

Service Department Profitability

Optimizing your company's service center with burdened labor costing

By Kelcey Thompson

Nowadays it seems every discussion on growing a business or even surviving the current economic conditions begins with: "How can I do more with what I have?" Our clients continue to ask us, "What can I do and where can I go to grow?" Our answer is always the same: Maximize your current assets.

By maximizing the assets in their service departments, companies have the opportunity to expand their businesses into new revenue streams with the confidence of knowing accurate profit margins and costs. By focusing on pricing and efficiencies in their service departments and understanding their burdened labor costs, our clients have seen increased profits of 20% or more.

Service departments, if unchecked, can eat up your profits and potentially cause a net loss. Without breaking down your costs and expenses, you may not realize how much you are spending to run the department—you may continually be throwing good money after bad. Detailed financial reporting and burdened

labor costing give you the data you need to make an informed decision on the profitability and growth of your service department, and thus your business.

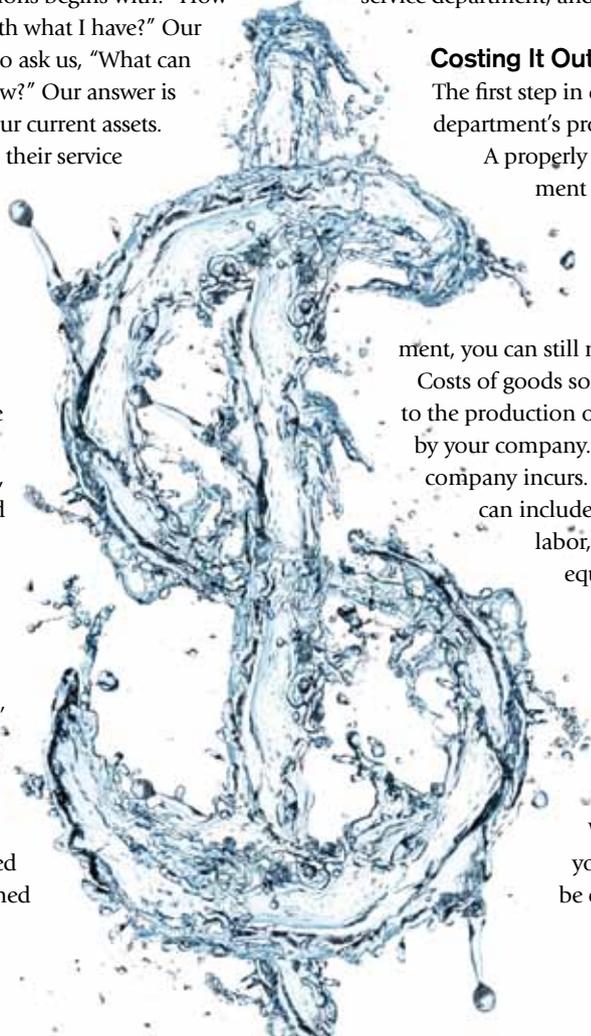
Costing It Out

The first step in determining your service department's profitability is to identify its costs.

A properly departmentalized income statement that utilizes cost of goods sold will provide the required information. Note that if you do not currently departmentalize your income statement, you can still move forward with this process. Costs of goods sold are direct costs attributed to the production of the goods and services sold by your company. They are the costs that your company incurs. In a service industry, these can include, but are not limited to, direct labor, materials, equipment, rental equipment, etc.

An income statement that is not only departmentalized but that also properly uses the cost of goods sold accounts will give you a thorough view of your gross profit for each department.

Without cost of goods sold, your revenue and gross profit will be exactly the same, rendering your



gross profit useless.

The second step in determining your service department's profitability is to know your true direct labor costs, otherwise known as your burdened labor cost. Owners and managers usually know how much they pay each of their service technicians per hour. They also realize that there are other payroll employee-related costs. The issue lies in properly calculating how much those related costs affect profitability. If you are pricing your labor without knowing your burdened labor costing, you may not be covering all of your costs and expenses, thus creating a net loss for your service department.

Burdened labor costing tells you how much that service technician costs you for every hour he or she is on the payroll—in other words, how much he or she is costing you per hour, not how much you pay him or her per hour. Burdened labor costing is the sum of direct labor costs, associated indirect labor costs, vehicle costs and an adjusted percentage of

the overhead costs associated with your service technician and vehicle. Taking the time to calculate your burdened labor cost can lead to higher profitability. Implementing this process may require some mentoring.

Burdened labor costing provides the following information based on financials:

- Burdened labor cost;
- Percentage of net profit: your current labor rate compared with your burdened labor cost;
- Break-even hours: the number of hours needed to bill to break even for your current labor rate; the number of hours needed to bill to break even for your labor rate at your various profit margin percentages; and the number of hours needed to bill to break even for your new labor rate;
- Hourly rates: the amount to charge for various profit margin percentages; and
- Cost per day: the total amount each service technician costs the company per workday.

Burdened labor costing can increase the profits of both your service department and your overall business by providing you with the information to:

- Create benchmarks based on performance;
- Create bonus structures based on performance;
- Accurately estimate labor costs for regular hours and overtime;
- Determine more efficient labor usage;
- Make informed hiring decisions;
- Make informed human resources benefits decisions;
- Control overtime costs;
- Bill interdepartmental labor charges;
- Use subcontractors profitably; and
- Create pricing that will achieve your desired profit margin per hour or per job.

Gross profit is useless without the addition of cost of goods sold. Improper labor pricing can be detrimental to your service department.



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The Customer Experience

When it comes to labor pricing, there are several schools of thought. One common idea is that you have to be priced lower than your competition, even if it is just by a few dollars. Believing that those few dollars will give you the competitive edge when trying to win customers may cause you to price away your profit margin.

Cheaper is not always better. Customers no longer base their decisions on how much you charge; they base their decisions on their relationship with your business. They consider: How well do you know me? Do I have to tell you who I am and how long I have been a customer every time I call? Do I have to tell you which equipment I have and what services you have provided me? Do I feel like I am part of your team and that you appreciate me?

Customer service is no longer—it has changed to customer experience. Customers expect your business to anticipate their needs—to know what they need before they even know they

need it. When they call, they do not want to have to tell you who they are—they want you to know. They want to feel like they are part of your team and that you know them personally and they know you—not just your business, but you.

Taking the time to calculate your burdened labor cost can lead to higher profitability.

They understand that this type of service is not the cheapest, but they are willing to pay for it. If they feel connected to you and your business, they most likely will stay with you, even when presented with a lower bid or hourly price from another company.

Customers' actions have proven that price is not the only factor in deciding on a company. However, the pricing of your products and services is still a major component of your public image and is crucial to securing and keeping your customers.

Take ownership of your numbers; know your numbers and work your numbers. Once you have complete visibility of your costs, expenses and customer expectations, you can make the proper labor pricing decisions for your business. By maximizing your current assets, you have the ability to move your service department into being a profit center. How much profit will depend on the educated decisions you make.

It is time to make your service department a profit center. **WQP**

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