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# MTD

MODERN TIRE DEALER

THE INDUSTRY'S LEADING PUBLICATION

## IS YOUR PAYROLL TOO HIGH?

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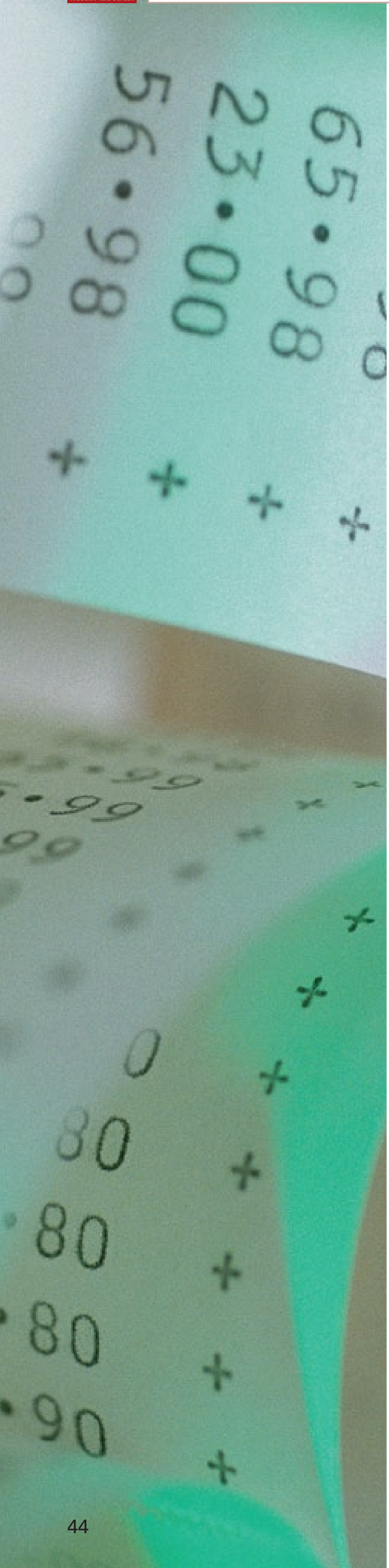

# Is your payroll too high?

## *It should never be more than 45% of your gross profit*

By Norm Gaither

If you own a retail tire shop and wonder why you can't show a reasonable bottom line profit, it might be because your payroll is not in line with your gross profit. Many retail dealers only focus on selling more tires or service, and they spend very little time on managing their business.

As you try to grow your business, your first concern is always to have enough people to help with the daily responsibilities of running a tire store. Maybe it's time to ask the question, "Can I afford to have all of these people on the payroll?"

Most accountants or bookkeepers provide you with a monthly profit and loss statement (Example #1) showing you the sales, cost of sales, gross profit, expenses and finally the profit or loss for that period of time. I suggest that starting with your next P&L, have your bookkeeper pull out all payroll, even the payroll in the cost of sales section, and show this expense below the gross profit line.

Have your bookkeeper show all of the other expenses below the payroll line (see Example #2). Nothing else changes except how you report the payroll on the P&L. Most bookkeepers and accountants will not want to list it this way because they have always done it their way and no one likes change. You must insist on showing your payroll this way so you can focus on this important area of the P&L.

Now that you have your total payroll in a section of the P&L all by itself, you can begin to manage it.

The next important change you need to make is to be sure that you measure the payroll expense as a percent of gross profit, not sales. This is another thing that will be hard for your accounting people to do. They have always measured all things by a percent of sales, not gross profit. You must

EXAMPLE #1
AVERAGE RETAIL TIRE DEALER
PROFIT & LOSS STATEMENT
FOR ANY PERIOD OF TIME

| | | |
|---|---|---|
| SALES | $1,200,000 | 100.0% |
| COST OF SALES: | | |
| BEGINNING INVENTORY | $150,000 | 12.5% |
| PURCHASES | $600,000 | 50.0% |
| PAYROLL — TECHS. | $100,000 | 8.3% |
| PAYROLL — GEN. SERV. | $45,000 | 3.8% |
| ENDING INVENTORY | ($150,000) | -12.5% |
| COST OF SALES | $745,000 | 62.1% |
| GROSS PROFIT | $455,000 | 37.9% |
| EXPENSES: | | |
| ADVERTISING | $10,000 | 0.8% |
| BAD DEBT | $1,000 | 0.1% |
| BANK CHARGES | $1,800 | 0.2% |
| COMPUTER FEES | $3,100 | 0.3% |
| DEPRECIATION | $4,600 | 0.4% |
| DUES & SUBSCRIPTIONS | $1,200 | 0.1% |
| EMPLOYEE BENEFITS | $28,000 | 2.3% |
| INTEREST | — | 0.0% |
| INSURANCE | $8,000 | 0.7% |
| LAUNDRY & UNIFORMS | $2,000 | 0.2% |
| PAYROLL — MANAGER | $60,000 | 5.0% |
| PAYROLL — COUNTER | $80,000 | 6.7% |
| PAYROLL — OWNER | $60,000 | 5.0% |
| PAYROLL — OFFICE | $40,000 | 3.3% |
| PAYROLL — OTHER | $10,000 | 0.8% |
| RENT | $60,000 | 5.0% |
| REPAIRS | $7,500 | 0.6% |
| SHOP SUPPLIES | $6,900 | 0.6% |
| TAXES | $4,800 | 0.4% |
| TELEPHONE | $4,100 | 0.3% |
| TRAINING | $2,300 | 0.2% |
| ALL OTHER | $30,000 | 2.5% |
| TOTAL EXPENSES | $425,300 | 35.4% |
| NET PROFIT BEFORE TAXES | $29,700 | 2.5% |

Payroll is the largest expense in the company and must be controlled if you are to make a profit.

| EXAMPLE #2<br>AVERAGE RETAIL TIRE DEALER<br>PROFIT & LOSS STATEMENT<br>FOR ANY PERIOD OF TIME | | |
|---|---|---|
| SALES | $1,200,000 | 100.0% |
| COST OF SALES: | | |
| BEG. INVENTORY | $150,000 | 12.5% |
| PURCHASES | $600,000 | 50.0% |
| ENDING INVENTORY | ($150,000) | -12.5% |
| COST OF SALES | $600,000 | 50.0% |
| GROSS PROFIT | $600,000 | 50.0% |
| PAYROLL: | | |
| PAYROLL — TECHS. | $100,000 | 8.3% |
| PAYROLL — GEN. SERV. | $45,000 | 3.8% |
| PAYROLL — MANAGER | $60,000 | 5.0% |
| PAYROLL — COUNTER | $80,000 | 6.7% |
| PAYROLL — OWNER | $60,000 | 5.0% |
| PAYROLL — OFFICE | $40,000 | 3.3% |
| PAYROLL — OTHER | $10,000 | 0.8% |
| TOTAL PAYROLL | $395,000 | 32.9% |
| AS A % OF GROSS PROFIT | | 65.8% |
| EXPENSES: | | |
| ADVERTISING | $10,000 | 0.8% |
| BAD DEBT | $1,000 | 0.1% |
| BANK CHARGES | $1,800 | 0.2% |
| COMPUTER FEES | $3,100 | 0.3% |
| DEPRECIATION | $4,600 | 0.4% |
| DUES & SUBSCRIPTIONS | $1,200 | 0.1% |
| EMPLOYEE BENEFITS | $28,000 | 2.3% |
| INTEREST | — | 0.0% |
| INSURANCE | $8,000 | 0.7% |
| LAUNDRY & UNIFORMS | $2,000 | 0.2% |
| RENT | $60,000 | 5.0% |
| REPAIRS | $7,500 | 0.6% |
| SHOP SUPPLIES | $6,900 | 0.6% |
| TAXES | $4,800 | 0.4% |
| TELEPHONE | $4,100 | 0.3% |
| TRAINING | $2,300 | 0.2% |
| ALL OTHER | $30,000 | 2.5% |
| TOTAL EXPENSES | $175,300 | 14.6% |
| NET PROFIT BEFORE TAXES | $29,700 | 2.5% |

| EXAMPLE #3<br>AVERAGE RETAIL TIRE DEALER<br>PROFIT & LOSS STATEMENT<br>FOR ANY PERIOD OF TIME | | | | |
|---|---|---|---|---|
| | YEAR 1 | % SALES | YEAR 2 | % SALES |
| SALES | $1,200,000 | 100.0% | $1,200,000 | 100.0% |
| GROSS PROFIT | $600,000 | 50.0% | $540,000 | 45.0% |
| PAYROLL: | | | | |
| PAYROLL — TECHS. | $100,000 | 8.3% | $100,000 | 8.3% |
| PAYROLL — GEN. SERV. | $45,000 | 3.8% | $45,000 | 3.8% |
| PAYROLL — MANAGER | $60,000 | 5.0% | $60,000 | 5.0% |
| PAYROLL — COUNTER | $80,000 | 6.7% | $80,000 | 6.7% |
| PAYROLL — OWNER | $60,000 | 5.0% | $60,000 | 5.0% |
| PAYROLL — OFFICE | $40,000 | 3.3% | $40,000 | 3.3% |
| PAYROLL — OTHER | $10,000 | 0.8% | $10,000 | 0.8% |
| TOTAL PAYROLL | $395,000 | 32.9% | $395,000 | 32.9% |

| EXAMPLE #4<br>AVERAGE RETAIL TIRE DEALER<br>PROFIT & LOSS STATEMENT<br>FOR ANY PERIOD OF TIME | | | | |
|---|---|---|---|---|
| | YEAR 1 | % SALES | YEAR 2 | % SALES |
| SALES | $1,200,000 | 100.0% | 1,200,000 | 100.0% |
| GROSS PROFIT | $600,000 | 50.0% | 540,000 | 45.0% |
| PAYROLL: | | | | |
| PAYROLL - TECHS. | $100,000 | 8.3% | 100,000 | 8.3% |
| PAYROLL - GEN. SERV. | $45,000 | 3.8% | 45,000 | 3.8% |
| PAYROLL - MANAGER | $60,000 | 5.0% | 60,000 | 5.0% |
| PAYROLL - COUNTER | $80,000 | 6.7% | 80,000 | 6.7% |
| PAYROLL - OWNER | $60,000 | 5.0% | 60,000 | 5.0% |
| PAYROLL - OFFICE | $40,000 | 3.3% | 40,000 | 3.3% |
| PAYROLL - OTHER | $10,000 | 0.8% | 10,000 | 0.8% |
| TOTAL PAYROLL | $395,000 | 32.9% | 395,000 | 32.9% |
| PAYROLL AS A % | | | | |
| OF GROSS PROFIT | | 65.8% | | 73.1% |
| TOTAL EXPENSES | $175,300 | 14.6% | $175,300 | 14.6% |
| NET PROFIT BEFORE TAXES | $29,700 | 2.5% | ($30,300) | -2.5% |

insist that they report payroll as a percent of gross profit, not sales.

### New competitor in town

Let's say you have a new competitor in town and he begins to discount all tires and service by just 5% so he can try to take away some of your business. In Example #3, you will see that in year two you were able to make the same sales, but your gross profit was only 5% less then last year. Most of us would not think this is a problem; after all, we were able to keep the same sales as last year.

Let's investigate what really happened. In Example #4 we compare year one to year two and we see that sales did not change, gross profit only went down by 5%, payroll and expenses stayed the same

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— so you might think this is alright. Look closely at example #4 and you see the real effect the decision to discount made on your goods and services. The net profit for year two only shows a loss of $30,300 compared to the previous year profits of $29,700. By focusing only on sales and not payroll, you could go bankrupt.

Maybe for the first time in your career, you are able to look at what happens to a business when you decide to discount your goods and services and what really happens to the bottom line.

In both of these examples, if you were focused on payroll as a percent of sales, then you would not know you have a problem. This is why you must measure payroll as a percent of gross profit — not sales.

The moral of the story is, "When your gross profit goes down, so must your payroll." Many retail tire dealers are running their payroll to gross profit at a rate of 55%, with a bottom line profit of less than 3%. In my experience as an independent consultant to the aftermarket for the past 25 years, when your payroll is too high, you will not make a profit. The problem is not that you don't have enough sales, it's always that you have too much payroll.

I recommend to all retail tire dealers that payroll should never be more than 45% of your gross profit.

### Improving your gross profit

If you check your current payroll to gross profit and find it's too high, there are only two things that you can do to fix the problem.

The first thing to focus on is whether or not you are earning a fair gross profit on tires, parts and labor. Many tire dealers do not charge enough for their products and labor. I think a fair gross profit on tire sales is 25%. If you keep discounting the profit on tires you will not have enough for your inventory costs and for covering expenses.

If you also offer service, you must get a fair labor rate. Always check to see what your competition is charging, and if their rates are higher, you need to raise yours. You have the same expenses and your techs are as good as theirs, so why not charge the same rate as they do?

The next step in improving your gross profit is to be sure that you make at least 45% on parts.

Be sure that your auto parts supplier is giving you the best price. Once you obtain their best price, I suggest that you use a price matrix (see Examples #5 and #6) to get your best gross profit.

EXAMPLE #5
JOBBER PARTS MATRIX

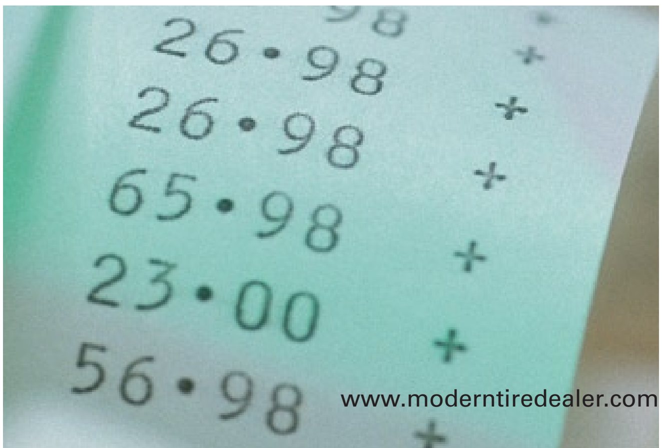
| COST | MARK UP | GROSS PROFIT % |
|---|---|---|
| $0.00- $10.00 | x 3.25 | = 69.2% |
| $10.01-$20.00 | x 2.75 | = 63.6% |
| $20.01-$75.00 | x 2.25 | = 55.5% |
| $75.01-$150.00 | x 2.0 | = 50.0% |
| $150.01-$750.00 | x 1.85 | = 46.0% |
| $750.01-over | x 1.54 | = 35.0% |

Example #5 is to be used when you purchase parts from your local auto parts supplier, and Example #6 is to be used when you purchase parts from your local new car dealership.

This will ensure that by the end of the month, your gross profit will be at least 45% of sales.

EXAMPLE #6
DEALER PARTS MATRIX

| COST | MARK UP | GROSS PROFIT % |
|---|---|---|
| $0-$5.00 | x 3.25 | = 69.2% |
| $5.01-$10.00 | x 2.75 | = 63.6% |
| $10.01-$50.00 | x 2.25 | = 55.5% |
| $50.01-$100.00 | x 1.82 | = 45.5% |
| $100.01-$175.00 | x 1.67 | = 40.0% |
| $175.01-over | x 1.54 | = 35.0% |



Finally, in order to raise your gross profit, I suggest that you charge a fee for shop supplies and environmental costs. Many tire dealers do not see the need for this. However, if you think of all the expenses you have for these two services, you will see the need to charge for them.

I suggest that on all invoices you charge 8% for parts and labor, not to exceed $50. This is the same charge that the new car dealers have been charging for the last 10 years, and their customers pay this on every ticket. This is the only way for you to cover all of the expenses you have in both of these areas.

### Reducing payroll expense

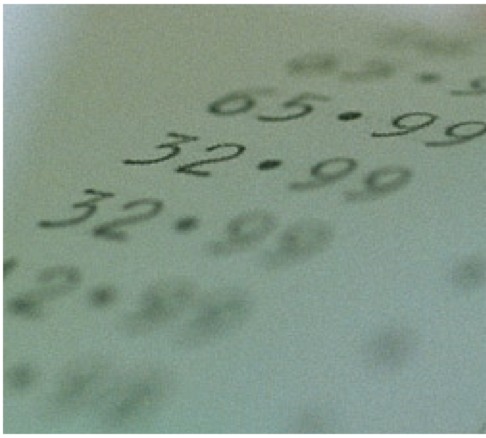
By making all of these changes, you now have gotten your gross profit higher. This will give you more money for payroll. But if you find your payroll expense is still not in line with the 45% goal, you must then decrease payroll.

If you find that your payroll is higher then the recommended 45%, first make sure you, as the owner, are taking a reasonable salary. Many times I find that the owner is taking a salary based on his personal needs, not what the company can afford.

If after you have checked your pay you still find that payroll is still too high, then you may have to reduce the number of employees on the payroll. This will be one of the hardest decisions you will ever make, but it may save your company. You must realize that payroll is the largest expense in the company and must be controlled if you are to make a profit.

EXAMPLE #7
AVERAGE RETAIL TIRE DEALER
PAYROLL vs. GROSS PROFIT REPORT
FOR THE YEAR - 2009

| WEEK ENDING | SALES | GROSS PROFIT | G/P % | GROSS PAYROLL | PAYROLL % OF G/P $ | OVER 45% |
|---|---|---|---|---|---|---|
| 9-Jan | $19,055 | $8,575 | 45.0% | $4,888 | 57.0% | $1,029 |
| 16-Jan | $18,469 | $7,345 | 39.8% | $4,752 | 64.7% | $1,447 |
| 23-Jan | $17,196 | $7,162 | 41.6% | $4,813 | 67.2% | $1,590 |
| 30-Jan | $20,455 | $10,155 | 49.6% | $4,997 | 49.2% | $427 |
| TOTAL | $75,175 | $33,237 | 44.2% | $19,450 | 58.5% | $4,493 |




Once you have made the necessary changes to your payroll, I suggest that you now measure payroll to gross profit every week! Yes, I said every week. I can't think of any report more important than the one that will help you get your payroll in line with your gross profit.

In Example #7, you will see information needed to control your payroll. Your bookkeeper already knows what the sales and gross profit for the week are, so the only other piece of information needed is the total gross payroll. You will then know if you were able to bring your payroll in line with the 45% goal and, if not, how many dollars you overpaid for the week. You now know that next week you must increase your gross profit dollars or reduce your payroll.

By looking at this report every week you will finally be able to bring this important item in line so you can increase your net profit. Many of you will find that the first week you produce this report, your payroll will be at 55% or higher. This should get your attention and alert you to the fact that you have some work to do.

And be sure to involve your store managers, because it will help them better understand why personnel changes are necessary. Once you achieve the 45% goal, be sure to reward your people with maybe gift cards to a restaurant or perhaps movie passes and maybe even a cash bonus for their help. It's important for them to know the need to achieve this goal, and just as important for you to reward the ones who help you get there.

Nothing this year is as important in your business as being able to manage your payroll to 45% of your gross profit. Get from behind the counter or shop and start to manage your business. Make this the year that you work "on" the business not "in" the business. ■

*Norm Gaither is president of Dealer Strategic Planning Inc., a company that promotes "Txxenty Groups" (20 groups) in multiple industries. He is a well-known consultant in the automotive aftermarket and has owned his own firm since 1984.*