

FIGURING THE TRUE COST OF LABOR

Figuring the true cost of labor can be as deceptive as well as very important to know. You probably have a good handle on what materials are costing per job as long as any scrap is included in the amount of materials used for a job.

Labor costs can be deceptive.

It is complicated to truly figure it out but once done, assuming there are not many changes it will be simple to figure on a job to job basis. It is quite important to get this correct as it will throw off all business plans if it is wrong.

You need to have three figures.

Three categories of figures are involved, some simple some complex.

- 1) Total management and overhead costs.
- 2) The direct labor salary for the person doing the job.
- 3) How much work you are doing.

It makes the most sense to do this in a well noted spreadsheet so that any change can be made instantly.

Overhead costs include ALL non-direct labor costs. Rent, management salary, supervisors salary, insurance, loan payments, transportation, gas, and employers contributions to paychecks.

There are other hidden costs, leases on equipment, advertising, phone, electric, window washers, postage etc. Include EVERYTHING that is not direct salary to employees that are directly doing the work. Include salary that you get for management not for producing items.

Rent	30,000.00
Management	25,000.00
Supervisors	35,000.00
Insurance	3,000.00
Car Insurance	7,000.00
Loans	3,000.00
Transportation	125.00
Gasoline	750.00
Fuel Oil	2,500.00
Emp Contrib	1,440.00
Leases	2,400.00
Advertising	3,000.00
Phone	2,200.00
Electric	4,800.00
Window wash	1,040.00
Postage	240.00
Garbage	400.00
Repairs	4,500.00
Miscellaneous	3,000.00
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Total	127,195.00

Surprise?
Overhead Figure

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The total per hour salary of the employees doing the actual labor. Include in this the portion of your salary, if any, that you put into direct labor at a rate that you think you deserve on an hourly basis. Include as a yearly salary to include vacation pay

	HOURLY	PER YEAR
Employee 1	8.50	17,680.00
Employee 2	12.50	26,000.00
Employee 3	10.25	21,320.00
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Total		65,000.00
Direct Labor Cost		

The percentage of actual production capacity that you are using. This is what you can do in a normal shift verses what you actually do. Do not figure this at top speed for capacity, occasional spurts can be much higher than every day of the week production. I usually figure that an employee can continuously produce about 80% of what I can, I am much more motivated.

Capacity usage = 40% (Don't be surprised.)

What to do.

Divide the overhead figure, by the direct labor cost. Then divide this number by the capacity (in decimal 40%=.40).

Overhead	127,195.00	divided by
Direct Labor	65,000.00	= 1.9568
Capacity	.40	= 4.892
MAGIC NUMBER = 4.89		

This is the magic number.

It usually runs between 4 and 10. Four is good, 10 or higher means that the overhead is high. High overhead is OK if the markup is very high.

How To Use This Number

To figure the true labor cost of a project add up all the direct labor hours multiplied by their per hour rate. Multiply this by the magic number.

This is what the labor is really costing the business. Remember that this is your cost, without markup!

Surprised? I hope not. If so it will help you re-figure out your pricing so you make a profit.

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Another Possible Surprise

Losing money on a job can be beneficial at certain times. If you are very slow and do not want to lay someone off, getting cost of materials and part of employees salary is better than not getting part of the employees salary. If this lasts for LONG periods out of the year then you are in BIG trouble.

Material Costs

Material costs usually can be figured as 40% above invoice amounts. In most cases this takes into account scrap, shipping and other hidden costs. Multiplying by 1.4 gives you a much more accurate cost than the invoice.

Author's Note:

I hope that this helps you in your business. I have reorganized the instructions to make it hopefully more understandable. These instructions are boiled down from an amazing accountant who probably never had a client that failed without first knowing it was happening.