



Making money in service

If priced correctly, the service function of your business can actually boost overall dealership profitability.

By Kevin Kehoe



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There is money to be made in expanding the service side of your business. Of course, there are the associated hassles and cost. But overall, I have found that dealers who increase their service operations also increase their profits. This is based on a financial study I conducted of 150 dealers last year. One of the key drivers of higher-profit dealerships was a higher level of service sales in the revenue mix.

The revenue mix is defined as the relative percentages of product, parts and service sales in relation to total sales. For example, a revenue mix I found, more typically, associated with lower-profit dealers looked like this:

Equipment sales	60%
Parts sales	30%
Service sales	10%

The revenue mix I found, more typically, associated with higher-profit dealers looked like the following:

Equipment sales	45%
Parts sales	30%
Service sales	25%

The reason for higher profits is fairly straightforward. The margins on service are potentially higher than the margins for either equipment or parts. This, of course, assumes that the service is priced correctly. The rest of this article will address a method for determining the correct price for service sales.

Getting the right pricing

The pricing model is based on the time and materials billing method. Time for service work is priced at an hourly rate with minimum half-hour charges and billing increments, and materials (or parts) are charged out at the standard retail markup. The model is also based on recovering all service department costs in the hourly labor rate.

The pricing model is based on the average wage paid to service personnel. This wage rate must be marked up for:

- Payroll taxes
- Non-utilized time
- Overtime
- Shop indirect costs
- Shop overhead costs
- Profit margin

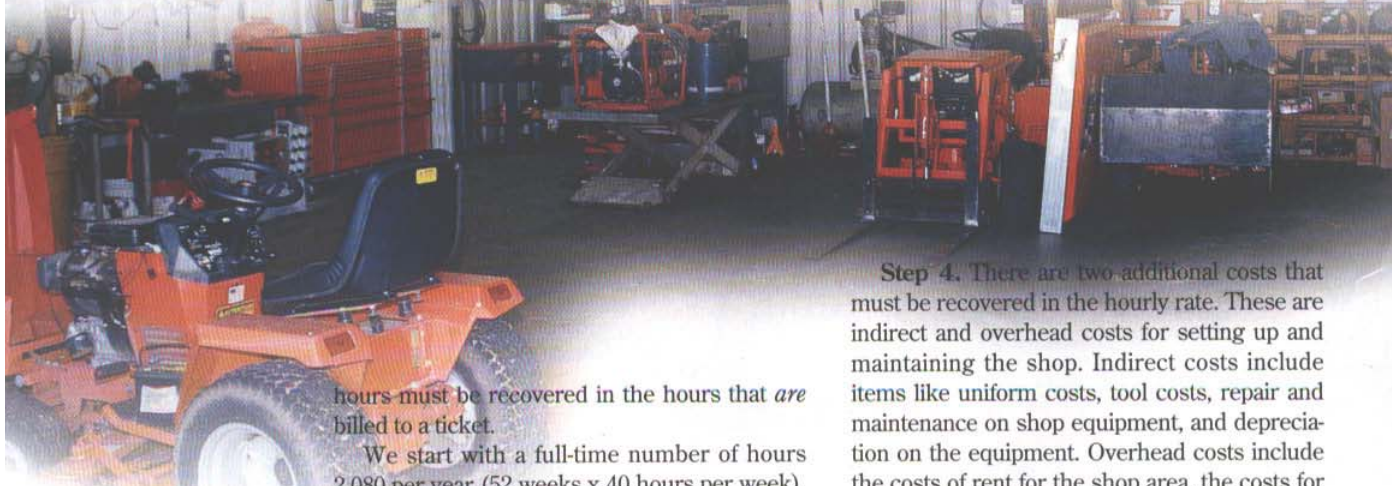
Let's use the following example to determine shop service rate. We are assuming for purposes of this example that the company employs one full-time service shop mechanic.

Step 1. We start with an average wage rate of \$15 per hour. We first mark up this rate by factoring in the associated payroll taxes and benefits paid by the company to employ this person for an hour. The markup includes the company-paid costs of SUTA, FUTA, FICA, vacation, sick, medical and workers compensation. In the example, these costs amount to 28% of each wage dollar paid. Yours may be higher or lower than this, so just be sure to use the right percentage for you when calculating your rates. However, the 28% rate is a fair average.

Wage/hour	\$15
Payroll taxes/benefits %	28%
(\$15 x 28% = \$4.20)	
First adjusted wage/hour	\$19.20
(\$15 + \$4.20)	

Step 2. We next calculate the cost of recovering non-utilized time. Non-utilized time is the time *paid* but not *billed* to a specific service ticket. This accounts for the hours that are not revenue-generating hours but are still paid for the mechanic to be at the shop.

You can easily estimate your utilization rate by comparing the number of hours charged to service tickets with the total numbers of hours paid through payroll. Based on survey averages, we will use a 60% utilization rate. This rate says that 40% of paid hours are not billed to a service ticket. Therefore, the cost for these



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hours must be recovered in the hours that *are* billed to a ticket.

We start with a full-time number of hours 2,080 per year (52 weeks x 40 hours per week). Multiply these hours by the utilization rate of 60% (or 0.6). This yields 1,248 billable hours (832 non-billable hours) at a cost of \$19.20 per hour. Total utilization cost is \$15,974 per year (832 non-billable x \$19.20). Dividing this cost per year by the billable hours provides us with an hourly utilization cost that must be added to the first adjusted wage/hour.

Paid hours annually	2,080
Utilization rate	60%
Billable hours annually	1,248
Non-billable hours annually	832
Utilization cost	\$15,974
(832 x \$19.20)	
Utilization cost per hour	\$12.80
(\$15,974 ÷ 1,248 hours)	
Second adjusted wage/hour	
(\$19.20 + \$12.80)	\$32

Step 3. We then calculate the cost of possible overtime. We do not know when the overtime will occur, but we are assuming it will show up during peak season.

We are using a 10% overtime factor. This means that 10% of the wage hours will be paid an overtime premium of one-half time. Multiplying this overtime factor of 10% by the total full-time hours, then multiplying this number by one-half of the adjusted wage rate of \$19.20 (or \$9.60), calculates the overtime cost. This yields \$1.60 per hour that must be added to the second adjusted wage/hour.

Overtime factor	10%
Overtime hours (2,080 x 10%)	208
Overtime cost (208 x \$9.60)	\$1,997
Overtime cost per hour	
(\$1,997 ÷ 1,248 hours)	\$1.60
Third adjusted wage hour	
(\$32 + \$1.60)	\$33.60

Step 4. There are two additional costs that must be recovered in the hourly rate. These are indirect and overhead costs for setting up and maintaining the shop. Indirect costs include items like uniform costs, tool costs, repair and maintenance on shop equipment, and depreciation on the equipment. Overhead costs include the costs of rent for the shop area, the costs for utilities, and the costs for administrative overhead to support the shop.

In the example, we have estimated these costs from the company's profit and loss statement, and we apply them here as \$5,000 per year for indirect costs and \$15,000 for overhead costs. We then calculate a cost per hour for these items by summing the two and dividing by the number of billable hours identified earlier (indirect \$5,000 plus overhead \$15,000 — and that total divided by 1,248 billable hours). This yields a cost of \$16.03 per hour. This must be added to the third adjusted wage/hour to arrive at a breakeven cost per hour of \$49.63.

Indirect shop cost	\$5,000
Overhead shop cost	\$15,000
Cost per hour	
(\$20,000 ÷ 1,248 hours)	\$16.03
Breakeven cost per hour	
(\$33.60 + \$16.03)	\$49.63

Step 5. Since we do not want to work for simply breakeven, we need to add a profit to the breakeven cost/hour. We are going to mark up the breakeven by 20%. The calculation for this is important. In order to yield a true 20% margin, we do not simply multiply \$49.63 by 1.20. Instead, we use the following calculation.

Breakeven cost of \$49.63 divided by 1.00 minus the 20%. This is the same as dividing the breakeven cost of \$49.63 by 0.80. This calculation yields an average shop-billing rate of \$62.03 per hour. This rate recovers all the costs associated with running a service business — and it makes you a nice profit of 20%.

Profit margin	20%
Service rate	\$62.03

As you can see, there is indeed money to be made in service. Just make sure that you are pricing your service correctly. **YG**