Pricing Your Work (Overhead Recovery Review)

To accurately price your work, you need to be aware of three main factors:

1. **The Estimate** – these costs are the direct costs of labor, equipment, materials, and subcontractors for the project. You need to calculate these costs on your estimate/bid.
2. **Overhead Recovery** – this is the amount of overhead (company operating expenses) that you will recover on this project. We discussed three different methods of recovering overhead earlier in this course.
3. **Net Profit** – you need to price your jobs so that your business earns a profit. Build profit into your pricing plan so that you are **planning** for profit, not hoping for it.

Let's begin by examining the first factor in pricing a job – the estimate

1. The Estimate

Your estimates should clearly define all the costs of doing a job. This course will not cover the estimating process entirely – LMN offers a course dedicated to the best practices of estimating work.

We recommend you think about all your estimates in terms of the four main components of work: Labor, Equipment, Materials, and Subcontracting.

You may also add a component called **General Conditions** – these are costs on a job that aren't directly related to production, but they are related to the job. Permits and temporary washroom facilities are good examples of general conditions costs.

Your estimate needs to allow you to calculate the costs of each one of your components, and they are typically broken down by individual work areas on the job. A sample bid worksheet might look like the following:

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Front Plantings	30	$500.00	$100.00	$4000.00	$0.00	$4600.00
Front Irrigation System	0	$0.00	$0.00	$0.00	$2000.00	$2000.00
TOTAL COSTS		$2500.00	$800.00	$8200.00	$2000.00	**$13,500.00**

Once you have built a proper estimate, where you have estimated all your production costs for the job, you can move on to step two, overhead recovery.

2. Overhead Recovery

Once you've calculating how much it's going to cost your company do to the work, you need to calculate how much of your company's overhead costs this job needs to recover. By actually calculating how much overhead each job needs to recover, your company will stand a much stronger chance of being a **profitable** company.

Using the three methods we covered earlier, single overhead recovery, field labor hours, and multiple overhead recovery, let's review how each method would add an overhead markup to our sample estimate.

METHOD #1: Single Overhead Recovery

The single overhead recovery method is the most simple overhead recovery markup. One markup percentage is calculated (using your operating budget) and then added to all your costs. Let's demonstrate how to apply the single overhead recovery markup to our sample estimate.

1. Using your operating budget, calculate your single overhead recovery markup %. Using the Danscaping example earlier in this course, we calculated this markup to be 32%.

   Reminder: Formula for Single Overhead Recovery %

   $$\frac{\text{Forecast Overhead Costs}}{\text{Forecast Total Cost of Goods Sold}} = \text{Overhead markup \%}$$

2. Add your overhead markup percentage to your job costs. The formula to do this is simple. Simply multiply your cost by 1 + (your overhead markup percentage).

   Remember – percentages are expressed in the form of a decimal. 15% is calculated as .15.

   If your costs were $10,000 and your overhead markup was 36%, the formula to markup your costs would be:

   $10,000 x 1.36 = $13,600

   You job costs, plus your overhead markup equals $13,600. Let's review our sample estimate we used earlier in the course and apply our markup percentages:

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Front Plantings	30	$500.00	$100.00	$4000.00	$0.00	$4600.00
Front Irrigation System	0	$0.00	$0.00	$0.00	$2000.00	$2000.00
TOTAL COSTS		$2500.00	$800.00	$8200.00	$2000.00	**$13,500.00**

Add Overhead Markup		32%	32%	32%	32%	
TOTAL COSTS + OVERHEAD		$3300.00	$1056.00	$10,824.00	$2640.00	**$17,820.00**

After adding overhead costs to our sample estimate, the total for the bid equals $17,820. This means that, using the single overhead recovery method, the **break-even** price of this bid is $17,820. This total covers the direct job costs, plus a percentage of the company's overhead costs. No profit has been added.

If you wanted to calculate the total of just one of the work areas, you could do so, simply by using the same formulas, but on just one of the areas. We can calculate the break-even price for the **Front Walkway** using the method below:

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Add Overhead Markup		32%	32%	32%	32%	
TOTAL COSTS + OVERHEAD		$2640.00	$924.00	$5544.00	$0.00	**$9108.00**

Using our example bid, and the single overhead recovery method, the **break-even** price of the front walkway is $9108.00. This amount covers the direct costs of building the walkway, plus a portion of our company's overhead costs.

Finally, we will have to add profit to our bid. This will be covered in step three of pricing – adding net profit.

METHOD #2: Field Labor Hours

The field labor hours method recovers all overhead costs based on the number of hours of labor worked on a job. To calculate your overhead recovery costs on an estimate using the field labor hour method, follow these steps:

1. Using your operating budget, calculate your field labor hour markup. Your field labor markup is not a percentage like the single and multiple overhead recovery methods. Your field labor markup is expressed in dollars per hour. Using the Danscaping example earlier in this course, we calculated Dan's overhead cost per hour to be $18.18.

   Reminder: Formula for Field Labor Hour Overhead Recovery

   $$\frac{\text{Forecast Overhead Costs}}{\text{Number of Forecast Field Labor Hours}} = \text{Overhead Cost Per Hour (\$)}$$

2. Add your overhead markup percentage to your job costs. The formula to do this is simple. Simply multiply the overhead cost per hour by the number of labor hours on the estimate. This number is your overhead markup cost for your estimate.

   For instance, if you bid 100 hours on a job, and your overhead cost per hour was $20 per hour, your overhead recovery markup on that job would be $2,000.

   Let's review the sample estimate we've been using to see how the Field Labor Hour method would calculate our overhead recovery costs. Remember, Danscaping's overhead cost per hour was calculated to be $18.18 per hour.

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Front Plantings	30	$500.00	$100.00	$4000.00	$0.00	$4600.00
Front Irrigation System	0	$0.00	$0.00	$0.00	$2000.00	$2000.00
TOTAL COSTS		$2500.00	$800.00	$8200.00	$2000.00	**$13,500.00**
Add Overhead Markup	**135 total man hrs x $18.18 per hour = $2454.30**					**$2454.30**
TOTAL COSTS + OVERHEAD						**$15,954.30**

After adding overhead costs to our sample estimate, the total for the bid equals $15,954.30. This means that, using the field labor hour overhead recovery method, the **break-even** price of this bid is $15,954.30. This total covers the direct job costs, plus a percentage of the company's overhead costs. No profit has been added.

If you wanted to calculate the total of just one of the work areas, you could do so, simply by using the same formulas, but on just one of the areas. We can calculate the break-even price for the **Front Walkway** using the method below:

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Add Overhead Markup	**105 total man hrs x $18.18 per hour = $1908.90**					**$1908.90**
TOTAL COSTS + OVERHEAD						**$8808.90**

Using our example bid, and the field labor hour overhead recovery method, the **break-even** price of the front walkway is $8808.90. This amount covers the direct costs of building the walkway, plus a portion of our company's overhead costs.

Finally, we will have to add profit to our bid. This will be covered in step three of pricing – adding net profit.

METHOD #3: Multiple Overhead Recovery

The multiple overhead recovery method is more accurate method of calculating your overhead recovery costs, but requires a few more calculations. Let's examine how we would calculate our overhead costs on a sample estimate using the multiple overhead recovery method.

1. Using your operating budget, calculate your multiple overhead recovery markup percentages. Remember, eac h cost type (labor, equipment, materials, and subcontracting) will have its own markup percentage.

   Reminder: Formula for Multiple Overhead Recovery %

   Equipment – 25% (industry standard – can be adjusted to suit)
   Materials – 10% (industry standard – can be adjusted to suit)
   Subcontracting – 5% (industry standard – can be adjusted to suit)
   Labor - ?% - Labor is calculated by taking the overhead expenses remaining (after subtracting the recovery amounts from the other three cost types) and dividing it by your forecast labor costs.

   Using the multiple overhead recovery formula, we calculated the multiple overhead recovery factors for Danscaping to be the following:

Expense Type	Markup %
Equipment Costs	25%
Material Costs (include tax)	10%
Subcontracting Costs	5%
Labor Costs	53%

2. Add your overhead markup percentages to your job costs. The formula to do this is simple. Simply multiply each individual cost type by 1 + (the cost type's overhead markup percentage).

   Remember – percentages are expressed in the form of a decimal. 15% is calculated as .15.

   If your labor costs were $10,000 and your overhead markup was 53%, the formula to markup your costs would be:

$10,000 x 1.53 = $15,300.

You labor costs, plus your overhead markup equals $15,300. You then repeat the same calculation for your equipment, material and subcontracting costs using their unique markup percentages. Let's review our sample estimate we used earlier in the course and apply our multiple overhead recovery markup percentages:

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Front Plantings	30	$500.00	$100.00	$4000.00	$0.00	$4600.00
Front Irrigation System	0	$0.00	$0.00	$0.00	$2000.00	$2000.00
TOTAL COSTS		$2500.00	$800.00	$8200.00	$2000.00	**$13,500.00**
Add Overhead Markup		53%	25%	10%	5%	
TOTAL COSTS + OVERHEAD		$3825.00	$1000.00	$9020.00	$2100.00	**$15,945.00**

After adding overhead costs to our sample estimate, the total for the bid equals $15,945. This means that, using the multiple overhead recovery method, the **break-even** price of this bid is $15,945. This total covers the direct job costs, plus a percentage of the company's overhead costs. No profit has been added.

If you wanted to calculate the total of just one of the work areas, you could do so, simply by using the same formulas, but on just one of the areas. We can calculate the break-even price for the **Front Walkway** using the method below:

Work Area	Labor Hrs	Labor Costs	Equip Costs	Material Costs	Subs Costs	Total Costs
Front Walkway	105	$2000.00	$700.00	$4200.00	$0.00	$6900.00
Add Overhead Markup		53%	25%	10%	5%	
TOTAL COSTS + OVERHEAD		$3060.00	$875.00	$4620.00	$0.00	**$8555.00**

Using our example bid, and the single overhead recovery method, the **break-even** price of the front walkway is $8555.00. This amount covers the direct costs of building the walkway, plus a portion of our company's overhead costs.

Finally, we will have to add profit to our bid. This will be covered in step three of pricing – adding net profit.