

Labor Burden & Profits – Part II: Exactly What Should Your Employees Contribute to the Bottom Line?

What do your employees really cost per production hour and how much should you charge for employee labor? Are each of your employees making a positive difference in your bottom line? Whether you have 1, 40, or 80 employees, it pays to know your labor burden numbers inside and out, so that you can use that data to increase your bottom line. Here are some ideas about how to use that critical information to make a positive impact in your take-home pay!

From Part I of This Series:

In our last article, we:

- Noted the fact that many business owners don't really know the true cost per production hour for each of their employees.
- Presented frequently used terms and "big-picture calculations" related to labor burden and employee costs.
- Illustrated how labor burden add-on costs, coupled with reducing paid time to actual production time, can make a tremendous difference in an employee's actual cost per production hour. (Our example employee, Pat, actually cost us 82% more than his/her gross hourly wage.)

Can You Project Pat's Cost Results to Other Employees?

It's tempting to think that you can perform labor burden calculations for just one or two employees, or to try to run totals across the company, but there are several good reasons to perform these calculations for **individual** employees:

1. Paid time off benefits can vary significantly between employees.
2. Fringe benefits can be quite different.
3. The cost of resources utilized can fluctuate from employee to employee (i.e., certain individuals may require vehicles or high-end equipment, while others don't.)
4. Base rates of pay differ, and as such, impact percentage calculations.
5. Knowing an individual's results will likely influence goals regarding anticipated income that they will earn for the company, or level of contribution to company objectives.



Of course, after you have performed individual computations, you may then choose to create employee groupings and create averages for different levels of employees (e.g., apprentice, mid-level, supervisor, admin, etc.) for estimating and/or pricing purposes.

Get Comfortable With the Numbers!



After performing initial labor burden cost calculations, you'll want to review the various elements, and your calculation formulas, closely. See if what you are looking at makes sense. Spending time to get very familiar with the results will help you make better business decisions. We will be exploring a number of ways that you can use this new information to make better pricing and hiring decisions, set employee expectations, build a stronger team, and increase profits – so you'll want to be sure that your assumptions and computations are accurate, and that you feel comfortable with what they are telling you.

[Click here to review an easy-to-use Labor Burden and Employee Profitability Calculator](#)

So What Should I Charge Per Hour?

In this case, after performing our computations, you discovered that **Pat's real cost per production hour was actually \$30.87 per hour, and you'd like to know what billing rate to use for Pat.** So, the next question to ask is "What is your target gross profit percentage?" Or more accurately, we should ask "**What is your target gross profit percentage for employee labor?**"

Why? Well, if your gross profit goal is 25% and you mark up all elements of your job equally, you would mark up all costs 33.3%. You would therefore **bill Pat out at \$41.15/hour to arrive at a 25% gross profit** (\$30.87 x 1.333).

But because **your gross profit is made up of various elements** (labor, subcontractors, materials, and other costs), many companies mark up individual aspects of the job differently. Therefore you should look at what you want to achieve with each element to achieve your “blended” total gross profit target.

For example, if your gross profit goal for a project is 25%, but your gross profit on materials is going to be 15%, and your gross profit on subcontractors is going to be 20%, you will need to reach for a much higher profit on your employees. Let’s look at the results for the that type of “mixed bag” scenario:

SCENARIO 1			Gross Profit		
	Antic Income	Antic Cost	Amount	%	Mark Up %
Materials	\$35,294	\$30,000	\$5,294	15%	17.6%
Subcontractors	\$25,000	\$20,000	\$5,000	20%	25.0%
Employees (Incl. labor burden)	\$39,706	\$25,000	\$14,706	37%	58.8%
Total	\$100,000	\$75,000	\$25,000	25%	33.3%

You can see that because your gross profit for materials and subcontractors is well below your total gross profit goal of 25%, you need to make up the difference on your employee labor. So to hit your overall goal for this job you’ll need to bump your employee gross profit to 37%, which means a markup of 58.8%. So **in this case you’ll need to bill Pat at \$49/hour (\$30.87 x 1.588).**

In this next scenario, you’ve decided that you can only look for a gross profit of 10% on your job materials (we’re holding subcontractor gross profit steady for this example). This means the employee labor gross profit needs to be increased to 40%, which requires a markup of 66.7%. **For Scenario 2 Pat will need to be billed at \$51.50/hour (\$30.87 x 1.667)** to achieve your target gross profit.

SCENARIO 2			Gross Profit		
	Antic Income	Antic Cost	Amount	%	Mark Up %
Materials	\$33,333	\$30,000	\$3,333	10%	11.1%
Subcontractors	\$25,000	\$20,000	\$5,000	20%	25.0%
Employees (Incl. labor burden)	\$41,667	\$25,000	\$16,667	40%	66.7%
Total	\$100,000	\$75,000	\$25,000	25%	33.3%

So, you can see that the billing rate range for these different situations is fairly broad – from \$41.15 per hour to \$51.50 per hour.

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And Now for the BIG Numbers,...

In our last article, we determined that Pat actually has 1,794 potential production (billing) hours. Let’s look at the annual difference in potential annual income from Pat’s activities:

$$\begin{aligned}
 & \$41.15 \times 1,794 \text{ hours} = \$73,823 \\
 & \underline{\$51.50 \times 1,794 \text{ hours} = \$92,391} \\
 & \text{Difference} = \underline{\$18,568}
 \end{aligned}$$

Let’s say that you have 6 employees at Pat’s level,...that means that the variance between high and low of \$18,568 would be multiplied by 6 **to equal a \$111,408 difference in your bottom line**



I think that you’ll agree that those kinds of numbers should make it worth your while to perform a series of calculations to determine what your employees’ billing rates should actually be!

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Next,...

More ways to use Labor Burden and employee cost information to enhance your bottom line,...

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She is the developer of the [eCPA \(employee Cost & Pricing Analyzer\) Labor Burden Calculator](#), an Excel-based program that automatically performs comprehensive labor burden and pricing calculations for up to 200 employees and 25 departments. Contact Gilson via [email](#) or call 734-544-7620 (9-5 Eastern).