Finding Real Profits in Used-Vehicle Inventory

Vehicle inventory is at the heart of every dealership; and as a vital asset, it demands prudent management. In light of the current economic downturn, more and more dealerships are turning to used-car sales to help offset the decline in new-car sales, making inventory management all the more critical.

With sound inventory management, a dealer's used-vehicle lot can be a lifeline to survival during tough economic times and the key to ongoing success. Higher gross averages and gross profit percentages are two ways to ensure success. Another is the opportunity to control the entire sales lifecycle – to choose which vehicles and brands to carry and to establish pricing – without having to abide by the usual requirements that accompany new-car franchise agreements.

Equally important to a dealership's survival and the ability to thrive is the need for cash flow and cash conservation. One of the biggest sources of locked-up cash, or frozen capital, is used-vehicle inventory – further emphasizing the need for good management to ensure liquidity.

Dealerships must work to aggressively reduce the amount of working capital that's tied up in their used-vehicle inventory. They must understand their inventory positions and asset valuations at any given moment in time in order to make informed, cost-saving decisions.

Ensuring the appropriate amount of used vehicle inventory is the first step to proper management. The industry target is typically a two-month supply, but given the need for constant cash flow, a better target is 1.3 to 1.5 months in both dollars and units.

The second measure is to secure the right mix of vehicles to promote faster turnover and yield higher profits. Theoretically, a dealer can have the right inventory amounts, but if the mix consists of Pintos and Yugos – cars that are guaranteed to age – the dealership has effectively made its inventory sale proof.

To derive the proper inventory mix, a dealership must closely evaluate historical market data, future trends and its sales history as well as other factors such as fuel prices, seasonal considerations, and demographics. A close relationship between the used-vehicle manager and the new-vehicle manager is also important for gaining viable trade-ins that will reflect an appropriate inventory mix.

Given the right inventory, the key to a successful used-vehicle department is sales velocity or the rate at which vehicles are sold.

Historically, dealers have measured the success of a used-vehicle department based on front-end grosses. A successful used-vehicle manager was one who could get $2,000 in a front-end gross.

While that may reflect a good job selling Fords or Chevrolets, which could have an average cost of $12,000, it's hardly considered successful on a used BMW or Mercedes sale with an average used cost of $20,000.

A better, more decisive measurement of used-vehicle success is return on investment (ROI).

Dealerships that regard inventory movement as paramount must then adopt a meaningful pricing and re-pricing methodology in support of that movement. Too often, there is a disconnect in how dealers price and how shoppers shop.

Some dealers still price their used vehicles based on cost plus $3,000. Their logic is that they need to hold on to as much gross in order to keep the "per vehicle retailed" (PVR) up, even at the expense of aged vehicles.

But "cost plus" is an antiquated pricing methodology that reflects "the greater fool" theory – that is, let's wait for the greater fool to walk into the showroom and pay the cost-plus price of the vehicle. It's a concept that doesn't fly in today's virtual marketplace. Buyers are much more purchase savvy and use the Internet to shop makes, models, year of manufacture, colors and even trim options. If a potential buyer today finds a selection of 10 used vehicles, the cost plus dealer will certainly be last on the list, having purchased the vehicle at auction; invested $800 into reconditioning, safety checks and cleanup and tacked on the arbitrary $3,000 gross. That unit will most assuredly get old.

Instead, dealers should price a vehicle based on how easy it is to replace. For instance, if a lot has a 2008 Ford Taurus program car newly out of rental fleet, a $3,000 gross is far too much because that vehicle can be replaced easily tomorrow with another just like it. Furthermore, a quick search might reveal that there are many 2008 Ford Tauruses for sale from other dealerships.

Furthermore, dealerships should develop strict aging or turn policies. After a vehicle reaches a predetermined number of days on the lot, it should be put to auction. Our experience shows that a good amount of time for this would be 75 days at an absolute maximum. After 60 days, most dealers will not make money on a vehicle and many will actually lose money on vehicles sold after this point. Moreover, aged vehicles are tying up precious capital that could be used to buy a fast-moving vehicle.

When implementing an aging policy, you may want to consider adopting the following policies as well:

- Check for missed reconditioning opportunities: When a vehicle reaches 30 days on the lot, different managers should drive it home for the night. Upon its return, have each manager complete a quick checklist of his or her general impressions of the vehicle. This firsthand information can often turn up additional and necessary reconditioning requirements.
- Track demos: Track how many times a vehicle has been demonstrated and test driven, as well as how many write-ups it has had. If no one has written a deal or even demoed the vehicle within 30 days, something is wrong.
- Take a short deal or even a loss on an aged unit: There are basically two options for clearing out an aged unit. A dealer can lose $500 at auction and deal with the hassle or sell it to a retail customer and still lose $500, but on the front end only. While the surface losses are the same, selling a vehicle at a loss to a retail customer gives you the chance to sell some F&I, possibly a trade, but most importantly wins another happy customer.
- Improve visibility: Take all the units that are within one week of going to auction and move them to a highly visible corner of the lot. Merchandise the vehicles, along with the visible territory with signs that tout the vehicles as “auction bound on X date… make us an offer.”

Today’s retail environment is drastically different than that of the past. Dealerships cannot afford to manage their used-vehicle inventory with guesswork. Mistakes are too costly and the stakes in this economy are just too high.

By adopting smarter ROI measurements, along with pricing and aging tactics, companies can better manage their inventories and position themselves to compete effectively today and into the future.

The Aftermath of Downsizing

Downsizing is one of the most difficult decisions that an organization’s leadership has to make. There are a variety of factors that are involved in making the decision about which jobs to keep and which to eliminate. One item that should be addressed during the decision-making process is how will the work of the displaced worker be absorbed by the remaining work force.

A key to reassigning work is to know what functions were actually performed by the person in the position that is being eliminated. A job description, if available, can be helpful, but the employee in the role that is being eliminated or his or her manager is more likely a more accurate source about what the job entails. The point here is that we cannot reassign work or make an informed decision about which positions to keep and which can be eliminated if we don't know what tasks are being performed.

When considering downsizing, it is also important to look at our processes. Do all of the processes that we follow add value to our customers? If we find processes that do not add value, they should be changed so they do or they should be eliminated. It is important that if we are going to ask the remaining staff to take on more responsibility, the additional work they do provides value.

There are many ways of reassigning the work of the jobs that have been eliminated to those that remain. Your specific situation will help guide that process. The key is communication. It is important to communicate with the remaining staff during a downsizing event. One item that should be discussed is, "How do we continue to function at our desired level with less staff?" The people who are closest to the processes will most likely have the best answers. According to the Society for Human Resource Management, employees are more willing to go "above and beyond" their normal job duties right now in order to help their organization succeed. Involve them in the work redistribution process since they are the experts and have a stake in the organization's success.

Once the work has been redistributed, don't forget to update your job descriptions. This can be as simple as adding the new tasks to the remaining job descriptions. Remember to keep the current job descriptions. They will be helpful as business improves and the organization looks to expand. If you would like more information or advice on how you can downsize successfully, please contact our professionals today.