Recovering the Overhead

Here Are Some Usable Techniques For Recovering the Proper Amount of Overhead on Extras

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For years, 10% and 15% margins have been associated with contractors as an industry overhead percentage. In the majority of cases, these numbers are purely fictitious and do not adequately represent a contractor’s indirect cost, particularly in the case of subcontractors.

Specifications and government claims may be processed with 10% overhead margins when in reality, subcontractors indirect costs are frequently in excess of 100% in relationship to field labor costs.

Overhead percentages based on sales volume will not apply to backcharges, work orders and other contract changes. Sales volume includes subcontracts, labor, material and other costs. Extras are usually very labor intensive with a low material relationship.

Field labor or subcontracting taking the place of labor—not sales volume—is what creates overhead. To prove this theory, should a contractor perform a labor only job (the owner furnishes material), the cost of overhead for installation will remain the same whether the material is furnished or not. Sales volume decreased, but overhead was not affected.

It is true that some general contractors may experience a 10% to 15% overhead expense in relation to total sales but even the general contractors cannot relate this 10-15% to a change order situation. Suppose Acme General Contracting’s annual volume appeared as follows:

| Field Labor & Payroll Taxes | $1,500,000-15% |
| Material                   | 2,500,000-25%  |
| Subcontracting             | 5,000,000-50%  |
| Overhead                   | 1,000,000-10%  |
|                           | $10,000,000-100% |

Even though Acme’s overhead is 10% of sales, it would be unreasonable to assume this 10% figure would hold true in a change order situation. The 10% overhead was generated by mass volume and this mass volume could not be generated by only change orders.

To make matters worse, general contractors and subcontractors experienced very different overhead structures. Should Acme decide to perform the $5,000,000 of sub sales volume with their own labor, Acme would have to substantially increase the 1,000,000 or 10% of sales overhead figure. Remember the subcontractor furnishes his or her own insurance, supervision, truck, equipment and administrative expense.

Also, common sense tells us that a 10% mark-up of $10.00 on a $100.00 change-order will not be enough money to process the charge. Overhead percentages related to entire sales volume, simply do not apply to extras.

What should a contractor’s overhead be on extras? There is no simple answer. Every contractor must work out an answer that works for his own firm. Simply using arbitrary percentages or national averages will not work. If you had one foot in a bucket of ice water and another on a hot stove, on the average you would be at a perfect temperature.

Overhead percentages that work for one contractor will differ from another. A painting, plumbing, general, electrical and landscaping contractor will more than likely have a different overhead percentage. It is time for the construction industry to accept this and abandon their archaic practices of arbitrary overhead percentage for extras. Bids for each trade vary according to the task performed. Overhead percentages also vary from trade to trade. One wouldn’t expect a plumber to work with a paint brush so why expect that same plumber to bid with another trade’s overhead percentage. You and only you can determine the cost of doing extras and a proper overhead recovery method for your company.