

Are You Pricing Your Job or Product Properly to Achieve Your Annual Profit Goals?

Jun 01 2011

Practice Area: Construction Law and Litigation

Many contractors do not accurately calculate their burden when bidding. Inaccuracies in calculating burden leaves them either underpricing or overpricing their products. The first can lead to massive losses; the second, massive losses. Yes, both take money right out of their pockets.

The dual overhead burden rate method of job costing/pricing is considered the most accurate method developed to determine a company's burden rates. Most companies unwittingly use a burden rate that allocates only a portion of their actual burden costs. Unfortunately, most don't know how to calculate their real "costs of doing business" and the burden rates they use are "rules of thumb," those used by others or from some other source.

Hence, for those jobs and/or products that use a disproportionately higher percentage of an incorrectly calculated burden component— i.e., direct labor—they will be overpricing their work and probably won't be awarded any of these contracts. Conversely, for jobs and/or products that use a disproportionately higher amount of other burden components—i.e., materials, equipment, subs, etc.—they will be underpricing their work and lose money. Unfortunately, they won't even realize it since jobs and/or product hard costs are typically checked and controlled by comparing the estimated hard costs to the actual hard costs as a job progresses or a product is manufactured. I call this phenomena "profit fade" and its negative effects are insidious. Companies that don't calculate their burden as their true cost of doing business will always experience this profit fade, have trouble maintaining their margins and achieving their profit goals. The sad part is, they won't realize it, much less understand why and how to avoid it.

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