

"How Much Does An Employee Cost?"

by Joe Hadzima

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This is another in a series of columns on "how much things cost." This time, some metrics on the cost of employees.

I have six clients who have been fortunate enough to receive significant early-stage venture capital financing in the past month or so. They are all struggling with the problem of rapid hiring to achieve their business plan. Before they were funded, life was easier in some ways—there was no money to spend on new hires. Now they have the cash to spend, but need to spend it wisely. Here are the results of an informal survey I did about what people are spending on employees these days.

Employment costs fall into several broad categories:

Recruiting Expenses.

Finding technically qualified people who can function effectively in a rapidly growing startup venture is not an easy task. In another column, I discussed the economic alternatives for head hunting. For this column, it suffices for me to remind you to be sure to devote the time to make sure that your hires are as close to perfect A-10s as possible. Anything less will be a drag on your business.

Basic Salary.

Basic salaries vary all over the place depending on the industry and a variety of other factors. There are data that can help you calibrate an appropriate base salary; for example, a Google search for "[compensation survey](#)" returns more than a half-million Web pages. Be sure to establish rational salary ranges given your growth plans. This means that in most cases there should not be great salary differentials between early hires and later employees; any "risk component" of being an early hire should be made up in the equity compensation component.

Employment Taxes.

In preparing your personnel budget, be sure to include allowances for Social Security/FICA, Unemployment/FUTA, and Medicare. Workmen's compensation premiums will depend on the category of your employee, with clerical at about 0.3 percent of salary and manufacturing at 7.5 percent.

Benefits.

Basic salary and employment taxes are a minimum; in most cases, you will need to provide some benefits. Typical benefits for a salaried employee include life insurance and health coverage. Other benefits could include long-term disability insurance, dental plans, dependent care assistance, tuition reimbursement, retirement plans, etc. These involve actual payment of benefits by the employer. There are also "self-funded" plans where the employer contribution is the administrative costs, e.g., 401(k) savings plans where a portion of the employee's salary is withheld. Vacation is another cost but is subsumed in the basic salary.

The costs to this point (basic salary, employment taxes, and benefits) are typically in the 1.25 to 1.4 times base salary range. So the cost range for a \$50,000 a year employee might actually be \$62,500 to \$70,000.

Space.

Unless you are hiring traveling salespeople, you need to provide some physical space to house the new employee. Obviously the rent per square foot varies depending on the fanciness and location of the facility. But how many square feet does an employee need? Again this varies, but there are some guidelines. Work cubes are typically 8' x 8' and private offices range in size. In high-tech, figure on 225 to 250 square feet per employee when you add in common space. Furnishing the space, even with used work cubes, will add up fast.

Other Equipment.

The basics for workers has to include a computer and telephone. This needs to include both the hardware and software, servers and printers, and telephone installation. Don't forget the periodic expensive upgrades you will need to your LAN and voice mail systems.

Other Approaches.

Instead of figuring out each cost component separately, you can develop some simple metrics. For example, one entrepreneur I talked to is in the engineering services business and his people are billed on projects on a time and materials basis. The entrepreneur takes the employee's base salary and multiplies it by 1.25 to cover employment taxes and benefits. She then multiplies that number by 1.75 to cover rent, equipment, etc. Because some management personnel are needed and some of the employee time is spent in non-billable technology development, she multiplies *that* number by 1.25. She figures that for her professional engineering consulting business, the fully functioning managed employee costs about 2.7 times the base salary. She has a different metric for planning the manufacturing side of her business. In both cases, even though the metrics are simple and easy to apply, it has taken her some time to really understand the cost components of her business segments in order to develop the metric. She notes that although her "rule of thumb" is helpful in planning rapid growth, like any rule of thumb, the underlying assumptions need to be recalibrated periodically.

Hiring is always a difficult and important activity, especially in a rapid-growth business. There is always too much to do and often the new entrepreneur has little experience in hiring. It is the rare case when you can hire exactly to meet your needs. Delay in hiring and you will have trouble meeting your plan; hire too quickly and you may burn through cash before revenue catches up. Consider using independent contractors to cover peak periods if your business does not have too steep a learning curve. One of my clients staffs at 85 percent of forecasted needs and contracts out the remaining 15 percent.

Although you can't control the hiring process exactly, you can understand the economic metrics of what you are doing, and that can help you avoid some really unpleasant results.

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