



Overhead:
Knowing your costs so that you actually make money

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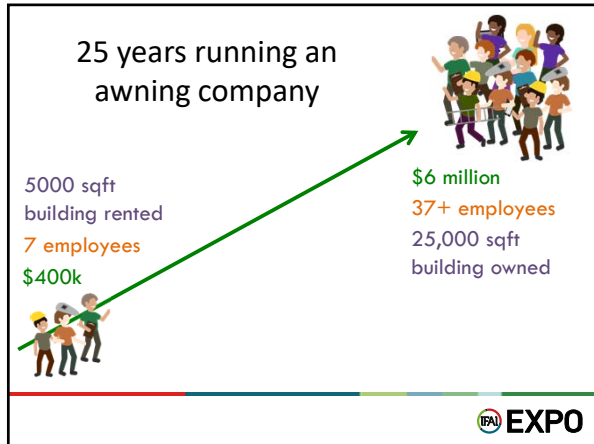
Why does overhead matter?

- Overhead is a **real cost**
- Unless you properly account for overhead, **job bids are a guess**
- Need assurance of meeting profit goals

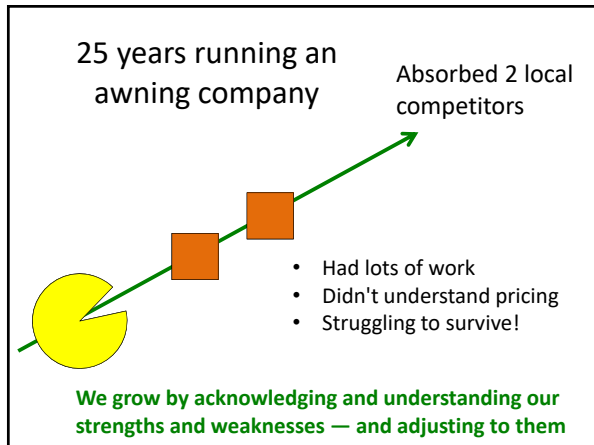


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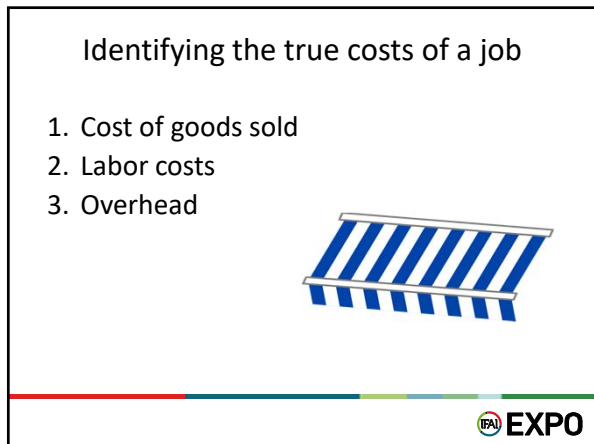
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Cost of goods sold




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Labor costs

Direct labor

- Employee productivity: 75%
- Self-motivated



Indirect labor



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Overhead


???

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What is overhead?

- Ongoing business expenses
- Indirect costs
- Necessary to keep business running
- Incurred no mater what (even if business is slow)




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What is overhead?

Rent	Office supplies
Utilities	Advertising
Insurance	Administrative salaries



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How do you calculate overhead?

Common methods

1. Percentage of project cost
2. Cost multiplier
3. Billable hours method

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Overhead & profit as percentage of project cost

Biggest problem: Misunderstanding mark-up

Example: 25% Profit goal

Cost	\$100
Sales price	\$125
Profit	\$25
Profit as %	$\$25 \text{ profit} / \125 sales price = 20% return on revenue (not 25%)



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Overhead & profit as percentage of project cost

Example: Overhead is 15% of revenue, profit goal is 20%

Cost (labor & materials)	\$50,000
15% Overhead	\$7,500
Subtotal	\$57,500
20% Profit	\$11,500
Sales price	\$69,000



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Overhead & profit as percentage of project cost

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Cost (labor & materials)	\$50,000
15% Overhead	\$7,500
Subtotal	\$57,500
20% Profit	\$11,500
Sales price	\$69,000
Profit as %	$\$11,500 / \$69,000$ = 16.7% return on revenue (not 20%)




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Overhead & profit as percentage of project cost

Example: Overhead is 15% of revenue, profit goal is 20%

Cost (labor & materials)	\$50,000	Overhead:
15% Overhead	\$7,500	\$7,500 allowed /
Subtotal	\$57,500	\$69,000 sales price
		= 10.9% (not 15%)
20% Profit	\$11,500	
Sales price	\$69,000	
Profit as %	\$11,500 / \$69,000	
	= 16.7% return on revenue (not 20%)	




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Overhead as a cost multiplier

Example: Overhead 15% of revenue + profit goal 20% = combined 35% of revenue

Cost (labor & materials)	\$50,000
Sales price	$\$50,000 / 0.65 = \$76,923$
Cost multiplier	$\$76,923 / \$50,000 = 1.54$



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Overhead as a cost multiplier

Example: Overhead 15% of revenue + profit goal 20% = combined 35% of revenue

Cost (labor & materials)	\$50,000
Sales price	$\$50,000 / 0.65 = \$76,923$
Cost multiplier	$\$76,923 / \$50,000 = 1.54$

Breakdown


65% cost	\$50,000
15% overhead	\$11,538
20% profit	\$15,385




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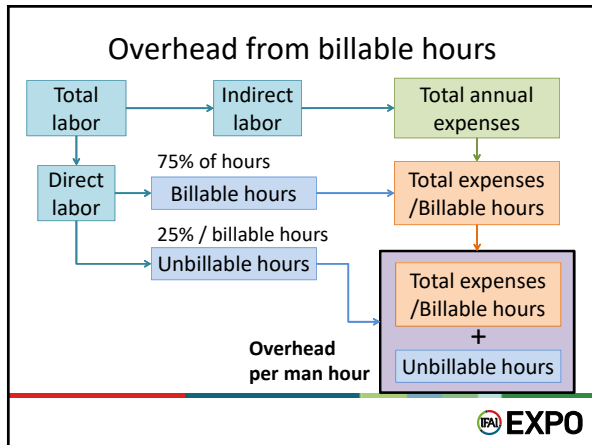
Overhead from billable hours

Best method:
Matches overhead to the amount of burden placed on shop resources






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Pricing example: Billable hours



	Job A	Job B
Materials	\$30,000	\$40,000
Direct Labor	1000 hours	500 hours
(\$20/hour)	\$20,000	\$10,000
Subtotal	\$50,000	\$50,000
Overhead	1000 hours	500 hours
(\$40/hour)	\$40,000	\$20,000
Total cost	\$90,000	\$70,000
Sales price	$\$90,000 / 0.80$	$\$70,000 / 0.80$
for 20% profit	= \$112,500	= \$87,000



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Other impacts on pricing

- Paying overtime can be **good**
- Adjust overhead rate for new expenditures
- Real value and cost of the owner's time



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Building a successful company

Staying out of trouble



- Do what you do best and forget the rest

Your competitors

- Don't try to price match
- Build alliances

Your profit goals



- Project recaps
- Time loss and job tickets
- Build a database for information tracking



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Takeaways

- Calculate overhead accurately
- Price jobs with confidence
- Achieve your profit goals



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