Pricing for Profit

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Only two out of five jobs earn the expected profit margins based on the original bids submitted, according to "The E-Myth Landscape Contractor: Why Most Landscape Companies Don't Work and What to Do About It" by Michael Gerber and Anthony Bass. That's a lot of money left on the table. Estimating jobs for profitability is one of the toughest tasks for landscapers. And in a recovering economy, accurately estimating job costs is more important than ever before to ensure landscape companies realize profitable margins.

Accuracy is key to effective bidding

The goal is to bid as accurately as possible, so you can come out of the contract with the profit necessary for business growth. But this is easier said than done Ñ not only because the inclination today is to lower prices in order to nab the job, but also because there's less time to carefully prepare thorough estimates.

"The vast majority of green industry contractors have estimating systems that contain deficiencies," says James Huston, a Granby, Col.-based green industry management consultant for nearly three decades and author of "How to Price Landscape & Irrigation Projects" and "Estimating for Landscape and Irrigation Contractors."

Landscapers often step on land mines when entering the battlefield of cost estimating. They run the gamut from not planning for design and installation changes to biting off more than they can chew to not checking into current site conditions or factoring in all the overhead costs.

Huston, who has talked with thousands of contractors and personally worked with hundreds, finds that many estimating systems don't account for all of the direct costs in a project. Others don't address general and administrative overhead costs effectively. "I've seen some of these flaws cost contractors thousands of dollars," he notes.

The most common complaint Huston hears from landscape and irrigation contractors when pricing a job is: “I don’t know if I’m making money on this project. ” The basic problem is that these contractors don’t have a clear and well thought out estimating system to address all of the contingencies that might arise.

“Pricing work doesn’t happen in a vacuum,” stresses Huston. “Neither does your business operate as an island. It’s important to understand the environment and the market within which your business operates. I refer to this as ‘business context.’ It’s comprised of all of the external forces and market conditions that shape the environment surrounding your business.”

Pricing right from the get-go

Huston recommends landscape professionals start by calculating the material, labor, equipment and subcontractor costs for the production and general conditions phases of the bid. Then, begin to add markups and margins. After that, add sales tax and labor burden to determine the total of direct costs for the job being bid. The specific amount of net profit to be added to a particular job is determined by several factors:

- How badly you need the job
- The size of the job
- The risk involved
- What the market will bear
- A landscaper’s ability to negotiate and win the confidence and trust of the client

It’s easy for landscapers to have a firm tread on material costs, yet determining overhead costs is like being on a Slip ‘N Slide. Too many landscapers gamble by not truly understanding what their overhead costs are, or how to recover those costs.

“First and foremost, you have to know and recognize all your true overhead costs,” says Francisco Serrano, landscape architect at Landry’s Landscape, Baton Rouge, La. “Then and only then can you figure what margins to use. I wish there was one rule for all, but each case is different and needs close attention.”

Overhead, sometimes referred to as operating expenses, is the real cost of doing business. These costs do not contribute directly to the physical or hard costs of a project, but include items such as marketing and advertising, permit fees, administrative tasks, insurance, office space, vehicle and equipment expenses and even salary management.

To simplify the formula, take the total annual cost of running the business as separate from direct project costs, such as material or field expenses. To recover these overhead costs, you must distribute them over the total available work hours, which is usually done by establishing an hourly rate that includes overhead.

Why Every Cost Matters

James Huston, a Granby, Col.-based green industry management consultant, shares an example of how knowing every cost in a landscape operation can really pay off.

“A commercial landscape company in the West was billing about $1 million in annual sales revenue. Net profit on this type of work should have been at least 10 percent, or $100,000. However, the two owners were barely breaking even when they called me in to consult with them for a day.

“I knew there had to be a pretty big “leak” in the operation and was trying to find it. I asked the two owners to describe a typical production day. They told me they had 10 people in the field who arrived in the morning, punching in on the time clock. Then they would go next door to a doughnut shop to buy coffee and doughnuts.

“With coffee and doughnuts in hand, they loaded the trucks. Then the crews would drive to the job sites a minimum of 30 to 45 minutes away. At the end of the day, they would drive back to the yard, unload the trucks and punch out.

“Coffee, doughnut, load/unload and drive time totaled a minimum of 1.5 work hours per day. For a season lasting 200 days, that totaled 3,000 man-hours per year (200 days 10 crew 1.5 work hours per day). At a crew average wage of $10 plus 30 percent for labor burden, that’s $39,000 per year.

“I asked the owners who were paying the $39,000 if they were putting the 3,000 man-hours in their bids in general conditions and passing them on to the client to pay, or were they paying the $39,000 out of their pockets — out of profits?

“I’ll never forget the expressions on their faces. They looked at me, turned and looked at each other, and then turned back to me. Right there, it hit them. You could see the sinking expression on their faces.

“We found a $39,000 leak, or about 40 percent of the missing $100,000 net profit. That’s a pretty big leak!”

Labor liability is another big factor in profitability. “Knowing how long various tasks take to complete is crucial,” says Tom Nordloh, design and project management and landscape architect for Reesman’s Service Corp. in Burlington, Wis. “If you don’t estimate the correct amount of labor it will take to install the job, then you will lose money. Determine your direct labor costs and calculate how many hours your crews will work in the year, and then divide the overhead into your labor and material costs.”

Eleanor James, landscape designer/owner at Sparrow and Brambles in New York

City, adds 10 to 15 percent labor time to whatever she thinks a job will take. “That way, a little ‘fluff’ covers us from things we can’t predict,” she says.

Labor should be marked up by a predetermined percentage in order to recover such costs as FICA, FUTA, SUTA, general liability insurance, field crew vacations, holidays, sick days, workers’ compensation insurance and medical insurance.

A number of methods are commonly used by contractors to recover general and administrative (G&A) overhead. Quite often a percentage markup is used on materials, labor (including labor burden), equipment and subcontractors (or just one or two of these items). A G&A overhead cost per field labor hour may also be used.

Landscape professionals may or may not have commissioned salespeople in their companies. If they do, they should have a category in “direct costs” where they account for their commissions.

Projecting subcontractor costs is done in much the same way as materials and supplies. “If subcontractors have been running 15 percent of sales on your P&L (profit and loss) statement and you’re going to increase or decrease sales in the next year, then you can multiply projected sales by the historical 15 percent in order to calculate projected subcontractor costs,” explains Huston. “If your sales are going to change significantly from the previous budgeting period, this procedure will make the appropriate adjustments.”

In many cases, subcontractor costs as a percent of sales will vary dramatically from year to year, but there’s no way to project these fluctuations.

Huston finds many contractors mark up costs by some factor or combination of factors without realizing that mathematically they’re going to lose margin points along the way. “If you’re marking up your direct costs by 25 percent to achieve your final price, you automatically lose 5 percent,” he explains. “Even a 10 percent markup costs you 1 percent on your bids.”

To achieve a true 25-percent margin using the markup method, you’d have to mark up the true downtime costs by more than 33 percent. “This may not seem like much, but if your sales are $500,000 per year over a career of 25 years, a 1-percent margin increase will get you an additional $125,000 of net profit,” Huston says.

When drawing up the estimate, many contractors overlook sales tax. “Be sure to provide appropriate sales tax markups to materials and other items as required by state and local laws,” Huston says. “In some states, tax is now applied to the final price of the job, not just to the materials.”

Huston also recommends the inclusion of the “aggravation factor” in estimates. “Basically, this is additional money tacked on to the price of a job that will make it worth it to incur additional risk or put up with certain situations or individuals (architects, engineers, owners, developers, homeowners, etc.) with whom you’d rather not deal,” he says.

Remember that except for the contingency factor, you’re constantly attempting to determine and differentiate between two numbers in the bidding process: total costs, which include direct and general and administrative overhead costs, or the breakeven point (BEP), and the maximum price the market will bear.