

Basics of Benchmarking

Improving your business through analysis verses “gut feeling” is one of the most important steps in the business evolving to the “next level”. During the initial early stages of a business, the owner’s entrepreneurial skills often determines the success of the venture. However, at some point in the business maturity, better managerial skills at required to make the business sustainable and advancing.

By Tony Passwater

Benchmarking is the process of comparing your business performance to performances of either like businesses, or to generally held performances for all businesses. This new feature in e-BSB will examine a specific area each issue and focus on how it can be measured, evaluated, what effect does it have on your business, and also provide some improvement possibilities.

If you are asking yourself why you should consider this for your business, you are not unlike thousands of small business owners that believe they can just “work harder” to make things better. This simply only takes you and your business so far. There have been many profound statements made by many very “smart people” about the importance of benchmarking or measurement in general. One that comes to mind is, “You must measure it to manage it.” Or, “To measure it is the first step in improving it.” Both equally reinforce the importance of the time you spend analyzing your business performance with a quantifiable comparison system, like benchmarks. We are going to use KPI’s, Key Performance Indicators, interchangeably in these articles when in actual fact they are slightly different. When appropriate, I will explain the differences.

We have worked with many repair facilities worldwide to improve their business performance. Whether it is with process, quality, marketing, technical skills, or even HR issues, they all can be measured, managed, monitored, and improved. Make sure to check out our website at: www.aeii.net as resource for your improvements.

Gross Profit:

To begin, we will start with the basic benchmarks and work through them one by one. Each issue we will progressively get more advanced and more detailed. The first benchmark area we will examine in this issue is gross profit.

Gross profit is defined as the profit dollars that are left over. This is the sales price (your revenue) less the direct costs for the item. In accounting terms Direct Costs are referred to Cost of Goods Sold (COGS). It is usually benchmarked as a percentage by using the following formula:

$$\text{[[Sales Price (Revenue) minus Direct Costs] divided by Sales Price] times 100\%}$$

This formula can be used for total income and its Direct Costs, or any department of the business. This often would include: Parts, Paint/Materials, Sublet, Labor Categories (Metal, Paint, Mechanical, Frame, etc), and Towing. It can be as detailed as you would like it to be as long as you can accurately associate the revenue and costs together. This means if you can not determine your accurate costs for frame labor, then it does not provide benchmarking information if you track the revenue for frame labor only.

This is one of the first obstacles that take place when a client decides to begin analyzing their business. It is often very easy to break out revenue since most estimating and management systems do this automatically. However, to track costs one must have a system to determine who did what, when. Time clocks provided by

management systems, even though they have been around for years, are often not being used properly to get consistent accurate information. There are some innovative solutions to this problem just on the horizon that should become available early 2004 ... I will keep you posted.

In addition, a discussion can begin about what are "Direct Costs". This topic is discussed in a past article which can be reviewed by clicking the following link:

[Perplexed by Profits, Tony Passwater, BodyShop Business, May 1999](#)

In this series we will be using "unloaded " calculations for labor benchmarks. This simply means the Direct Costs do not include such items as: employer portion of wage taxes, workman's compensation, or any benefits. Direct Costs will only include what the employees gross wages (and bonuses) are, nothing else. This is purest number to use in benchmarking. We will cover the other costs in a later e-bsb article.

The typical Gross Profit Levels to expect your business to reach or exceed are:

Profit Center	GP%
Parts	30 to 34%
Materials	25 to 40%
Metal Labor	60 to 65%
Paint Labor	60 to 65%
Mechanical	60 to 65%
Frame Labor	60 to 65%
Sublet	20 to 25%
Towing	10 to 20%
Total GP%	40 to 45%

The above are by no means the "Best of the Best" we have worked with, but they may very well be much higher than what you currently are performing at. Use this for a starting point.

There are many ways that accounting is performed especially if you are a dealership organization. In all cases, you must "normalize" your data and reporting to benchmark with the Industry Benchmarks listed. You must also accurately distribute the revenue and the costs in the proper accounts as well. As an example, if you put a reconditioned bumper cover in the sublet column of the estimate, and when you pay for it, you put the cost under parts, you have a problem unless you distributes the income listed in the sublet column to parts as well. Income and expenses must be distributed properly first. This is often a very long process to get right.

Improving Performance:

Once you determine where you are and where you want to be ... the next step is to do something to get there. It will not happen by itself even though if you begin by measuring, and people know you are measuring and it is important to you ... many times performance levels improve. Keep in mind, what everyone knows what is important to you, will be what they will focus on as well. This leadership quality is often lacking in many

organizations. The first to keep in mind is ... To change output ... input must change. You will have to do things differently to get a better performance.

Since what we do, AEII, is work with organizations to become more profitable and make sustainable changes to their business, we know there are hundreds of ways to make improvements in these above Gross Profit areas. This article certainly can not examine all of these, but we do include many methods in The BOSs™ a subscription based web designed knowledge manager. The Knowledge Base includes many of the same programs we use for our clients to make business improvements in all phases of operation including Gross Profit. You can access the program at: www.TheBOSs-Online.com

Basic Improvements:

Since parts constitutes 37 – 45% of the total dollar revenue normally ... it is an important area to maximize first. For this article we will focus on this department and will continue each issue with the other departments. Some may be combined because the suggested techniques are similar.

Improvements can be from the “Revenue” and/or “Cost” Sides. In other words, you can increase your gross profit on parts from either increasing the amount of dollars you collect or the amount of dollars you spend.

You may be thinking, how do I increase the revenue side ? Charging for parts when they are not needed ? By no means ... NO! That is a black eye our Industry has received today by many media sources, and where great focus is being placed. This we do not need, and certainly if one is to blame for this, they should not be part of our Industry.

To increase the revenue side, we are referring to making sure what you order for a vehicle and the vehicle needs, matches what you bill out. This not only includes catching any forgotten parts which do not get billed, but also checking the pricing is accurate.

Next, the following are the basic “cost side” improvements we begin with for each client.

Discounts:

The supplier of your parts will provide you the discount they feel you will accept (or have accepted). You may be in a strong position or a weak position based on many factors. These include:

- Purchase Volumes
- Payment History
- Returns and Return Rates
- Strength of the Supplier
- Competition in Market Place
- Your Location and Ordering Habits

The first thing to remember is volume allows for a stronger position. The more volume you purchase the more discount you can expect (to a point). However, due to the competitive nature of a given market area, the differences between buying \$300,000 and \$1,000,000 may one be a few percentage points. Just keep in mind, it all adds up ! Just 2% on a \$1,000,000 is \$20,000 which drops directly to the bottom line.

There is another factor which is overlooked often and that is payment history. If you have often been behind in paying your vendor obligations, you are not in a strong position. Many clients do not consider or understand this. If you knew a specific company is always late in paying you ... would you provide the same pricing ? If you say, “yes”, it is the wrong answer ... pricing should always consider terms.

If you have a history of late paying, but now it is not a factor ... you can approach this with a “risk” for you to the suppliers. Negotiate a “on time” payment discount ... pay by 10th of the following month and receive 2%–5%+ discount. There are many variations for this.

An additional factor to consider is your returns and return rates. Do you have a system in place to make sure if a part during the repair process is determined to not be needed, to correct the work order/repair order, and to get the part back for credit ? If not, this is a very critical process you must put in place.

Then along with this, you also need to make sure your rate of returns is minimal. High return rates do not put you into a strong position. This must be kept to a small percentage, 1% - 2%. This can only be accomplished by utilizing a good process in staging or blueprinting the vehicle. Returns increase paperwork for everyone, not returning when required will also drive up your costs as mentioned before.

A few additional factors that affect discounts are the strength of your supplier, the market place, and your location and ordering process. There are many suppliers which are simply not large enough or not very interested in the wholesale business sales. Most of these parts managers are very low motivated managers of a department that normally provide grief to their own body shop (if they have one).

We have worked with dealer principles in changing this situation for the dealership body shop. It is not easy, but creates huge upsides for the entire dealership organization. If you are an independent repairer in a market area that this exists ... get another supplier. The internet and competition has opened up the supply chain for parts to make this possible. You can get just about anything from across the Country as fast or faster as you can get it from these local difficult suppliers. We work with clients everyday on these areas.

Your location is a secondary factor unless it is "Guam" or 50 miles from any town in America. However, how you conduct business (the ordering process) can be a major factor. Are you the shop that calls in orders ? Are you the shop that calls in orders 5 times a day for the same vehicle ? Are you the shop that needs the part, now ? If so, your process needs extreme improvement.

This article's scope can't possibly explain how to improve this, we take weeks working with clients on this, however keep this in mind ... if you improve your process, you will reduce your costs ... time is money for you. It is also true for the supplier ... reduce their costs and you may be able to benefit too.

The above are a few of the areas we start with. Since each market is different as well as each client's position and situation, there is analysis required before ever implementing any solution. There are many more programs to implement as well to achieve results designed to improve the gross profit level of this major but often overlooked income area. Again The BOSs™ provides many of them.

Feedback:

This new e-bsb feature will be provided each month, but I do ask you provide feedback by e-mailing your comments and questions to: Tony.Passwater@aeii.net . This will certainly assist me in providing valuable information to our Industry. Until Next Month ...