

How to Improve Gross Profit on Labor Sales

The last segment of *Learn To Earn* began the discussion of how to improve gross profit

on labor sales by discussing the *Profit Eating Time Losses*. The following chart demonstrates the cost to your shop of seemingly insignificant time losses:

The Cost of Profit Eating Time Losses (In Labor Revenue ONLY)

Minutes Per Day	Days Per Week	Number of Techs	Minutes Per Week	Hours Per Week	Hourly Labor Door Rate	Weekly Lost Revenue	Monthly Lost Revenue	Yearly Lost Revenue
10	5	2	100	1.67	\$60	\$100.20	\$430.86	\$5,170.32
10	5	3	150	2.5	\$60	\$150.00	\$645.00	\$7,740.00
10	5	2	100	1.67	\$70	\$116.90	\$502.67	\$6,032.04
10	5	3	150	2.5	\$70	\$175.00	\$752.50	\$9,030.00
10	5	2	100	1.67	\$80	\$133.60	\$574.48	\$6,893.76
10	5	3	150	2.5	\$80	\$200.00	\$860.00	\$10,320.00
10	6	2	120	2	\$60	\$120.00	\$516.00	\$6,192.00
10	6	3	180	3	\$60	\$180.00	\$774.00	\$9,288.00
10	6	2	120	2	\$70	\$140.00	\$602.00	\$7,224.00
10	6	3	180	3	\$70	\$210.00	\$903.00	\$10,836.00
10	6	2	120	2	\$80	\$160.00	\$688.00	\$8,256.00
10	6	3	180	3	\$80	\$240.00	\$1,032.00	\$12,384.00
30	5	2	300	5	\$60	\$300.00	\$1,290.00	\$15,480.00
30	5	3	450	7.5	\$60	\$450.00	\$1,935.00	\$23,220.00
30	5	2	300	5	\$70	\$350.00	\$1,505.00	\$18,060.00
30	5	3	450	7.5	\$70	\$525.00	\$2,257.50	\$27,090.00
30	5	2	300	5	\$80	\$400.00	\$1,720.00	\$20,640.00
30	5	3	450	7.5	\$80	\$600.00	\$2,580.00	\$30,960.00
30	6	2	360	6	\$60	\$360.00	\$1,548.00	\$18,576.00
30	6	3	540	9	\$60	\$540.00	\$2,322.00	\$27,864.00
30	6	2	360	6	\$70	\$420.00	\$1,806.00	\$21,672.00
30	6	3	540	9	\$70	\$630.00	\$2,709.00	\$32,508.00
30	6	2	360	6	\$80	\$480.00	\$2,064.00	\$24,768.00
30	6	3	540	9	\$80	\$720.00	\$3,096.00	\$37,152.00

REDUCE THEFT

Somehow, things have a way of getting up and walking out of your shop — escorted out by technicians, other staff, and customers. The two categories of theft to watch are:

- External Theft — Technicians working on your customer’s cars at their houses (any moonlighting must be approved by you), and customers

“removing” items from your shop.

- Internal Theft — parts, fluids, accessories, tools, materials, shop supplies, food and drinks (if also a service station).

You need to constantly be on the lookout for any kind of theft because, as the following graph shows, theft eats into profits at a very significant level.#

Revenue Needed to Recover Losses

To Cover the Loss Of	Revenue Needed At 2% Income (Net Profit)	Revenue Needed At 3% Income (Net Profit)	Revenue Needed At 10% Income (Net Profit)	Revenue Needed At 20% Income (Net Profit)
\$2.00 Missing Fluids	\$100.00	\$66.67	\$20.00	\$10.00
\$5.00 Cash Theft	\$250.00	\$166.67	\$50.00	\$25.00
\$25.00 Missing Part	\$1,250.00	\$833.33	\$250.00	\$125.00

PRICING / CREDITS / INVENTORY SHORTAGES

Before delivering a vehicle back to a customer, the pricing and extensions should be double checked, as well as verifying that all parts used on the repair are recorded on the work order (parts added after the job starts — particularly small items such as clamps — can easily be left off the work order and not charged to the customer).

Make sure you have up-to-date costing so that mark-up for sale to customers is accurate. Also make sure that you receive credit on returns the same day you return them.

LABOR DOOR RATE

By now you should either know the door labor rate you need to be charging, or you know how to determine the rate you need to be charging in order to make a profit. New equipment, added facility space, additional employees, higher expenses can all affect the door labor rate you need to make a profit.

While you should certainly keep track of the door rates for OEs and other competitors in your market, their rates should not necessarily determine your rates.

Rates are not the only factor to consider. There are other critical factors that determine customer acceptance of labor rates. The most significant is customer satisfaction.

Do your competitors take care of their customers as well as you do? Are they doing a better job? Study after study, in all kinds of industries, has shown conclusively that satisfied customers are willing to pay more for goods and services from vendors who treat them honestly, fairly, with respect and consideration, and with personal attention.

Customers only shop price when their more important concerns, needs and desires are not being met

It is much easier to provide top-notch customer satisfaction and quality service when you and everyone in your shop are making a good living. As we covered in an earlier segment of *Learn To Earn*, "Employees treat customers no better or worse than the way they are treated by their employers." A frightened, "Scrooge" owner will not stimulate employees to treat customers in a way that justifies higher than market door rates. A happy, customer-focused staff will keep customers' attention away from price shopping because it is such a relief and pleasure to do business with the shop.

Your shop can either function in a downward spiral (things always getting worse) or in an upward spiral (things constantly improving for everyone). You are the determiner of which spiral your shop will have. A door labor rate that enables you to pay your people well and make a good profit for yourself is one key ingredient in an upward spiral shop.

Law of 15% Perceptible Change

Both door rates and labor wages can be adjusted based upon the *Law of 15% Perceptible Change*. As humans, we are not able to clearly perceive a change in anything until that change reaches 15% or more. Up to 10% change, people will have no awareness of anything being different (unless pointed out to them). From 11% - 14% change, people will feel uncomfortable, but not know why. At 15% change, people will recognize a change has taken place.

The following are studies that were conducted to test this law:

- In various manufacturing companies where assembly lines were used, no workers noticed that the speed of the line had been either increased or decreased to a 10% change. Workers became irritable without knowing why when the increase or decrease reached 11% - 14%. In every case, the day the speed of the line was increased or decreased 15%, workers immediately said either, "This thing is going faster" or "This thing is going slower."
- Night school business students (people who worked jobs during the day) were given a dollar amount as a salary figure, then asked, "Assuming that all other employment factors are equal, raise your hand when the amount given would be enough for you to change jobs?" No one raised their hands at 10% or less. 2.3% raised their hands between 11% and 14%. All remaining students raised their hands when the amount was exactly 15% higher.

- When traveling for most of a day, subjects were asked if they would be willing to continue beyond the designated stopping place for a specified number of extra miles. All agreed to continue when the extra distance was 10% or less of the miles already traveled. There were complaints from those who were asked to go 11%-14% farther. And, everyone asked to go 15% farther said they wanted to stop and not continue.
- Before radar guns, police and highway patrol officers could not tell a person was speeding until the speed reached 15% over the limit. That's why you could go 60 mph in a 55 mph zone without being stopped if radar was not being used.

Many companies are able to keep wages lower when they pay no more than 10% below what their competitors are paying. The same applies to pricing. If their prices are no more than 10% higher than competitors, they do not experience a drop in sales (this does not include highly promoted items that focus solely on price).

They also know that a "15% off" sale price on an item has a much greater chance of pulling customers away from competitors than a "10% off" sale price because customers will generally not experience 10% as a great savings, but they will consider 15% a good deal.

They won't care if the bill is even higher if they are satisfied, loyal customers. At the same time, your staff are not likely to jump to another shop if their pay is no more than 10% below what they could get elsewhere (assuming other employment conditions don't drive them away). As was covered previously, you need to maintain a 60% gross margin on labor (that's a 2 ½ times markup rate).

ADDITIONAL AREAS FOR CHARGING

The following are services that service centers often do not charge for that they should charge for. You may have some additional ones in your shop:

- Charging batteries (there is the cost of using your equipment as well as your time).
- Installing batteries (takes longer with many newer model vehicles).
- Shop supplies (up to 5% of labor charge).
- Environmental charge (cost of disposing of old oil, old antifreeze, old tires, etc.).
- Anything you are doing outside of a bay that has been done as a courtesy. You may still choose to do these as a courtesy to your regular customers as a marketing investment in retaining their business.

Customers are not likely to notice a difference in their repair bills when your door rate is not more than 10% higher than it was 3 months earlier.

LABOR SALES DIVISION SUMMARY

The Labor Sales Division of your shop needs to be the primary focus of your management efforts.

If your Labor Sales Division is not producing enough Labor revenue to cover your Labor & Operating Overhead, the funds needed to meet Labor & Operating Overhead are being stolen from your parts profits. By not managing your Labor Sales Division effectively, you are in essence helping the "thief" to steal from you.

When your Labor Sales Division is producing properly, your Parts & Sublet Sales Division will essentially take care of itself.

Tiered Pricing

Tiered pricing and its close cousin menu pricing have been tools of successful new car dealers for many years. Tiered pricing allows competitive pricing for most commodity jobs.

Typically, there will be three pricing levels (shop labor door rates):

- "C" Rate — generally 25% lower than current or updated door rate; applied to:
 - Lube services
 - Tire work
 - Scheduled / preventative maintenance
 - Belts and hoses
 - Possibly simple undercarriage repairs (routine brakes and shocks)

- "B" Rate — the current or updated Shop Labor Door Rate; applied to:
 - Most repair operations
 - R & Rs (water pumps, timing belts, brake master cylinders, starters and alternators)
 - Straightforward A/C and heater work
- "A" Rate — generally 15% - 20% higher than current "B" rate; applied to:
 - Driveability
 - Electrical shorts
 - Climate control problems
 - ABS and electronic suspension repair
- Diagnostic Rate — generally 1½ - 2 times the current or updated rate.

Two things happen under tiered pricing:

- You are now more competitive on commodity jobs that consumers price-shop.
- Your average labor door rate normally increases by one to two dollars an hour (total labor revenue divided by total hours billed).

One way to evaluate tiered pricing for your shop is to re-price 1 – 3 month's repair orders as they would have been if you were on tiered pricing. You must first determine what your "A" rate and "C" rate would have been if your current Shop Labor Door Rate is your "B" rate. (If tiered pricing will benefit you, carefully set your new "B" rate to 60% over the cost of a "B" rate technician.)

The other consideration is to estimate the mix of work you would have had in your shop if you had already been on tiered pricing. For example, would you have promoted and generated more "C" rate commodity work if your pricing had been more competitive?

In order for tiered pricing to be profitable for your shop, you will also need to carefully determine:

- Which of your technicians will perform which kind of work. Generally:
 - Your "A" rate technician is your superstar, true master technician
 - performing the kind of work that will be more challenging and fulfilling for a really top-notch technician.
 - Your "B" rate technician may not be a master technician, but will probably be certified in multiple areas.
 - Your "C" rate technician will more likely be an entry-level technician, possibly a recent technical school graduate with one or two ASE certifications.

NOTE: If you promote "C" rate work and generate more business than one technician can handle, think about hiring another "C" rate technician instead of pulling your "A" rate or "B" rate technicians to perform commodity work. They are paid too much for this type of work and, if forced to perform it on a regular basis, may become bored and seek

employment elsewhere. YOU DO NOT WANT TO LOSE YOUR TOP TECHNICIAN(S).

- How much you will pay technicians for each type of work.

You want to maintain the 60% margin of labor door rate over labor cost for each type of work. Using an average labor door rate of \$60.00 per hour:

- Your "A" rate would be \$69.00 (+15%) to \$72.00 (+20%). A 40% labor cost means you could pay an "A" rate technician \$27.60 to \$28.80 per hour.
- Your "B" rate could be \$60.00. A 40% labor cost means you could pay a "B" rate technician up to \$24.00 per hour.
- Your "C" rate would be \$45.00 (-25%). A 40% labor cost means you could pay a "C" rate technician up to \$18.00 per hour.

NOTE: If you pay technicians a flat rate, and if on any given day there is not enough "A" or "B" rate work to keep your technicians busy, you can offer them the opportunity to perform "C" rate work at the pay rate of a "C" rate technician. This enables them to make some additional money without you losing the 60% needed margin on labor sales.

An effectively structured and managed tiered pricing program gives you the opportunity to provide service to a broader range of customers, remain competitive, and pay your technicians top dollar for the type of work they perform. You provide your technicians with the opportunity to work on tasks that best utilize their skill levels. You also establish an "opportunity path" for newer, less experienced technicians who take advantage of training and learning through experience.

As stated earlier, a tiered pricing program will likely result in a higher average labor door rate. This will allow you to keep your better technicians because you will be able to pay them better without sacrificing profits.

Business Improvement Assignment

Calculate the difference in your gross revenue for the previous month based upon increasing your labor door rate by 10% (# Labor Hours Billed X \$amt of Labor Door Rate Increase = Increased Revenue).

The increased revenue drops to the bottom line as profit if all expenses have been paid out of the previous amount of revenue for the month.

NOTE: The Excel spreadsheet program CD contains several spreadsheet templates for you to use to project the changes in revenue and profits by adjusting various *Critical Success Factors* items to the goal amounts (such as 60% margins on labor and parts, increased labor door rate, additional billed hours per month, etc.).

Continue to calculate the *Critical Success Factors* for the Labor Sales Division of your business (either manually or using the Excel spreadsheet program available on CD). Track them on a monthly basis.

Continue the series of shop meetings to cover the *Profit Eating Time Losses*. Be sure to ask your staff for their ideas on how to improve the time losses. Review any shop issues that have come up in previous shop meetings.

Keep discussing ways to improve the performance of your shop. If assignments have been made to staff members, get reports on results and next steps to take (and by whom).

In a study conducted with 455 shops that raised their labor door rate by 10% or more (only one increase in a three month period), only two shops had any customers who commented on the increased door rate. In both of those cases, neither customer complained about the increase. One shop raised their door rate from \$38.00 per hour to \$65 per hour over a six-month period without one customer comment about the increase.

Review Quiz

Answers to quiz at the bottom of this page.

Volume 3, Segment 1

Circle Your Answers

1. If you have 3 technicians who lose only 10 minutes a day, 5 days a week, and you have a door rate of \$70 per hour, you stand to lose about \$9,000 a year in labor revenue.
A) True
B) False
2. If your shop makes the national average of 3% net profit, a "missing" \$25.00 part will require how much additional revenue to recoup the loss.
A) \$66.67
B) \$166.67.
C) \$833.33.
3. Customers are likely to recognize immediately that a change in labor door rate has taken place if that change is 10% more than the previous door rate.
A) True
B) False
4. Services that some service centers do not charge for that they should charge for are:
A) Charging and/or installing batteries.
B) Shop supplies.
C) Disposal of environmental items.
D) All of the above
E) None of the above
5. It is recommended that you charge 1½ to 2 times your standard labor door rate for diagnostics services.
A) True
B) False

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Review Quiz Answers: 1:A / 2:C / 3:B / 4:D / 5:A