



MAKING THE Markup Move

Getting paid what
you're worth can be
as easy as asking for it

Builders become builders because they love to build things, not because they're passionate about sales calls and estimating. But there's no way around it: You can't be a successful builder without also running a profitable business. And for many builders, the biggest barrier to turning a profit is that they simply don't charge enough for their work.

Why do builders undercharge? The habit often takes root when a startup company uses fire-sale pricing as a way to drum up business. That may be a fair exchange at first — it boils down to giving the customer a rebate for letting you use his or her home to practice in — but it's a dead end in the long run.

Unfortunately, more than a few very good builders never find a way to boost their initial "practice rate" to a level that will let them grow a profitable business. The lucky ones see the writing on the wall in time to avoid disaster and go into another line of work or find a job with a competitor; the less fortunate drown in red ink, leaving a trail of bounced checks and hurt feelings. Worse yet, the cash-starved business may struggle on indefinitely, allowing the overworked owner to scratch out a living but not to prosper.

The good news is that many others *do* manage the transition. In this article, seven builders who made that markup move tell how they did it and what they've learned since.

— Jon Vara

Markup 24%

Profit

Margin 19.45%

■ Hold Your Breath — and Suffocate

When my brother and I started our business, we used what I now call the “ten plus ten and hold your breath” method — you add 20% to the cost of the job and assume that the first 10% will cover your overhead and the second 10% will be your profit.

One of the turning points I remember was a job where the customer asked us whether our bid included the cost of the kitchen cabinets. I was just about to say it did when I stopped myself and said no, it included an allowance for cabinets. That ended up saving me \$500, and it could just as well have been \$5,000. That started me thinking that maybe all you had to do was ask. Today our produced gross margin is 38%.

When you undercharge, you obviously don't make enough money. But another problem with it is that the only way you can make more money is to do more jobs. Guys who don't charge enough tend to sell like mad at the beginning of the year so they know they'll be able to stay afloat. But when you're booked through the summer and fall, you miss out on the really profitable jobs that come up on short notice, where the customers are happy to pay top dollar so they don't have to wait. Leaving some slack in your schedule lets you grab those sorts of opportunities when they appear.

Alan Hanbury and his brother Robert own the House of Hanbury builders in Newtown, Conn.



■ Scraping By No Longer

In the coastal area of Delaware where I work, we developed a reputation for doing beautiful work on custom homes, but we were barely scraping by. We were making a gross margin of something like 11% — an absolutely insane figure. For me, the eye-opening experience came in the fall of 1994, when I joined a Builder 20 group, which is a peer review group put together by the NAHB. It's a group of 20 geographically diverse builders who do similar work but aren't in competition with one another. At each meeting, the group evaluates a different builder's business. It's sort of like having a board of directors — they go over your numbers with a fine-tooth comb and ask hard questions.

They looked at my books and smacked me upside the head and said, “You've got to charge more.” I tried to explain that our business was different — that our customers were our friends and that doing nice work

was what was really important to us, and all the other reasons people give when they're afraid to raise their rates. The other builders didn't buy it. That's the great thing about a peer review group — it's easy to fool yourself, but you can't fool the group. Today my margin is 30%.

Patty McDaniel is the president of Boardwalk Builders in Rehoboth Beach, Del.



■ Home Repair Hobby Doesn't Cut It

When I was living in Dallas during the 1980s, I started doing some small home repair jobs, almost as a hobby. When we moved to California, we could just barely afford to buy a place there, even though we'd sold our house in Texas at the top of the market. My life partner, Ann, told me that it couldn't be a hobby anymore — I had to make money. I had a master's degree in educational administration, but I didn't have any idea how to run a remodeling business.

That was actually helpful, because I didn't have a lot of old habits to overcome. I joined a peer review group in 1985, and when I worked through the numbers, I found — somewhat to my surprise — that I was already producing a 40% gross margin. At that time, I was working out of my home and doing all time-and-materials work, but as the business grew and I began to set budgets and make estimates, I stuck to that 40% margin.

That was encouraging to some of the more experienced people in my network group. As time passed and they saw us making that margin, they realized that the only reason they weren't getting it was because of their own head trash. Failure to mark up enough has everything to do with self-esteem and lack of business savvy, and nothing to do with where your business is located.

Iris Harrell is president of Harrell Remodeling in Mountain View, Calif.



Markup vs. Margin

The terms “margin” and “markup” are closely related, but they’re not interchangeable, and using one when you mean the other can be an expensive mistake. Both are calculated by comparing the direct cost of a given project to its selling price. In the case of markup, the difference between those figures is expressed as a percentage of cost; for margin, it’s expressed as a percentage of the selling price.

To give a simple example, consider a job that cost \$1,000 to complete and sells for \$1,500. The difference between the two is \$500, so the markup is 500/1,000, or 50%. But expressed in terms of margin, it’s 500/1,500, or 33¹/₃%. The table below shows how much a job must be marked up to yield a given margin.

Markup vs. Margin

Markup %	Margin %
20	16.67
22	18.03
24	19.35
26	20.63
28	21.88
30	23.08
32	24.24
34	25.37
36	26.47
38	27.54
40	28.57
42	29.58
44	30.56
46	31.51
48	32.43
50	33.33
52	34.21
54	35.06
56	35.90
58	36.71
60	37.50
62	38.27
64	39.02
66	39.76
68	40.48
70	41.18

■ A More Balanced Life

I used to go to trade shows and listen to speakers pound on the table and talk about charging more, but it didn’t sink in until I heard the same thing from other builders like myself. I was sitting at a lunch table at the Southern Builders Show a few years ago when somebody pointed out Les Cunningham, who runs a peer review organization called Business Network, and said, “There’s a guy you should talk to.”

Business Network is pretty expensive. It costs \$3,500 to join, and with travel and lodging, the twice-a-year meetings cost another \$6,000 apiece. But for me, it’s been well worth it. At my very first meeting, the other builders zeroed in on the fact that I was working about 60 hours a week. They told me I had to charge enough so I could stop working my fingers to the bone.

For me, that’s turned out to be a 35% to 40% gross profit. Two years ago, I thought 20% was just great. But there’s more to it than just having more money. What it’s really about is enjoying the work more and leading a more balanced life.

I’d been in business for nine years by the time I made that move. Looking back, I could have done it years earlier. But you’ve got to be confident that the product and service you deliver is worth it. You want customers to think, “Well, he’s expensive, but he does awfully nice work.” It’s hard to do that if you don’t have any references or pretty pictures of past jobs. You do have to pay your dues when you’re just starting out.

Mason Hearn is the owner of McGuire, Hearn & Toms in Manakin-Sabot, Va.



■ Charging More Means Better Work

I started doing carpentry on my own in December of 1998 after my old boss’s business fell apart. I had the worst possible training, because he did everything wrong. He gave off-the-cuff estimates, and then he’d rush through the job to keep from losing his shirt. I ran my business the same way for about two years. I got a lot of jobs because I was so cheap, but I wasn’t making any money — I look back on some jobs where my bid barely covered the cost of materials.

The big change for me came when I went to the JLC Live show in Providence, R.I., three years ago. One of the speakers, Alan Hanbury, mentioned that he’d paid his lead carpenter \$92,000 that year — \$54,000 in salary and the rest in bonuses. That got my attention. I raised my rates two days later. After a few more price

increases, my labor rate is now \$61 an hour. It's changed my whole life. I enjoy the work more, and after years of renting, I was able to buy a house of my own last year.

If you're going to charge top dollar, you obviously need to be able to back it up by doing top-quality work. But the important thing to remember is that charging more makes it a lot easier to do quality work. You can hire better people and take time to do things right. Probably half of the work I do involves fixing the mistakes of an earlier low bidder. When you can afford to do a good job, you end up with happier customers and better referrals. It's the opposite of a vicious cycle. No matter how much or how little you charge, some people are always going to complain that your rates are too high. But good customers don't care: They know that quality work is worth paying for.

Robert Augart is a carpenter
in Medford, Mass.



■ Raising Rates Can Be Scary

When I started my business 16 years ago, my initial goal was to make a 20% to 22% gross profit. I hoped to eventually increase that to 30%, which I managed to do 5 years later. It was a big psychological barrier. One breakthrough came when I hired professional salespeople, who wanted to make money. When I was controlling the process, I couldn't avoid the impulse to give the customer a good deal. I've since raised my margin to about 38%.

Raising your rates is scary. You're afraid that no one is going to hire you and you'll go out of business and have no way to feed your family. If it's too scary, if you feel like you can't raise your markup enough to support the type of work you're doing, you should get out of the business. Another approach is to develop a niche market, where you work by yourself and charge by the hour.

Peter Feinmann is
president of Feinmann
Remodeling in Somerville, Mass.



■ Underchargers Anonymous

Like most contractors, I learned the business by working for others. When I went into business for myself, I felt very confident about the work I was doing, but I didn't feel nearly as secure about the business end of things. For years, I marked up jobs by 20% because that's what my former employer used to do. When you talk to other builders down at the material yard, nobody ever talks about markup and profit, so I really had no idea what anyone else was charging. If anything, I thought my markup would be considered on the high side, so I was careful to keep it a secret. I think learning to stop undercharging is probably something like overcoming an alcohol problem: You've got to admit that it is a problem, and you've got to get help from others who know what it's like.

For the last few years, I've been part of an informal group that met at an all-day seminar on markup and profit given by Michael Stone [moderator of the "Markup and Profit" forum at *JLC Online*]. There were probably 35 of us in the room, and at the end of the seminar someone stood up and suggested that we set up a phone tree to keep the discussion going. A number of us met for a few weeks afterward, but it eventually boiled down to a core group of me and two other contractors. One of them does mostly industrial construction, and the other is a property manager. I'm a remodeler, so we're not in competition with one another. We've been meeting about twice a month ever since.

When you first think about raising prices, you're sure it will cost you jobs. Michael Stone suggested a simple experiment to prove to yourself that it won't: Next time you prepare a bid, he said, estimate it the way you ordinarily would, then raise your price by 10%. I did, and I found that he was right — it made no difference to anything except my bottom line. That fear of losing work was totally unwarranted.

I realize now that my thinking about markup used to be completely backwards. It's a mistake to pick a markup figure — whether it's 20% or whatever — and try to build your business around it. The right approach is to figure out how much you need to make your business work, then adjust your markup accordingly.

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Towne Reavey in San Pedro, Calif.

