



BUSINESS FEATURE

Strategies to Stretch Profit Margins

Your options for increasing profit margins are limited when a vendor supplies you with the part, material or service. Instead, focus on improving the one profit margin you do have direct control over: labor.

By Jake Snyder

Your goal as a shop owner isn't to starve your family, not send your kids to college and file for bankruptcy as you near retirement age.

Obviously, making money is the ultimate objective of owning a collision repair business.

Without profits, there'd be no incentive for owners to undertake the risk of investing time and money in a venture. Besides the fact that profits are a nice thing to have, measuring and comparing profits is a great way to determine a business' health and competitive viability.

On average, labor generates the largest amount of dollar profit margin per job compared to other revenue and cost categories. Labor sales generally range from 36 to 44 percent of total sales revenue, while parts sales are also in the same sales percentage range. But parts profit margins are typically between 20 and 28 percent of parts sales, while labor profit margins commonly fall between 50 to 65 percent of overall labor sales, resulting in higher profit dollars.

You say you want to make more money? Then focus on the profit margin you have direct control over: labor.

Why Do I Care About Profit Margins?

Just to be sure it's clear why a discussion on profit margins is so important, let's review how financial benchmarks or measurements are used in the autobody business.

Similar to manufacturing operations, body shops transform raw materials into finished products that are sold to customers. To account for the expenses needed to conduct the transformation process to a final product or customer good, "cost of goods sold" financial statements are commonly used for both tax and management reporting. And since autobody businesses use line-itemized reports to record the tasks and materials used in each job's transformation process (estimates, repair orders, customer invoices), variable cost categories can be matched to their associated sales dollars.

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We're then able to measure and gauge shop profitability by individual revenue and cost categories (i.e. parts, labor, materials, sublet, etc.). When applied to a single repair order or job, it's called "job costing." By rolling up the total repair jobs completed and their job-costing data together, you get cost-of-goods-sold financial reports.

Cost-of-goods-sold has the same meaning as variable or direct costs (i.e. parts, labor, materials, sublet, etc.), which is a financial measurement for the resources used to perform vehicle repair operations that create finished products sold to or purchased by customers (sold repairs generate sales revenue dollars).

Changing Labor Profit Margins

Labor Usage & Wage Comparison

Consider the expense for resources "touching the car" during repair processing as direct costs that will either increase or decrease (vary) as production volume and the number of cars repaired increases or decreases. All other business costs - the ones not directly used for repairing the car - are usually grouped together on financial statements under the term(s) fixed, overhead, indirect, and sales, general and administration costs or expenses. Examples of overhead costs are those for rent, business insurance, telephone, and management and office staff.

In the short term, overhead costs don't vary in proportion to increases or decreases in sales or production volume. Some costs and expenses like tech benefits, technician wages - when paid hourly or salaried - selling or estimating compensation, warranty and rental car costs for customers could be either "above the line" (variable costs) or "below the line" (overhead costs). It depends on what works best for your operation and reporting system.

When using the term gross profit margin, I'm referring to profits and dollars coming from the excess or difference between all sales revenue and all direct or variable costs/expenses needed to produce those revenues. When referring to the profitability of individual cost-of-goods categories, I omit the term "gross" and simply say, labor profit margin or labor margin.

YOU Control Labor Profit Margins

Finding methods and strategies to better manage and improve labor profit margins or the utilization of labor resources is less restrictive but requires greater management creativity and experimentation than profit-improvement strategies for parts or materials.

Parts, materials and even sublet resources are basically purchased and transferred onto the repair job: Mark ups are applied to purchase costs, and a profit margin is set. There are a limited number of ways for a body shop to improve profit margins when another vendor or supplier manufactures the part, material or service needed for a job. Usually, savvy buying results in the best (or lowest costs) profit margins for these externally provided parts, materials and services. But to improve labor profit margins, there are many approaches and strategies to consider.

All profit-improvement strategies are fundamentally based on meeting one or more of these three goals:

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Reduce technician cost levels.

Increase sold labor hours output/keeping labor costs constant.

Raise retail prices.

Although these same three profit-improvement objectives basically apply to all variable-cost categories, technician labor, which is internally developed and maintained, needs more of management's time and resources to implement effective profit-improvement strategies. And numerous profit-improvement variables have to be considered. There isn't one single magic bullet.

Each body shop's profit-improvement formula is different and needs to be mixed, matched, tested and even blended to suit unique cultures, environments and circumstances that exist on each shop floor.

What follows are some of the strategies management can consider as a means for improving labor profit margins. Certainly this list isn't exhaustive, and some of the tactics may not be practical for smaller body shops or if a shop already pays low existing technician benefits and wages.

Tactics to Reduce Technician Cost Levels

- **Reduce number of technicians;**
- **Reduce absolute wage levels;**
- **Reduce overtime and/or bonus pay;**
- **Reduce health benefits;**
- **Reduce paid vacation time;**
- **Reduce paid personal or sick time;**
- **Reduce number of paid holidays;**
- **Reduce training time during work hours;**
- **Reduce uniform or tool subsidies;**
- **Reduce training expenses;**
- **Use training subsidies from outside sources (government, paint company, suppliers);**
- **Use wage subsidies from outside sources (state or local government).**

Labor Profit Margins

At first glance, it may seem that trying to reduce pay rates and benefits is unrealistic. Although compensation might be untouchable, management needs to access local competitive wage and benefit levels to determine if an opportunity exists to reduce compensation costs. Many progressive operators emphasize above-average working conditions, job security, training and career opportunity to attract and retain employees - while keeping compensation rates somewhere in the middle of competing local wage and benefit rates.

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Ways to Increase Sold Labor Hours Output/Keeping Labor Costs Constant

- **Increase tech workloads (higher expectations and responsibilities);**
- **Reduce techs wasted time (improve technician utilization);**
- **Consistently use proven work processes and systems (including tools, equipment and motivation);**
- **Eliminate vehicle handling duties;**
- **Deliver parts and materials to work space;**
- **Eliminate movement to tools and equipment;**
- **Eliminate distractions;**
- **Reduce re-work, breakdowns and comebacks; and**
- **Employ technical repair teams with specialized labor and repair processes and with different pay scales for different repair segments (i.e. lower pay rates for team members who do disassembly and reassembly work than for those who do structural work). The assumption is that specialty techs who perform few, but repetitive, tasks are more efficient than a tech responsible for performing many job functions.**

Most body shops today (with sufficient repair volume to afford specialized techs - yearly sales somewhere greater than \$750,000 to \$1 million) use labor segmentation and job specialization. Detailing, paint prep, disassembly and reassembly, mechanical; unibody repair and staging are some of the repair tasks and associated skill levels commonly performed by dedicated techs with different pay levels.

Even with the autobody industry's trend toward specialization, challenges slowing down this cost-saving trend are flat-rate and commission-based pay systems. Sharing and accounting for the sold hours on a single job and between multiple techs is difficult to accomplish on a consistently fair basis.

Splitting up or allocating sold labor hours among techs who work on the same car is often a cause for debate and disagreement, since each tech seeks to maximize his weekly number of "flagged hours" or weekly paycheck. The commission or flat-rate paid tech has to constantly focus on flagging hours (producing a certain number of sold labor weekly) to maintain his desired weekly income levels. This need to produce hours discourages techs from losing valuable production time during the day to train and to assist fellow employees.

Furthermore, percentage commission pay rates lock in labor profit margin percentages and limit management's ability to improve percentage profit margins. But shops can (and do) address this by paying different commission or flat rates to technicians with varying skill levels. Instead of paying a single tech a high flat rate of pay to perform all repair procedures, rudimentary repair tasks are off-loaded to lower-compensated techs. Why use a \$22-per-hour tech to do \$12-an-hour work?

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Source Data for Tables 1 & 2 "Heavy Hit" Job Category

Assumptions for Tables 1 & 3

Commission and flat-rate pay systems also make it hard for management to drive innovative or new process-improvement strategies that could help technicians become more efficient by producing more sold hours in less time. If a tech were making a satisfactory average weekly wage to live and prosper, why would he be motivated to use new work methods to produce more sold hours each week?

On the other hand, hourly paid techs aren't solely motivated as are commission or flat-rate techs to focus on number of hours turned each week - since they get paid based on the number of hours they attend work and not the number of sold hours they produce.

When team repair methods are used with hourly workers, there's no reason for techs to debate who should be credited for a job's labor tasks and sold labor hours produced on a repair order. And when management invests time and money to create and purchase new production or shop systems that help hourly techs become more efficient (more sold hours are produced in less or the same amount of labor time), the shop receives a better return for its investment because hourly paid techs are still receiving the same weekly pay - as opposed to commission or flat-rate paid techs, who would realize higher weekly wages as their weekly sold hours output increased.

For many smaller body shops (less than \$1.5 million in annual sales) with few technicians and little or no support personnel, it's difficult to keep technicians constantly focused on the actual repair tasks because the techs also have to move cars, clean up, transport parts, etc. Similarly, it's harder to create and maintain work teams (but not impossible) with fewer people. Instead, smaller operations have to maximize tech output by maintaining employee motivation, optimizing shop and equipment, eliminating rework and comebacks, assuring quality parts and supplies are delivered, and making sure employees are properly trained on shop processes.

Ways to Raise Retail Prices

- **Increase "door" rates;**
- **Increase number of sold labor hours on estimates*: insurance negotiations, estimate accuracy, supplemental labor.**

***Doesn't increase labor profit margin percentages when flat rates increase with labor rate increases or commission-based pay systems are used, but will increase overall labor profit margin dollars.**

You've likely read many articles in Body Shop Business on the importance of estimate accuracy and including all repair tasks on the repair order. If you have, you know it's possible to influence labor prices using more than a hourly labor rate increase.

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Getting Started

In addition to these three tactics to improve labor profit margins, management also has to make certain that the shop's working environment (physical and psychological) helps and doesn't hinder new systems from succeeding.

To begin the labor profit-improvement process, measure where labor margins currently stand, decide where you want to go and then start making assumptions on what factors you need to change in your operation to achieve lower technician costs, and increased repair output and labor prices.

Spreadsheets are useful tools to help shop management sort through different "what-if" scenarios for improving profits. Like word processing programs, spreadsheets make it easy to edit and change information. This editing versatility is handy when shop management is attempting to forecast or predict the outcome of numerous options and combinations of those options.

The most popular form of spreadsheet for "what-if" analysis is a "profit & loss" (P&L) or "income statement." (See sidebar tables and graph.) A body shop's current P&L statement copied onto a spreadsheet allows management to see how income will increase or decrease when changes are made to revenues or expenses, or both. Most paint companies and consultants offer this type of financial analysis - typically sold as a "benchmarking analysis."

If you can't use a spreadsheet to place different ideas into numbers for comparing causes and effects, you might want to reconsider whether or not your idea will actually produce tangible (i.e. profitable) results.

Writer Jake Snyder has been in the industry for more than 15 years, has managed a collision repair facility, held various claims positions with Allstate Insurance Company, and performed consulting and product development for Body Shop Video's Business Development Group.

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