

Labour costs and productivity

In any industry in which labour is a significant cost, its monitoring and control is vital. This is certainly the case in the hospitality industry. However, labour costs in themselves do not give a full picture. A labour percentage or cost does not indicate whether an employer employs a few people at high rates of pay or a large number of people at low rates of pay. It is important therefore for a well-managed enterprise to monitor both its labour costs and its productivity.

In some industries it is reasonably simple to state with some degree of confidence what labour costs should be as a percentage of total costs, of revenue or of some other clear standard. However, hospitality enterprises often offer a service to other industries, apart from creating an end product in their own right, so no such simple yardstick exists; for example, labour costs in a modern, efficiently designed and well-managed public house may be as low as 10%, whereas in many sectors of institutional and industrial catering labour may cost 60–70% of revenue. In some clubs labour costs can approach 90% of trade done. In this case the apparently high labour cost is often caused by the very high level of subscription income not accounted for in trade revenue, and by the low level of price charged for goods and services.

Factors influencing labour costs

The factors that influence labour costs are numerous but probably what determines labour cost more than anything else is the precise nature of the enterprise, and the employer's particular policy; for example, if the business provides a subsidized service, with low selling prices to employees, then labour costs as a percentage of revenue



will be high. If, at the other extreme, it wants to maximize profit in the short term, by providing a product involving minimum service from capital-intensive plant, using unskilled staff, as in many fast food operations, then the labour costs will be low. Figure 18.1 illustrates some factors influencing labour costs and productivity.

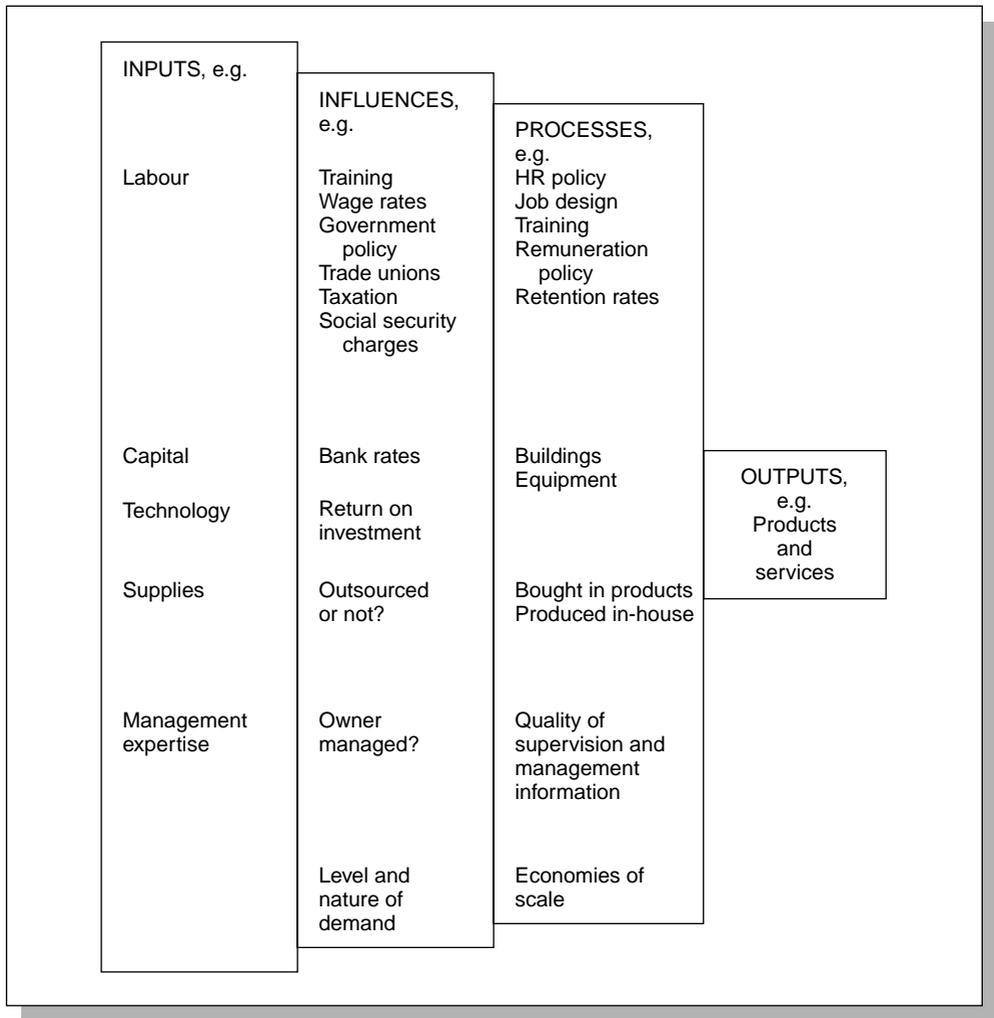


Figure 18.1 A simple 'input-output' productivity model

Another major factor is efficiency of design. Modern, carefully designed hotels can now expect room attendants to service around 17 bedrooms per section, in contrast to older hotels, where sections often have to be much smaller.

Equally important of course is the level of service provided. A fast food takeaway operation or a wine bar may operate with a labour percentage of around 15%, whereas a high-class restaurant offering skilled personal attention may need to operate at around 35% labour cost. Likewise a modern three-star hotel with minimal personal service can operate at around 18–20% labour cost while some five-star hotels may need to spend around 40% on labour. Such percentages also vary from country to country.

Trade unions

Trade unions can influence rates and labour costs in a number of ways. In the public sector they negotiate on behalf of catering workers along with many other workers. In the private sector some catering employees' rates are determined along with rates that unions have negotiated for another industry's primary workers such as motor manufacturers' or warehouse staff.

Owner managers

In establishments at the smaller end of the scale a vital factor influencing labour costs is whether an establishment is run by the owner or by an employed manager. Owners managing an establishment can influence labour costs in a number of ways. First, some owners pay themselves unrealistic wages for a variety of reasons, not least to minimize tax liability. Second, owners generally are much firmer in controlling costs and third, they avoid employing excess labour as cover for themselves and for other employees.

The labour percentages in Figure 18.2 are intended to indicate the approximate level of labour cost (as a percentage of revenue, net of value added tax) likely to be

Type of outlet	Percentage range (as a percentage of revenue) per annum	Factors which can affect labour percentage	
		low	high
Hotels			
2–3 star	18–32	efficient design, limited menu, living-in staff, limited services	inefficient design, extensive menus, high level of service, e.g. room service
4–5 star	25–35		
rooms division	12–20		
food and beverage	30–45		
Restaurants – waiter/ waitress service	25–35	as above	as above
Popular catering – waitress service	22–35		
Self-service	15–25	as above	as above
Wine bars	15–22	as above	as above
Fast food takeaway	11–18	as above	as above
Department stores	20–25	as above	as above
Kiosks, mainly confectionery and tobacco	around 6	very high tobacco element	
Public houses	10–20	efficient design, e.g. one bar, mainly liquor sales	high catering ratio, several bars/restaurants

This table is intended to be a guide only, and it must be recognized that businesses may still operate successfully outside of these. These should be viewed as the range within which most viable businesses operate on a long-term (e.g. annual) basis. There can be considerable fluctuation on a short-term basis as labour costs are not a completely variable cost.
Note: Contract catering is not included as results are totally dependent upon client policy.

Figure 18.2 Labour costs as a percentage of revenue

encountered in viable establishments. This does not mean that there are not successful establishments operating outside these ranges. Likewise, it must be recognized that labour costs are partly fixed and partly variable, so if trade drops dramatically there is a point beyond which labour costs can no longer be reduced to maintain them within the normally accepted percentages – a problem all too familiar to the management of seasonal establishments.

In some cases the wage percentage may well be reviewed on an annual basis. Most organizations, however, monitor labour costs on a shorter-term basis, monthly or maybe even weekly, with many of the fast food outlets now planning labour on an hourly basis.

Figure 18.3 illustrates a format used by some fast food operators. The consequence of this precise hour-by-hour planning is that labour costs are planned and controlled accurately to precise percentages. One of the international fast food chains operates branches at around an 11.5% labour cost, with management costs ranging from 2% for the most efficient and busy branches up to 6% for others.

Payroll burden

There are other factors to take into account, however, which influence labour costs. In particular there is what is often referred to as the ‘payroll burden’. This consists of costs that are additional to the wages and salaries paid to labour and includes elements such as holiday pay, meals, uniforms, staff transport, etc. One key element is the extent to which an employer incurs tax or social security liabilities. In the UK the basic state social security cost (National Insurance) can be around 11%, which is relatively low compared with some other countries such as France or Sweden, where it can be as high as 40–50%.

Productivity measurement

As already mentioned, one of the problems of using labour percentage as the main means of labour cost control is that it does not indicate whether the cost is the result of employing a large number of low-paid people or of employing fewer people but paying them a higher wage. In addition, in many sectors of the industry, such as the school meals service, the hospital service and employee meal services, labour costs cannot be expressed as a proportion of revenue because there may be little or no revenue, or because subsidies distort the picture. Other measures, therefore, become necessary. Basically these are concerned with relating labour input to the various forms of output. Such measures include physical and part-physical, part-financial measures and they vary among the different sectors and also within departments. These may be based on some constant (i.e. a factor unaffected by inflation) such as time. Some examples are shown in Figure 18.4. It should be borne in mind, however, that straight comparisons can be dangerous; for example, in one contract-catering situation a ‘main meal’ may offer each customer a wide choice, whereas in another situation there may be no choice. Other factors such as shift work and night work also play an important part, as do national and international work patterns; for example, an Industrial Society survey (*Catering, Prices, Costs and Subsidies*) showed that for every individual catering worker employed, about 22 main meals were served. The author’s own consultancy work shows that in some other

Department	Description of productivity measure	Some examples
<i>Catering</i>		
Employee meal service	1 Number of meals served for each member of staff (full-time equivalent)	30 meals per day
	2 Covers served per paid hour	4.5 covers
	3 Paid minutes for each meal served	
	plate wash waiters cooks Coffee Shop	7 minutes 24 minutes 15 minutes 15 minutes
Hospitals	4 Labour as a percentage of direct costs $\frac{\text{Labour} + \text{Materials}}{\text{Labour}} \times 100$	e.g. 52%
School meals	5 Labour to materials ratio	£2 labour to £2 material
<i>Hotels</i>		
	1 Employees per room	e.g. 0.9 per room
	2 Number of guest nights for each member of staff (full-time equivalent)	21 sleeper nights for each member of staff
	3 Number of rooms served for each member of staff on duty	17 rooms to 1 member of staff
	4 Number of paid minutes for each sleeper night room-attendants reception	27 minutes per room (attendants on duty only) 33 minutes per guest night
<i>Public houses/bars</i>	1 Barrels and barrels equivalent per full-time equivalent	3–7 barrels per week

Figure 18.4 Some examples of productivity measures

European countries the number of meals served is frequently between 50 and 60 for each industrial catering worker employed.

The list in Figure 18.5 is taken from one North American hotel. Not all items listed are direct measures of labour cost or productivity but they all inform management decisions, most of which will affect staffing.

Number of units sold per employee

A commonly used crude measure of productivity is that of the number of units produced/sold for each employee. This measure is frequently used, for example, to compare car-manufacturing productivity between nations. In order to make use of such a measure it is necessary to have additional information, e.g. how many components are outsourced. In hotels and restaurants one very simple measure is to relate the number of employees to the number of units of service, e.g. rooms, guests or meals served. These are usually extremely crude measures, since comparisons

Total food outlet sales
 Breakfast, lunch, dinner 'capture'; number of hotel residents taking breakfast, lunch and dinner
 Breakfast, lunch and dinner average checks, i.e. spend per head
 REVPAR (Revenue per available room)
 House profit PAR (per average room)
 Rooms division hours per occupied room; total of rooms division hours paid divided by total of occupied rooms
 Laundry hours per occupied room; similar to the above
 Kitchen hours per cover; total of kitchen hours paid divided by total of covers served
 Stewarding hours per cover; similar to the above
 Beverage sales per hour paid; total of beverage sales divided by paid hours
 Banqueting hours per cover; total of banqueting revenue divided by total of banqueting hours paid
 Total of administration and general expenses per available room; total administration and general costs divided by total relevant labour costs including senior management.

Figure 18.5 A North American example of some key ratios

are rarely like with like. Some rooms may be larger than others, some meals may be more complex than others, some elements may be outsourced and some guests may stay for longer periods than others.

Number of employees per 100 rooms

This is a simple measure which can (but not always) indicate the level of service provided.

Sales to payroll index

This is another way of expressing the labour cost as a proportion of revenue. It indicates the amount of revenue in pounds generated by each pound spent on labour. For hotels in the UK, for example, the index for rooms was about £4.00 for every pound spent on labour (British Hospitality Association, 1999).

Sales and payroll cost per employee

Another method is to look at the sales per employee and, after deducting the employee cost, the net sales per employee.

Added value

This method assesses the value added by each pound spent on labour. It is calculated by representing the gross profit (sales less material costs) as a proportion of the labour cost.

Materials-to-labour ratio

In many catering operations where there may be little or no revenue, or where there is a subsidy element (e.g. hospitals, schools, employee meal services, clubs), expressing labour costs as a proportion of sales is either not possible or can be meaningless for comparative purposes. Other measures are, therefore, necessary – these can include the materials-to-labour ratio, i.e. how much labour is needed to process the materials required. In hospitals this can be around a 1:1 ratio, whereas in some school meals operations it can range from around 0.4:1.0 in centralized production operations to as high as 2.6:1.0 in some labour-intensive, localized production systems.

Effective use of available labour is obviously one of the key measures to controlling labour costs. Other factors to take into account include considering alternative ways of getting work done which can reduce the payroll burden. For example, many companies such as IBIS (part of the French Accor Group) use contract cleaners to service their hotel bedrooms. Whilst this may appear an expensive method in the short term, in the long term their labour cost is reduced and management can concentrate their efforts on the core business.

The international context

Costs of labour and productivity of the workforce vary considerably from one country to another for a whole range of reasons – to do with skill, training, government policy, management expertise and attitudes to work. Several of the leading specialist management consultancies produce regular reports on the worldwide hospitality industry and these show considerable differences in labour costs. Examples of these statistics are shown in Figure 18.6.

Bahrain	1.42	London (upper tier)	1.62
Berlin	0.68	London (lower-tier)	0.62
Brussels	0.51	London (all)	0.87
Cape Town	0.94	Moscow	1.20
Copenhagen	0.29	Paris (upper tier)	2.17
Helsinki	0.24	Paris (lower-tier)	0.62
Jerusalem	0.57	Paris (all)	0.95

Figure 18.6 Staff to room Ratio

Source: PKF 2003.

Good productivity measurement enables comparisons to be made between units or groups of workers employed on the same operations, or the same unit or groups of workers at different times. In spite of the many problems encountered in attempting to make comparisons, productivity measurement is a vital control tool for management, helping with budgeting, forecasting, human resource planning, incentive schemes and diagnosis of poor performance. Productivity measurement has the advantage over straight labour percentages of providing a constant measurement that is unaffected by inflation and changes in wage rates.

Further Reading and References

- British Hospitality Association (1999) *British Hospitality Trends and Statistics*, London: BHA.
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- Catering Prices, Costs and Subsidies*, London: Industrial Society, published annually.
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- Ingold, T. and Yeoman, I. (2000) *Yield Management in the Hospitality Industry*, 2nd edn, London: Continuum.
- Medlik, S. (1999) *The Business of Hotels*, 4th edn, London: Heinemann.

Questions

- 1 Describe the objectives of and alternative approaches to labour cost and productivity measurement.
- 2 Discuss the differences between labour cost measurement and productivity measurement.
- 3 Discuss what external factors influence (a) labour costs and (b) productivity.
- 4 Evaluate the approach to managing labour costs and productivity used by an employer you know well.