

Labour Costing

Objectives

- ▶ Intro to Labour Costs
- ▶ Remuneration methods
- ▶ Incentive schemes and productivity
- ▶ Labour turnover
- ▶ Classifying and accounting for Labour costs

Managing Labour Costs

- ▶ Critical cost in all organisations
- ▶ Need to make employee 'investments'
- ▶ Labour intensive industries need strong productivity management
- ▶ SL Labour laws and employee relations

Elements of Labour Cost.

Labour Cost can either be direct, or Indirect they include.

- ▶ Basic Wages
- ▶ Overtime premium
- ▶ Bonus payment
- ▶ Idle time
- ▶ Holiday pay

Remuneration methods

Various methods by which basic wages can be determined include.

- ▶ Fixed salary per month. This applies to permanent employees who are salaried a fixed amount per month.
- ▶ Time based systems.
- ▶ Piece works systems.
- ▶ Bonus / incentive schemes.

Remuneration methods

Time work

- $\text{Wages} = \text{hours worked} \times \text{rate per hour}$
- Overtime premium = extra rate per hour for hours over and above basic
- Quality more important than quantity
- No incentive for employee performance improvement

Piecework schemes

- $\text{Wages} = \text{units produced} \times \text{rate per unit}$
- Guaranteed minimum wage
- Differential schemes pay higher rates for increased levels of productivity
- Output inspected carefully

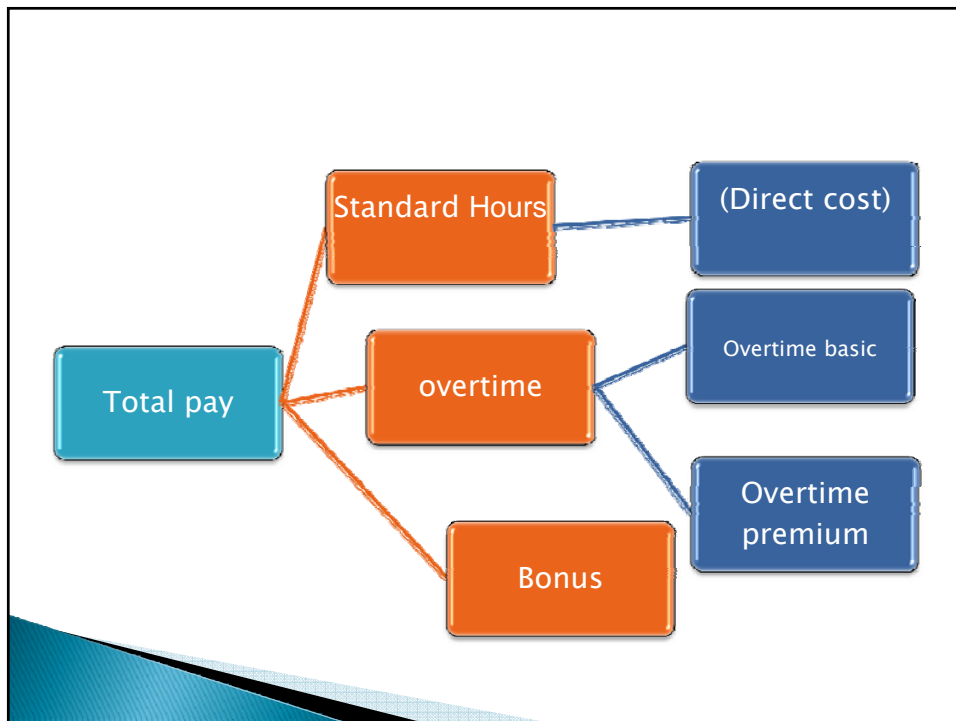
Bonus/incentive scheme

- Employee paid more for productivity
- Increased profits shared between employer and employee
- High day-rate system
- Bonus schemes (group and individual)
- Profit-sharing schemes
- Incentive schemes involving shares
- Value added incentive schemes

Class Exercise 1

- ▶ Example in handout... Page 1

James is a direct labour employee.....



Class Exercise 2

Susan is a direct labour employee who works a standard of 40 hours per week. She is paid a basic rate of Rs120 per hour. Overtime is paid at 1.5x the basic hourly rate

In a certain week Susan worked for 75 hours and due to her improved efficiency she was entitled to a bonus of Rs. 500

Required. Calculate Susan's pay and break it down to direct and indirect labour cost.

Solution

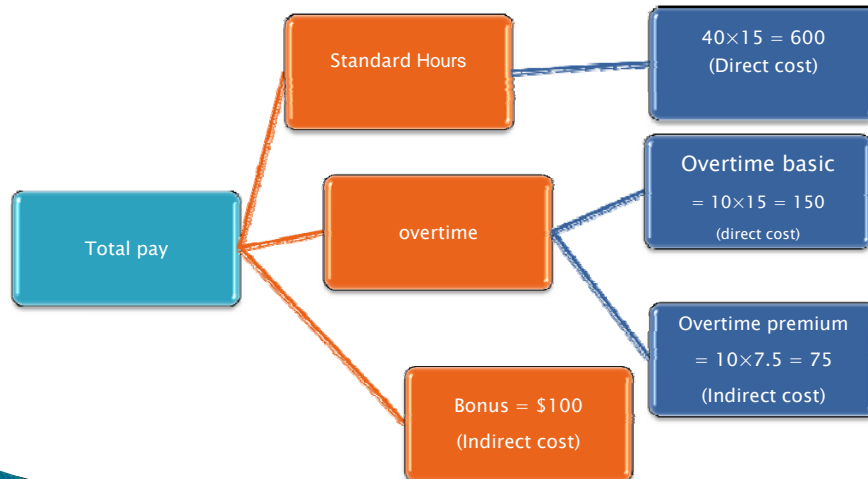
Of the total 75 hours worked:

40hrs are standard and
10hrs are overtime hours.

Overtime (OT) is paid at time and half means;

Total overtime pay = OT hrs x standard rate + half
of standard rate x OT hrs

Cont...



Class Exercise 3

Normal working day 8 hours

- ▶ Basic rate of pay Rs. 60 per hour
- ▶ Standard time allowed to produce 1 unit 2 minutes
- ▶ Premium bonuses 75% of time saved at basic rate

Required

- ▶ What is the cost of producing 340 units in one day?
- ▶ What is the saving in labour cost as a % of the standard rate per unit?

PIECEWORK SYSTEMS.

In this case wages depend on level output

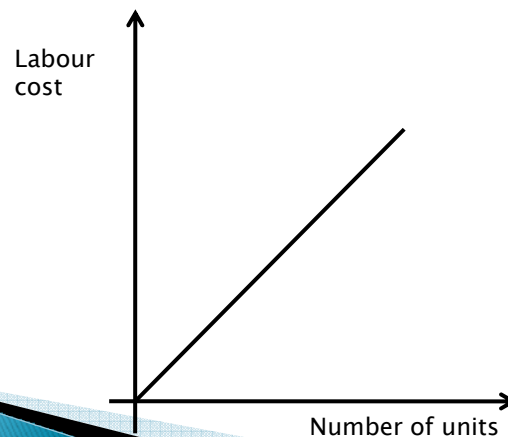
Basic earnings = Unit Produced x Rate of Pay per unit.

There are three types

- ▶ Straight piece work system
- ▶ Straight piece work with guaranteed minimum wage
- ▶ Differential piece work system

Straight Piece work system

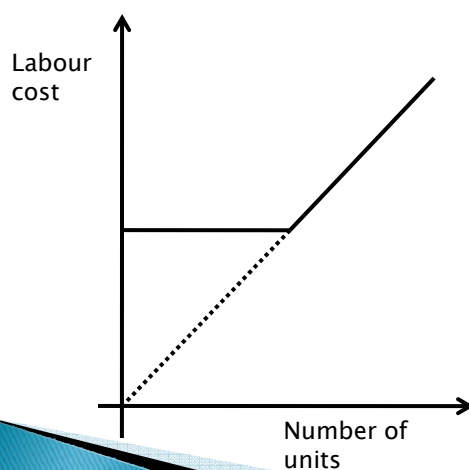
The basic rate per unit remains constant irrespective number of units produced



Straight piecework with guaranteed minimum wage

- ▶ Employees are paid based on the number of units produced.
- ▶ However employees are guaranteed a minimum wage since there are occasions when production doesn't take place due to unavoidable circumstances e.g. power failure, shortage of materials or machine breakdown

Straight piecework with guaranteed minimum wage



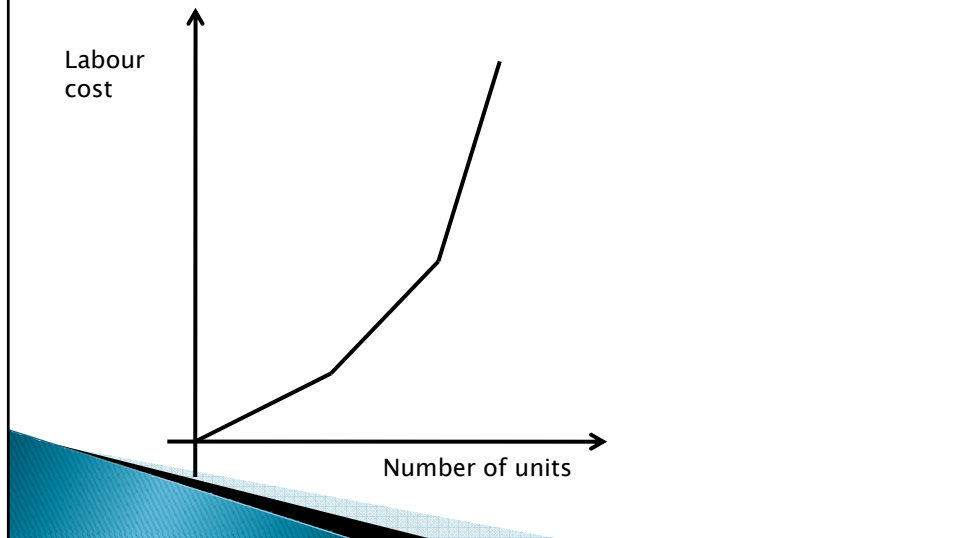
Class Exercise 4

- ▶ Page 2
- ▶ “sam is paid.....”

Differential Piecework System

- ▶ Employees basic rate of pay per unit changes as level of activity changes.
- ▶ Rate of pay per unit increases on additional units produced when certain output levels are reached.
- ▶ It doesn't provide security for a guaranteed wage but it can enhance incentive for increased rates for higher production.

Differential piecework system



Class Exercise 5

- ▶ Page 2
- ▶ "X Ltd operates a ..."

Class Exercise 6

A company pays its employees using piecework scheme. The rates are as follows:

0–100 units per week	Rs. 4 per unit
101–150 units per week	Rs. 4.50 per unit
151–200 units per week	Rs. 5 per unit
201 + units per week	Rs. 5.50 per unit

Required

- ▶ If an employee produces 163 units in week 48, what would their pay be for that week?

Bonus/ Incentive scheme

- ▶ Bonus is paid to employees to increase efficiency.
- ▶ An increase in production units *without an increase in productivity* will not reduce unit cost.
- ▶ Improved productivity will enable a company to achieve its production targets in less time and therefore at lower costs.

Types of Incentive Schemes

- ▶ High day rate system.
- ▶ Individual bonus scheme.
- ▶ Group bonus scheme.
- ▶ Profit sharing schemes.
- ▶ Employ share ownership plan.
- ▶ Value added incentive schemes.

High Day Rate System

- ▶ A system where employees are paid a high hourly wage in expectation that they will work more efficiently than similar employees on a lower rate in a different company.
- ▶ Opinions are mixed on the outcome...
 - Large companies pay average wages to better people
 - Smaller companies will pay higher wages to attract better talent

Characteristics of bonus / incentive schemes

- ▶ Employees paid more for efficiency.
- ▶ Despite the extra labour cost, the unit cost of output is reduced and profit earned per unit of sales is increased.
- ▶ Morale of employees is increase. Due to the receipt of extra reward for extra effort

Class Exercise 7

X Ltd operates a premium bonus scheme for its employees of 75% of time saved compared with standard time allowed for a job. The data relating to a certain job completed by an employee is as follows.

- | | |
|-----------------------------|-------------|
| ▶ Allowed time for a job | 4 hours. |
| ▶ Time taken to complete | 3 hours. |
| ▶ Normal hourly rate of pay | Rs. 80/hour |

Required

- ▶ Total pay of employee for the job.

Time rate or piece work System?

Advantages of time rate over piece rate.

- ▶ **Quality of output** is better since there is no hurry to produce more unit.
- ▶ Employees feel secure and they are assured of some pay at the end of the period if time is determining factor.
- ▶ Does not lead to hard negotiations when rates are being revised.
- ▶ More appropriate when quality of output is more important than quantity.

Disadvantages time rate over piecework.

- ▶ No incentive for employees paid on a daily rate to improve performance as more efficient are equally compensated as less efficient.
- ▶ Quantity of output is much lower and supervisory cost are high since employees need close attention.

Conditions of a successful bonus scheme.

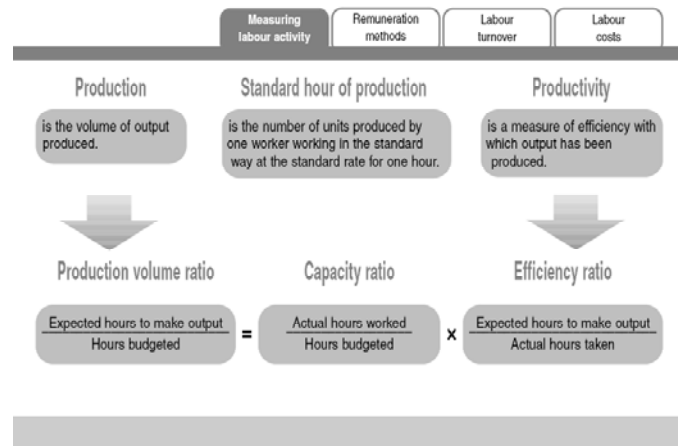
- ▶ Objectives should be clearly stated and attainable by employees.
- ▶ Rules and conditions of the scheme should be easy to understand and not liable to misinterpretations.
- ▶ Must be fully acceptable by everyone concerned including trade union negotiators and officials.
- ▶ Allowance should be made for external factors outside employees control which reduce productivity such as machine breakdown or raw materials shortage.
- ▶ Only those employees who made the extra effort should be rewarded.
- ▶ The scheme must be properly communicated to the employee.

Production and Productivity Measures

Measuring labour activity

- ▶ **Production** is the quantity of volume of output produced.
- ▶ **Productivity** is a measure of the efficiency with which output has been produced. An increase in productivity is likely to reduce unit costs.
- ▶ **standard hour of production** is the pre-determined output from one worker for one hour. In other words a standard hour is a 'quantity of work' not a period of time.
- ▶ **Standard labour hours** = actual units output x standard time per unit.

Efficiency, capacity and production volume Ratios



Class Exercise 8

Barnes Ltd budgeted to make 13,000 standard units of output during a budgeted period of 26,000 hours (each unit should take two hours). During the period, the company actually made 14,000 units which took 35,000 hours.

Required. Calculate efficiency, capacity and volume ratios