

Do The Math!



The Real Cost of Overtime

By Jay Goltz

Business seems to be getting better for most people. For those of us that have gotten pretty lean over the last couple of years, it might be time to start hiring. Many employers are hesitant, since this sometimes seems like the recession that never ends. Are you better off paying time and a half to your existing staff, or adding a person and take the risk of not having enough work to go around? The overtime premium can really add up over the long run, but it is not as bad as it looks. In reality, it is not really time and a half because of other costs and benefits. Let's do the math!

Say you pay four workers \$12 per hour, and because you are short handed they work 50 hours a week. That means that you are paying a premium of 50 percent more on the additional 40 hours of pay. This costs you 10 hours x 4 people = 40 hours overtime. This adds 40 hours with a 50 percent premium or 40 x \$6 = \$240. You do this for 40 weeks of the year (\$9,600). It feels like you are always paying out a lot of overtime. In total, overtime costs you 40 weeks x 40 hours x \$18 per hour = \$28,800 a year. You feel like you have wasted money since you could have hired a new person, had them work all 52 weeks, and they would have cost less—\$24,960 (40 x 52 x \$12). Almost \$4,000 less.

But this is not really the case. There are some efficiencies involved in working overtime. The full-time person you didn't hire would have had some other costs related to them. Health insurance (\$2,500?), two weeks vacation (\$960), unemployment insurance (\$400), disability insurance (\$1,500?), and holiday pay (\$576 for 6 days) to just name the obvious. That totals \$5,936 and completely eats up the premium you paid for the overtime, though it does get you another 12 weeks of labor.

But even that is not black and white. The less obvious expenses are the cost of training and the fact that when things get slow, people frequently slow down. On the other hand, if they know that they have to get the job done before they can go home, they can move mountains!

When to actually hire more staff is part art and part

science. It is hard to predict demand, and there are other factors. Does your staff want to work overtime? Are they burned out? Is the job physically demanding? Is it easy to hire people? Are you confident that business is increasing, or it is a temporary blip?

After some really painful layoffs, it is natural for business owners to be extra careful before bringing on new employees. Paying overtime does not look so bad compared to laying off someone who you no longer need. Do the math. ■

Overtime vs. New Hire

Overtime Expense

Assuming \$12/hr. reg. pay and \$18/hr. for OT
10 hrs. OT/week x 4 employees = 40 hrs. total OT/week

Overtime costs:

$$40 \text{ weeks} \times 40 \text{ hrs.} \times \$18 = \$28,800/\text{year}$$

New Hire Expense

Regular pay:

$$40 \text{ hrs.} \times 52 \text{ weeks} \times \$12/\text{hr.} = \$24,960$$

Health insurance \$2,500

Vacation pay \$960

Unemployment insurance \$400

Disability insurance \$1,500

Holiday pay \$576

Total new hire expense \$30,896/year

Comparison of overtime vs. new hire

New Hire = \$30,896/year

Overtime = \$28,800/year

OT Saves = \$2,096/year

Jay Goltz owns Artists' Frame Service in Chicago, IL, which employs over 50 people at its main framing operation. He has received many business honors and is known for his straight talk on succeeding in business.