

# THE REAL COST OF STAFF AND SETTING YOUR PRICES

Do you really know how much your employees are costing?

If you said, wages plus super plus workers' compensation insurance, that's only the beginning.

For your business to be successful and budget to make a profit, you must review exactly the cost of your purchases and business inputs, and a significant component of these are labour costs.

How much per hour does an employee cost an employer, and thus

How much should we charge for labour, or factor into the cost of each unit of product?

For every employer and business the answers are different. But because we all want to make money for the huge effort we put in each week and the risk of being in business, we must plan to make a profit. The first step of doing so is setting our prices, and if this is done only by looking at what the competition charges (although we must be aware of this), we will never be successful.

The success of your business relies on the fact that your business is unique. It is not the same as everyone else's, and can't possibly have the same costing structure. You and your business must distinguish it from those around, on the basis that its product or service is the reason customers deal with you, and not your competitor.

Lets look at an example of really determining the cost of your labour, as the first step in your new planning and price setting process. If you run into any difficulties with the example, or want to know more about how to effectively plan to make your business a success, we look forward to assisting you.

Employee A:

|                               |                |
|-------------------------------|----------------|
| Full-time salary              | \$500 per week |
| Hours worked                  | 38             |
| Superannuation                | 6%             |
| Workers' comp insurance       | 4%             |
| Payroll tax on salary & super | 6%             |
| Fringe Benefits               | \$nil          |

Lets calculate the total costs of having the employee for the year.

|        |          |
|--------|----------|
| Salary | \$26,000 |
|--------|----------|

|                   |          |
|-------------------|----------|
| Superannuation    | \$1,580  |
| WorkCover         | \$1,117  |
| Payroll tax       | \$1,675  |
| <br>              |          |
| Total annual cost | \$30,722 |

The next step is figuring out how much time the employee has available to work.

|                    |           |
|--------------------|-----------|
| Days per year      | 365, less |
| <br>               |           |
| Weekends           | 104       |
| Public holidays    | 10        |
| Sick leave         | 12        |
| Annual leave       | 20        |
| Long service leave | 6         |
| <br>               |           |
| Subtotal           | 152       |

Leaving the actual work days as 213

The cost of the employee is then \$144.23 per day worked, or  
as this is an 7.6 hour day, \$18.98 per hour.

This is 44 per cent higher than the base hourly rate of pay. This type of calculation is relevant for employees not directly producing income.

For employees who directly produce income, for example by manufacturing or rendering services, an allowance must be made for unproductive time.

At 90% productivity, the cost of the employee is \$21.09, whilst  
at 80% productivity, the cost of the employee jumps to \$23.72 per hour.

After working out the real cost of the labour in a service organisation, the question is how much should be charged for direct labour provided to customers?

Clients who are service organisations need to be aware of the real cost of labour in determining their charge rates. Additionally, allowance must also be made for business overheads, including non productive support or administration staff, and of course the necessity to make a profit.

Lets continue with the facts above, extending them to a business with five 80% productive employees earning \$500 per week (as above). But now we will factor in some business overheads.

| Business overheads    | cost \$ |
|-----------------------|---------|
| Rent & rates          | 10,000  |
| Phone & facsimile     | 2,000   |
| Gas & electricity     | 1,000   |
| Repairs & maintenance | 2,000   |
| Car expenses          | 10,000  |

|                                |                 |
|--------------------------------|-----------------|
| Tax & accounting               | 1,000           |
| Administration wages and costs | 20,000          |
| Sundry                         | 4,000           |
| <b>Total cost of overheads</b> | <b>\$50,000</b> |

First determine how much time is available in which to produce the income.

|                |       |
|----------------|-------|
| Employees      | 5 x   |
| Days available | 213 x |
| Hours per day  | 7.6 x |
| Productivity   | 80% = |

Total hours available = 6475

What is the cost of each of those productive hours to the business owner?

|   |                |
|---|----------------|
| Direct labour costs at 80% as calculated above  | \$23.72        |
| Overheads total \$50,000 divided by 6,475 hours | \$7.72         |
| <b>Total cost of each productive hour</b>       | <b>\$31.44</b> |

This simple example shows that the break-even point for charging direct labour is \$31.44, and this excludes the necessity to make allowances for problems occurring on jobs, or to recoup a profit for use in business expansion, debt reduction, and provide a return to the business owner for the risk undertaken.

### Conclusion

As you can see this example is simplistic. But it does convey the need to carefully consider the real cost of staff, and the importance of costing your product or service carefully.

The only way your business will become or remain successful in the dynamic and competitive world of the late 1990's, is to plan each step with care. The days of "Fly by the seat of your pants" success is gone.

Brad Huckel & Co look forward to assisting clients with the business planning process, to ensure your success by "accounting for your business needs".