

## Understanding Mark-ups

During the tender process, it is important to separately identify the true cost of construction, preliminary costs, overheads and target profit. Without this, it is difficult to successfully negotiate a tender price.

The project cost is the (total labour hours multiplied by the cost of labour) plus the materials cost, which is also referred to as the *First Cost*.

Mark-ups are the sum of the preliminaries, overheads and target profit expressed as a percentage. The percentage may vary, however it will be minimal.

Preliminary costs are those which the company incur due to the foreman's non productive time, such as organising workers, attending site meetings, ordering materials and recording time sheets. Other costs include the site shed, phone charges, deliveries, tools directly related to the project and maintenance costs. Preliminary costs are calculated as a fixed amount and converted to a percentage that forms part of the mark-up. During construction, these allowances are used as a budget for the foreman. It is anticipated preliminary costs will account for 3% to 5%.

Overheads are the cost of running the company. Such items include, wages for administration staff, supervisors and directors. As well as, office phones and power, vehicle leases, fuel, oil, and servicing. Insurance, public liability, advertising, promotion, bank charges, accounting fees and the list goes on.

Too often contractors add the princely sum of 5% to 10% for overheads. Unless the company is turning over \$15m to \$50m a year, it is simply too low. The result is that the company will have to raise capital and increase debt, just to service the increasing bank overdraft limits, raising a personal loan or increase credit card limits are typical examples that can be detrimental to the company.

If turnover is \$1m a year and 10% was included for overheads, only \$100,000 is available to cover all the items listed above, yet the director's salary should be greater than that amount. Based on this example, there is no hope of meeting the company's obligations.

Overheads are individually calculated for each business, and will be affected by the structure of the business. After many years of observation, the following are provided as a guide only. Here is a reasonable indication for *subcontractors* in the building and construction industry.

Turnover	Overheads
• \$0.5m to \$1.0m	28%
• \$1m to \$3m	20%
• \$3m to \$10m	16%
• \$10m to \$30m	12%
• \$30m to \$50m	8%
• \$50m to \$80m	5%

The higher the turnover, the lower the percentage.

Within the free enterprise system a company must make a profit, lest it will fail. A company may base its profit on 'a return on investment', which is good if looking at a business that was purchased, or if it is a saleable item, many contracting businesses don't fit this criteria. In which case, it could be better to view profit as 'a return on the risk taken in running a business'. It may be a builder does not pay, which could place the family home at risk. A reasonable profit is required to build working capital and ensure suppliers are paid on time. A good credit rating is imperative to the company.

Profits can also be viewed as a return on the licensed contractor's time studying and gaining trade qualifications as well as the time and effort in keeping up to date with the latest rules and regulations. Profit represents the quality of life we want.

Target profit is determined by supply and demand. How important is winning the tender? If it is not important a higher target profit would be appropriate. Conversely, a lower profit should apply if it is important. When work is in short supply, 8% may be realistic, while on other occasions 12% to 15% may be appropriate.

If preliminaries are set at 3%, overheads at 17% and profits at 12%, this equates to 32%, however, it actually represents 30.5% mark-up, due to the method of adding each percentage to the previous cost during the final summary of the estimating process.

In suggesting that mark-ups should be around 32% to 36%, it is often scoffed at, with the suggestion that by allowing such mark-ups one would never win a job. The difference is, tenders should be priced at cost and therefore the suggested mark-ups are both realistic and keep the company profitable. By using the estimating principles, methods and procedures outlined in Paul Funnell's FREE Estimating Courses, that can be downloaded from [www.pfestimating.com](http://www.pfestimating.com). Contractors are finding that they have in fact been marking-up their projects by 40% without realising it. A company will become more competitive by pricing the tenders at cost then adding the mark-up separately.

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