



DBE ENTERPRISES

JUNE 2003 ISSUE 6

Making A Profit In Construction

How do you make a profit in construction? If you follow the thinking of many, it is all in how you build your jobs. That has been the focus of national construction related magazines and conventions for years. If getting better at production is the way to make money, why then do construction businesses have such a high failure rate?

Getting better at production is not the answer to financial success. It is charging more for the work you do and it is just that simple. Most contractors do not charge enough for the work they do. That includes new homebuilders, remodelers or specialty contractors.

Learn the basics of how to establish the correct sales price for your work. Once learned, you can put those basics into action, and become one of the few that ever makes more than a living in this business.

First, let's define MARKUP. MARKUP is a number that, multiplied times the job cost, will yield a sales price that will cover all job costs, overhead expenses and profit. The very first thing that you need to know is your OVERHEAD EXPENSES for the last year, or what you project them to be for the next year. That number should include both fixed and variable overhead. Then you need to convert that expense to a percentage of the total work done while incurring those expenses.

Here are some percentages for contractors that are doing under 2.5 million dollars in volume a year. Remodeling contractors will typically have overhead expenses ranging from about 24% to 42%, or even higher, with the average being about 28% - 32%. New home contractors will have a range of about 12% to 28% with an average being about 18% - 22%. Specialty contractors that do just one trade will normally have overhead expenses similar to remodeling contractors but slightly less.

You will note the large difference in the overhead expense percentage between the new homebuilder and the remodeling contractor. That difference is why general contractors doing new home construction must use a different markup than those doing remodeling work. That is the main reason that you should not try to do both. Few general contractors have the discipline to use two separate MARKUPS, one for new homes and one for remodeling as their numbers will dictate. They make the mistake of using the smaller MARKUP thinking it should cover them for all jobs. It won't, in fact can't. When you're done with this column, you will know how to do the math to prove that statement to yourself.

(to be continued on next page)

★ ★ Low Cost marketing Tips ★ ★

By Jan Norman

Now is not the time to cut back on marketing. In fact, when the economy struggles is a great time to build market share. If you're not spending at least 20 percent of your time on marketing, your business won't be successful. But what's the best way to do that? Here are just four of the many low-cost ideas that have worked for thousands of other small-business owners:

1. No single marketing effort works all the time for every business, so rotate several marketing tactics and vary your approach. Your customers tune out after awhile if you toot only one note. Not only that, YOU get bored. Marketing can be fun, so take advantage of the thousands of opportunities available for communicating your value to customers.

But don't be arbitrary about your selection of a variety of marketing ploys. Plan carefully. Get feedback from customers and adapt your efforts accordingly.

2. People do business with people they know. So use this fact to your advantage by building relationships with other business owners, neighbors and people who can benefit from products and services you sell.

Networking is the most effective means for small-business owners to market themselves. But this doesn't mean hard sell. Participate in groups full of your most likely customers. Get to know them and let them get to know you.

3. Practice residual marketing. You cannot be at all places at all times, so look for ways to market that will continue to convey your message even when you're not there. This technique varies from being diligent about handing out business cards to setting up a useful Web site. When properly designed and used, these marketing tools remind customers of your value to them even when you're not there.

4. Ask for business. Sounds obvious, but it's amazing the number of people who don't follow through when given referrals, don't ask people to buy from them after cultivating a relationship, don't return telephone calls from potential customers and don't show up for appointments when potential customers want a quote for services.

Read Jan's "It's Your Business" columns each Monday in the Orange County

Register at www.ocregister.com/business

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Once you have your overhead expense established, you need to set a goal for PROFIT. Your goal should be no less than 8%, and preferably 10% or more. We need two more numbers to arrive at the correct selling price for your work. The first number is the volume of work for the same period of 12 months. If you have been in business more than three years, you should be able to predict that number very closely. If you're still new, you will have to make an educated guess.

Let's assume that we have \$250,000 in sales. Looking at a remodeling company first, if we assume \$250,000 in sales and 30% overhead, we have an expected overhead expense of \$75,000. An 8% profit would be \$20,000.

To compute our job costs, we subtract overhead and profit from total sales and get \$155,000 (\$250,000 - \$75,000 - \$20,000 = \$155,000).

\$155,000 is our job costs, or the money we have to build the job(s) sold.

The formula to arrive at the correct MARKUP for our company is:

$$\text{SALES PRICE} \div \text{JOB COSTS} = \text{MARKUP} \quad \$250,000 \div \$155,000 = 1.6129 \text{ or } 1.62$$

Now let's do the markup for a company building new homes. If we assume a total of \$250,000 in sales, and we have 18% overhead, that means an expected overhead expense of \$45,000. An 8% profit is \$20,000.

Now to get job costs, subtract overhead and profit from total sales and get \$185,000 (\$250,000 - \$45,000 - \$20,000 = \$185,500). \$185,000 is our job costs.

The formula to arrive at the correct MARKUP for our company is:

$$\text{SALES PRICE} \div \text{JOB COSTS} = \text{MARKUP} \quad \$250,000 \div \$185,000 = 1.3514 \text{ or } 1.36$$

If you think that you can't use the markup numbers that we have calculated here or the formula presented here, you are in all probability undercharging your own customers for your work. Second, remember this is a hypothetical case showing the correct math formula to arrive at the correct sales price for your work.

Every once in a while we hear some contractor say that they will take a job for less than their markup dictates because . . .

"I must be competitive," or . . .

"I have to keep cash flowing through my company." and of course there is the famous . . . "I need to keep my guys working!" My answer to each is the same, "No you don't . . . what you have to do is make a profit." If you don't, you and your company are going to go away.

Then there is always the line about . . . "I'll make it up on the next one". Right!

The bottom line is this; you have to make a profit or you will not stay in business.

For more information see www.theconstructionmarketplace.com/marketing.asp

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Contractor/Consultants	Total Contract Amount	Total Paid to Date	DBE Paid to Date	(1) DBE % Actual to Date	(2) DBE % Total Contract Value	Target DBE % Goal
Minnesota transit Constructions (MnTC)	303,691,586	215,108,987	30,092,242	13.99%	9.91%	15%
Other Contractors	5,819,825	5,335,757	738,861	13.85%	12.70%	
O'Brien Kreitzberg (OBK) (3)	14,411,331	12,935,598	2,569,105	19.86%	17.83%	15%
Marsh	545,000	395,000	100,795	25.52%	18.49%	5%
Other Consultants	33,530,643	27,992,186	1,339,677	4.79%	4.00%	
SUB-TOTAL	357,998,385	261,767,528	34,840,680	13.31%	9.73%	
Other Commitments *	80,024,396	71,600,650	N/A	N/A	N/A	N/A
TOTAL	438,022,781	333,368,178	N/A	N/A	N/A	N/A

* ROW Cooperative Agreements, Other Direct Costs, etc. (1) Calculates DBE percentage based upon DBE dollars expended vs. contract dollars paid to-date (actuals). (2) Calculates DBE percentage based upon DBE dollars expended vs. total contract value. (3) Value as of April 2003 - Preliminary