

DBE ENTERPRISES



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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.

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.

★ ★ Featured DBE ★ ★

Dave "Red Wing" Odden

As Executive Director of the National Association of Minority Contractors - MN (NAMC-MN) Odden has facilitated and participated in the organization's transformation into a more vocal, visible, and strategic association. Recently, we were successful in getting Odden -- who would rather be the silent engine in the background - to talk about himself and the organization. Here is what he said.

Q: What is the biggest challenge to the organization today?

A. *NAMC has a number of challenges. Even when our membership is growing we have to convince potential members and remind current members and other construction companies of the value NAMC holds for them. Adjacently, we need to increase our name recognition in the local market. Another challenge to the organization is our need to engage in collaborations with other minority organizations.*

Q: What is the easiest or most positive thing about your job?

A. *The thing that makes my job easier is most definitely the NAMC Executive Committee I have the pleasure of working with. The members of the Executive Committee do a lot of work and commit a lot of time to engaging in outreach and ensuring that the voice of the body is heard in many places throughout the Twin Cities.*

Q: What do you feel you contribute to the organization?

A. *I am responsible for making sure things are running smoothly. I facilitate information flow.*

Q: What have you learned about NAMC-MN issues?

A. *My experience with NAMC-MN has been an eye opener particularly in terms of understanding the efforts and strategies used to keep minority companies from working on major construction projects.*

Dave Odden is from Red Wing, Minnesota. He works for Harrington Company, the company that provides back end management support for groups like the NAMC-MN.

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: SALES PRICE ÷ JOB COSTS = MARKUP**

$$\$250,000 \div \$155,000 = 1.6129 \text{ or } 1.62$$

(to be continued on next page)

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. 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: SALES PRICE ÷ JOB COSTS = MARKUP** $\$250,000 \div \$185,000 = 1.3514$ or 1.36

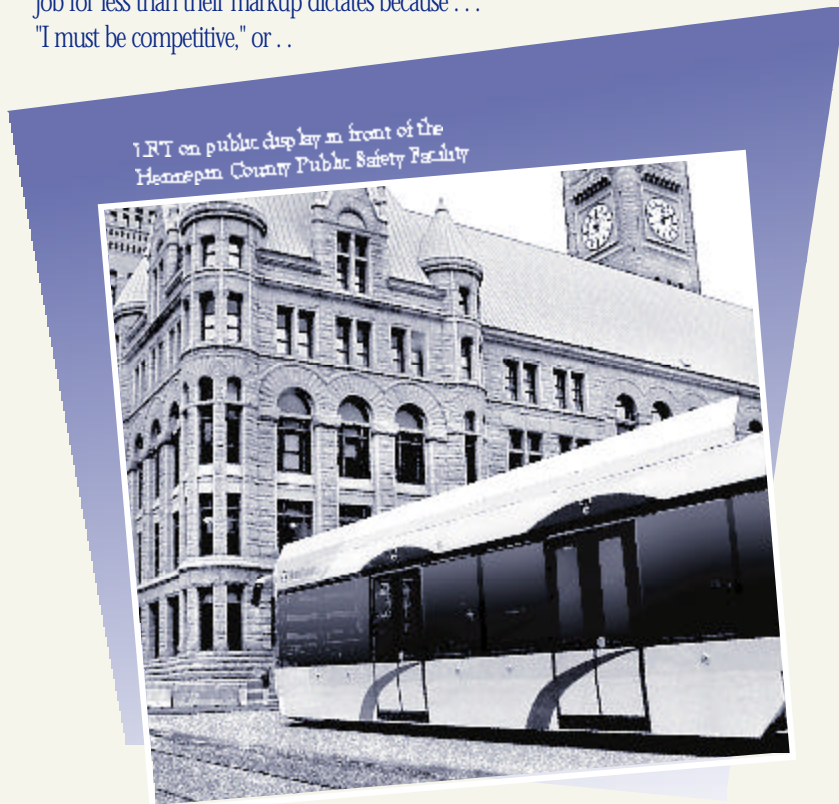
If you think that you can't use the markup numbers that we have calculated here or the formula presented here, you are in all probability undercharging your own customers for your work. Second, remember this is a hypothetical case showing the correct math formula to arrive at the correct sales price 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! Last but not least is the . . . "The insurance company won't let me charge more." Right, again! **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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Contractors/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 Constructors (MnTC)	304,023,334	168,572,024	24,186,605	14.35%	7.96%	15%
Other Contractors	4,528,865	4,554,372	692,091	15.20%	15.28%	
O'Brien Kreitzberg (OBK) (3)	14,411,331	8,489,284	1,908,908	22.49%	13.25%	15%
Marsh	545,000	305,000	76,281	25.01%	14.00%	5%
Other Consultants	40,458,710	33,728,884	720,851	2.14%	1.78%	
SUB-TOTAL:	363,967,240	215,649,564	27,584,736	12.79%	7.58%	
Other Commitments *	59,397,155	58,911,645	N/A	N/A	N/A	N/A
TOTAL:	423,364,395	274,561,209	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.