POWER STEERING

Steering your dealership to higher profits

A publication of Woodward & Associates
Consultants to the Automotive Industry

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Year 2016 was another good profit year for most new vehicle dealers. The NADA reported that dealers had their seventh good year in a row. We have not had seven good years in a row in the last 40 years. This is based on net profit as a percentage of sales being 2.5% for 2016 and all years from 2010 to 2015 were in the range of 2.1 – 2.3%. Average annual reported sales from the NADA were $60 million. Our group of over 200+ dealers were also in the size and profit range as compared to the NADA summary. The NADA reported pre-tax return on equity was approximately 25%. This is the reason new vehicle dealerships are so desirable due to the return on equity that investors can expect. This return on equity is more than most of the 1,000 largest companies in the United States.

Service Department Profitability

Each manufacturer has a different financial statement with different summaries and sub-totals by department for department "profit." It is often not obvious how well or poorly a department is performing and contributing to the dealership by reading the financial statement. Ford has a term called "selling gross." We believe their metric is a good way to quickly compute if the expenses for a department is reasonable based on that department's gross profit.

For example, below are reasonable service department metrics:

Service department Gross Profit	100%
Service salaries, compensation, commissions (direct)	35% of total service gross profit
Training	
Advertising and promotion-direct	
Policy expense	
Service Loaners	
Tools and Supplies	
Equipment & Vehicle Maintenance	
Vacation-Holiday pay	
Sub-total above misc. expenses	15%
Retained Department Gross after above direct expenses	50%

You can compute for your financial statement with the above metrics and if the expenses exceed 50% of the service gross, your expenses are out of line high for the size of the service department. You need to analyze and take action.

"Winners are not afraid of losing. But losers are. Failure is part of the process of success. People who avoid failure also avoid success."
--Robert T. Kiyosaki

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New Vehicle Sales

All dealers either receive or have available metrics from their manufacturer on their new vehicle sales effectiveness. Many dealers do not review these reports. We believe it makes sense to spend a few minutes reviewing these reports from a new vehicle sales perspective. Even if you do not believe these reports are accurate or realistic, which they are not many times, it is a good starting point to analyze your new vehicle sales effectiveness. First, you are looking to see where you are below the guideline by manufacturer and then by model. It is possible you are low in a model line due to low inventory or erratic inventory levels of a certain model because the day's supply was very low. If you or your factory allow this to happen, you need to put in writing with management at the factory that they are costing you sales of certain models. If at the level you contact you receive no reasonable response, then move up the management line in writing by email until you get results. These middle managers do not want you writing upper management that you are losing sales due to their shortcomings in your inventory. If your day's supply has always been reasonable, then you need to ask yourself why you are below average. It is probably partially your fault, though no one wants to admit it is their fault. Be open minded and analyze this area, and you will probably increase sales and profits.

Accounting for Factory Interest and Credits

As we all know, most manufacturers pay new vehicle dealers interest credits and advertising credits. Many will receive interest and advertisers credits automatically, so know the amounts you will receive no matter how much you spend on advertising. Some manufacturers give guidance on the accounting for these advertising and interest credits that is technically wrong and cause the dealer statement to mislead the dealer on the timing of their real profits. Some manufacturers have the dealer put these credits into income or expense reduction when the dealer buys the vehicle or when the dealer receives payment of these credits. However, the better accounting method is to recognize these credits in the month the vehicle is sold. It will be painful for dealers to transition to this correct method, but it can be done if you transition over several months and catch up by the end of the year. Feel free to call us if you need guidance to transition to the preferred accounting method with minimal disruption.

Gross Profit by Department

The enclosed survey reflects gross profit by department including other income of the total dealership gross profit plus other income. The summary results are as follows:

NEW GROSS PROFIT	23%
USED GROSS PROFIT	30%
SERVICE GROSS PROFIT	20%
PARTS GROSS PROFIT	13%
BODY GROSS PROFIT	4%
OTHER INCOME	10%

As we all know, most of the Gross Profit produced in Other Income is generated from the new vehicle department, but some is from vehicle DOC fees. Allowing for this, total new gross including other income approximates the same total gross profit as used. However, most dealers spend a disproportionate amount of time on new vehicles to the detriment of the used, parts, body, and service departments. If you are a dealer and selling what is expected for new vehicles, it would seem more effort on used would be more productive for increasing profits than on new vehicles. What else might you learn from the survey? If you find your used gross is less than 30% of total gross, it might indicate that more effort should be in the used department on a comparative basis. If you find your parts and service gross in total is less than 34%, it might indicate more reasonable opportunity in these two departments. We determined the net profit as a percentage of sales for the dealers that had an above average used gross of the total gross compared to the other dealers. We found that these dealers had an above average net profit as a percentage of sales. What does this mean? For these dealers, they make more profit either doing better on used or spending more effort on used. As compared to your dealership, you should look for where you are out of line with the above summary, figure out why and what can be done to improve the departments that show more opportunity.

New Unit Sales Versus Used Retail Sales

As you can see from the enclosed survey, the ratio of new to used retail average is 51% new to 49% used. If you determine the ratio of new to used retail median (middle dealer out of 200+ dealers) is 46% new to 54% used. You can see where both Chrysler and Import dealers have an above average ratio of new to used. We believe the reason Chrysler is this way is because its market share improvement has created this trend. Imports have always seemed to have a much higher ratio of new units sales to used unit sales.

Increased Vehicle Sales

We visit about 50 dealers from the middle of January through March each year. When we discuss selling more vehicles, there is one main observation we see: dealers need to have more salespeople. Usually they agree, and often times say they cannot find good salespeople. Our answer is how many months will they allow the salesperson's count to be low? We do find a correlation between missing sales and the number of salespeople. A general rule is if you need to sell 100 units per month, you need 10-11 salespeople. This does not mean you will sell 100 units, but if you have less than 10 salespeople, you are almost guaranteed to not sell 100 units. Some will argue with this thinking, but very few of our 200+ new vehicle dealerships violate these ratios.

Information Technology (I.T.) Data

Many dealers are still allowing third parties to access their confidential I.T. data. This also includes dealers' manufacturers. We recently read that one manufacturer has, as part of its franchise agreement, the ability to have complete access to its dealer's I.T. data. This means the manufacturer has the ability to share or sell all of your data to others. This includes data the manufacturer has no valid reason to obtain. One way you can restrict the manufacturer is to "push" data to them that they are reasonably requesting and not allowing them to "pull" all the data they want since you have no control over this. In other words, do not allow them to "pull" your data but you will "push" reasonable requests for data. There is no benefit to a dealer allowing this, but there are many negatives. We do not know any dealer that trusts their factory enough. What we need is some kind of document from those factories that state they will not ever share or sell a dealer's data to anyone. This is probably something the dealer council for each manufacturer needs to deal with.

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