Driven

NADA MANAGEMENT SERIES SP29

Service Department Performance Analysis

NADA
NATIONAL AUTOMOBILE DEALERS ASSOCIATION

The National Automobile Dealers Association (NADA) has prepared this management guide to assist its dealer members in being as efficient as possible in the operation of their dealerships. The presentation of this information is not intended to encourage concerted action among competitors or any other action on the part of dealers that would in any manner fix or stabilize the price or any element of the price of any good or service.

Service Department Performance Analysis

THE AVERAGE DEALERSHIP RETAINS LESS THAN 35 PERCENT OF ITS SERVICE MARKET POTENTIAL.

There it is. A fact of business. It's been a fact for so long that we almost take it for granted, but we shouldn't. Are you willing simply to accept that the customer who just drove away his purchase—the vehicle he bought from you—is more likely than not to have that vehicle serviced elsewhere?

Sixty-five of 100 of your customers do just that.

Can you imagine what your service department's dollar volume would be if you retained all 100 sales customers as service customers?

You don't have to imagine. You can do the numbers. Here's how to calculate your service potential:

1. Determine your owner base, which is your total number of new-vehicle sales (excluding fleet) over the past five years. These customers, the ones to whom you made the sales, represent most of your potential repeat service business.

Annual new-units sold x 5 years = Owner base

2. To calculate total annual service potential: Multiply the owner base by the average number of service hours required over five years—today's new-vehicles usually need 11-12 hours of labor per owner, per year over the first five years, including warranty work—and your hourly rate.

Owner base x 12 hours x hourly rate = Annual total service potential

Reaching your potential takes effort on many fronts, and though we will offer suggestions in this bulletin, our main purpose is to sound a wake-up call—if your dealership is typical, you are not realizing even half your service income potential—and to give you the tools to judge where your strengths and weaknesses lie.

The first step to reaching your potential is knowing where you stand, and where you should stand. So, let's take a look at your profit picture. Bottom line, you want to earn the best net profit you can. What gross profit will yield your best net? How many labor hours must you sell to make that gross?

GROSS PROFIT RETENTION

Study your financial statement. Analyze the service department's labor-only sales and grosses. Divide gross by sales to find gross profit as a percentage of sales, and divide each labor category by the total to find the portion of the total that category yields.

CATEGORY	LABOR SALES	LABOR GROSS	GROSS PROFIT AS % LABOR SALES	% TOTAL
Customer Car	$	$		
Customer Truck	$	$		
Customer Other	$	$		
Warranty	$	$		
Warranty Other	$	$		
Internal	$	$		
NVI/Road Ready	$	$		
Adj. Cost of Labor	$	$		
TOTAL	$	$		

Based on NADA Best in Class 20 Group guidelines, which represent the most profitable NADA 20 Group dealers, the service department should aim for 70 percent or higher gross retention in every labor category. Moreover, customer-pay labor—car, truck, and other— should account for 60 percent of total labor sales, with warranty and internal contributing 40 percent.

Are you holding 70 percent of your gross? If not, look into your cost of sales (should be 30 percent or lower) and the percentage of your sales from each category. Don't charge less for internal labor sales; *every* sale is a retail sale.

PARTS TO LABOR RATIO

Now, analyze your financial statement for the parts to labor ratio. Focus on customer-pay labor. Using the figures for parts sales and labor sales in the customer-pay category, divide parts sales by labor sales to get the ratio. It should be at least $.80

parts/$1.00 labor, meaning that for every dollar of labor sold, you should sell 80 cents of parts.

After all, a portion of every service sale is a parts sale, and though prices for parts are pretty consistent, labor rates vary, sometimes dramatically. If your parts to labor ratio is not at least $.80, look at your service menu to ascertain that it mirrors what the manufacturer recommends or requires. (The service menu should mimic the language of the owner's manual so that there is no confusion.)

If you don't have a service menu, consider developing one, says Robert Atwood, NADA Academy Instructor. Atwood also suggests installing a parts display board in your service department. Show new disc pads next to old ones, new brake shoes next to old ones, a new serpentine belt next to an old one. And display clean air filters and cabin air filters next to dirty ones. Get your technicians (and your customers) thinking about parts that may be needed, depending on the age and mileage of the vehicle and how it has been utilized—and encourage them to inspect the vehicle for parts that may be worn and/or potentially dangerous. You may upsell needed parts and service, and your customers will be grateful.

ACHIEVING YOUR BEST NET PROFIT

The next major calculation in your analysis concerns finding your net profit—or, put another way, ascertaining that expenses are in proportion and under control. Use your financial statement to subtract total expenses from total gross; the result is your net. You may find it convenient to use the table in the next column. As a rule of thumb, personnel expenses (which may appear on your statement as personnel, variable, or selling expense) should amount to 45-50 percent of the gross. All other expenses should run 25-30 percent of the gross. In general, successful service departments should net 20 percent after absorbing their share of administrative or indirect expenses. If your expenses are greater than 80 percent, and the culprit is not gross retention, concentrate on lowering expenses—common costs to rein in include shop supplies, policy work, uniforms, and parts washers. You *can* achieve a 20 percent net; like a small increase in gross, a small decrease in expenses can have a big impact on sales needed to make your best net.

EXPENSE CATEGORY	DOLLARS	% SERVICE LABOR GROSS	PROFILE DEALERS
DEPARTMENT GROSS (TOTAL)	$	100%	
VARIABLE/SELLING EXPENSE	$		
PERSONNEL EXPENSE	$		
SEMI-FIXED EXPENSE	$		
FIXED EXPENSE	$		
UNALLOCATED EXPENSE	$		
DEALER'S SALARY	$		
TOTAL EXPENSES	$		
NET PROFIT (GROSS LESS EXPENSES)	$		20%

FIXED ABSORPTION

Fixed absorption is yet another area to scrutinize. Fixed absorption is the extent to which the fixed departments (service, parts, and body shop) can cover the entire dealership's adjusted overhead expense (i.e., total dealership expense less expenses directly attributable to vehicle sales—commission, delivery, and policy). Absorption, important in any sales climate, becomes critical when vehicle sales slide. Variable income flow goes down, but expenses increase. The more of the debt load you can take off variable operations, the easier it is for them to sell vehicles. Aim for as close to full (100 percent) absorption as possible. NADA 20 Group guidelines, which include used-vehicle gross in the formula below, recommend 100 percent absorption. NADA Academy, basing its guidelines on the experience of the top 20 percent of dealers who are successful in all departments, recommends 75 percent absorption, with or without a body shop. If your absorption is low, look at your grossing patterns. Service should be holding 70 percent, parts should be holding 38 percent, and body shop should be holding 65 percent on labor, 30 percent on paint and

materials. If you're holding gross in all these areas, examine expenses. Advise the general manager or sales manager if you find that the service department is in the position of absorbing costs it cannot control, i.e., floor plan interest on and advertising of aged inventory.

Calculate your fixed absorption using the numbers from your financial statement in this formula:

Gross profit
(Parts dept. + Service dept. + Body shop) divided by
Dealership overhead expense = Absorption percentage

LABOR SALES POTENTIAL

In the service department, your inventory is time—the highly marketable time of highly trained technicians. You need to utilize technician time skillfully in order to retain profits while giving customers value exceeding expectations. Thus, you should price service labor competitively, and carefully monitor the mix of work your shop does. You should also analyze your repair orders (ROs) every day, making sure every RO is complete, that pricing is correct and effective, and that your Effective Labor Rate (ELR) is where it should be.

Of the various labor pricing options, Atwood favors variable labor rates based on job complexity. When tech skills are matched to the job, you use labor efficiently while enhancing your competitive stance. Guidelines for the work mix are 60 percent competitive and maintenance, 40 percent repair. **Competitive labor** comprises such services as lube, oil, and filter changes (LOF) and tire rotations, and is charged at a low hourly rate, perhaps at or near the LOF rate charged by local quick lube shops and gas stations. **Maintenance labor** is work the manufacturer recommends or requires. Including common but less competitive services (e.g., emission control or air conditioning service), maintenance labor is priced at a moderate hourly, perhaps at or above the existing warranty rate. ***The maintenance rate is the target rate for the department and should never be lower than the warranty rate.***

Repair labor comprises the least competitive, most specialized services charged at your highest hourly rate, which might be $8-$10 above the maintenance rate. Fuel injection calibration or engine overhaul are examples of repair labor.

Monitor performance. Use daily reports to study ROs and calculate your ELR, which is the dollar figure you get when you divide sales in each category by hours billed in that category. Analyze ROs monthly to determine what needs to be done to maintain an ELR that always exceeds target. Then, use a month's actual performance to calculate your monthly labor sales potential:

1. $ Labor sales ÷ Hours billed = Effective Labor Rate

2. Number of techs × Hours/day × Working days/mo. = Clock hours available/mo.

3. Available hours/mo. × ELR = $ Labor sales potential/mo.

How does your *actual total* (dollar amount labor sales in #1) compare with your *potential total* (labor sales potential, #3)?

Among the many adjustments you can make to achieve potential—pricing tweaks, minimizing one-item ROs, upselling needed service and maximizing the use of menus, pricing guides, extended hours, and work mix scheduling—are improvements in facility utilization and in technician performance.

FACILITY UTILIZATION

You know your labor sales potential; now calculate your facility potential. Here's the formula:

No. Bays × No. Days × No. Hours × ELR = Facility potential

Use the total number of service bays excluding the wash and undercoat bays. The number of days is the total number of days in a month that the service department is open, and "hours" are hours per day that service is open. To calculate the extent to which you are actually making use of your facility, compare your actual total labor sales for the month against your facility potential:

Actual labor sales ÷ Facility potential = Facility utilization

To compute your potential facility utilization, compare your labor sales potential against your facility potential:

Labor sales potential ÷ Facility potential = Potential facility utilization

TECHNICIAN PERFORMANCE

If each of your technicians consistently produced to his or her maximum potential, you would achieve your true sales potential:

No. of clock hours available × 120% = FRH potential
FRH potential × ELR = True sales potential

How do you tell if your techs are making the most of available time? You measure. You can measure technician productivity (hours worked divided by hours available). Or you can measure technician efficiency (flat-rate hours—FRHs—produced divided by hours worked). Or you can use a measure that combines productivity and efficiency—technician proficiency. The equation:

Hours produced ÷ Hours available = Proficiency

Proficiency may be the truest measure of techs' time usage. Best-case—the tech is producing to his maximum—the guideline is 120 percent. Warranty work makes 120 percent unrealistic—but 100 percent proficiency is sustainable.

ADDITIONAL GUIDELINES

There are additional service performance guidelines to consider. For instance, every day each service advisor should write 18-22 ROs—with single items representing only 10-15 percent—totaling 40-50 FRHs. Analyzing the factors covered in this bulletin, however, should give you a firm handle on your service department's performance. For more information, consult the resources below.

FURTHER RESOURCES

Service department performance is discussed in these NADA *Driven* guides: *Analyzing Customer-pay Service* (SP24), *A Dealer Guide to Greater Service Opportunities* (SP11), *Repair Order Analysis* (SP3), and *A Dealer Guide to the Three Ps of Effective Service Management: Profit, Productivity, Personnel* (SP23). All products are available online at nada.org. In addition, service-specific workshops are held at each NADA Show, and seminars are presented throughout the year.

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