

A financial analysis of g.wilson

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Construction is a cyclical business. During economic booms, both individuals and corporations tend to build too much and too quickly. Profit-seeking entities, anxious not to miss out on the economic potential of the boom, push up the demand for both construction materials and labor, which then increases the prices of those variables.

In time, and with more and more infrastructure erected, an excess supply develops. When the economy suddenly turns downward, this excess supply, finding no demand, then pushes prices of related industry products downward.

G. Wilson and Its Erratic Earnings

G. Wilson is an example of a company that finds it hard to produce consistent earnings. In one sense it is inevitable for a company that is completely devoted to the production of construction materials to have cyclical earnings. While it has a solid balance sheet, G. Wilson is simply too vulnerable to the boom and bust cycles of the construction industry to realize stable and lasting profits.

However, a certain level of innovation can help insulate the company from these systemic shocks, with one example being Mr. Monroe's proposal of direct costing. By changing how the company estimated its costs for the production and sale of rebar, Mr. Monroe was in effect bringing a modicum of both clarity and stability into the earnings picture.

With the direct costing method, the price arrived at for the rebar was more precise, in contrast to the old method which used industry-approved, but inaccurately determined fixed costs, including items such as overhead. In

this specific instance it was determined that out-of-pocket expenses for a ton of rebar averaged at \$406, but fixed costs remained more or less constant, so that profits earned or losses realized depended on the amount of tonnage actually sold and shipped.

The proposal to “ add tonnage in the proposed job to the backlog for the month in which it is to be produced” was meant to produce a method by which a more précis costing could be arrived at, especially in relation to the fixed costs involved.

When it came to selling the rebar to the contractors, the more precise costing would allow the company to see immediately which deals were going to produce a profit and which were not, thereby avoiding bad deals in the first place. Without this more precise costing, the company might enter into deals that would make little economic sense, and be saddled with costs that it will in essence pay for in future production.