Small-Job Versus Large-Job Markup

I have heard this saying several times throughout the years: “It takes a lot longer to starve to death than it does to choke to death.” It is very simply stated but quite profound in its meaning. We could probably keep the doors of our businesses open longer from a lack of work than we could if we had a lot of work in progress that was secured at a low margin.

You might have the idea that all estimates should have the same markup. Well, I’m here to tell you that it just isn’t so.

Even though the same personnel might perform the tasks for the large and small projects alike, there is an actual cost difference. For the sake of this illustration, I will use an actual case study that came out of a meeting with a large subcontracting company. One of the primary goals of this meeting was to determine why the company wasn’t profitable. They had plenty of volume, but the bottom line for the year was way below their expectations.

The company had thought they might need to reduce their overhead by eliminating some estimating and management positions. Maybe having everyone take a reduction in salary would be the answer, at least for the interim. I would have agreed with some of these cost-cutting measures, however, the volume of work they completed for the year was impressive, and from this volume of work they should have realized a nice profit.

After reviewing the cost accounting records, I could see that the actual (labor and material) costs for the projects was very close to the budgets, so that told me the deficiency was probably in the markup they were applying to the estimates. I asked what percentage markup they were using for the overhead and profit on their estimates. The response from the chief estimator was that they applied a combined 16 percent gross markup for their overhead and profit to each estimate. That markup percentage would be marginal for even the large projects, I thought. I then asked if they were also applying this 16 percent markup to their estimates under $20,000. The chief estimator confirmed that the markup was 16 percent straight across the board.

I asked how many projects they performed in a year that were under $20,000. Their answer astounded me! The number of projects below $20,000 for the previous year was in the neighborhood of 300. Those combined figures represented almost half of their total dollar volume for the year. With that information, I asked them how many steps were involved in a small project from beginning to end. They identified these steps, and we applied a cost to each step. Keep in mind that the cost for each step is an educated guess, but probably not far off the mark. This, of course, depends on where you do business and where the project is located in proximity to your office.

Even if you are tracking job cost on each small job, you will probably not realize the cost and impact associated with the (direct) overhead for each job. The overhead is applied to your financial statement as an operating expense and is deducted from your total gross profits.

This subject will be continued in next month’s Estimator’s Edge.

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