

A Key Determinant of Profitability is Production Not Labor Costs

A huge myth in Human Resource (HR) management is that you can increase your profitability by simply reducing labor costs. Labor costs are a function of how much a business pays its labor force and how much that labor force produces in a given period of time.



The problem with just reducing labor costs is that it does not take into consideration how much that labor force is producing. Production is not solely a function of labor cost. Production is determined by efficiency. If lowering labor costs results in an equal or greater reduction in production, the business is actually worse off. The better solution is to focus on increasing production efficiency not on lowering labor costs. The end result is increased profits.

Employee Classification

In order to understand the true relationship between labor costs and efficient production, it is important to analyze how labor costs are classified. The rules governing the payment for labor are enforced by the [Wage and Hour Division of the United States Department of Labor](#). Labor is defined as being performed by either Independent Contractors or Employees. Independent Contractors are defined by many different criteria that will be discussed at a later time. Employees are basically classified as follows:

Exempt Employees

Exempt employees are not entitled to overtime pay no matter how many hours per week they work. Employers must pay exempt employees their full salary amount as long as they do any work during a pay period. If they miss work, the employer can require them to make up the lost time or deduct the time from their accumulated leave time. Exempt employees must have work responsibilities that are primarily executory in nature (meaning supervisory or managerial). Professionals in “learned” occupations such as Doctors, Lawyers and Engineers may be exempt from overtime rules by definition because of their education and licensing requirements.

Non-Exempt Employees

Non-Exempt employees must be paid time and one-half for all time worked in excess of forty hours in a week. When an employee’s contract includes a non-exempt salary, the employer must state the number of hours the employee is expected to work each week. The expected hours are divided by the salary amount to determine a base pay rate in the event an employee works more than forty hours in a week.

Non-Exempt with Overtime

“Non-Exempt with Overtime” employees required to work an expected work week of less than forty hours are not entitled to overtime unless their total hours exceeds forty hours in a week. For example, if the employee’s employment contract specifies that the employee work twenty hours per week and the employee works thirty hours during the week, the employer is not required to pay overtime for the ten hours in excess of the required twenty hours. However, if the employee works more than forty hours in a week, the employer must pay the base rate for the entire forty hours plus time and one-half for the hours worked in excess of the forty hours for the week.

Exempt versus Non-Exempt

A common misconception is that hourly employees are non-exempt employees and salaried employees are exempt. This is not true. Classification of exempt versus non-exempt employees depends on job titles, duties, responsibilities and in some cases ownership of the company. The primary determining factor is that exempt employees perform activities that have an impact on the management of the company because they are expected to exercise independent judgment as part of their job. Non-exempt employees do not have this requirement as part of their employment.

Employee Misclassification

The cost of making a mistake in the classification of an employee can be staggering. This point is illustrated well in the Pacific Crest Group (PCG) case study titled “[Proper Differentiation between Wage and Hourly Employees is Critical](#).” In this case, PCG wrote two different employee manuals because the employee’s roles, responsibilities and compensation amounts were so different. Pacific Crest Group professionals also provided office hours on site for employees and

management to answer questions about employment policies and procedures. Providing access to trained Human Resource (HR) professionals was critical in building trust between employees and management.

The Pacific Crest Group provides professional services that keep your business focused on your critical objectives. We create custom made financial and Human Resource (HR) systems based on creative strategies that are always delivered with exemplary customer service. A PCG professional is happy to meet with you to discuss solutions for your unique requirements designed specifically to maximize all of your business opportunities.