

## Labor Profitability Improvement

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

by Tony Passwater

This month, we continue our examination of the various basic benchmarks you should be tracking and responding to each day, week and month.

Last time, we focused on gross profit, basic gross profit targets and some basic improvements to focus on for parts. What was covered in parts can be equally applied to many areas including paint and material supplies, sublet vendors and towing.

Actually, any purchasing of a product or service can be reviewed to ensure you're getting the best discount or cost. Keep in mind that paint and material, along with parts and sublet purchases, represent from 49 to 60 percent of your total sales dollars, so they're very important to focus on.

This month, we'll focus on labor costs of production staffing.

When it involves labor, we add a human-resource management component that, frankly, our industry as a whole stinks at addressing. (This will be covered in a later article as well, once we complete the financial components.)



Labor revenue usually represents 40 to 50 percent of your total sales dollars, so it's very important to focus on. And let's not forget the human component involved here, which scares a lot of managers and owners.

I've heard so many times, "What if they quit? What will I do?" Although this sounds more like a hostage situation than a focus on the success and future of the business, management is often too afraid to even look at this area of their business.

## Definitions and Targets

The first step is to define how labor is costed and what targets should be achieved. Today's collision repair shop is divided into three main departments: metal repairs, mechanical work and refinishing. Within these, additional division can be performed with disassembly, structural and preparation, to list a few.

In the past, the entire job may have been done by one individual. We often called them combination men. Today, combination work isn't often done for many reasons outside the scope of this article. Probably the biggest reason the divisions are as they are today is due to the estimating and management systems breakdown of metal, mechanical, structural (frame) and refinishing.

For this article, let's use the basic departments as our estimating system uses. Each of these operations represent activities that are associated with specialized skills. Often labor rates will differ between many of them.

So what's your target for gross profit on labor? Labor should represent a cost of 33 to 35 percent of the total sales of labor.

Where do you think the benchmarks used for years in our industry came from? These are basics for *any* business to remain healthy. So obtaining 65 percent gross profit is a basic target that can actually be achieved.

The question that still comes up too often is, "Is this loaded or unloaded?" The first indicates the employee costs include all or some portion of the following: employer paid taxes (FICA/Medicare match, unemployment, workers comp, etc.), holiday and vacations, benefits, uniforms and the kitchen sink. The latter is the gross pay of the individual only. In an hourly wage, it's calculated with the number of hours worked times his hourly rate (including overtime). In an incentive-based system, the commissions they earned (or flat-rate hours turned) in a given period.



The answer is that basic business is referring to "unloaded" labor percentages for these targets.

Now this is where a battle line is often drawn with shop owners. However, if you're going to accurately benchmark your organization against others, you must do it apples to apples. With the differences in employee costs for medical, unemployment insurance and other benefits, no comparison can be made with those costs included in labor benchmarking.

Now before I receive several hundred e-mails and calls, don't get me wrong — knowing your total costs for each employee is critical to manage your business successfully. It just shouldn't be done in the Cost of Goods Sold (COGS) accounts. (We'll certainly cover this in a later article.)

## Labor Efficiency and Costs

The collision repair and mechanical industries are two of the few service businesses that use a "times manual" to help to determine pricing. The suggested times listed in each system today as everyone knows do not represent "true" time, unless the person is on artificial life support.

How the times are determined and what is or isn't included in the provided times is an ever-changing

debated topic — and not part of this article. However, what is important to understand is that improving efficiencies is one of the best methods to increase profits.

What's important at the end of the day is the effective labor rate received. I've received many inquiries from managers and technicians who simply do not understand this concept. One call went something like: "How can we have a \$40 per hour door rate, when we pay our technicians \$25 per hour? That's only a 37.5 percent gross profit! We have no way to get to 65 percent."

When I asked how long it would take his technician to repair a typical 5.0 hour dent on a quarter panel or door, the answer was 1.5-2.0 hours. This, of course, isn't a thorough analysis of the pricing of this shop and we don't know what the replacement times "add-ons" are, but it certainly demonstrates what I attempted to explain to this caller.

With this example, the effective gross profit at this efficiency is 75 percent or more! The method you would use here is:

**5.0 hrs x \$40 labor rate = \$200 (Total Revenue)**

**2.0 hrs (time spent by tech) x \$25 (their hourly cost) = \$50 (total cost)**

**Calculate Gross Profit \$ - Total Revenue - Total Cost = \$150 (GP\$)**

**Calculate Gross Profit % - GP\$ Divided by Total Revenue = .75 (75%)**

The key here is that you must measure and monitor the efficiency of your technicians.

We've worked with many repair facilities worldwide to improve their business performance. Whether it's 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 Web site at [www.aeii.net](http://www.aeii.net) as a resource for your improvements.

## Improving Performance

Now that you're measuring this, the next step is to do something to get where you should be. It won't happen by itself, even though when you begin measuring and people know you're measuring, you may automatically see performance levels improve.

There are basically seven areas to look at when trying to improve performance in this area:

1. Leadership.
2. Equipment and materials.
3. Systems and processes.
4. Pricing.
5. Staff skills.
6. Division of labor.
7. Staff motivation.

This article's scope can't possibly explain how to improve these in great depth. It normally takes weeks working with clients to accomplish these improvements. However, these can at least give you a better understanding of what's needed.

### 1. Leadership

An expression I often use is, "To effectively lead, one must have a plan, commit to it, be able to communicate it in a way others can believe in it, execute it as a team and be able to move quickly to get out of the way!"

Often, management creates an environment that stymies production and performance. Often, management and leadership are lacking along with systems that make sense.

For this to change, you must commit to change. Learn better management skills and improve your leadership skills. In addition, communication is critical. You need to not only tell everyone what you're doing, but get them involved and get them to totally buy into it. There are thousands of books, tapes, seminars, consultants and coaches for this. Check out our Web site for additional resources at [www.aeii.net](http://www.aeii.net) under consulting services and educational services.

## 2. Equipment and Materials

There's no doubt that if you factor in all the labor-saving claims made by the latest and greatest equipment and materials available today, the vehicle may get repaired before the accident ever occurred! But in reality, many of the upgrades do make a difference.

One easy example to look at is a resistance spot welder (STRW) unit versus a GMAW (MIG) welder where applicable. An STRW can perform probably three to four welds in the same time a MIG plug weld is performed. They also has little additional finish work required and look like OEM welds.

Others time savers include using air jets in the spraybooth, ultraviolet systems and infrared. All will and have improved the ability to shorten the refinishing process. We constantly look for these to improve production for our clients worldwide.

Very few facilities that I've visited understand this to the extent that it needs to be implemented. It's critical that you understand that the location of every piece of equipment, tool, supplies or parts affects the efficiency of your labor production. Using inefficient equipment and materials is almost as costly to your profitability as poor systems and processes, covered in the next section.



## 3. Systems and Processes

Another often-observed condition I come across is, "Management does just about anything to hinder production, when it should be doing everything to improve it."

I received a question from a reader a couple of months ago asking if I had any suggestions for a pay incentive for estimators to write supplements. Now, if I was an estimator with an incentive system to write supplements, what do you think I'd do? Don't get me wrong, pricing (covered below) is very important, but what does this system do to pre-production processes (scheduling, parts) as well as to production? It simply destroys it and would allow an estimator to be less accurate when writing an estimate. Certainly on-time deliveries will also diminish, and cycle time will increase.

The No. 1 change in systems and processes that will improve profitability through increased throughput is extremely easy to say — but very difficult to implement at an acceptable quality level. You need to:

- Verify that parts ordered are needed;
- Stage (blueprint) the vehicle to disassemble the major components and identify all sub-assemblies needing replaced;
- Properly store and mark parts;
- Check received parts to the vehicle and to the parts being replaced to ensure they're complete, in usable condition and correct.

And this is all to take place before the vehicle takes a technician's production space.

## 4. Pricing

When it comes to labor pricing, this is where the good and the bad estimator make all the difference in the world. It's extremely important that the proper pricing is received for each job. But how does one know, for example, when to replace the quarter panel versus repair?

What we've found is that often the decision to replace is made because the estimator doesn't want to risk underbidding the time. He can easily pick the times from the estimating systems and put a few additional hours on inner components, while supplementing the "unseen parts" he missed.

But this is not good for business.

You need to review pricing of some individual jobs for each technician and categorize what kind of job they are (mostly bolt-on replacement, weld replacement, repair only, small, medium and large jobs). Then see how your pricing compares to the effective hourly rate needed to operate your business.

You also need to have a method to audit your estimates for missed items and to stay in compliance with any of your insurance relationships. This can be done manually, but there's very effective software available that does it better. It's called EMSReview™. Check it out at [www.aeii.net/EMSReview1.htm](http://www.aeii.net/EMSReview1.htm).

It's important to verify and correct this area before implementing any changes to pay plans — especially if you're considering moving from an hourly pay system to any incentive-based system. Otherwise, a mutiny is bound to occur.

## 5. Staff Skills

This is also pretty easy to say but isn't often implemented. Training is a commitment that has to be taken to heart by senior management because it must be in the budget and accepted by those who are to be trained. This training can include I-CAR, manufacturer, equipment and product training, etc.

Training, however, isn't like a smallpox vaccine — once you get it, you'll never need it again. Training is continuously needed.

This area also determines the qualified versus the not. Our industry has received many "shots" for shoddy workmanship. Some may have been justified, but for the most part, the cause for the hundreds of improper repairs I've examined was most often the technician not being trained properly. He simply didn't know better. The next would be lack of proper equipment.

Through proper training, technicians can efficiently restore a vehicle back to pre-accident condition as it relates to safety, function and appearance. Otherwise, the internal and external comebacks cost you money. Poorly trained technicians also cost you money.

## 6. Division of Labor

In our industry, jobs are commonly divided into the basic departments of metal, structural (frame), mechanical and refinishing. And in many cases, the metal, structural and most mechanical work is performed by a Level 3 technician (journeyman).

The question is why?

It certainly isn't a financially sound, long-term business practice.

Henry Ford discovered a very long time ago that it was much more cost effective to break down the manufacturing process into smaller, easily trainable tasks that improve quality and reduce costs. This idea also applies to our industry — though very few apply it well.

The concept of production teams with multi-level technician skills isn't new. It does work, but what's been missing for many years is the skills and training of the team leader (mentor) to actually succeed in this system.

Often the individual(s) selected to be a team leader has never received a minute of training for coaching, teaching or management. This dooms the project and forces the now "helper" to perform the dirtiest tasks without guidance, supervision or support. It doesn't take long for most to fail and/or quit in this system.

There's no reason today for this to be the case when implementing a mentorship program within your organization. There's a very cost-effective solution provided by Mentors@Work. Check out the program at [www.MentorsatWork.com](http://www.MentorsatWork.com).

This program allows your organization to integrate lower skilled (and cost) technicians into your organization to improve teamwork, which will ultimately increase profitability.

## 7. Staff Motivation and Pay Systems

Do you clearly communicate your expectations to your production staff? What motivation do they have to be efficient and cost effective? (Flat-rate systems do not accomplish this.)

Sorting out who's to do what, when and how will go a long way in reducing waste and "hidden" costs. Who works with the production staff to keep them motivated and on target? Or are you attempting to use a pay system to accomplish this?

A pay system may be able to assist in providing some control over profit levels as it pertains to gross profit percentages. But another favorite phrase is, "You can't go into a bank and deposit percentages." It certainly isn't a "breakthrough" strategy that can improve your long-term profit picture.

The best system is to have a workforce who's paid an appropriate wage according to their skill level and performance (production and employability). This is often where it disconnects — no one wants to "manage" and motivate.

But this requires communication and support to provide the staff with the vision and belief that they're a vital part of the organization. Every staff member — whether production or not — must also understand their effect on the profitability of the company. In addition, as competition increases, they need to assist in finding ways to reduce waste and costs for the company to remain competitive.

It again comes back to leadership.

### It's Not a Quick Fix

The above ideas are a few of the areas we start with. Since each market is different — as well as each client's organizational structure — an analysis is required before implementing any solution. There are many programs out there designed to improve the gross profit level of this area. The BOSs™ at [www.TheBOSs-Online.com](http://www.TheBOSs-Online.com) provides many of them.

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## Need Your Feedback

Please e-mail your comments and questions to [Tony.Passwater@aeii.net](mailto:Tony.Passwater@aeii.net). This will certainly assist me in providing valuable information to our industry. Until next time ...

**Coming Next Time ...  
We'll focus on paint and  
material management**

