A Smarter Way of Charging for Overhead and Profit

Accurate bids require more than just applying a formula

BY DAVID GERSTEL

Figuring overhead and profit (O&P) is the most challenging step in creating a bid for a construction project. By contrast, estimating direct costs of construction—namely the costs of labor, material, and trade partners (subs)—is relatively straightforward. You provide your material suppliers and subs with lists, plans, and walk-throughs and get back written quotes. For labor costs, if you have developed a file of labor productivity records, you need only count and multiply to reliably project costs. (If you are not up to speed at figuring direct costs of construction, see my book *Nail Your Numbers: A Path to Skilled Construction Estimating and Bidding* and my earlier *JLC* articles about the creation of labor productivity records and other tools of estimating.)

In this article, I will turn to calculating overhead and profit charges for a project.

For several reasons, those calculations are not as simple as figuring direct costs. To begin with, overhead and profit charges are not as tightly linked to the project at hand. The studs you buy for an addition are for that project and none other. And their cost is a cost of that project and none other. Overhead costs for items such as equipment, office supplies, and owner's pay for running the company, however, are spread across many projects. Questions then arise: How do you best apportion overhead to each of your projects? Likewise, how can you best determine the amount of profit to aspire to on each project?

STARTING OUT WITH FIXED PERCENTAGES

When we are starting out and still naïve about business, we tend to respond to the challenge of charging for overhead and profit by ignoring it. We commit the thinking error of "overhead obliviousness." We are spending steadily for equipment and supplies. We are working late into the night and on weekends at estimating and administrative work. But we don't yet appreciate that we need to get reimbursed for the expenditures and paid for our time.

As for profit, we think that's the payment we collect from our customers for our jobsite work—which we are likely charging for at a rate less than our former bosses charged for our labor at their projects. We find ourselves working 60 or more hours a week between our jobsite and office tasks. Yet we are keeping less money in our pockets than when we worked 40 hours in someone else's company. At that point, many of us, exhausted and poor, give up. We retreat to employee-hood or perhaps, as did certain friends of mine, move into window sales or peddling Tupperware.

Some of us are luckier. We become aware of the necessity of charging for—that is, "recapturing," to use a technical term—overhead costs and realizing a profit. We begin to wonder how much to include for overhead and profit (O&P) in our bids. Maybe we ask Hank, sales manager at the local lumberyard, or some other graybeard whom we revere as a fountainhead of construction wisdom, how much to charge for O&P. "Go with 10 & 10," we are told. "Add 10% of your direct construction costs for overhead and 10% for profit. That's industry standard."

Though he may not use the term, Hank is advising what is called the "fixed percentage method" of charging for overhead and profit. Typically, it does involve use of "10 & 10." That's partly because those percentages are insisted on by certain insurance adjusters and architects though they may have no understanding of overhead and profit in the construction business.

BASIC TERMS

Costs of construction

Also termed direct costs and costs of goods sold (COGS)

Costs of construction include costs for labor (including by an owner), material, subcontractors, and services used at a jobsite.

Overhead

Also termed indirect costs

Overhead is the ongoing cost of running a company. It includes out-of-pocket costs for everything from stamps and staples through heavy equipment. It also includes owner's pay for company management tasks from sales calls and estimating through hiring and firing employees.

Profit

Profit is income, as *JLC* author Michael Anschel explains, that you "aspire" to take in above and beyond all costs for construction and overhead. Realistically, it is also insurance against what I call "profit costs" such as litigation that can arrive even after a project is long over and take a bite out of your hide.

MOVING TO GPM

Often, builders who start with the fixed percentage method move to an alternative method of charging for overhead and profit on their projects. It goes by the abbreviation "GPM," for gross profit margin. It's an odd term. It refers to overhead and profit combined as a percentage of sales price. For example, say a remodeling company bids $150,000 for a project, with $50,000 of the bid for overhead and profit. In that case, it is aiming for a GPM of 33% on the project ($50,000 / $150,000 = .33 = 33%).

GPM for a specific project is figured by applying a formula to the direct costs of construction to produce a bid or so-called "selling price." In the example above, the company would first figure the direct costs ($100,000) for the renovation job. Since it was aiming for a 33% GPM, it would apply the GPM formula, slotting in 33%, to produce a bid of $150,000. The selling price thereby includes $50,000, or 33% of the total price of $150,000, for overhead and profit.

Though I go through it in *Nail Your Numbers*, I'll spare you a full explanation of the GPM formula in this article. I will just note that the formula is complex. It's impressive looking. Maybe that's why construction pros think that when they switch from the fixed percentage method to the GPM method for figuring overhead and profit that they are moving up the ladder of business sophistication.

They are not. At its core, GPM represents no advance on the fixed percentage method. Though wrapped up in fancier math, it's just another formulaic percentage calculation.

Think about it. When you use the GPM formula, you are doing the same thing as with the fixed percentage method. Namely, you are including a predetermined percentage for overhead and profit in a bid. You may be using a bigger number—say the 33% long recommended for remodelers—instead of 10% and 10%. But you are still relying on a rigid formula to determine overhead and profit charges for your projects.

THE DEFICIENCIES OF FORMULAIC METHODS

Some construction companies have survived or even prospered, at least for a time, while relying on a fixed percentage or GPM formula. Nevertheless, both methods are deficient. Both incorporate a troubling assumption about overhead. That is, both assume that all companies have the same overhead. Thus, 10 & 10 assumes that overhead is actually 10% of construction costs for all companies. The GPM method does not even separate out overhead and profit charges. Yet, when the formula is put forward with a recommended percentage, which it often is, the assumption is that the percentage will adequately recover overhead for any company that elects to use the formula and automatically provide for profit as well.

Such percentage calculations may be adequate for your company if you manage overhead very tightly. But if you are outfitting an office or shop or showroom, hiring office staff, or making other

substantial investments in marketing and administration, a fixed 10% for overhead likely won't come close to recapturing your actual overhead outlays. If you are using the GPM method with a typical recommended percentage such as 33% (or for that matter, the 40% also often recommended for remodelers), that may or may not be enough to recapture your overhead costs, including pay for your own management work, and provide profit as well.

Also troublesome, when you go with a recommended percentage for overhead—whether 10% or some percentage wrapped up inside of a GPM—it will at best have a coincidental connection to your actual overhead on a specific project. It may have no connection. You are assuming that your overhead, whether figured as a percentage of construction costs as with the fixed percentage method or of selling price as with GPM, is an identical percentage for all jobs. It likely won't be. It can be very different for, say, a kitchen remodel, a new home, a foundation replacement, and construction of a bridge over a creek (a range of projects similar to those done by my company).

Jerrald Hayes, a builder and consultant with deep expertise on overhead and profit issues, insists the formulaic percentage methods of figuring overhead on specific projects are "arbitrary." I agree. Similarly, for profit. A profit charge figured as a standard percentage of construction costs or selling price might happen to be appropriate during some phases of the economic cycle. At others, it could be woefully off. During good times, when work is abundant, you might be leaving money on the table. During hard times, your percentage might force your bids so high you cannot get enough work to keep your company going.

Use of a formulaic percentage for profit assumes, just like the use of a formulaic percentage for overhead, that all jobs are alike. It assumes that all jobs present the same opportunity for profit. It assumes that all projects burden a company with the same level of risk during construction. It presupposes that all projects saddle a company with the same degree of liability after construction is complete. But, as you know, some projects, clients, and designers impose far more hazard than others. Projects with different levels of hazard demand different levels of profit charges to buffer the hazard.

Use of the percentage-based formulas can lead to sheer foolishness. I have seen capable companies pass up good opportunities to build custom homes because of rigid adherence to their formula. They aspired to gross profit margins of around 40% on each and every one of their projects. That was reasonably competitive for remodels given their reputations and the level of service they rendered to clients. It was unnecessarily and unacceptably high for new homes. As a result, they rarely or never got those projects.

BEYOND STANDARD FORMULAS

Is there a smarter method of charging for overhead and profit? I think so. I call the method the "capacity/duration method (CDM)." In the next few paragraphs and the sidebar on the following page, I will describe CDM in general terms. A friendly warning: If you are unfamiliar with the concept, even though it is straightforward, you may find this first pass through CDM heavy sledding. But the specific examples of applying CDM that we will go into shortly will be easier going and should clarify the concept.

Here's what CDM does not do: It does not rely on the use of percentages to figure charges for overhead or profit on a project. Percentages may come into play when a bid is complete with overhead and profit already included, but only to compare your charges to those of competitors. Percentages are not used to calculate your charges.

Here is what CDM does do: It allows for overhead and profit to be figured independently of one another. That is as it should be. They are such different creatures. Though they are figured separately with CDM, both the overhead and the profit calculations are based on the same two factors: first, your capacity for work—the number of projects your company can handle at one time; and second, the duration of a project—the length of time it will take your company to build it.

The goals for CDM are simple. With each project, you aim to recapture the overhead with which the project actually burdens you. With each project, you aim for a profit that is obtainable and that makes doing the project worthwhile for your company. To further explore CDM, let's look at its use in a range of companies from smallest to larger.

CDM FOR A ONE-PERSON COMPANY

Say that you operate without employees. You are the project manager and lead person at your projects. You may work with trade partners, such as plumbers. You may wear your bags. Or you may do both. Off the jobsite, you handle marketing, estimating, bidding, and other office work.

You have enough business savvy that you realize you have overhead (lots of it). You see it as breaking down into two categories: 1) "out-of-pocket overhead"—the money you spend on everything

PROBLEMS WITH STANDARD FORMULAS

- **The percentage-based formulas** for charging for overhead and profit typically incorporate "industry standard" percentages. The charges resulting from use of those recommended percentages may have little relationship to the actual overhead needs or profit opportunities of any particular company using them.
- **Overhead charges** may have little relationship to the overhead burden incurred on a specific job. For some, the percentage may be too high. For others, it may be woefully low.
- **Profit charges** may be divorced from market conditions and opportunities and a company's need for work.
- **With the fixed percentage method**, the percentages, such as the oft recommended "10 and 10," may be too low for a company to recapture its actual overhead and earn a profit adequate for survival.
- **With the GPM method**, overhead and profit are jumbled together. That can encourage overhead obliviousness, which can result in lost jobs or missed opportunities for profit.

THE CAPACITY/DURATION METHOD

For overhead, use the steps below to figure your necessary weekly and total overhead charges for a project:

1. Project your total company overhead for the year.
2. Divide your projected overhead for the year by the number of weeks you expect to have projects under construction. That will give you a figure for overhead per week.
3. Divide overhead per week by the number of projects your company does at a time. That will give you a figure for weekly overhead on each of your projects.
4. Figure overhead charges for an entire project by multiplying your weekly project overhead by the number of weeks you expect the project to be under construction.
5. Modify the figure to fit the particular project, if appropriate.

For profit, use the steps below to figure your necessary weekly and total profit charges for a project:

1. Set a reasonable profit goal for the current year.
2. Divide that profit goal by the number of weeks you expect your company will have projects under construction during the year. That will give you a profit per week figure.
3. Divide profit per week by the number of projects your company can do at a time. That will give you a figure for profit per week for each project.
4. To figure a profit charge for a project, multiply your figure for profit per week for the project by the number of weeks you expect the project to be under construction.
5. Modify as appropriate for the degree of risk the project presents.

from new tools to truck maintenance and office supplies and 2) time spent meeting prospective new clients, creating estimates, doing administrative work, reading *JLC* to keep up with new developments in construction, and otherwise running your company.

You also realize that the pay you take for your work on your jobsites is not profit. You understand that it is a cost of construction—just as wages and labor burden would be if an employee did the work. Profit, you appreciate, is something apart. It is your company's pay. It is necessary to build up working capital. It's essential as insurance against all the liabilities that construction businesses take on.

To ensure top quality on every project, you button up each one before moving on to the next. Therefore, your capacity is one project at a time. How, then, do you use CDM to figure an accurate overhead charge per project?

As you can see in "Weekly Overhead for a One-Person Company" on the facing page, overhead costs for a hypothetical one-person construction company are $2,400 per week. Therefore, for a one-week repair job, the company needs to recapture $2,400 (1 x $2,400) in overhead. For a four-week deck project, $9,600 (4 x $2,400 = $9,600). And for a 310-square-foot bed and bath addition that takes 13 weeks, the basic overhead charge works out to $31,200 (13 x $2,400 = $31,200). If the company owner thinks a project will burden them with more than usual overhead costs—say extra paperwork, unusual purchases of equipment, or time spent soothing an anxious client—they might want to modify the charge upward.

For your own company, you may, of course, value your off-site management work at a different level than suggested in the sidebar. Likewise, your out-of-pocket costs might run lower or higher. If so, your charges for overhead would vary accordingly. But the key point is that if you establish valid figures, you can calculate a valid weekly average figure for overhead. And using that figure, you can arrive at a valid charge for overhead for small and larger projects.

Figuring profit for projects done by a one-person company can be done with similar steps. For purposes of our example, let's assume that you operate in a prosperous area and that there is strong demand for good builders. Solid profits are within reach. You set a profit goal for your company during the upcoming year of $96K—or $2,000 a week for each of the 48 weeks you expect to be constructing projects (48 x $2,000 = $96,000).

For a one-week job, you would charge $2,000 in profit (1 x $2,000 = $2,000). For a four-week job, $8,000 (4 x $2,000 = $8,000). For that 13-week addition, you would charge $26,000 in profit (13 x $2,000 = $26,000). That is, you would charge those amounts assuming you don't need to bump up or lower your profit charges because of contingencies or circumstances. In some cases, it might be prudent or practicable to make an adjustment. For example, if a project involves much unfamiliar work, consider increasing profit charges in your bid to protect your company against unforeseen costs.

On the other hand, at times, you may have to lower or even forgo profit to fill in a hole in your schedule or to ride out a down period in the economic cycle. If things get really bad, you may have to find ways to slash your overhead—like reducing your pay for running your company. With such moves, you may be able to stay busy enough to at least recapture your remaining overhead during even an extended bad period that makes earning a profit all but impossible.

Finally, when profit is possible, you have to decide what level of profit your conscience and beliefs require. I have known builders who feel guilty about maximizing profit at the expense of clients. At the other end of the spectrum, I have met those who see maximizing profit as a necessity and even as a precious right of an entrepreneur working in our free enterprise economy.

Over time, I came to a middle position. I recognized the need for my company to earn substantial profit—particularly because we had a generous profit-sharing program and because I needed profit for the investments that would give me financial independence. But I also wanted my company to offer good value to our clients. That generally required keeping profit at levels that were highly competitive with other well-established and respected companies.

OVERHEAD ADJUSTMENTS

At times, you may choose to adjust overhead just as you may decide to adjust profit from an initial figure you arrive at with a capacity/duration calculation. But as with profit, any adjustment of overhead will involve judgment calls. For example, I have thought

that, generally speaking, overhead charges for smaller jobs, like bathroom remodels, vs. new homes could be discounted by roughly 10%. Conversely, I have felt that for a larger job, they should be bumped up by 10%. Why? Because I have assumed that small jobs generally would burden me with proportionately less office work and wear and tear on equipment used by my crews. In other words, I have thought that weekly overhead is lower on smaller projects.

Michael Anschel—a seasoned builder who has thoroughly thought through CDM—suggests that I have it backward. A bathroom, he points out, can burden you with more management costs, like client hand-holding. With a small remodel, you are working inside your client's home. They need a lot of attention and reassurance. The reverse, Anschel has found, holds for construction of a new home. He has concluded that his overhead is lower on new construction than on remodels.

There is no hard and fast rule about overhead adjustments. I have done remodels where little hand-holding was necessary. I have built new structures where the client and the designer were both serious PITAs (pains in the hindquarters). I have concluded that adjustment calls can legitimately vary from company to company and project to project. Neither you nor I will get them perfectly right. In fact, we won't get overhead or profit charges for a bid or even direct construction charges in an estimate perfectly right. But as Jerrald

WEEKLY OVERHEAD FOR A ONE-PERSON COMPANY

How to figure overhead charges for a hypothetical one-person construction company

Yearly overhead

- Truck: $10,000
- Other equipment for jobsite and office: $8,000
- Office and shop rental (or value of office and shop space in home): $12,000
- Tools, supplies, professional services, other: $6,200
- Value of owner's work running company: $76,800 ($80/hr. x 14 hrs./week x 48* weeks = $76,800)
- Total annual overhead: $113,000

Overhead per week: $2,400 ($113,000 / 48 = $2,400)
Modify as necessary for particular job conditions.

*48 weeks is used to allow for vacations, dead spots in a schedule, etc. because overhead must be recaptured and profit earned during the time the company is actually in operation.

Hayes puts it, "The idea is to be mostly correct rather than absolutely wrong." And if you are mostly correct, over time, across many bids, the law of averages is on your side. You may run somewhat high on some bids and low on others. But your numbers can average out just where you need them to be.

CDM FOR LARGER COMPANIES

Let's say that over time you build a larger company. You take off your tool belt. You develop your three best carpenters into project leads. You devote yourself entirely to running your company. With each lead running a project, your capacity is three projects at a time. Allowing for vacations and other downtime, you aim to have each lead running jobs 48 weeks a year.

As was the case for a solo operator, you have overhead at two levels, out-of-pocket overhead and owners pay. Running the numbers, you arrive at weekly overhead of $13,500, or $4,500 per project per week (see how those numbers were derived in "Weekly Overhead and Profit for a Larger Company," below). To recapture your overhead, you must charge $4,500 for overhead for each week that a project is under construction.

WEEKLY OVERHEAD AND PROFIT FOR A LARGER COMPANY

How to figure overhead and profit charges for a hypothetical company with three project leads

Yearly overhead

- Out-of-pocket costs for construction equipment, office and shop space, office personnel, etc.: $460,000
- Owner's pay: $188,000
- Total annual overhead: $648,000 ($460,000 + $188,000 = $648,000)

Overhead per week for the 48 weeks that projects are under construction: $13,500 ($648,000 / 48 = $13,500)

Overhead per week per project with each of three leads doing one project at a time: $4,500 ($13,500 / 3 = $4,500)

Overhead charges for individual projects

- For a four-week window replacement project: $18,000 (4 weeks x $4,500/week)
- For a 13-week addition: $58,500 (13 weeks x $4,500/week)

Profit charges

- Goal for year: $250,00
- Average intended profit per week: $5,208 ($250,000 / 48 = $5,208)
- Profit goal per week for each lead and their project: $1,736 ($5,208 / 3 = $1,736)

Let me be clear about the underlying logic here: The purpose of charging for overhead is to recapture the overhead costs of production. That's apparently a challenge for a manufacturing company with a variety of products; allocation of overhead to different product lines is said to be notoriously difficult. We're luckier in construction. Using CDM, we can allocate overhead to each product—that is, each of our projects—readily and accurately.

Even so, use of CDM to charge for profit when a company is building several projects simultaneously does involve judgment calls similar to those that must be made by the solo operator. You need to consider your familiarity with the work required; the other risk factors such as the reliability of the designer and owner; and market conditions and your need for work as well as your profit goals.

Let's say you have built a respected company and are working in a high-cost metro area where there is a lot of demand for your product. You've set your profit goal at $250,000 per year—in part because you have inaugurated profit sharing. (You have realized it's one good way to minimize turnover on your crews. And turnover, you have discovered, is a huge headache and eats up much more profit than profit sharing). To bring in $250K in profit, you will need to charge $1,736 per project per week (again, please see the sidebar for the math).

CAPACITY VARIATIONS

Capacity/duration is not a one-size-fits-all method. Some builders who prefer a capacity-based method to the formulaic percentage methods do not equate capacity with the number of projects they can handle simultaneously. They see capacity as the total number of hours their employees can log at their jobsites each week. To charge for overhead, they figure the amount they need to recapture weekly on average. They then divide that amount by the number of hours they expect their employees to log weekly and charge accordingly.

For example, say a builder has overhead of $8,500 per week. On the basis of payroll records, they know that their 10-person crew averages 380 hours per week at their jobsites. After doing the math, you will see that overhead works out to $22.36 per person hour. To recapture that overhead, the builder adds $22.36 per hour to the other costs—wages, benefits, and other labor burden—for each hour of work by a crew member.

Likewise, for profit. These builders establish an annual and per-week goal. They then figure the amount of profit they need to take in for each hour of labor by a crew member to reach their goal. Finally, they add the hourly profit figure to labor and overhead charges to arrive at a total charge for an hour of crew labor.

Figuring overhead and profit charges on an hourly basis was initially favored by a builder whose operation I got to know well as their consultant. I recommended against it. I see capacity as the number of people in a company who are capable of running a project. After all, if you have 100 people on your crew, but none can run a project, your capacity is zero.

Focusing on leads as a basis for figuring overhead and profit can work as effectively for companies that rely on trade partners

ARE CDM BIDS REALISTIC AND COMPETITIVE?

At this point, even if you are finding merit in CDM, you may be wondering whether it will contribute to business-like bids. A good way to run a check is to compare the bids that you create using CDM to the general level of construction pricing in your market. And a path to accomplishing that is to take a look at the square-foot charges you arrived at using CDM versus the prevailing square-foot charges of contractors in your area and at your level.

One-person company. For example, let's say that you are operating a well-established one-person company and have bid on the 310-square-foot bed-and-bath addition mentioned on page 34, and that your numbers are as follows:

1. Direct construction costs at $160,000.
2. Overhead at $31,200.
3. Profit at $26,000.
4. Total bid at $217,200 ($160,000 + $31,200 + $26,000 = $217,200).

That pencils out to just over $700 a square foot for the addition's 310 square feet ($217,200 / 310 = $700.64).

At the time I am writing this article in late 2022, $700 a square foot is a moderate price or, in some markets, even toward the low side, for good-quality residential remodeling in major cities. So, CDM did deliver realistic charges for overhead and profit for the addition. If you wish, you can run the numbers to see how well the method would work for smaller or larger jobs by your one-person company.

Larger company. Will the CDM method produce a business-like bid for a larger operation? Here, I will leave the math to you. But again, the answer is yes. The bid produced by the larger, three-lead company described above comes in at $777 a square foot. Though higher than for the one-person operation, that's in line with what larger established builders have been charging in major metro areas during the recent good years.

Comparing your numbers. To compare your figures to other companies, you need to learn about the typical construction charges in your area. You can find rough but useful approximations in the construction cost catalogs available at online and even brick-and-mortar bookstores. You can simply run a search on Google. Alternatively, and best, you can join or organize a local builder's association such as those described in my article "Your Best Opportunity for Business Education Might Be in Your Hometown" (*JLC*, Mar/19). Construction costs and pricing are frequently a subject of conversation at such groups. And, by the way, so are gross profit margins.

That conversation, too, can be of value to you. Knowing how your charges for overhead and profit as a percentage of your bids (selling price) stack up against other builders can be useful. Yes, to reemphasize, GPM is a crude, one-size-fits-all method of figuring overhead and profit. But it has some value as a way of comparing financial performance of companies in the same industry.

Thus, if you find that you are charging a relatively low percentage of selling price for overhead and profit, you have learned that you have room to bump up your overhead and profit charges.

On the other hand, a comparison of your GPM to that of similar builders might bring unpleasant news: that your overhead and profit charges are a low percentage of your selling price only because your construction costs are bloated. Whenever your costs are an unduly high percentage of your bids, they squeeze out room for overhead and profit.

(subcontractors) for on-site work as it does for companies deploying in-house crews. For example, a company has two project managers (PMs) who run all jobs. Production at the jobsites from foundations through finish, and even cleanup and punch-list work, is handled by trade partners and outside services. In that case, the company's capacity is two. It can't do more projects at a time than the PMs can handle. Using math similar to that used for our earlier examples, overhead can be recaptured across each of the supervisors' projects.

Let's say that you do have two project managers and that your overhead is $5,000 per week, or $2,500 per week per PM. One is responsible for a single project, construction of a small apartment building. You have estimated that the project will take nine months, which is 39 weeks. Therefore, to recapture your overhead, you will have to charge $2,500 x 39 weeks, or $97,500, for overhead on that apartment project.

Meanwhile, the other PM handles three relatively small projects—repairs, renovations, remodels—at a time. To recapture overhead on those projects, you divide $2,500 by three and see that you must charge $833 ($2,500 / 3 = $833) per project each week to recapture the overhead. If the PM's responsibilities shift, and he moves to handling two larger projects or five very small ones rather than three projects at a time, you adjust the overhead charges accordingly.

Jerrald Hayes raises another interesting case: using CDM for a company that has multiple divisions—design, general contracting, cabinetwork, and home repairs. Hayes, whose take on CDM is closely parallel to but not identical to my own, offers a solution at his thought-provoking website, paradigmprojects.com. My own

inclination would be to separately account for overhead for the various divisions—and where overhead costs spread across several divisions, apportion it among them as accurately as practicable. Then the appropriate variation of CDM could be selected for each division. For the general contracting division, overhead could be recaptured and profit assigned on the basis of capacity and of the duration of each project. For design, and for the handyman division as well, it might be best to include overhead and profit in a charge for each hour billed. And so on.

PRESENTING THE BID

After figuring overhead and profit charges for a project using CDM, you must decide how to display the charges in your estimate and bid. Among the possibilities:

- Placing them on a separate line or lines at the end of an estimate.
- Providing for them as part of your charges for project delivery in the general conditions section of your estimates.
- Simply wrapping them up in a single figure to be submitted as a lump-sum bid.

Each choice has its pros and cons and its place. But in all cases, you are accomplishing the same vital tasks: You are recapturing the amount of overhead with which a project actually burdens you. You are aiming to take in profit that aligns with the amount of your company's capacity that a project is actually using and the risk it entails. That is quite different, and in my view better, than taking a stab at overhead and profit with a formulaic percentage divorced from the duration of a project, the portion of your company's capacity it absorbs, and the risks with which it burdens you.

DO YOU WANT IT EASY OR ACCURATE?

You may find yourself shying away from the capacity/duration method, especially if you have long used percentage formulas. After all, it is so easy to automatically apply 10% & 10% or 35% GPM. You can even have a spreadsheet do it for you with just the click of a key. You can readily come up with reasons for continuing on that path. For example, you may have found that using 35% GPM and confining yourself to a narrow niche like kitchen and bath remodeling has consistently recaptured your overhead including good pay for yourself as company manager and provided acceptable profits.

On the other hand, the decision to go that route may be an ill-advised shortcut. Michael Anschel suggests that it is: "I'll argue that builders like a formulaic percentage-based system because it lets them avoid thinking about the real cost of overhead and how to assign it properly to a project."

I have to agree—and ditto for profit. I have encountered so many builders who wish that estimating and bidding would just go away. They want shortcuts. They want someone else, a cost book or a software package, to tell them what their costs for labor, material, and subs should be. They want plug-in formulas for overhead and profit. To be blunt, they want to avoid thinking about their single most important financial responsibility as owners of a business. They want to avoid thinking about and learning to nail down appropriate charges for their product.

I say "good luck" to those who want to go that route. I am concerned about their likely results over any longer term. The give-up-and-drop-out-rate in construction contracting, not to mention the sheer going-broke rate, is hard to pin down. But it appears to be astronomical. And a major reason, along with leaky buildings and sloppy change-order procedures, is resistance to the work of learning to estimate skillfully and figure overhead and profit thoughtfully.

The resistance is understandable. The learning curve can be steep and the work painstaking for a time. It surely was for me when I began running my own company. But the learning is not nearly as painful as robotically calculating overhead and profit via an "industry standard" formula and, as a result, finding yourself deep in a hole. That was the experience of a friend who became habituated to the GPM method.

> "Learning CDM is not nearly as painful as robotically calculating overhead and profit via an 'industry standard' formula and, as a result, finding yourself deep in a hole."

He built a respected company. He did OK financially for a couple of decades. Then a severe recession struck. His overhead, meanwhile, remained about the same—same office, shop, office personnel, etc. But the average size (in dollars) of his projects and total revenue dropped by 75%. Since he was habituated to his 35% GPM, the dollars he was taking in for overhead also fell by 75%.

He was soon not collecting enough on his projects to recapture his ongoing overhead much less make a profit. That is, he was losing money on every job. Because he had overhead and profit jumbled together in his GPM, he did not clearly see what was happening. His company did survive. But only because he slashed his own pay, then burned through all his working capital and mortgaged his home to raise the cash needed to keep his company afloat.

Had he been using CDM, he could have seen that his new, smaller jobs required different charges for overhead than his GPM method was providing. Now, just how he might have dealt with that hard truth is a matter for a whole other article on how you keep a company going when a severe downturn in the economy strikes and work shrinks radically. Whatever the case, you are better off starting with numbers that are clear and true—numbers CDM delivers.

David Gerstel is a veteran builder and the author of bestselling books on construction company management including Nail Your Numbers: A Path to Skilled Construction Estimating. *His most recent book is* Building Freedom: A Construction Pro's Path to Financial Independence. *You can reach him via his website, DavidGerstel.com.*