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

25 years running an awning company

5000 sqft
building rented

7 employees

$400k

$6 million

37+ employees

25,000 sqft
building owned

25 years running an awning company

Absorbed 2 local competitors
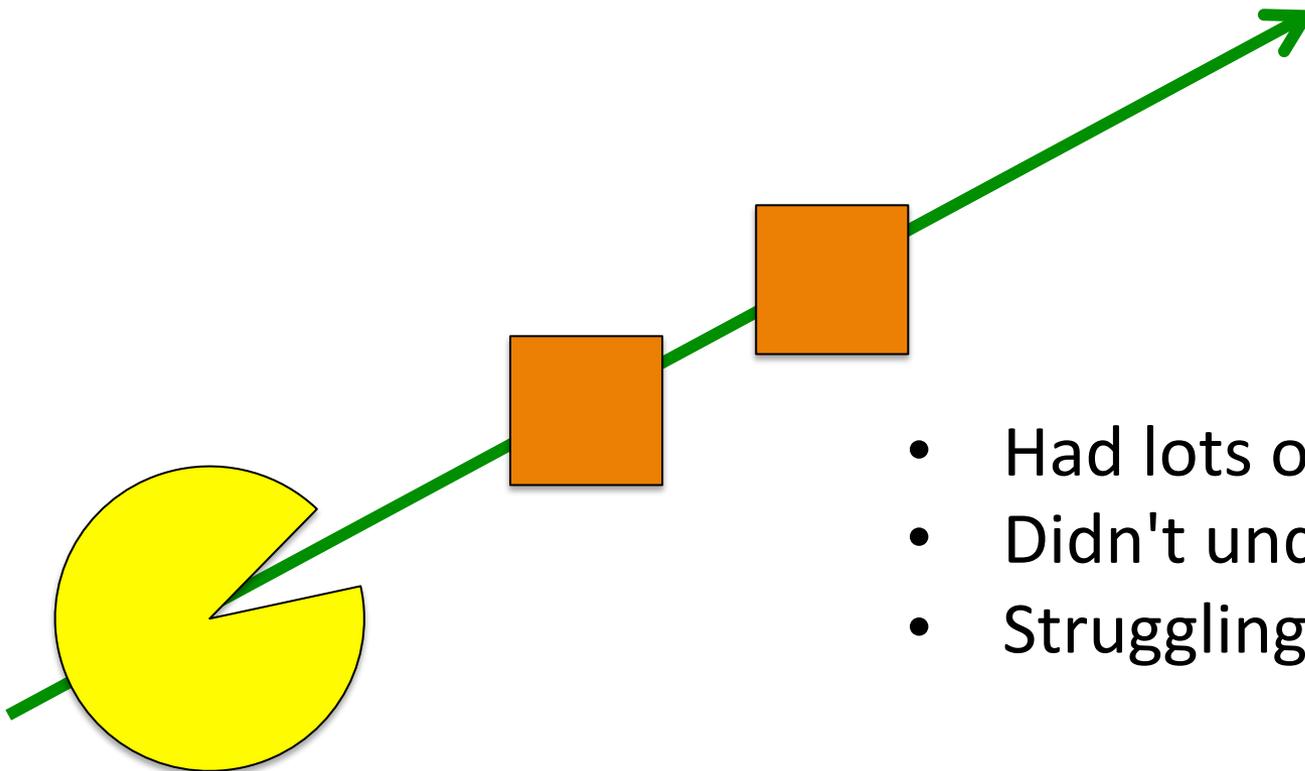
- Had lots of work
- Didn't understand pricing
- Struggling to survive!

We grow by acknowledging and understanding our strengths and weaknesses — and adjusting to them

Identifying the true costs of a job

1. Cost of goods sold
2. Labor costs
3. Overhead
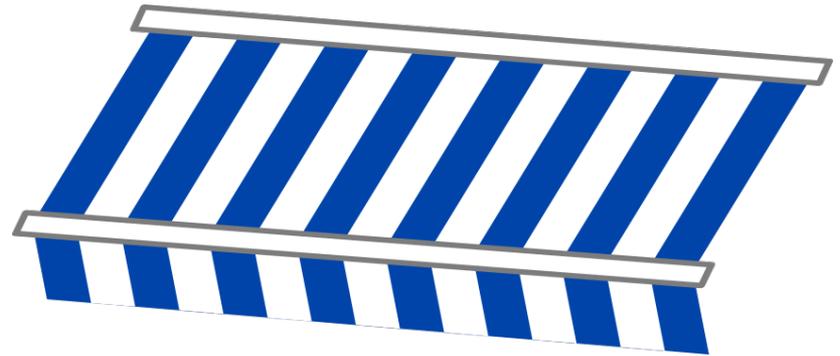
Cost of goods sold
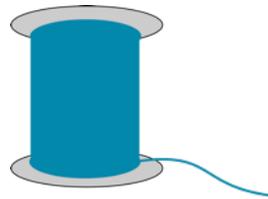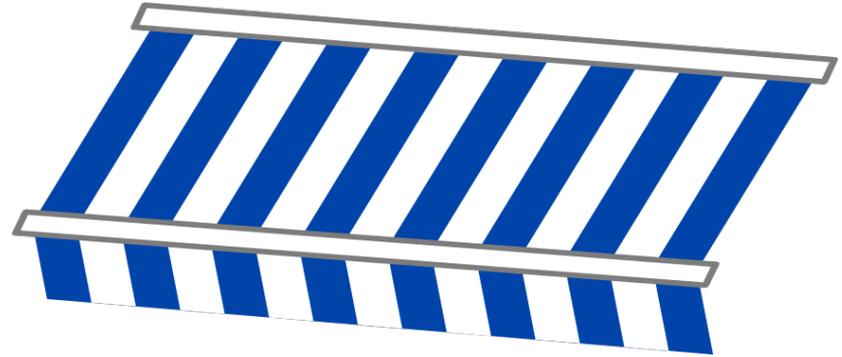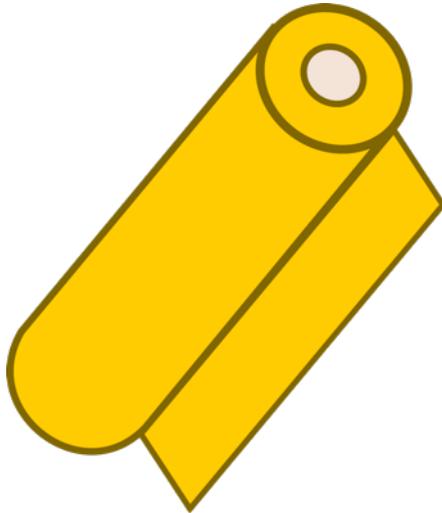
Labor costs

Direct labor

- Employee productivity: 75%
- Self-motivated

Indirect labor

Overhead

???

What is overhead?

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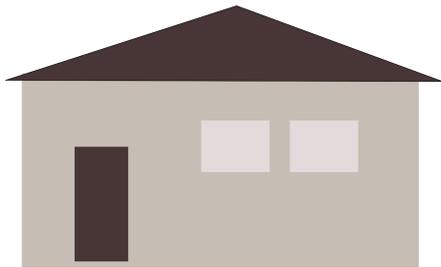
What is overhead?

Rent   Office supplies

Utilities   Advertising

Insurance   Administrative salaries
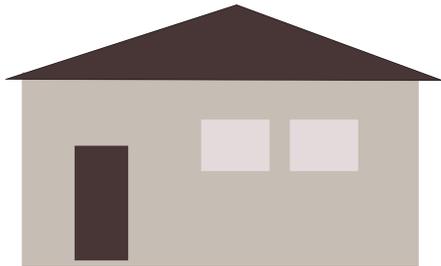
How do you calculate overhead?

Common methods

1. Percentage of project cost

2. Cost multiplier

3. Billable hours method

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 profit / $125 sales price
= 20% return on revenue (not 25%)

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

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
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

Overhead from billable hours

Total labor in dollars → Indirect labor in dollars → Total other expenses in dollars

Total labor in dollars → Direct labor in dollars → Total hours worked

75% of hours → Billable hours → Total expenses / Billable hours

25% / billable hours → Unbillable hours → Unbillable dollars / Billable hours

Total fixed costs

Total expenses / Billable hours
+
Unbillable dollars / Billable hours

Overhead per man hour

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 for 20% profit	$90,000 / 0.80 = $112,500	$70,000 / 0.80 = $87,000

Other impacts on pricing

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

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

Takeaways

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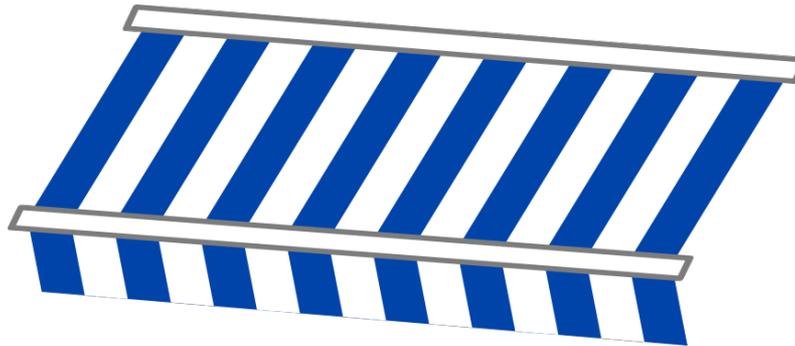
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