

# Using Incentives to Control Costs

By Eugene Price

Everyone these days is concerned with the cost of production and understanding how it can be controlled. If your production facility is anything like ours, labor is the largest component of that cost.

There are many factors involved in labor but, basically, most employees want to make more and the company wants to pay less. The reality is that we can only afford a budgeted amount and that determines what we charge for our services. If production labor costs are expected to be 8 percent of sales, we can estimate what our payroll costs should be to make a targeted profit per piece. We can then break down production labor costs and estimate individual labor costs by department within production.

For example, if your average custom frame order sale is \$150, you may decide to allocate 8 percent or \$12 to production labor. Of this, you could assume 33 percent (or \$4) for employer taxes and benefits. After some simple research, you could assume the remaining \$8 to be allocated as follows:

Process Order	\$1.00
Cut/Join Frame	\$1.50
Cut Mats	\$1.50
Mount Art	\$2.00
Fit/Wrap Art	\$2.00

At this point, you can analyze costs by department by multiplying your estimated costs times the number of custom orders produced and compare that against your actual payroll expense. Labor assumptions change significantly for different types of work. Ready made frames or large contract work would have much lower labor costs than custom framing. Complicated, specialty framing could be much more. This type of analysis would prove helpful in quickly determining how total production costs are influenced by department.

The next step is to apply these numbers to production-based incentives. Our goal is to maximize productivity while controlling costs. Based on the numbers above, we would be willing to pay \$2 per average frame for fitting/wrapping. A fitter making \$8 an hour would make \$64 in an eight-hour shift, which corresponds to 32 pictures fit in a day (four per hour). We would motivate this worker by paying \$2 per picture, so that every picture over four per hour would earn the employee more money. An employee who did five fits an hour would finish 40 pieces in the same eight-hour period and make \$16 more. Adjustments for difficult projects or reductions for errors or poor quality could be added to this process to create the desired behavior.

This process can be applied to all departments. As a percentage of sales, the cost per piece should remain the same—8 percent—but more product would be produced in less time (possibly with fewer people). Also, an employee would have the ability to make more by becoming more efficient and motivated to be more productive. For management, it would become important for every worker to make or exceed their “break points” since less efficient workers would cost more than the allocated percentage to sales. This would provide a yardstick for impartially evaluating employees based on performance and would help “weed out” poor performers.

This process should be kept as simple as possible so employees can easily understand it. If they don't, the program loses its impact. That's why this information should be simple to understand, useful, timely, and communicated throughout the organization. Implementing an incentive-based system will change employee behavior. It is important that this behavior fits with the company's culture and vision. ■



Eugene Price is general manager of Pictures Plus in the Honolulu area.

