence cheaper than you, bales the same size bale as you but they're consistently a third lighter than yours and his baler keeps breaking down but you have a spare baler in the shed for when the weather is really poor and the working window is halved. Don't chase those customers, they will frit faster than the wind blows and it's very difficult to base a business on that. Concentrate on those who are prepared to pay fairly for good service and quality and your customer base will not only prosper from the quality you provide but most likely be loyal and build, allowing you to operate a successful business with consistency in strength and depth.

2) Service is King

Service is multifaceted. Good contractors over equip the business in order to not only provide a service when the weather is poor, and the working window is short but also when extra work is offered allowing the revenue stream to fill.

Always do what the customer wants. By all means offer a suggestion if you think the customer might be going down the wrong path but never push your own agenda. If you do what the customer wants you will never be wrong.

3) Your business is only as good as your staff

Train your staff to be respectful and polite. Farmers and growers are largely a traditional respectful bunch and good manners go a long way. After all, business is about relationships. It's always great to hear a customer remark 'he's a nice lad that chap you sent.'

Pay fairly for good staff. You're going to ask a lot from them at times, so they need a rate aligned with their age, ability and contribution to your business.



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