“Understanding and Creating Effective Pay Plans”

Sponsored by: 340th Anniversary

Author: Cecil Bullard
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3. The Big Mistakes
4. Balancing Margins
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"Achievement is not always success, while reputed failure often is. It is honest endeavor, persistent effort to do the best possible under any and all circumstances."

Orison Swett Marden
What is an EFFECTIVE Pay Plan?

• Keeps margins BALANCED
• Helps MANAGE the employees
• Helps MOTIVATE the employees
• REWARDS for Accomplishment
• Lets the employee and the business WIN

Basic Pay Plans

Hourly
   Employee is paid for each hour spent on the clock

Salary
   Employee is paid a set amount for a given period

Commission
   Employee is paid a percentage of what is done or sold

Flat-Rate
   Employee is paid for each hour of produced work

Hourly/Salary with Bonus
   Employee is paid for each hour spent on the clock with a bonus amount for set tasks & performance

Modified or Bonus Flat-Rate
   Employee is paid for each hour of produced work with a bonus amount for set tasks and performance

“Here is a simple but powerful rule-always give people more than what they expect to get.”

-Nelson Boswell
What doesn’t work Kills Margins

Hourly
- No motivation to work harder
- Employee can milk the clock
- Low productivity & overtime can kill you

Salary
- No motivation to work harder
- Employee finds lowest performance level
- Low productivity & overtime can kill you

Flat-Rate
- Will not work if not enough work in the shop
- Employee may try to sell things not needed if you don’t keep an eye on it and keep him/her busy

The BIG Mistakes
1. Management by Abdication
2. No Measurement or Visible Progress
3. Believing you don’t need a bonus plan
4. Thinking that employees will work harder without incentives
5. Creating bonus plans that will not motivate
6. Inconsistent (or no) QA or follow-up
7. Creating bonus plans that do not reward for the right things

“You don't get paid for the hour. You get paid for the value you bring to the hour.”

-Jim Rohn
**Keeping Margins Balanced**

**What can I afford?**

**For Sales:** 8% of Sales (may have to pay higher – then must increase other margins)

**For Techs:** 40% of labor rate (loaded) Or 20% of Parts and Labor (loaded)

**For your Parts:** 18% of Sales

**If you pay more profits disappear!**

**Balancing Margins to insure Profits:**

How much of each $1.00 should go where?

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Recommendations:

Hourly/Salary with Bonus

- Employee has a base that he/she feels comfortable with
- Employee can be motivated to work harder
- Bonus plan is reward for doing what you need
- Bonus Plan can be built to keep margins in place

Modified/Bonus Flat-Rate

- Bonus plan is reward for working harder
- Can use bonus plan to stimulate employee over natural stopping points
- Bonus plan can keep margins in place at high and low output

“Ultimately, it is in your own best interest to accept responsibility for getting what you need to succeed in the workplace.”

Ken Blanchard
The 50/50 or 60/40 Rule

50% to 60% of pay is base

Employee is paid 50% to 60% (total pay allocated for that position) of his/her pay as a base

The other 40% to 50% is paid for specific performance and for specific tasks

Bonus levels are calculated to kick in after business exceeds the nut

Bonus plans can increase employee pay considerably without hurting margins

Pay Plan Theory

Employees should be both paid for showing up and for meeting clearly defined expectations

Maslow’s Hierarchy of Needs

• People must take care of base needs (food, shelter, etc.) before they can think of higher functions (science, God, self-actualization, creativity, etc…)

• People that must worry about base needs cannot spend time on self esteem, creativity, or problem solving

A Successful Pay Plan must meet three tests:

• Does it pay enough to meet basic needs?
• Does it keep margins in place
• Does it reward sufficiently for higher performance

You can build a successful pay plan that keeps margins in place and increases rewards when the NUT is surpassed.
**Bills Auto** – Labor Rate $92/hr. - Actual $77.28
Each hour sold is worth $140.65
Fixed Expenses are $16,532 per month
4 bays, 3 Techs, 1 SA
Pays hourly – $24 per clock hour
Techs 70% productive – 84 Hrs per week
Actual Tech Cost: $44.57 per hour – 58% of LR

**Labor Margin is 42%**

**Parts Margin is 55%**

$11,815 per week total sales
Parts to Labor ratio is 45/55
Actual Gross Profit: 47%
Fixed Expense is 34%
SA Expense is 8.5%
Marketing Expense is 3%
SA Paid $1,000 wk (no bonus)
Techs Paid $960 wk (no bonus)
Tech Cost is $1,248 week
Total Tech Cost is $3,744
No Money for Marketing
No Money for Equipment
Low Salary if ANY for owner

**Net Profit is 1.5%**

**Weekly net profit: $177.23**

**Annual net profit: - $9,216**

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“The longer you wait, the harder it is to produce outstanding customer service.”

-William H. Davidow
Jim’s Auto – Labor Rate $92hr. - Actual $86.28
Each hour sold is worth $157.30
Fixed Expenses are $16,532 per month
4 bays, 2 Techs, 1 SA
Pays hourly – Modified Flat-Rate Avg. $33 Hr
Techs 110% Productive – 88 Hrs
Labor Margin is 50%
Parts Margin is 55%
$13,842 per week total sales
Parts to Labor ratio is 45/55
Actual Gross Profit: 52%
Fixed Expense is 29%
SA Expense is 8.7%
Marketing Expense is 3%
SA Paid $800 wk (+ $400 bonus)
$1,200 Total
Techs Paid $1,452 wk avg
Tech Cost $1,888 Wk
Total Tech Cost $3,776 wk
$$$ for Marketing
$$$ for Equipment
Net Profit is 11.3%
Weekly net profit: $1,564
Annual net profit: $81,336

“The productivity of work is not the responsibility of the worker but of the manager.”

Peter Drucker
**Bills Auto** – LR $92hr. – Act. $77.28
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**Performance Bonuses**

Employees need 4 types of bonuses

**Individual and Team**  
Weekly and Monthly

Individual bonuses are based on clearly defined individual goals and accomplishments.

Some employee bonuses kick in before the business exceeds the nut but these bonuses never exceed margins.

Team bonuses are based on the performance of the whole team and clearly defined team goals.

**Weekly bonuses give quick FEEDBACK**

**Monthly bonuses help protect the business from manipulation**

Once the business has exceeded the NUT it keeps an additional $.25 for every dollar collected.

Monthly expenses are $16,532.

Nut is $16,532 / .25 = $66,218

If the business does $70,000 there is an additional $946 in profit.

At $80,000 there is an additional $3,446 in profit.

At $100,000 there is an additional $8,446 in profit.

You can afford to share some of the monthly profits with your staff and still make more money than you thought if you build performance based pay plans and hold margins.

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“In the last 5 years, American employers have lost over $150 billion of productivity to depression alone. That is more than the GDP of 28 different States during the same period.”

Patrick J. Kennedy
Before Building Pay Plan you MUST:

- Know your NUT
- Know your proper HOURLY RATE
- Know your EFFECTIVE LABOR RATE
- Know your PRODUCTIVITY
- Know your LOADED LABOR COSTS
- Understand current LABOR COSTS
- Have a way to measure and monitor performance
- Have a way to make performance visible

Calculating your Nut

Total all Fixed Expenses – including Management Salary (monthly)

- Management Salary $8,000
- Rent $5,000
- Utilities $2,200
- Vehicle Payments $500
- Insurance $400
- Gas $600
- Miscellaneous $2,000
- Savings (equip, etc.) $1,500
- Debts payback $2,300
- Misc. etc… $1,000

Total - $23,500

Fixed Expenses should be 25% of total so divide the total by .25 to get monthly nut

$23,500 / .25 = $94,000

If open 5 days a week then divide by 21 - Daily Nut = $4,477
**Determining Car Count, ARO necessary with a $4,477 daily nut**

For car count take nut and divide by current ARO

I.e. $4,477 / 248 = 18.05 cars per day

For ARO take nut and divide by current car count

I.e. $4,477 / CC13 = $344.38 ARO

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**Determining Techs Necessary with a $4,477 daily nut**

Must know how many dollars you produce for each hour billed.

If hourly rate is $98 then:

- Billed hour = hr X (1+ parts%/labor %)
- Bh = $98 X (1 + 45%/55%)
- Bh = $98 X (1 + .82) = $98 X 1.82
- Bh = $178.36 per hour

Then divide $4,477 by $178.36 = 25.1 hrs a day

We need to produce 25.1 hours of billable work per day.

- If techs are 105% productive then we need 3
- If techs are 75% productive then we need 4.2
- 8 X .75 = 6 hrs per tech, divided into 25.1 = 4.2
- If techs are 62% productive then we need 5
- 8 X .62 = 5 hrs per tech, divided into 25.1 = 5

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"The gem cannot be polished without friction, nor man perfected without trials."

*Chinese proverb*
Calculating Proper Hourly Rate

Hourly rate is a combination of what you must do and what the market will stand.

If I need to pay a tech $36 per hour then I need to charge $117 per hour (if 100% productive)

$36 X 1.3 (benefit load) = $46.80
$46.80 / .4 (60% margin) = $117.00 per hour

Don’t forget Productivity

$117.00 / .82 (Productivity = $142.68 per hour

Unless you fix your productivity problem you need to charge $142.68 per hour to make the money you desire

Calculating Effective Labor Rate

Effective (actual) rate tells you what you actually get per hour for each hour you bill out

For effective rate you add all labor dollars and divide by all labor hours charged out in the period

$46,555 / 543 hrs = $85.74 actual rate per hr
$46,555 is the labor dollars collected
543 are hours billed to customers

If I need $117.00 per hour and I got $85.74 then I lost $31.26 per hour or $31.26 X 543 = $16,974 in labor lost
Calculating Productivity

**Productivity** - The amount of work produced in a unit of time. (I.E. A tech works 8 hours ‘on the clock’ and produces 8 hours of billable labor, this is 100% productivity)

To calculate tech productivity you take the number of billable hours that he/she produces and divide it by the time spent on the clock
If a tech produced 34 hours of billable work while working 40 clock hours then 34/40 = 85% productivity
If we pay the tech $800 per week then we paid an extra $120 for the work performed

Calculating Current Labor Costs

To calculate your current tech costs you take the dollars paid and divide by the actual hours produced in the period

If a tech was paid $1,000 for the week and produced 28 hrs of billable labor then your actual cost per hour is:
$1,000 X 1.3 (benefit load)= $1,300
$1,300 / 28 = $46.43

If labor rate is $90 then labor margin is 53% (you lose 8%)
Assuming this is a $25 per hour employee (plus 30% for benefits) –
$1,300 / 40 = $32.50 per hr. – you overpaid by $390.04 in one week and will overpay $20,282.08 for the year.
Building Custom Pay Plans?

*Hourly with Bonus (Tech):

To build custom pay plans we need to know what we can pay and what we want the employee to do.

If labor rate is $117.00 – we can pay $36 hr. plus benefits

I want the tech to be:
  - Productive
  - Educated
  - At work on time
  - There every day

Base rate is $18 per clock hr. or ½ of $36

Bonus schedule:
- Over 30 hrs produced = $1.00
- Over 40 hrs produced = $3.00
- Over 45 hrs produced = $5.00
- 12 hrs of education in quarter = $2.00
- 4 ASE certs = $2.00
- ASE Master = $2.00
- On time everyday = $1.00
- At work every day = $2.00 (bonuses are cumulative)

If tech is an ASE Master, produces 45 hrs, gets education hrs, shows up on time, and is there every day then pay is $36 per hour.

(*This is an example only and should be specifically designed for your business)
*Salary with Bonus (Tech):*

To build custom pay plans we need to know what we can pay and what we want the employee to do.
If labor rate is $117.00 – we can pay $36 hr. plus benefits

I want the tech to be:
- Productive
- Educated
- At work on time
- There every day

Salary is $720 per week

Bonus schedule:
- Over 30 hrs produced = $1.00
- Over 40 hrs produced = $3.00
- Over 45 hrs produced = $5.00
- 12 hrs of education in quarter = $2.00
- 4 ASE certs = $2.00
- ASE Master = $2.00
- On time everyday = $1.00
- At work every day = $2.00 (bonuses are cumulative)

If tech is an ASE Master, produces 45 hrs, gets education hrs, shows up on time, and is there every day then pay is $1,440 per week.

(*This is an example only and should be specifically designed for your business)*
*Modified Flat-Rate (Tech):*

To build custom pay plans we need to know what we can pay and what we want the employee to do.

If labor rate is $117.00 – we can pay $36 hr. plus benefits

I want the tech to be:

- Productive
- Educated
- At work on time
- There every day

Base rate is $18 per flagged hr.

Bonus schedule:

Over 30 hrs produced = $1.00
Over 40 hrs produced = $3.00
Over 45 hrs produced = $5.00
12 hrs of education in quarter = $2.00
4 ASE certs = $2.00
ASE Master = $2.00
On time everyday = $1.00
At work every day = $2.00 (bonuses are cumulative)

If tech is an ASE Master, produces 45 hrs, gets education hrs, shows up on time, and is there every day then pay is $36 per hour.

(*This is an example only and should be specifically designed for your business)
*Hourly with Bonus (SA):*

To build custom pay plans we need to know what we can pay and what we want the employee to do.

If normal sales are $15,000 wk – can pay $1,200 wk

Service Advisor will be judged on:

- Total Sales
- Margins
- CSI
- ?

Base pay is $15.00 per clock hour (40 hrs = $600)

Weekly Bonus schedule:
- Sales below $7,999 = 0
- $8,000 to $12,499 = $100
- $12,500 to $14,999 = $200
- Over 1$15,000 = $300

If margins are below 55% then take back ¼ of bonus
If CSI is below 95% then take back ¼ of bonus

(Bonuses are cumulative)

If Service Advisor sells over $15,000, holds margins above 55% and holds CSI above 95% then pay is $1,200 per week.

(*This is an example only and should be specifically designed for your business*)
*Salary with Bonus (SA):*
To build custom pay plans we need to know what we can pay and what we want the employee to do.
If normal sales are $15,000 wk – can pay $1,200 wk

Service Advisor will be judged on:
- Total Sales
- Margins
- CSI
- ?

**Salary is $600 per week**
Sales below $8,000 = 0
$8,001 to $12,500 = $100
$12,501 to $15,000 = $200
Over $15,000 = $300

If margins are below 55% then take back ¼ of bonus
If CSI is below 95% then take back ¼ of bonus
(Bonuses are cumulative)
If Service Advisor sells over $15,000, holds margins above 55% and holds CSI above 95% then pay is $1,200 per week.

(*This is an example only and should be specifically designed for your business)

*Salary with Bonus (SA):*  
**With additional bonus over NUT**

To build custom pay plans we need to know what we can pay and what we want the employee to do.
If normal sales are $15,000 wk – can pay $1,200 wk

Service Advisor will be judged on:
- Total Sales
- Margins
- CSI
- ?

**Salary is $600 per week**
Sales below $8,000 = 0
$8,001 to $12,500 = $100
$12,501 to $15,000 = $200
Over $15,000 = $300

If over $65k for month then additional 1% of all sales
If margins are below 55% then take back ¼ of bonus
If CSI is below 95% then take back ¼ of bonus
(Bonuses are cumulative)
If Service Advisor sells over $15,000, holds margins above 55% and holds CSI above 95% then pay is $1,200 per week. (can make more)
Important Information

Effective Pay Plans:
- Keep margins BALANCED
- Help MANAGE and MOTIVATE the employee
- REWARD for Accomplishments
- Let the employee and the business WIN

Don’t make these Mistakes:
- Abdicate Management
- No measurement – No follow-up
- Don’t need bonus plan
- Bonus Plan is not enough
- Bonus plan that doesn’t’ reward for the right things
- Believe employees will work harder for nothing

The right pay plan:
- Keeps margins in place
- Creates happier employees
- Makes managing easier

With the right pay plan in place you can actually pay more and work less!

“Productivity is never an accident. It is always the result of a commitment to excellence, intelligent planning, and focused effort. “

Paul J. Meyer
Thank You

This course was created by Cecil Bullard for NMEDA

We welcome your comments and suggestions. Your feedback allows us to become better. You can find us online at www.WorldPac.com or email cecil@iforabe.com.

“A positive attitude may not solve all your problems, but it will annoy enough people to make it worth the effort.”

Herm Albright

We often suggest books to read that we think will expand upon the topics in our courses. You might find the following book will inspire you.

“Positioning, The Battle for Your Mind.” - Ries and Trout

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