

PROFIT MOTIVE: YOUR COMPASS TO FINANCIAL SUCCESS

Doing the parts profit math

Determining parts gross profit margins is not as simple as it may seem

BY TOM MCGEE | CONTRIBUTING EDITOR

Every week I have the opportunity to look at several profit or loss statements for shops in different parts of the country. When we do a shop analysis, one of the areas that we look at is parts margin.

Not only are shops dealing with one or more estimating systems and parts procurement methods, but they also handle multiple types of parts, vendors and discounts or markups to determine the sale price or cost of the parts.

For most shop owners, parts seem pretty simple. We have income for the parts sold and a cost for the parts purchased. So when looking at parts margin as a key performance indicator (KPI), I am often asked, "Why is there a fluctuation in my parts gross profit margin?"

Gross profit margin

Gross profit margin is calculated by subtracting cost of goods sold (COGS) from total sales and dividing that number by total sales. For example, if a shop sells a part for \$125 and has a cost of \$80, the gross profit margin is 36 percent.

Discount from list price

When you calculate your parts margin, you need to consider the discounts you are receiving from your vendors. For example, a shop may have negotiated different discounts off the list price with different dealerships.

If a shop purchased parts from three different dealerships and each had a dif-

ferent negotiated discount, the shop's gross profit margin would fluctuate depending on the list price of the parts and the discounts used to determine the cost paid.

Cost plus a markup

Is there a difference between margins and markup? Absolutely. More and more in today's world, these two terms are being used interchangeably to mean gross margin, but that misunderstanding can have a drastic impact on the bottom line. Markup and gross profit margin are not the same! Shops must have a clear understanding of the two within a pricing model. The term markup refers to the percentage difference between the actual cost and the selling price. Many shop owners mistakenly believe that if a part is marked up, say 25 percent, the result will be a 25 percent gross profit margin on the income statement. But that's wrong.

For example, when a shop buys a used part for \$100 and marks it up 25 percent, the selling price is \$125. When you calculate the gross profit percentage on that part [$\$125$ (sale) - $\$100$ (cost) divided by $\$125$ (sale)] the gross profit margin percentage is only 20 percent.

Parts vendor volume

The number of parts purchased from each vendor will also cause a fluctuation in the gross profit margin. For example, if one week or month you purchase more OEM parts than you do LKO (used) or aftermarket, the margin will increase or decrease depending on the discounts applied to each part.

Parts vs. materials

When you start analyzing your parts margin, you also need to consider how your estimating system is handling materials such as seam sealers. For example, if you charge seam sealer to a vehicle repair order, and the estimating system treats that material as a part, you may be impacting both your parts and paint margins. In this situation, it is not uncommon to have the sale of the seam sealer shown as part revenue and the cost applied to your paint and materials. While it may not be significant if you only consider that one vehicle, it can be important over a period of a month, quarter or year.

Markup vs. margin

When purchasing parts or other products or services on a cost plus a markup, you must understand the gross profit percentage you will make on that purchase. We have created a table for you that shows the gross profit you will make based on the markup percentage applied. Try it free for a limited time by going to www.ationlinetraining.com/abrn1409. It also makes a great tool for training and coaching your staff on how the work they do makes a difference to the business. ☛

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