

## EXACTLY HOW HEAVY IS YOUR LABOR BURDEN? *Frequently Asked Questions about Labor Burden Rates.*

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### What is Labor Burden and why is it important to my business?

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You are probably in fairly close touch with each employee's hourly wage or salary, and may have a good idea of approximately what payroll taxes cost. But you may not have taken the time to research and compute all of the additional "hidden" costs associated with each individual, including (but not limited to):

- Paid time off
- Health insurance
- Worker's compensation insurance
- Uniforms or special work clothes
- Training
- 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:** The costs – *above and beyond gross compensation* – that you incur in order for an employee to perform the work that you hired them to do.

**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 cost and then divide it by the number of hours that employee actually works on projects, businesses often find that workers typically cost the company from 50% to 150% (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!

### How can Labor Burden Calculations and Information Improve my Bottom Line?

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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

- Q. If you have employees working on fixed price jobs, what's normally your greatest financial risk?  
A. 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 bi-weekly) basis, management reports showing total estimated labor cost vs. actual labor cost to date by job stage. By continually reviewing these variance reports, and comparing fully burdened estimated employee cost against fully burdened actual cost, 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 keep overtime to an absolute minimum or actually forbid overtime work. After all, overtime costs 1.5 times 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, and 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.

### 5. Better Compensation and Benefit Decisions: E.g., 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.

### 6. Hiring Decisions: Should we Hire that Sales Manager? Add another Supervisor? Increase our 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.

## 7. 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.

## 8. 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.

## 9. Cross-company employment cost assignments

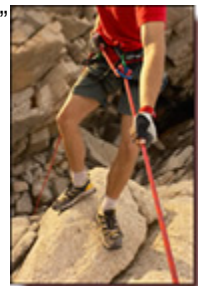
If you own or are partners in multiple companies, you know that employees typically perform services for the various companies, but payroll is often processed in only one of the companies. If employment costs are not assigned out to the related companies, the company paying out the payroll shows too 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.

## 10. 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.



### The Cost of an Error – A True Story....

When presenting seminars on this topic, I like to include a real-life story about the cost of errors. This is something that happened when I purchased my first home.

There was a small vanity countertop near my bath area, and I requested a Change Order that asked for only one sink, instead of two. (Due to the limited area, I wanted to use the remaining area as countertop.) This was a small item, but a relatively important to me as the purchaser of the home.

Well, as the home was being built, I visited the site each weekend. When we reached the vanity area finishing stage, I noticed that the counter had been mounted and showed cutouts for two sinks. I mentioned it to the builder/sales rep at that stage, and was told that it would be corrected. Over the course of the next week, the two sinks were set in and the plumbing fixtures connected (I mentioned the issue again), and then, the next week the full sized vanity mirror was mounted (tight to the countertop), and the towel racks went in (blocking in the mirror). Needless to say I discussed this with the builder/sales rep again.

Of course this was all ultimately taken care of to my satisfaction, but I always ask seminar attendees what they think this little communications snafu cost the builder to correct.

For costs we need to include:

- The Sales Rep's time/cost to communicate with the Construction Supervisor.
- The Construction Supervisor's (fully burdened) time/cost to learn of the error, check out and figure out what needs to be done about the error, schedule workers to correct the error, re-order materials, and check the work.
- The workers' (fully burdened) time/cost to dis-assemble the error, and re-do the work correctly.
- The cost of replacement materials.

Seminar attendees (builders) usually indicate that they estimate a cost of between \$500 and \$800. And that was a fairly small mistake! Unfortunately, it came right out of the builder's bottom line profits.



I'm sure the builder could have found more worthwhile and enjoyable ways to dispose of those funds! The moral of the story is that these kinds of problems eat away at your bottom line, but no one seems to realize to what extent. If you have a full understanding of the cost of labor, and can help to increase employee awareness of how this type of situation is extremely important to the company's success or failure, it can only help to improve your bottom line results!

#### How do I calculate my Labor Burden rate?

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The basic formula to calculate a company's labor burden rate for an individual employee is:

$$\text{Number of actual production hours} \div \text{the total additional cost of the employee} \\ = \text{Employee labor burden cost per production hour.}$$

For a more detailed explanation, [CLICK HERE](#).

#### These calculations looks like a lot of work! Are there any products that can help me perform these labor burden calculations and scenarios more quickly and easily?



The answer here is "Yes". Over the years of working through these calculations with literally hundreds of clients from a wide range of industries, we have developed our Qlean\$tart Worksheet: Labor Burden Calculator. This handy Excel spreadsheet kicks off your information-gathering with the recommended Reference Sheet. Then, with minimal entry, it automatically performs all of your labor burden calculations for up to 40 individual employees.

You will immediately see your regular and overtime Labor Burden percentages and true production costs (annual, per hour, and even down to the minute!) for each employee. It even reveals what you need to charge per hour for each production employee based upon your desired gross profit %.

Additionally, there is a "Summary & Links Sheet" that shows your results in a summary format for each employee. You can use this sheet to accumulate results for various "groups" or "levels" of employees so that you can create estimates and/or establish pricing based upon employee expertise or experience levels.

**BONUS #1!** We've included a special "Cost of Lost & Wasted Time" sheet with 4 different scenarios that you can use to quickly and humorously illustrate to employees how their actions (or lack thereof!) can have a dramatic impact on the company.

**BONUS #2!** If you are a QuickBooks® user you will see the exact percentages to use in employee records for automatic QuickBooks® labor burden allocations. (Complete instructions for integration into QuickBooks® management and job-cost reports included.)

If you'd like to view an on-line demo please [CLICK HERE](#).  
To be taken to our on-line store, [CLICK HERE](#).

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**After I've performed the underlying Labor Burden Calculations can I get my QuickBooks accounting system to automatically assign fully burdened cost to jobs?**

The answer here is "Yes". **IF** you know how to set up the underlying accounts and Payroll Items, and how to "trick" QuickBooks® into performing the cost assignments!

For a more detailed explanation, [CLICK HERE](#).

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