**Contract Costing**

The issue of **contract costing** is very important to labor and management. One mistake can have a significant impact on the firm or the employee. Identifying, explaining, and costing the articles of a collective bargaining agreement can be a very complicated process. It is important to determine which articles in the contract have both direct and indirect costs.

While wages and health insurance have direct costs, other components of the total compensation package may have indirect costs. Some indirect costs resulting from contract provisions that address such topics as seniority, layoffs, grievances, and arbitration procedures are more difficult to estimate. More subtle and complex areas to measure are found in the relationship that exists between changes in labor costs and employee attitudes.

* **Direct costs** include:
  + Hourly, daily, weekly, and monthly incentives
  + Commissions
  + Allowances
  + Tools
  + Clothing
  + Differentials
  + Profit sharing
  + Premiums
* **Indirect costs** include:
  + Vacation
  + Holidays
  + Sick leave
  + Funeral leave
  + Health insurance
  + Pensions
  + Social Security
  + Workers compensation
  + Unemployment insurance

In negotiations, the union proposals and the company proposals will not be the same when it comes to cost. In order to decide which items will be addressed at the bargaining table, labor and management may utilize several options in narrowing the items down to be discussed.

The first order of business is to examine some of the factors in the cost and indirect costs.

Contract costing requires a method to estimate and compare the costs of union proposals and company offers. The way to do this is by costing out the contract. Demographic data, financial data, and accounting can all be used for costing a contract in the following ways:

* **Demographic data** supplies a breakdown and a statistical profile of the labor force in terms of criteria such as age, sex, seniority, and marital status.
* **Financial data** provides information on the workforce regarding specifics such as direct pay, overtime, vacation, and holiday pay.
* **Accounting** provides figures on projected revenues, output, product mix, and non- labor costs.

These three areas combined are significant in costing out a labor contract. The human resource department, financial analysts, and accountants can all play a role in preparing and conducting contract costing. It is important that management ensure that under the law, certain information that is requested by the union should be prepared and presented to the union (Herman, 1998).

Generally, employee benefits can be categorized into two broad groups: time-not-worked benefits, and security and health benefits.

* **Time-not-worked benefits** include:
  + Vacation
  + Holidays
  + Sick and funeral leaves
  + Jury duty
  + Military service
  + Reporting pay
  + Call-in and call-back pay
  + Wash-up
  + Clothes changing time
  + Time spent on union business
* **Security and health benefits** include:
  + Life insurance
  + Medical insurance
  + Accident insurance
  + Workers compensation insurance
  + Sick leave
  + Pensions
  + Social Security
  + Unemployment insurance
  + Guaranteed annual income
  + Severance pay allowances

Today more than ever, health and pension benefits are the two largest items being discussed at the bargaining table. In years past, people believed that the company pension plan was good forever, and they had nothing to worry about after they retire. This is no longer the case with the number of companies having pension plans that are not properly funded. Health benefits have been on a steady rise, with no sign of relief in the near future. Labor and management are both very concerned with the rising costs, and each has been exploring new ways to limit or reduce the cost of health benefits (Herman, 1998).

As the negotiating stage comes to a close, labor and management must be allowed ample time to ensure that the cost associated with the proposed contract is accurate and if each side can agree on the conditions. It is recommended that all contract costs be rechecked to ensure that no mistakes have been made, which might have a significant impact on labor or management. It is very surprising how many companies will have the accounting office cost out the contract after it has been signed.

References:

Herman, E. E. (1998). *Collective bargaining and labor relations* (4th ed.). Upper Saddle River, NJ: Pearson.

**Labor Costs**

When management or labor is looking to negotiate benefits for the workers, it is critical to know the true cost of such benefits before entering into negotiations. This way the team can determine the **bargaining range** of the benefits. Labor and management will each have an established bargaining range for the benefits. If the two bargaining ranges overlap, then it is likely that there will be a mutual agreement. If the two bargaining ranges are very different, it is unlikely that the two sides will reach an agreement.

**Benefits**

One way to determine the cost of **benefits** is to look at the benefits package as a percentage of total payroll. The total annual cost of the benefits package being contracted is divided by the annual payroll. It seems simple, but the problem lies in determining what

actually constitutes the "payroll" portion and what constitutes the "benefits" portion. While some companies see bonuses as payroll, others see them as a benefit.

There is no universal standard on what is considered a benefit. In Topic 1, benefits are broken down into two general categories: **time-not-worked** and **security and health benefits**. It is important that policies be established so that consistency remains in the costing strategy for the company. Even if the union understands how the company would categorize each piece, this method is often used in comparing to other companies in an industry. This can be very hard when all companies consider benefits differently. There is also no consistent method utilized when discussing benefits.

In years past, the cost for employee benefits was paid by the employer. Benefits cost had very little impact on the employee. Today, almost all employers share the cost of employee benefits with the individual employee. This shift has resulted in unions taking a more active role in negotiating employee benefits at the bargaining table.

Benefits costs discussed at the bargaining table may also impact non-union employees who may receive the same benefit privileges as the union. This may include management and exempt employees. Hence, the discussion may impact the union, but it is important to understand the ripple effect the article increase may have on the entire organization.

**Overtime**

The benefit of **overtime** is one upon which many American workers thrive or, in some cases, survive. On the labor side, it is important that employees are paid fairly for the time outside of the 40 hours they spend at the company. This takes away from family and free time.

However, it is a necessary benefit for employees and employers to rely on workers who can devote extra time. Labor may want to bargain a higher overtime rate—time-and-a-half to double pay, or somewhere in between. This may have a significant impact on the annual cost of employees per year. A further consideration involves when it is cost-effective to hire additional personnel compared to paying overtime wages. This compares the previous rate to the new rate. The anticipated rate may be based on what the employer can afford to bear, rather than just what the union wants.

**Funding Issues**

When management is considering an economic increase in a contract pending at the bargaining table, they must determine, from a business standpoint, the funding location for such an increase. Can the increase be absorbed into the operating budget, or will the company need to pass along the increase into the product cost? If the company can pass the cost increase onto the product, this is called the elasticity demand. The **elasticity**

**demand** is defined as the measure of the sensitivity or responsiveness of quantity demanded to change in price. Hence, management must take into consideration price changes on volume produced and sold, product mix, and capital-to-labor costs (Herman, 1998).

The issue of public sector bargaining is not an issue of profit and loss. Any economic increase in the collective bargaining agreement is passed onto the taxpayer. If taxpayers are unwilling to increase funding by voting down a tax increase, the agency must make reductions in other areas of the budget, such as goods and services. In the case that other cuts cannot take place, the agency will be forced to reduce personnel costs within the budget. Hence, the union may seek and receive a wage increase, but to fund the increase, the agency may be forced to reduce the workforce if the money cannot be raised by a tax increase and/or other budget areas.

**Computer Software**

When discussing benefits costs and other contract cost items, labor and management should focus on open communication involving methods and assumptions applied in the costing of a new contract. Today, many organizations have the benefit of computer programming that can provide current instant updates on contract costs. The software program can only formulate the information entered and in what area the data is entered. It is important that a company-wide policy be established to ensure all costs are entered the same way across all departments.

It is very common to see a bargaining table today with labor and management each having laptop computers filled with data for bargaining. In the old days, it may have taken days or weeks to research and calculate economic increases.

This module has provided an overview of the many items that must be considered in costing out a labor contract. The labor contract contains direct and indirect cost items that will have a significant impact on the bargaining process and the operation of the firm. Benefits packages still remain one of the most significant issues at the bargaining table today. Labor contract costs may also have an impact on other areas of the company that must be taken into consideration.

References:

Herman, E. E. (1998). *Collective bargaining and labor relations* (4th ed.). Upper Saddle River, NJ: Pearson.