

Recovering Administrative Costs

by Dennis Dixon

I became a contractor because I liked working with my hands, being outdoors, and making something that demonstrated accomplishment.

Initially, I was too busy building custom homes to worry about expenses, budgets, and quarterly reports. Besides, my office manager took care of those things. The company always paid its bills on time, so things had to be fine. Yet I had one continually nagging problem at the end of every job: There never seemed to be as much cash left over in the checking account as I felt there should be. Where was my profit?

I noticed that anytime I needed clarification on a design issue from a project architect, either my company or the owner soon received an invoice for the architect's services at \$60, \$80, or even \$100 per hour. Although I'd been fully involved in resolving the issue, the owner and the architect invariably assumed that my time was somehow already paid for in the contract. Whether I spent two hours or five hours solving a problem that I didn't generate, I wasn't compensated for that time. The architectural firms understood that their employees incur overhead costs and therefore must generate income, whether their

time is spent resolving design problems in the field, selecting windows, or drafting blueprints. What made my operation any different? Nothing. I needed to change my approach, cover all my costs, and realize a profit.

Costs in Review

One of the first things I looked at was my estimating checklist. In order to allocate a fair and accurate portion of my operating costs to each project on the schedule, I added a line item for administrative time. To condense the various costs into a single item at an hourly rate, I worked up the annual expense totals for my office operation and field supervision (see Figure 1).

Calculate annual costs. Calculating overhead costs is relatively easy; use last year's expenses as a starting point or guesstimate your operating expenses for the coming year. Once you've tabulated the expenses, summarize all line items to generate a total yearly overhead expense. The total can then be used to determine your overhead costs per month, week, day, and hour.

I used that information to allocate overhead expenses to my jobs. If my

Annual Office Operating Expenses

Office Equipment	\$600
Office Insurance	\$1,500
Liability Insurance	\$5,000
Salaries & Office Labor	\$28,000
Office Labor Benefits	\$2,500
Office Lease	\$13,800
Office Miscellaneous	\$700
Office Supplies	\$1,500
Office Telephones	\$3,600
Office Utilities	\$950
Office Vehicles	\$12,600
Worker's Comp	\$4,800
Total Annual Cost	\$75,550

Figure 1. To figure your operating expenses, list the annual totals for all of your office and administrative expenses. The sum total can then be divided by the number of months, weeks, workdays, or working hours in the year to provide useful factors for job estimating.

Overhead Allocation by Job

Project Name	Project Estimate	÷	Annual Sales Volume	x	Annual Overhead	=	Job Overhead
Andrews	\$335,000.00		\$1,000,000.00		\$75,550.00		\$25,309.25
Brown	\$492,338.00		\$1,000,000.00		\$75,550.00		\$37,196.13
Clark	\$172,662.00		\$1,000,000.00		\$75,550.00		\$13,044.61
Totals	\$1,000,000.00						\$75,549.99

Figure 2. Every project should carry its share of your overhead burden. Divide the job cost by your annual sales volume and multiply the result by your annual overhead cost. The product is the amount attributable to the job.

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company built six identical jobs each year, I could simply divide my overhead expense by 6 and include the resulting number in my cost estimates. But should a job with a lower selling price pay the same share as a much costlier project? And how could I predict which jobs would require the most hand holding or administrative time? Historical costs are one thing; client temperament is another.

Prorating costs. Given the inherent uncertainties, I find it easiest to prorate my annual costs based on each job's estimated price. Say my esti-

of \$1,000,000 and an annual overhead of \$75,500, that 5% markup nets me only \$50,000.

Oops, I guess I came up a little short. Well, at least I have the 10% profit markup to cover the gap. The only problem left is what to call it, because it isn't profit anymore.

It becomes obvious that I should be charging a higher percentage for my overhead expenses. Research your overhead costs for the past one or two years. Calculate that overhead percentage as a function of gross sales dollars ($OH / \text{Gross Sales} = \%$). Once

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ated overhead costs are \$75,550 per year. To allocate the proper percentage to a particular job, I divide the selling price of the job by the amount of my gross annual sales, then multiply the result by my annual overhead figure. The result is the dollar amount chargeable to that job (Figure 2, previous page). This simple method ensures that my administrative time is compensated over the course of the year.


To convert the dollar amount for overhead to a percentage of job cost, divide it by the selling price, then determine whether it's appropriate to apply a standard percentage markup to all your jobs.

Overhead as a Percentage

Many contractors proceed on the assumption that a 5% to 10% overhead markup is adequate for a building project. But is this really a safe, effective, and consistent factor to cover your overhead expenditure, or just a toss at the dartboard? What if I plug in 5% overhead and 10% profit on a cost-plus job? With annual sales

you've found your percentage, use a higher number when you're pricing a job. The point is to *make* money, not merely recover your expenses. If your historical costs average 6% of the contract amount, don't be afraid to boost that percentage slightly when bidding, to 8% or even 10%, to make sure you're going to make money.

Cost of Involvement

In the building business, decisions take time, substantial personal involvement, and commitment. Your clients are involved not only financially, but emotionally as well. There's no magic formula for calculating the value of your time, or the amount of money a client should be expected to pay for your professional effort and services. But understanding that your involvement costs money is a major step in the right direction. 

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