Employee Labor Burden

-A Business Strategy-

Business owners and managers usually know what their employees’ hourly wage or salary costs are, and they may also have a good idea of approximately what payroll taxes cost. But they generally do not have any idea of what the extra or ‘hidden’ employment costs are, as they may not have taken the time to research these. Employee burden costs may include:

* Paid time off
* Payroll taxes
* Health insurance
* Worker’s compensation insurance
* Uniforms or special work clothes
* Training
* Bonuses
* Usage of equipment and vehicles
* Workspace (e.g., office or floor space) costs

So how do we refer to these extra employee-related costs (including taxes)? Here are some of the definitions (and calculations) frequently used by businesses who closely track employee labor burden costs:

* **Labor Burden:** These are costs – above and beyond employees’ gross compensation—that a business incurs on behalf of its employees.
* **Labor Burden Cost per Production Hour**(or Fully-burdened Cost): (Labor Burden Cost + gross payroll labor cost) ÷ the number of actual work (production) hours.
* **Labor Burden Rate per Production Hour (%):** The additional total labor burden cost, expressed as a percent, above and beyond regular hourly payroll. I.e., Labor Burden Cost per hour ÷ hourly payroll cost.

After you compute an employee’s fully burdened labor, and divide it by the number of hours that the employee actually works on projects, businesses often find that that their workers typically cost the company from 30% to150% (or more), above and beyond their gross hourly labor rate. Getting in touch with, and carefully managing employment-related costs can be the critical difference between staying in (or needing to get out of) business!

Here are 10 different ways that you can use Labor Burden Calculations and information to improve your bottom line:

1. **Estimating Calculations and Pricing Decisions:** Being armed with accurate labor burden calculations and information will help you refine your operations in a variety of ways. Most commonly, accurate labor burden information can change how you estimate and price your jobs. When you know how much each direct labor employee actually costs per production hour, and if you know what your desired gross profit margin is, you can create an estimate which will not only cover your true employee costs but will also help you to earn the profit that you deserve from each job.
2. **Assigning fully burdened costs to job cost reports:** Most company owners cite “labor over-runs” as their biggest ongoing risk. After you have calculated your labor rate, you can use your results to assign the correct (fully burdened) employment costs to job costs via your accounting system. Then you will want to review, on a weekly (or biweekly) basis, management reports showing total estimated labor cost vs. actual labor cost to date and by job phase. By continually reviewing operating variances, and comparing fully burdened estimated employee costs against fully burdened actual costs, you should be able to make an immediate impact on your bottom line by heading off labor over-runs before they get out of hand.
3. **Overtime or No Overtime?** Many company owners and managers keep overtime to an absolute minimum or actually forbid overtime work. After all, overtime costs 1.5 time regular wage rates, right? In many cases however, when you actually “run the numbers”, overtime may actually cost less per labor hour because many of the “fixed costs” of employment (e.g., health insurance) stay the same. When you actually compute the numbers on an employee-by-employee basis, and test various overtime scenarios, you will know whether overtime, and how much overtime, is a good financial decision for your company.
4. **Productivity Measurement, Employee Goals and Evaluation:** When you know exactly what a direct labor employee is costing you, you have a more objective way of determining productivity goals. For example, if it actually costs you $54,000 per year to have a specific employee perform a particular type of work, you can use that cost to determine the income that employee should generate for your company. In this case, if your gross profit goal is 35%, your markup needs to be 43%, so that employee should be bringing in more than $77,000 in income per year (or approximately $6,500/month). Now you have a tool to establish productivity goals, and to measure how well (or how poorly) that employee is meeting the goals that you have established.

1. **Better Compensation and Benefit Decisions**: Vehicles or No Vehicles? Benefits? Higher Wages? Should you supply vehicles to employees? Provide an auto allowance? Reimburse for mileage? Pay for cell phone usage? Require insurance co-pays? Add retirement benefits? Increase wages? Pay bonuses? Until you compute the results of various scenarios, and look at how the alternatives impact employee labor costs, you’re “working in the dark” (and possibly “in the red” as well). By starting with your current situation, and computing the results, you’ll see where you currently stand. Then you can begin to “play with the numbers” to see how potential changes will flow through and impact your employee costs and bottom line. As costs increase (or decrease), you’ll also know how that will impact your pricing model, and/or how employee productivity goals will need to be adjusted.

1. **Hiring Decisions:** Should you hire that Sales Manager? Add another Supervisor? Increase Direct Labor? A bad hiring decision can have a devastating effect on your bottom line, so you want as much objective data at your fingertips as possible before you hire. You can use labor burden calculation information to determine whether to bring on new employees, and to measure the total cost of different potential employees. First, determine all of the costs, in addition to salary or wages that you will be adding to the company for each potential employee. Then determine the income (or other anticipated benefits) that each potential new employee will bring to the company. Match the total costs against the anticipated benefit of bringing each employee on board. We all know that not all hiring decisions can be totally cost justified or quantified, but having that objective information at hand can be a great help in the decision-making. AND knowing what the goals are for that employee can assist in close monitoring to be sure that he or she is contributing to the company’s success as planned.
2. **Direct Labor vs. Sales & Admin Labor Costs:** Traditionally, the emphasis on labor burden calculations has been focused on direct labor employees (also known as “line” or “front-line” employees), but as profit margins tighten, and organizations become flatter and/or smaller – there is less delineation between front line employees and staff. In some cases employees may perform both front-line and staff roles, so business owners want to assign the appropriate “fully burdened” cost out to jobs. It’s therefore necessary to perform labor burden calculations for these employees. A full understanding of all employment costs is critical to business owners in today’s economy, so even when sales and administrative employees aren’t able to assign their time out to jobs, more and more business owners are interested in knowing each employee’s actual total annual cost and cost per work hour.

1. **Labor Burden Calculations for Business Owners**: We often find that business owners don’t have an objective way of determining their own cost or value to the company. If you are a business owner, getting in touch with your fully burdened hourly cost can help you to place an appropriate value on your time. You can use the results to assign your production cost to actual jobs and/or to company management. If your company has several owners or partners, measuring the fully burdened cost becomes even more important, as the owners may have different benefits, vehicles, and so forth. Keeping owners properly synchronized in terms of compensation and benefits can be a challenge, but using labor burden calculations to help document actual circumstances can be extremely helpful.
2. **Cross-company employment cost assignments:** If you own or are partners in multiple companies, you know that employees typically perform services for the various companies, but payroll is often processed in only one of the companies. If employment costs are not assigned out to the related companies, the company paying out the payroll shows too much employment cost, and the bottom line for that company will be too low (i.e. it won't show the correct profitability). Because it IS important for each company to reflect the actual net income earned within that specific company, employment costs should be allocated or invoiced to the related companies. These cross company cost assignments often include not only direct labor but sales, admin, and owner employment costs. To determine the correct amounts to be assigned to the related companies, you’ll need to perform the calculations necessary to determine fully burdened employment costs.
3. **The Cost of Errors and Lost and Wasted Time:** Another way you can use labor burden information is to share with employees their “true” cost per hour. By having factual information at hand, the company owner personally understands, and is able to explain to employees how valuable their time is to the company — and why the company needs to maximize that resource. Having this discussion with employees can help you build stronger, more cohesive teams. Placing a proper monetary value on employee time leads to fewer errors, less wasted time, and more productive hours in the work week.

Closing Thoughts

The Labor Burden Calculator is critical management tool, and the labor burden process can play a critical role in management decisions regarding pricing, productivity, cost control and a company’s business and productivity management strategy. Finally, it can also be used to discuss and interpret an employee’s value to the organization.