The Burden of Labor

by Sal Alfano

Have you ever wondered why, despite accurate estimates of materials, subcontractors, and labor, you keep losing bids to other builders' lower prices? Or why you lose money on some of the jobs you win, even though the construction goes as planned? One reason may be the way you deal with labor burden — the hidden costs of labor. If you treat labor burden as overhead instead of as a direct cost, your prices will be either too high to win the work, or too low to make money.

Sample Labor Burden
(based on $10/hr. wage)

$ .77	FICA/Medicare (7.65%)
.20	FUTA (2%)*
.15	SUTA (1.5%)*
1.80	W. comp. (18%)
2.00	Health insur. (20%)
.40	Vacation (4%)
$5.32	Total Labor Burden

* Federal and State Unemployment Insurance.

Figure 1. *For every dollar you pay an employee, you must also contribute additional amounts to cover social security, insurance, and other benefits. Calculate these hidden costs of labor as a percentage of gross wages.*

How Labor Burden Inflates Overhead

$30,000	Owner's salary
2,000	Phone, utilities
500	Office supplies
1,000	Tools, repairs
1,000	Liability insurance
2,000	Vehicle expenses
$36,500	Total Overhead Builder 1
22,131	Labor burden
$58,631	Total Overhead Builder 2

Figure 2. *With expenses identical to Builder 1, total overhead for Builder 2 is higher by the amount included for labor burden. This will increase his gross profit percentage.*

What Is Labor Burden?

Direct costs for materials and subcontractors are easy to estimate. Some suppliers will even do the material takeoff for you, and most subs will submit an accurate quote that you can plug into your estimate. As long as you include sales tax for materials, and supervision time for subs, there are no additional costs to worry about.

When it comes to labor, however, there are many hidden costs. For every dollar you pay in gross wages, you must also pay a percentage for social security, unemployment tax, insurance, and other expenses. The total labor burden is the difference between how much you pay employees and how much you charge for their labor.

The employee in Figure 1, for example, is paid $10/hr., but actually costs an additional $5.32/hr. When estimating labor costs, some builders include labor burden as a direct cost; in other words, they price the $10/hr. employee at $15.32/hr. Others use the $10/hr. figure in the labor line item in estimates, and lump the extra $5.32/hr. into overhead. But the two methods of handling labor burden determine how gross profit affects a job's selling price.

Case in Point

Here's how it works. Following the example in Figure 1, let's assume that two builders each have two employees whom they pay $10/hr. apiece. This makes the yearly gross wage for both

Calculating Gross Profit Percentage

Builder 1

$$\frac{\$41{,}500 \text{ Gross Profit (not incl. labor burden)}}{\$250{,}000 \text{ Gross Sales}} = 16.6\%$$

Builder 2

$$\frac{\$63{,}631 \text{ Gross Profit (incl. labor burden)}}{\$250{,}000 \text{ Gross Sales}} = 25.5\%$$

Note: Gross profit equals overhead from Figure 2 plus $5,000 net profit.

Figure 3. *Including labor burden as part of overhead results in a higher gross profit percentage. In most cases, this results in higher selling prices for the work you estimate.*

Sample Estimates

	Builder 1 (Labor Burden incl. in Direct Labor)	Builder 2 (Labor Burden incl. in Overhead)
Job A		
Materials & Subs	$39,000	$39,000
Labor	+6,128	+4,000
Total Direct Costs	45,128	43,000
Gross Profit Divisor	÷ .834	÷ .745
Selling Price	$54,110	$57,718
Job B		
Materials & Subs	$120,000	$120,000
Labor	+29,414	+19,200
Total Direct Costs	149,414	139,200
Gross Profit Divisor	÷ .834	÷ .745
Selling Price	$179,153	$186,846
Job C		
Materials & Subs	$ 5,000	$ 5,000
Labor	+14,707	+9,600
Total Direct Costs	19,707	14,600
Gross Profit Divisor	÷ .834	÷ .745
Selling Price	$23,630	$19,597

Figure 4. *When material and subcontractor costs are higher than labor costs, as in Jobs A and B, Builder 2's price is too high to be competitive, because labor burden artificially inflates his overhead. In Job C, Builder 2's low price may win the bid, but there are not enough material and subcontractor costs to cover the hidden costs of labor, even with a higher gross profit percentage.*

employees $41,600, so the total labor burden for each builder is $22,131 ($5.32/hr. x 2,080 hrs. x 2 employees). Let's also assume that both builders do $250,000 worth of business each year, that both run companies with identical expenses, and that both want to earn $5,000 in net profit.

The only difference is that Builder 1 estimates labor at a rate that includes labor burden, while Builder 2 estimates gross wages only, putting labor burden into overhead. The sample calculation in Figure 2 shows how this difference affects the total overhead for each builder.

When it comes time to calculate a job's selling price — by adding gross profit to the estimate for direct costs — the numbers in Figure 3 show that Builder 2 has a higher gross profit percentage than Builder 1.

The bottom line. How does this affect the selling price of the jobs each builder estimates? The three sample bids in Figure 4 (next page) assume that both builders have calculated the hard costs of all three jobs — including the number of labor hours required — the same way. But the two builders' selling prices are very different.

In a competitive bid for Jobs A and B, in which material and sub costs are higher than labor costs, Builder 2 would lose because his price is too high. In Job C, in which labor costs are much higher than material and sub costs, Builder 2 would win the bid, but lose his shirt.

What happened? The high hidden cost of labor artificially inflated Builder 2's selling price when it was applied to the totals for materials and subs as a gross profit percentage. When materials and subcontractor costs are higher than labor costs — which they usually are — Builder 2's selling price will always be higher than it needs to be.

Builder 2's price will be too low, however, when materials and subcontractor costs are lower than labor costs. His labor line item covers only the hourly wage of his employees. In most cases, even with his higher gross profit percentage, there will not be enough materials and subs to cover labor burden.

Builder 1 never has this problem. His labor line item always includes both the hourly wage of his employees and the labor burden. The higher labor line item is offset by a lower gross profit percentage that more accurately reflects the true costs of running his company.

Don't let the hidden cost of labor cost you the job. Always include labor burden as part of the hourly wage you charge for labor. This will ensure that you correctly cover the hidden costs of employees, and will make your prices more competitive. ■

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