

Construction Accounting and Financial Management

Chapter 10
Setting Profit Margins for Bidding

Profit Equation

- Revenues = Construction Costs + Overhead + Profit
- Profit = Revenues – Construction Costs – Overhead

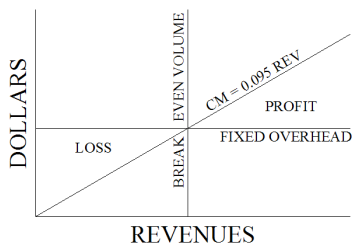
Contribution Margin

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

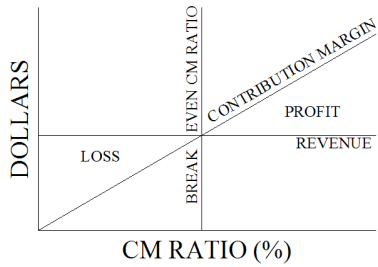
Break-even Volume of Work



Break-even Contribution Margin Ratio

- Without profit
 - CM Ratio = $\frac{\text{Fixed Overhead}}{\text{Revenues}}$
- At fixed level of profit
 - CM Ratio = $\frac{\text{Profit} + \text{Fixed Overhead}}{\text{Revenues}}$

Break-even Contribution Margin Ratio



Adjusting the Financial Mix

- Change prices
- Reduce construction costs
- Reduce general overhead

Profit and Overhead Markup

- P&O Markup = $\frac{\text{Gross Profit Margin}}{1 - \text{Gross Profit Margin}}$

Tracking Competitors

- Determine what their profit and overhead markup would be based upon your construction costs
- P&O Markup = $\text{Bid/Construction Costs} - 1$
- Use competitor's historical P&O markups to aid in setting your profit and overhead markup