

What value does an individual add to a business?

For a sole trader, the answer is usually quite simple: turnover less the cost of doing business – usually the gross profit.

For more complex organizations, it is more difficult to identify. There are, however some basic principles to help guide us.

1. An individual employee must add at least as much value as they cost to employ.

$$\text{Value Added} \geq \text{Full Cost of Employment}$$

For some indirect positions, the public sector and other 'not for profit' organizations, the formula may be restated as:

$$\text{Value of the service provided} \geq \text{Full Cost of Employment}$$

2. Full Cost of Employment is much greater than the individual's pay, pension, benefits and employment taxes. It also includes the cost of their office accommodation (eg rent, rates, utilities), services (phones, computers etc), management and support infrastructure and so on. A simple method of estimating office accommodation costs is to divide the total cost of the office building by the number of employees locate their. City central accommodation can be very expensive. Taking account of these additional costs, the Full Cost of Employment is usually in the range of 2 – 4 times Basic Pay. A good rule of thumb is:

$$\text{Full Cost of Employment} = 3 \times \text{Base Pay}$$

3. An individual's per diem cost should be based on Full Employment costs and the number of days worked. In the UK, the average office worker works 5 days a week, has paid holiday allowance of 25 days plus 8 days public holidays, take paid sick leave, and are involved in many indirect activities such as training, conferences, internal meetings etc. Even the most demanding professional firms expect less than 190 billed days a year. Most well-run organisations manage 150 – 170 days of 'real work' per annum.

As an example.

- Base salary of £30,000 a year
- Full Cost of Employment will be £60,000 - £120,000 a year
- Cost per day of work will be £353 - £800

There are a number of assumptions and averages used in these calculations. They are usually found to be very conservative. In one organisation studied, the annual cost per person for accommodation and services was £120,000.

It is relatively easy to calculate accurate rates and 'rules of thumb' for any organisation, and you are encouraged to do so.

Individual performance differences

When a number of people are doing the same job, some will perform better than others. A seminal study investigating individual performance differences found that:

Performance differences between the 'average' and the 'best' employees varied according to the relative complexity of the job.

- Low complexity: eg machine minders, cleaners, labourers
- Medium complexity: eg nurses, electricians, supervisors,
- High Complexity: eg professionals (doctors, architects, lawyers), managers,

	Best 15% compared with the Average	Top 1% compared with the Average	Top 1% compared with the Bottom 1%
Low complexity	at least 19% more	at least 52% more	at least 300% more
Medium complexity	at least 32% more	at least 85% more	at least 1200% more
High complexity	at least 48% more	at least 127% more	> 1600% more

**Hunter, Schmidt, & Judiesch, (1990), Journal of Applied Psychology, Vol 75(1), pp.28-42*

As an example:

- A professional with a salary of £50,000 a year in a city based office will cost approx. £150,000 a year to employ.
- If we assume that they deliver 160 days of real work a year, their daily cost of work will be £938.
- If we assume that they must achieve 'average' performance as a minimum, then a 'superior' performer will deliver 48% more value, ie £72,000 more value a year.

Two groups of jobs show different results.

In sales jobs performance differences were much greater: 48% - 120% when comparing the best 15% with the average. A similar result has been found with jobs which decide the deployment of large sums of capital, eg investment fund managers, oil exploration engineers, London market insurance underwriters. The value these jobs add to their companies is compounded by the impact of the capital they deploy.

As a rule of thumb, in Capital Deployment jobs the value added by professionals is multiplied by a factor of 10

As an example:

- An Investment Fund Manager with a salary £75,000 a year in a city-based office will cost approx. £225,000 a year to employ.
- If we assume that they must achieve 'average' performance as a minimum, then a 'superior' performer will deliver 48% more value, ie £108,000 more value a year.
- Taking account of the impact of the capital deployed, the difference between the best 15% and the average becomes £1,080,000.

Again, there are a number of assumptions used in these calculations, but they are usually found to be very conservative. With performance differences of this magnitude, it becomes very important to calculate accurate ratios and 'rules of thumb' for particular jobs in specific organisations.