



## Overhead Rate Calculation



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Overhead rates are typically used by manufacturing companies to allocate overhead costs to products and by service companies to allocate overhead costs to client projects. A company can use performance ratios, such as an overhead rate, to effectively manage its operations and to measure its overall performance against that of similar companies in its industry.

An overall overhead rate can be calculated by dividing:

**overhead (indirect) costs (for example, rent and utilities)**  
**direct costs (for example, labor)**

If your overhead costs are \$30,000 and direct costs are \$60,000, your overhead rate is .50. If the typical overhead rate for companies in your industry is 1.3, and your rate is .50, you have a competitive advantage with your lower overhead. Performance ratios such as overhead rates should be tracked monthly, quarterly, and annually. Tracking overhead rates over time will highlight trends and normalize exceptions caused by extraordinary items or the timing of monthly expenses.

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