“Understanding and Creating Effective Pay Plans”

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Written by: Cecil Bullard
Introduction

“Understanding and Creating Effective Pay Plans”

1. What makes an Effective Pay Plan...
2. The Big Mistakes
3. Balancing Margins
4. Recommendations – 60/40 Rule
5. Pay Plan Theory
6. Bonuses
7. Building Pay Plans
An Effective Pay Plan

What is an effective Pay Plan?

An effective pay plan:

• Keeps margins BALANCED
• Helps MANAGE the employee
• Helps MOTIVATE the employee
• REWARDS for accomplishments
• Lets the employee and the business WIN
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 for 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 & performance
An Effective Pay Plan

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

Management by Abdication

No Measurement or Visible Progress

Believing you don’t need a bonus plan

Thinking that employees will work harder without incentives

Creating bonus plans that will not motivate

Inconsistent (or no) QA or follow-up

Creating bonus plans that do not reward for the right things
Keeping Margins Balanced
What can I afford to pay?

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

For Techs: 40% of your labor rate (loaded) or 20% of Parts and Labor (loaded)
• Must account for productivity (true costs)

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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<tr>
<th>Item</th>
<th>Perfect</th>
<th>Unbalanced</th>
<th>Balanced</th>
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<tbody>
<tr>
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</tr>
<tr>
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<tr>
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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
The 60/40 Rule

Or the 50/50 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

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

Maslow’s Hierarchy of Needs

• People must take care of basic needs (food, shelter, etc.) before they can think of higher functions (science, God, self-actualization, creativity, etc...)
• People that must worry about basic 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 keeps 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.
Pay Plan Theory

Bills Auto – Posted 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
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
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 average
Tech Cost $1,888 Wk
Total Tech Cost $3,776 wk
Additional $$$ for Marketing
Additional $$$ for Equipment
Net Profit is 11.3%
Weekly net profit: $1,564
Annual net profit: $81,328


**Bill's Auto**  — LR $92/hr. – Act. $77.28
Pay hourly – $24 per clock hour
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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 their 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 profit
If the business does $80,000 there is an additional $3,446 profit
If the business does $100,000 there is an additional $8,446 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
Before You Build

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
Before You Build

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...

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 ARO = 18.05 cars per day

For ARO take nut and divide by current car count
I.e. $4,477 / CC 13 = $344.38 ARO
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
Determining Techs Necessary with a $4,477 daily nut

Continued...

We need to produce 25.1 hrs of billable work per day

If techs are 105% productive then we need 3

If techs are 75% productive then we need 4.2

$8 \times 0.75 = 6$ hrs per tech divided into $25.1 = 4.2$ techs

If techs are 62% productive then we need 5

$8 \times 0.62 = 5$ hrs per tech divided into $25.1 = 5$ techs
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 (40% margin) = $117.00 per hour

Don’t forget Productivity

$117 X .82 (Productivity) = $142.68 per hour
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.

\[
\frac{\$46,555}{543 \text{ hrs}} = \$85.74 \text{ actual rate per hr}
\]

$46,555 is the labor dollars collected.

543 are the hours billed to customers.

If I need $117 per hour and I got $85.74 then I lost $31.26 per hour or $31.26 \times 543 = \$16,974 in labor.
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.

If a tech was paid $1,000 for the week and produced 28 hrs of billable labor then your actual cost per hour is:

\[ \frac{1,000 \times 1.3 \text{ (benefit load)}}{28} = 46.43 \]

If labor rate is $90 then labor margin is 52% (you lose 8%)

Assuming this is a $25 hour employee (plus 30% for benefits) - $1,300 / 40 = $32.50 per hr. - you overpaid by $390.04 in one week and $20,282 annually.
Building Custom Pay Plans?
Building Pay Plans

*Hourly with Bonus (Tech):*
To build a custom pay plan we need to know what we can pay and what we want the employee to do.

If labor rate is $117 - 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  
- Over 30 hrs = $1.00  
- Over 40 hrs = $3.00  
- Over 45 hrs = $5.00  
- 12 hrs of Ed = $2.00  
  (per quarter)  
- 4 ASE certs = $2.00  
- 8 ASE certs = $2.00  
- On time every day = $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.*)
Building Pay Plans

*Salary with Bonus (Tech):*
To build a custom pay plan we need to know what we can pay and what we want the employee to do.

If labor rate is $117 - can pay $36 Hr. plus benefits

I want the tech to be: Salary is $720 per week
- Productive
- Educated
- At work on time
- There every day

Over 30 hrs = $1.00
Over 40 hrs = $3.00
Over 45 hrs = $5.00
12 hrs of Ed = $2.00
(over 30 hrs)

4 ASE certs = $2.00
8 ASE certs = $2.00
On time every day = $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 Wk.

(*This is an example only and should be specifically designed for your business.*)
*Modified Flat-Rate (Tech):*
To build a custom pay plan we need to know what we can pay and what we want the employee to do.

If labor rate is $117 - 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 hr prod. or ½ of $36

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<tr>
<td>(per quarter)</td>
<td></td>
<td>Avg over 100% Prod. Last Month</td>
<td>$2.00</td>
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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.)*

(bonuses are cumulative)
*Hourly with Bonus (SA):*
To build a custom pay plan 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.

SA judged on:
- **Total Sales**
- **Margins**
- **CSI**

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

Sales below $7,999 = $0
$8,000 to $12,499 = $100
$12,500 to $14,999 = $200
Over $15,000 = $300

If Margins below 55% then Take ¼ of bonus back
If CSI below 95% then Take ¼ of bonus back

If SA 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 a custom pay plan we need to know what we can pay and what we want the employee to do.

If normal sales is $15,000 wk - can pay $1,200 wk.

SA judged on:

- **Total Sales**
  - Sales below $8,000 = $0
  - $8,001 to $12,500 = $100
  - $12,501 to $15,000 = $200
  - Over $15,000 = $300

- **Margins**
  - If Margins below 55% then Take ¼ of bonus back

- **CSI**
  - If CSI below 95% then Take ¼ of bonus back

- **?**

Salary is $600 per week

If SA sells over $15,000, holds margins above 55%, and holds CSI above 95% then pay is $1,200 per week (can make more)

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

With additional bonus over NUT

Nut is $60,000 per month

If normal sales is $15,000 wk - can pay $1,200 wk.

SA judged on:

- **Total Sales**
  - Sales below $8,000 = $0
  - Up to $12,500 = $100
  - Up to $15,000 = $200
  - Over $15,000 = $300

- **Margins**
  - If Margins below 55%, take ¼ of bonus back

- **CSI**
  - If CSI below 95%, take ¼ of bonus back

- **?**
  - If over $65k for month then pay additional 1% of Sales

(bonuses are cumulative)

If SA sells over $15,000, holds margins above 55%, and holds CSI above 95% then pay is $1,200 per week (can make 1% more)

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

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 that is not enough
• Bonus plan that doesn’t reward for right things
• Believe employees will work harder for nothing
The right pay plan:

• Keeps margins in place
• Makes managing easier
• Creates happier employees

With the right pay plan in place you can actually pay more!
And work less!
The End!!!

Thank You

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Please address additional questions or comments to:

cecil@iforabe.com