Service & Parts-More Gross or Less Expense to Obtain Profitability?

Are you wondering how you can increase your parts and service departments' net profitability? Some of the factors that affect profitability are sales, cost of sales, management and technician's abilities, number of technician stalls available, number of hours each technician turns and expenses.

Gross profit is simply **sales** less **cost of sales**. Sales are generated from customer retail, warranty and extended warranty, sublet, internal and maintenance repair orders. Cost of sales has a direct relationship to sales. In service, it is the technician's cost per hour they are paid, either in hourly, salary, or flat rate time. In parts sales, it is the cost of the parts you purchase for the repair order.

Management's ability plays a key part in profitability. If your technicians are not supervised, if repairs are not scheduled properly among the techs, if customer followup is not a high priority, etc., then service and parts will have a lower chance of being profitable.

Technician's ability, **number of stalls** available and the **number of hours** each of your technicians produce will greatly affect your ability to be profitable. You can have too many stalls for your current sales, which increases your overhead unnecessarily. Too few stalls will result in not being able to complete all the work you have available, resulting in unhappy customers, retail and/or internal (yourself), and unnecessary expense moving vehicles in and out of the shop before the repairs are completed.

If your techs are not trained properly, or have too few years of experience in ride, drive and diagnostic capabilities, the number of hours sold will be below what would normally be produced in most profitable repair shops. If you do not concentrate on up selling, which is normally generated from inspecting the customer vehicles when they arrive at your shop for maintenance or repairs, your average hours per repair order will also suffer. Check to see how many one line repair orders you have generated over the last three months. Most were probably oil changes and you may have been so busy you did not have or take the time to perform adequate inspections of the vehicles to recommend further service while it is in your shop.

The amount of maintenance type repairs is increasing because vehicles are lasting longer. With this in mind, you need to market yourself similar to the way the other maintenance shops in your town are promoting themselves. You have to have competitive pricing, tiered pricing based on the type of repair, loss leaders, etc, if you are going to get your fair share of the business. Customers still seem to think dealerships are much more expensive places to get their vehicles maintained than the smaller shop down the street. It is up to you to dispel this thought.

Charging retail prices to yourself for all internal sales is also very important, since **you are your own best customer**. Your managers and sales people will argue that it can be repaired cheaper down the street at another shop and you are cheating them out of potential gross profit. The only answer I would give them is this: **When your name is on the building, you can take it down the street to repair the vehicle**. **Until then, retail prices from our own shop will be charged to the vehicles for reconditioning and detailing.** This only makes sense as your service and parts gross profit help cover a tremendous amount of your total overhead.

For internal repairs, the minimum service labor gross profit should be 70%, sublet repair should be 15% and parts gross profit should be at least 40%. I have yet to see where increasing the internal gross profit from substandard grosses to the minimum grosses described above, reduces the commissionable gross profit that sales commissions are based on. Normally, we see when internals are priced to achieve the above minimum grosses, the average gross profit on the vehicle increases.

Now, what do you do to have profitable parts and service departments? Increasing sales, lowering cost of sales and expenses, having the right managers and fully trained techs with the right number of stalls available to maximize the hours your techs can turn, will all result in a higher net profit in the service and parts departments.

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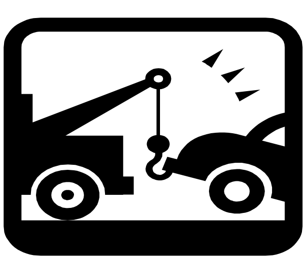
Expenses are a large part of your key to profitability in parts and service. You can generate all the gross you want, but if you don't control your expenses, the gross profit can be overwhelmed, leaving you with little or no net profit.

Fixed expenses are expenses that are not directly tied to the production of sales, such as rent, utilities, telephone, administrative salaries, employee benefits, real estate taxes, data processing, legal and accounting, depreciation, owner(s) salaries, payroll taxes, insurance, etc. For example, rent would not normally increase just because you sold a few more cars or produced extra repair orders in a month.

Selling expenses are those directly related to the production of sales, such as service advisors pay, payroll taxes, absentee compensation, shop supplies, equipment repairs, advertising, training, data processing, uniforms, health insurance, workman's compensation, etc. Paying your managers and techs bonuses on how well expenses are controlled can help you achieve lower expenses that may not necessarily increase as your sales increase.

Since **net profit** is the ultimate goal you want to achieve, then **expense control is just as important as producing gross profit**. Normally you should generate approximately $1 of service sales for every $1 of parts sales. The combined average gross profit will be approximately 50% of every dollar in total parts and service sales you generate. For example, if your total combined sales are $50,000 per month, you should generate approximately $25,000 in gross profit. To be profitable, your expenses would have to be less then $25,000. How profitable, depends on how well you manage your expenses.

Remember, to produce $1 of gross profit you have to generate $2 in sales, while saving $1 of expense achieves the same result. Try both.



TAX TIP

REPAIR REGULATIONS

As your business completes its year-end accounting and income tax preparation process, you may want to consider whether certain changes in accounting methods are beneficial for tax purposes. In many cases, changing to a different accounting method will result in deferring income taxes to a later tax year. A business that is not on an optimal accounting method for its particular transactions is effectively prepaying taxes, an undesirable and unnecessary result.

Upon reviewing your business and its tax situation, your ATA representative may identify opportunities to defer income taxes by changing your existing accounting methods. This is accomplished by filing a Form 3115 with the Internal Revenue Service. In many cases, the accounting method change is applied retroactively to previous tax years and you will receive a tax refund upon filing Form 3115.

In March of 2012, the IRS had passed the Tangible/Repair regulations which address a particular group of accounting method changes for expensing capital improvements and major repairs. These regulations are generally effective for tax years beginning on or after January 1, 2012 and allow your business to expense current major repairs and retroactively apply this accounting method to previously capitalized major expenditures.

The IRS extended the implementation of these regulations until they are issued later in 2013 in final format effective for the tax year beginning January 1, 2014. However, if your business has incurred substantial costs to repair or "refresh" real property in 2012, it may be beneficial to expense these items in 2012. This kind of treatment represents a change in accounting method if the business always capitalized such expenditures in prior years. By filing a Form 3115 with the IRS in 2012, the current year major repair can be expensed and previously capitalized repairs can be written off.

Your ATA representative can advise you whether your business will benefit from implementing an accounting method change and prepare the Form 3115 to be filed with the IRS. In many cases, filing Form 3115 will result in a claim for refund of income taxes paid in prior years.