What is the Cost of the Next Pizza? Estimation of Marginal Labor Costs in the Presence of Minimum Staff and Long Notice Periods

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Abstract:

This paper discusses how marginal labor costs can be influenced by flexible labor and activities using an illustration from the pizza restaurant business.

Marginal cost, the economic cost of producing the last unit, is crucial for firms in setting profit-maximizing prices and plays a significant role in competition cases. However, accounting systems do not provide estimates of economic marginal cost necessitating practical methods for their estimation. We use a mix of the account analysis method and the conference method from managerial accounting – interviewing experts from the restaurant business – to inform estimation of marginal cost.

We make use of a decision by the Norwegian Competition Authority on a merger by two national pizza restaurant chains to illustrate. In the restaurant business labor costs compose around 30% of total sales which implies that accurate assessment of labor costs can significantly influence marginal cost estimates, impacting both regulatory tests and managerial pricing decisions.

We conclude that seemingly fixed or unavoidable accounting labor costs may hide opportunity costs relevant to estimating economic marginal cost. Managers' ability to perform various tasks implies that their time spent serving customers has an opportunity cost despite their accounting cost being unavoidable. Furthermore, flexibility in performing asynchronous activities such as unpacking and stocking of raw materials or cleaning can reduce slack during minimum staff periods, making parts of labor costs for minimum staff variable. Attention towards such flexibilities that eliminate slack can prevent underestimation of marginal labor cost, avoiding incorrect regulatory decisions and suboptimal managerial pricing.

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