Construction Accounting and Financial Management

Chapter 10
Setting Profit Margins for Bidding

Profit Equation

- Revenues = Construction Costs + Overhead + Profit

- Profit = Revenues – Construction Costs – Overhead

Contribution Margin

- Contribution Margin = Revenues –
  Construction Costs –
  Variable Overhead

- CM Ratio = Contribution Margin/Revenues

- Contribution Margin = CM Ratio(Revenues)

- Profit = CM Ratio(Revenues) –
  Fixed Overhead

Break-even Volume of Work

- Without profit
  - Revenues = $\dfrac{\text{Fixed Overhead}}{\text{CM Ratio}}$

- At fixed level of profit
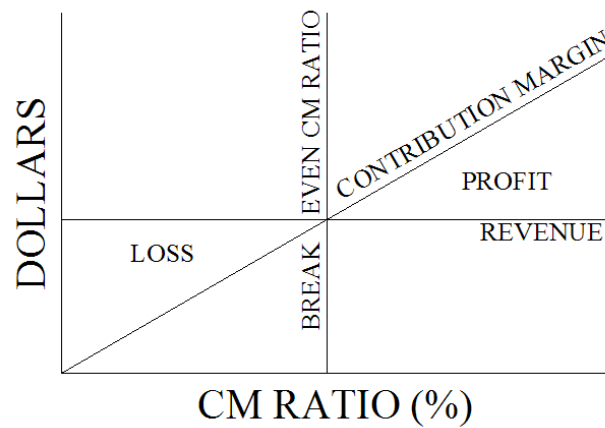 - Revenues = $\dfrac{\text{Profit + Fixed Overhead}}{\text{CM Ratio}}$

Break-even Volume of Work
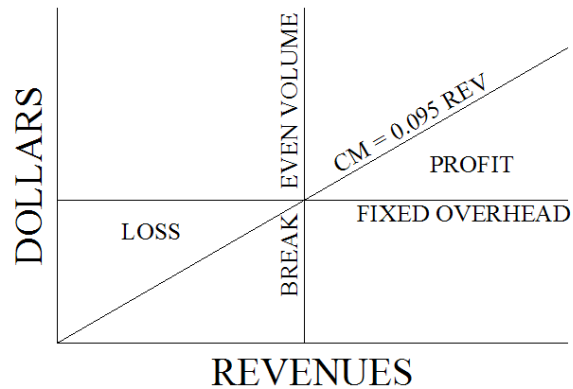
Break-even Contribution Margin Ratio

- Without profit
  - CM Ratio = $\dfrac{\text{Fixed Overhead}}{\text{Revenues}}$

- At fixed level of profit
  - CM Ratio = $\dfrac{\text{Profit + Fixed Overhead}}{\text{Revenues}}$

Break-even Contribution Margin Ratio

Adjusting the Financial Mix

- Change prices

- Reduce construction costs

- Reduce general overhead

Profit and Overhead Markup

- P&O Markup = $\dfrac{\text{Gross Profit Margin}}{(1 - \text{Gross Profit Margin})}$

Tracking Competitors

- Determine what their profit and overhead markup would be based upon your construction costs

- P&O Markup = Bid/Construction Costs – 1

- Use competitor's historical P&O markups to aid in setting your profit and overhead markup