

BY MELANIE HODGDON

The Pitfalls of Hybrid Estimating

I recently had a conversation with a client who had noticed that he usually failed to sell jobs that were labor-heavy, but had no idea why this was happening. When I asked him how he put his estimates together, he described three main steps:

- Multiply hours of labor by charge-out rate
- Price materials and add a 25% markup
- Add a 10% markup to subcontractor costs

There are two problems with this method. First, it's a "hybrid": Some components of the sale price are based on costs (materials and subs); some are not (labor). Second, the markup varies, and the labor charge-out rate was a black box.

To figure out what was causing his problem, we first determined what markup was underlying his charge-out rate. After working through my Labor Burden Calculator, we found that an employee being paid \$25 per hour was costing the company \$37.50 per hour. The

charge-out rate was \$60, so the markup on labor was 60% ($\$22.50 \div \37.50).

THREE SCENARIOS

Let's look at three estimates with varying proportions of labor, materials, and subcontractors. Remember, in all three the cost to the company is identical (\$54,000).

Job A: Equal costs. The company will spend equal amounts on labor, materials, and subs. After a 60% markup is applied to labor, 25% to materials, and 10% to subs, the job would be sold at \$71,100, for an overall markup of almost 32% and a margin of about 24% (see tables, left).

Job B: Labor heavy. Here, most costs are for labor. With the same markups as Job A, the selling price would be \$84,169. Overall markup is almost 60%—nearly twice that of Job A—and margin is also higher—almost 36%.

Job C: Sub heavy. Job C relies heavily on subs, with only 200 hours of labor. If I again apply the same markups, Job C would be sold at \$64,875, making the overall markup just over 20% and the margin just under 17%.

Job A - Equal Costs

	Hrs	Cost/Hr	Cost	Markup*	Sale Price			
Labor	480	37.5	\$18,000	60%	\$28,800	Gross Profit	Overall Markup	Margin
Mat'l			\$18,000	25%	\$22,500			
Subs			\$18,000	10%	\$19,800			
Totals			\$54,000		\$71,100	\$17,100	31.7%	24.1%

Job B - Labor Heavy

	Hrs	Cost/Hr	Cost	Markup*	Sale Price			
Labor	1300	37.5	\$48,750	60%	\$78,000	Gross Profit	Overall Markup	Margin
Mat'l			\$2,625	25%	\$3,281			
Subs			\$2,625	10%	\$2,888			
Totals			\$54,000		\$84,169	\$30,169	55.9%	35.8%

Job C - Sub Heavy

	Hrs	Cost/Hr	Cost	Markup*	Sale Price			
Labor	200	37.5	\$7,500	60%	\$12,000	Gross Profit	Overall Markup	Margin
Mat'l			\$11,500	25%	\$14,375			
Subs			\$35,000	10%	\$38,500			
Totals			\$54,000		\$64,875	\$10,875	20.1%	16.8%

*Markup is a percentage of cost.

ONE MARKUP FOR ALL COSTS

When you look at the numbers, it's easy to see why my client was having a hard time selling labor-heavy work. His high markup on labor inflated his sales price well above that of his competitors. Our exercise also taught him something else: He was underpricing jobs on which most of the work was done by subs.

It is certainly possible to apply multiple markups, but the overall markup must meet your company's requirements. The lesson here is that once you've determined the markup your company requires to cover annual overhead and achieve your target profit, applying that markup across all costs will produce the same selling price no matter what the mix of cost categories. This is the simplest way to arrive at a price you can trust to meet your targets.

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/HR/

Probationary Period for New Hires

BY DOUGLAS DELP

WHAT HAPPENED

Good Guys Construction Co. wants to make sure it hires the right person for any open position with the company. After making a hire, Good Guys explains to the new employee that the first 90 days is a probationary period during which the company and the employee can determine whether the employee is the right fit for the job and the company.

WHY IT'S A PROBLEM

Probationary or introductory periods may jeopardize Good Guys' at-will employment policy. At-will employment means that the employer and the employee can terminate the employment relationship for any reason or no reason, except for certain exceptions prohibited by law. In a number of court decisions, probationary or introductory periods were ruled to have created an implied employment contract that gave the employee extra job security once the initial period was completed. In other words, these cases suggest that once a new

employee successfully completes the initial 90-day probationary period, the burden is on the employer to show a valid reason to terminate that employee.

WHAT YOU SHOULD DO

There are no advantages to having a defined probationary or introductory period. A better practice for employers is to develop a formal performance review process in which all employees are evaluated 90 days after their hire date, and at least annually thereafter. This performance review program should include a statement that an employee's performance can also be informally evaluated at any time throughout the year. This practice achieves the same outcome for the employer as a probationary period, without implying extra job security for the employee after the initial employment period is completed.

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/LEGAL/

No Written Change Order?

BY ALEXANDER BARTHET

Throughout the course of a project, your client requests and pays for several change orders, although you never get around to putting anything in writing. In one final request, you're asked to build a tiki hut in the backyard. On the basis of the client's agreement to your price, also undocumented, you do the work. But when you present the client with your final invoice, you find out that he didn't clear construction of the tiki hut with his wife and she's refusing to pay anything extra. Worse, she's a lawyer and has read your contract, which clearly states that all change orders must be in writing to be valid. Can you still get paid?

Depending on the jurisdiction you're in, the answer may be yes. Courts have found that, even where contracts specifically state the written-change-order requirement could not be waived, parties can waive the provision by prior course of conduct such as these cli-

ents displayed—requesting and then paying for several undocumented change orders during the project.

Additionally, some courts have found that written change orders are not needed when change-order work on a private project is required for proper functioning of the project. (When the owner is a public entity, however, the law is not as forgiving and the court generally finds undocumented change orders invalid.)

Best practice is to put change orders in writing and to get them signed by the owner. But if for some reason you don't, the waiver agreement may apply.

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