Paint and Materials Profitability Improvement

This month's benchmark — paint and materials profitability — has never ceased to amaze me. Huge differences exist from shop to shop.

by Tony Passwater

Why is it that some organizations boast high paint and materials gross profit percentages exceeding 40 percent and costs at 5 percent or below (no matter what paint line they use), while others just hope to break even (with the same paint line)?

Based on my experiences examining facilities worldwide, I can reach only one conclusion: Those who succeed in getting the highest profits and reduced costs manage the department well and understand the factors that control their profitability. It has little to do with what you pay for the products you use or what brand you select.

Great emphasis has been placed on paint and materials the last few years, yet this department is only about 10 percent of your revenue and generally 5 to 7 percent of your costs. Why are we concentrating on paint and materials when our parts purchases are 35 to 40 percent of our sales and average 30 to 35 percent of our costs?

It's true that a smaller improvement in parts and labor efficiency may improve your bottom line much more effectively than improvement in paint and materials.

But to run your business as profitably as possible, you need to manage all departments well — including paint and materials — and understand the factors that control their profitability.

The Target

Paint and materials profitability should easily exceed 25 percent, and most clients we've worked with exceed 40 percent. So where is your gross profit level? It should be at least 35 to 40 percent.

The most common problem I see with measuring paint and materials profit is that it's not being measured correctly. Common mistakes are:

- **Items not paint and materials being costed against sales improperly.**
- **Income not posted properly.**
- **Robbing Peter to pay Paul (mostly dealerships).**

Let's take a closer look at each of these ...

Know What's Included

Paint and materials costs and profitability are greatly affected by what you define as "paint and materials." To some, it includes everything that gets dumped into the account with many charges that aren't actually considered paint and materials. It's no wonder profitability and costs are unacceptable.

The following is a link to a paint and material distribution chart we put together a few years ago, which outlines what we consider paint and materials, and what we don't:

http://www.aeii-news.com/Documents/PMGuide.pdf

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Accounting Distribution Practices

A number of items may have been itemized on an estimate/repair order (RO) line that are considered paint and materials. These also need to be posted in the paint and materials revenue account.

Whether you decide to put hazardous waste disposal or any other line-itemized expense in paint and materials is up to you. However, you must then make sure the revenue is there as well. Costs and sales must be in the proper accounts for any accounting or benchmarking to be beneficial.

We've worked with a number of progressive jobbers and paint companies to provide clear direction as it relates to this area when invoicing the customer's products. They've even set up different accounts for a customer, one for paint and materials, and additional accounts for other items that aren't considered paint and materials. Some have set up a regular paint and materials account, a shop expense account for items such as booth filters, a small tools account for items such as sanding pads, and even a safety item account.

This can be as simple as two accounts or as detailed as five. The key on the supplier's side is to accurately invoice each order to the correct account and to place the customer's accounting code for quick and accurate accounting distribution. If multiple accounts aren't set up, then at least items are listed on separate invoices with the proper account codes listed for the customer.

Robbing Peter to Pay Paul

In some cases, when comparing the actual estimated materials allowances to the final RO, the amounts vary. This seems to happen more in a dealership facility but also happens at independents.

In these cases, the revenue provided in the paint and materials is robbed to offset other deficit-revenue areas (being done to balance the RO prior to input into the accounting system).

I've seen it done to allow for more metal/paint hours to the tech. They were too lazy to get it approved for a supplement, and now they have to shift it from somewhere. In other words, the bottom line is distributed in the system to balance and may not reflect the same distribution as the estimate.

This happens in a dealer system more often because the user doesn't want to charge other departments for parts and labor, since his profitability is shown per job by way of the dealer accounting system. And the only area left with much income that's not directly tracked per job for costs is paint and materials.

This cost shifting accounting shouldn't happen, yet it does. What we've found in these cases is that the owner/manager often didn't know these "adjustments" and "charges" were even going on. The bookkeeper, data-entry person or accountant made the call.

Taking Accurate Monthly Inventory

The inventory you're carrying each month affects your costs within that accounting period. This is especially true if you received a stock or large order, which could increase your inventory at the end of that period.

If a large order for paint backup tints and a few cases of clear, hardener and reducer hits at the end of the accounting period, it could mean $2,000-plus to the costs of materials. However, they shouldn't be costed at this point, since they haven't been consumed on the vehicles you repaired for the accounting period.

For example:

Total Revenue Sales = $100,000 for the month

Total Cost of Materials = $9,000 for the month from the statement

Cost to Sales Percentage = 9%

Total Materials Revenue = $10,000 for the month

Gross Profit for This Period = 10%. This is below acceptable standards.

But this included a large stock order of tints, clears and other related projects. The order arrived on the 30th of the month, and the invoice was for $2,350. By subtracting the $2,350 from that month's statement, you get a more accurate cost to sales and gross profit:

Total Revenue Sales = $100,000 for the month

Total Cost of Materials = $ 9,000 for the month from the statement

Less Stock Order = $2,350 purchase made the 30th

Adjusted Cost of Materials = $6,650

Cost to Sales Percentage = 6.65%

Total Materials Revenue = $ 10,000 for the month

Gross Profit for This Period = 33.50%

This example is all that should be done to change a high-cost-to-sales percentage back to an average cost and a low gross profit level to a favorable one. In actuality, you'd need to perform a complete physical inventory and reduce costs by everything that's not consumed.

This becomes a little too complicated for some. In fact, we've established certain lesser criteria that establish when materials are consumed to meet the needs of the specific shop. For one shop, we considered it consumed as soon as a technician puts it in his storage cabinet.

The more detail you use to define this parameter, the more accurate your analysis will be.

In fact, the most accurate method of tracking your true costs for this area would be to take all your purchases and place them in an inventory account. Then subtract your "change in inventory" at the end of the accounting period. This then would account for when large orders come in at the end of the month. Also, when the materials were eventually used, your inventory level would go back to normal.

There are countless ways to do this. Establishing a correct system is key.

Pricing Issues

The total paint and material revenue should generally represent approximately 10 percent or more of your total sales revenue. You calculate this by taking all your paint and materials revenue in a given accounting period, such as a month or quarter, and dividing it by the total sales revenue (total turnover) for that same accounting period, excluding taxes collected. Calculate this percentage to two decimal points for better accuracy.

But this isn't only controlled by the paint and materials rate you charge — as many shop owners would like to think. Many believe there's no room for improvement in this area because it's "out of their control."

Wrong! Too often we forget about operations where we can line item something that would be in the category of paint and materials because we're too busy to worry about it. As a shop estimator, one key job responsibility is to ensure proper revenue is received for each job. And this isn't done by cost shifting. Write it right and have the skills and desire to negotiate it to your real needs.

Many shops we've worked with have averaged more than 11 percent revenue for this area. This is an important factor for those who are having paint and materials profitability problems.

We provide a one-day analysis in which we review 50 to 100 ROs to determine if pricing in all areas of the business is in order. We call this a Target Analysis (TA1) in North America and a Sustainability Survey (SS1) in Australia. This analysis provides some key insights into a client's business that can go a long way in determining the solution.

Another important tool is to have a method to audit your estimates for missed items and for compliance with your work provider relationships. This can be done manually, but there's effective software available that does it better. It's called EMSReview™.

Check it out at *www.aeii.net/EMSReview1.htm*

A System that Works

The biggest contributing factor to profitability and costs of paint and materials are those who use the products.

Every company needs to have organization to control these waste factors. In fact, the extra paint that's over-mixed and not used is rightfully inventory and should be deducted from costs. This is whether it's stored (for future use?) or thrown into the waste container and hauled away. The latter most often costs you twice (wasted product and disposal costs). Consider a recycler!

We've actually worked with facilities that have a "mixed paint" inventory adjustment every accounting period that exceeds $2,000. Of course, when approached with this, their answer is, "We use those leftovers on future jobs." In this particular case, the number and quantity of products in this category increased by at least 15 percent monthly. In fact, in just a few short months, all the shelves, cabinets, and cubby holes were filled with partially filled cans. This is NOT using the inventory; it's wasted cost to the company.

It's important to reduce and eliminate waste in any phase of your operation. This is one area we've had a great deal of opportunity to look at worldwide. And these experiences prompted us to develop The SMART Program™.

The SMART Program™

S *Supply Organization*

M *Monitoring and Measurement*

A *Abolish Waste*

R *Review and Reward*

T *Training and Technology*

Supply Organization

• Centralize supply inventory to limited and secure locations.

• Standardize and organize working inventory storage for each technician.

• Reduce product variations down to as few as possible. Don't have multiple brands of the same product.

• Implement log sheets that track usage and distribution of all inventory.

• Implement computer scales (using RO and password) to provide usage reports.

• Implement taking monthly and quarterly inventories.

Abolish Waste

• Improve mixing process to reduce what's mixed to match what's actually needed.

• Eliminate storage locations to only a few shelves and to color family containers.

• Improve repair process to use the most effective use of materials.

• Use recycling equipment to reduce hazardous waste.

Review and Reward

• Perform monthly analysis of costs and profitability after adjustments.

• Establish "waste buster" committee to get staff involved with ideas and support.

• Provide quarterly reviews for all involved including sales, accounting and technical staff.

• Establish incentive system to share the profitability.

Training and Technology

• Provide continuous internal system training to improve process.

• Provide proper product training provided by manufacturers.

• Introduce and provide new product training. Always look for a better solution.

Each one of the modules requires a commitment from you and your company. They require change that your entire organization must adopt. Ultimately, it almost becomes a self-managed system because the staff has participated in the development of the program by way of committee involvement. They're reviewed quarterly on their participation in the program, and you provide an incentive system to reward them.

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I ask you to provide me feedback by e-mailing your comments and questions to *Tony.Passwater@aeii.net.*

Coming Next Time ...

We'll focus on increasing profitability in towing, subletting and other services.