Steering your dealership to higher profits

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May Profit Trends

Profits for new vehicle dealers for May 2011 were down slightly from April 2011 profits, which were down from March 2011 profits. We would expect this based on historical trends, but overall profits and profit margins still remain good for most dealers. The NADA has reported that the average dealer reflected 2.5% pre-tax net profit as a percentage of sales through April 2011 versus 2.3% for April 2010. This average, an excellent one, of pre-tax profit has not been at 2.3% or higher in the last 35 years, part of which is because the ratio of new vehicle (high dollar sales) sales of entire dealerships is down, which increases the net profit percentage. Also, many expect interest rates to increase, though there is nothing to indicate as such at this time. When it happens, profit margins will go down.

	May Better Than April	May Worse Than April	May Best Month	May Worst Month	May Loss Month	May Loss YTD
Chrysler	50%	50%	10%	0%	0%	5%
Ford	65%	35%	0%	0%	10%	5%
General Motors	45%	55%	20%	10%	0%	0%
Imports	35%	65%	5%	5%	5%	5%
Overall	45%	55%	10%	5%	5%	5%

Nationwide new car and light duty truck sales as reported by *Automotive News* are 1,053,000 units for June 2011 versus 984,000 for June 2010. May 2011 was only slightly higher than June 2011, not a good one-month trend. The following franchises that are up the most comparing June 2011 year to date to June 2010 year to date include Ford, Hyundai, Kia, GMC, Jeep, VW, Dodge, and Buick.

Used Vehicle Inventory

The enclosed survey shows the day's supply of used vehicles. This day's supply is calculated by (1) taking your year-to-date retail used vehicle sales (in units) divided by the number of months it represents. You now know the number of used sales you have averaged per month in 2011. (2) Divide that number into the number of vehicles in your inventory. This results in the percentage of inventory that you have to sales. It can be less than or more than 100.0%. (3) Multiply that percentage by 30. As you can see, the average day's supply shows 64. The lowest dealer shows 20 while the highest shows 117. We measured day's supply versus ratio of used to new retail to see if the dealers that did a better job on used vehicles sales had a larger or smaller day's supply. Based on our analysis, having a higher day's supply of used vehicles does not translate to selling more used retail vehicles, suggesting that selling more used retail in relation to new is due to factors other than carrying a larger used vehicle inventory based on a given day's supply.

Inside

Parts Department Metrics

We recently compiled a parts department survey, which measured the average and median parts sales per parts employee per month along with the compensation paid to parts employees as a percentage of parts department gross profit. We found a wide range of parts sales per parts employee per month, from a low of $26,000 to a high of $63,000. We had several similar amounts for these two in previous calculations, indicating we do not have an exception. We called several dealerships to confirm if their financial statements were accurate. The average parts sales per parts employee per month approximated $42,000 with the median being $40,000. For some dealers that are smaller in size and cannot have one-half of an employee, they might show a lower amount.

The second metric measured was parts compensation as a percentage of total parts gross profit, which ranged from 17% (average sales per employee being $53,000) to 43% (very low parts sales per parts employee). We suggest that dealers measure their parts sales per parts employee per month and parts compensation as a percentage of parts gross to see how they compare. If dealers are materially below average, they need to address this concern. This could result from simply too many people or too many people doing too little and being paid too much.

Factory Relations

We have written in the last three months about metrics which the factories use to measure dealer performance. There are four basic metrics: new vehicle sales registration effectiveness, consumer satisfaction index, working capital, and profitability. As we saw in over twenty arbitration cases last year that we were involved in, two factories used profitability against some dealers, stating that profits were low or that losses existed. If you have low profits or losses, this poor performance might be used against you as well. Other than just running your dealership more effectively, there are some things you can do to increase low profits or reduce losses:

1. Reduce the compensation paid to yourself.
2. Reduce the rent paid to yourself depending on the facts and circumstances.
3. Make sure you report the LIFO adjustment properly on your year-end financial statement so that the factory allows for the LIFO adjustment.
4. If you are creating accounting profit reserves on your books, you might reassess these reserves.
5. Review the amount of depreciation taken each month and save any additional income tax depreciation for only your income tax return.
6. If you have income generated by the dealership but do not run it through the accounting records of the dealership, have your office staff do so.

Also found in the arbitration hearings were inaccuracies in computations and summaries by the factory. At times, a factory's report would show certain dealers as improving or failing to improve as compared to other dealers when in fact these comparisons were simply inaccurate. You cannot always count on what the factories report, and you must be active if you are to improve profits or reduce loss.

Finance Reserves

All dealers sell retail installment contracts in which they earn a commission called finance reserve income. Some financial institutions pay these commissions when they pay the dealer for the contract. Many financial institutions credit these commissions to the dealer's reserve account, which is like a checking account. Some dealers' agreements with the financial institutions call for the balance of the reserve account to be at a minimum. We usually see this amount from $500 to several thousand dollars. Some dealers allow their reserve account to build up to many thousands or tens of thousands of dollars until they request a payment. We do not like to see dealers allow the reserve account to build up to more than a few thousand dollars at most.

Recently a financial institution notified many dealers they had not been charging back dealers for reserves on certain deals. Some of the proposed chargeback deals were more than ten years old. We have heard some dealers with a large reserve balance had the bank take from that account what the bank thought to be the correct amount. This upset many of these dealers. We suggest in the future that you have your office staff let you know at least quarterly how much of your money each of your finance reserve institutions is holding. If it seems excessive, have the bank pay down this excessive balance.

Finance Department Compensation

We regularly measure the amount of compensation paid on finance, insurance, service contract, or product income less chargebacks generated in the finance department. At almost all dealerships, only finance department employees and sales management are paid on the types of income listed above. At times we find dealerships paying sales employees on this income even though they do not help make the sale, a practice we do not endorse. At times we hear that salespersons help the finance department sell their products. We have seen no evidence to support this.

The percentage of income paid to the finance department employees varies based on the size of the dealership. We find at smaller dealerships with only one person that the percentage might need to be higher to justify keeping a highly productive finance department employee. That said, the large stores seem to pay finance department employees in the range of 14% -18% (after chargebacks) of the net department income. This includes a draw against commission and salary. We find the overall percentage of all compensation paid to finance department employees to approximate 20%. If you find you are paying much more than this, review the pay plans.

IT Vendors

We are involved, unpleasant work, in dealing with IT vendors on behalf of new vehicle dealers. In our experience, some vendors do not treat dealers very well. There are several consulting firms that advise dealers on their transactions with IT vendors, and we suggest most dealers hire a consultant to advise them.

One area of concern is IT pricing after an agreement, typically five years, with a vendor ends. In most agreements is an inflation clause stating that prices cannot increase more than the rise in the consumer price index. After the agreement has expired, dealers do not have a pricing mechanism. Since dealers have so much time and expense invested in their IT system, they either cannot or are not willing to switch vendors because of the hidden training time costs and disruptions in their business. The IT vendors know that and in some cases act accordingly. We have seen some vendors increase prices over 10% (over inflation increases), putting dealers in a corner and limiting their ability to negotiate.

When you sign your initial agreement, make sure that it reflects what the price increase can be for the first year after the initial agreement expires. If the IT vendor is not reasonable during negotiations, then you will have several months to be able to switch vendors in an orderly fashion.

An opportunist pulls himself up by your bootstraps.

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