Steering your dealership to higher profits

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April Monthly Profit Trends

April 2011 was generally a down profit month for most dealers. Historical trends show this is to be expected. As you can see below, 30% of new vehicle dealers had higher profits in April than March, while 70% had lower profits in April than March. The trend below shows 20% of new vehicle dealers had their best profit month of the year. With the disaster in Japan, the reduction in day's supply of vehicles with Japanese components has resulted in reducing new vehicle inventories in May.

	Apr. Better Than Mar.	Apr. Down From Mar.	Best Month Apr. 2011	Loss Month Apr.	Loss YTD Apr.
Chrysler	10%	90%	10%	5%	5%
Ford	35%	65%	35%	10%	10%
General Motors	35%	65%	20%	5%	0%
Imports	25%	75%	20%	0%	0%
Overall	30%	70%	20%	5%	5%

The six year month-to-month nationwide sales trend graph that we send to dealers from data obtained from the *Automotive News* shows that new car and light duty truck sales were down in April compared to March, (which we expected), and that May continued the downward trend, (which we did not expect.) January through April sales were up compared to the same months in 2009 and 2010. May 2011 sales were above May 2009 but below 2006 through 2008 and 2010, perhaps due to disruptions in product from Japan or from the poor U.S. economy. We probably will not know which, if not both, until later this year.

Common sense is not so common.

Information Technology Costs

This month's survey shows IT costs as a percentage of gross profit for the dealers in the survey. In the past, IT costs have approximated around 1.9-2.0% of gross profit. This survey shows IT costs again at 1.9% of gross profit, which varies by dealer group from a low of 1.8% to a high of 2.1%, not a statistically meaningful difference. We know that all dealers do not account for this IT cost the same way. We believe some dealers charge a portion of their IT cost to expenses rather than IT costs. Generally speaking, in the survey, the higher IT costs as a percentage of gross reflect 4.5% to a low of below 1.0%. We have heard at times from an IT vendor stating that though they might charge more, their dealers make more profit or a higher profit margin. We have asked for proof, but none was forthcoming. We did measure IT costs for the top 50% of profit margin dealers in this survey. The top 50% dealers had a 3.4% net profit as a percentage of sales versus the average dealer showing 2.4% net profit as a percentage of sales. IT costs as a percentage of sales for the top 50% of dealers was 1.7% of gross profit with the average being 1.9%, which might not indicate that the above-average dealer has below-average IT costs. These numbers also might indicate there is minimal correlation between higher IT costs and higher profits. If you find your IT costs are 2.5% or more of gross profit, you might review the services you are paying for and possibly consider other IT vendors.

Inside

Special Dealership Programs

We have seen over the last 30 years the same or similar programs re-appear. They were not good in the eighties and generally are not worthwhile now. These programs include service contract sales where if the customer does not make a claim, they receive their initial premium back; long-term warranties offered if the customer has all of their service work performed at the dealership under certain conditions; and tires for life where if the customer purchases a vehicle from the dealer and meets certain service work requirements at the dealership, they will receive tires for the life of the car.

Some of the reasons these programs do not seem to be worthwhile to us include:

1. We do not believe they sell enough incremental vehicles or parts and service to pay for themselves.
2. It is difficult or impossible to determine the future costs versus the current and future benefits. Does the selling dealer sell more vehicles now offering this program or sell a much higher percentage of service contracts offering refunds? It is doubtful.
3. The IRS does not allow you to reserve for these future obligations, so you have to pay taxes now on any reserves.
4. The sales department typically gets paid on all the gross now, and it does not appear that the future costs are charged back to the person that reaped the benefit.
5. We do not see third party service contract companies and others offering these programs with reasonable premiums. If they do not offer these products, how is a dealer to know how to price it?
6. We see dealers offering the above, not itemizing the charge to the customer, and in effect absorbing the future costs out of current gross profits. We do not see dealers making more gross today to absorb this "giveaway."

In summary, before you offer a future open-ended service or product, measure the benefit and what is the reasonably expected future cost. If you cannot determine either of these, then do not adopt the program.

Some days you tame the tiger. And some days the tiger has you for lunch.

Factory Relations

We have written in the past two months about two of the four main factory standards for dealers: new vehicle sales effectiveness and CSI effectiveness. We have written on these criteria because factories will use them against dealers when certain goals go unmet. This month we will talk about the third metric that the factories use: working capital and sometimes tangible net worth. Working capital is generally computed the same for all manufacturers, except GM who still has their own definition of working capital. Working capital is current assets less current liabilities adding back the LIFO reserve if it is included in the current assets. The working capital guideline formula varies by manufacturer. These guidelines are generally in the range of 4-5% of annual sales, and their formulas are usually complicated.

The concern here is that dealers need to meet these guidelines so the factory cannot use the dealer's status of being below the guideline against the dealer, which often results in litigation. Many dealers do not realize they are on the factory "watch list" until it is too late. You need to verify in writing what your working capital guideline is and determine if it is up to date and computed correctly. If it is and you are below the guideline, you need to make arrangements to meet their minimum guideline to get off of their watch list. If you have any doubts about your status send us your current dealership balance sheet, and we can discuss it free of charge.

Ford Motor Company-Lincoln

As we know, Ford is trying to reduce the number of its Lincoln dealers. They must believe that fewer Lincoln dealers will sell more Lincolns. Also we have read and heard that Ford is pressuring its dealers to spend substantial funds on their facilities. We have measured Lincoln sales from Automotive News data for ten years. The trend line shows they sold over 150,000 Lincolns in 2001 and only 86,000 in 2010. Lincoln dealers need to consider whether they want to take a chance spending a large sum of money before Ford proves it will be successful with Lincoln. If Lincoln sales continue this downward trend, the franchise might not exist in the near future.

Notes Payable Stockholder

Many dealers along with family members and certain employees loan funds to dealerships. These individuals generally obtain a higher interest rate than they would normally get, and it does not cost the dealership if the rate paid is the same or close to the dealership's floorplan interest rate. We have seen some dealers ask their attorneys to file a UCC form with formal written notes for these individuals. As we understand it, these individuals will become a "secured" creditor in case of default of the dealership or if the dealership loses in a lawsuit more than its insurance will cover. In other words, these individuals might obtain preferential treatment in case something unfortunate happens. If you, family, friend or employees have funds loaned to your dealership, you might consider discussing this option with your attorney.

Your struggle may be lasting, but it is not everlasting.

Factory Incentive Programs

Most factories have incentive plans for their dealers. However, many dealers question the integrity of these programs for the sales assignments given versus the inventory available, current and past performance, and percentage of market share obtained by the dealer in the past, current, and expected in the future. We have seen more than one dealer that was above average in market share while the factory continued to raise expectations. One dealer exceeds 150% of factory expectations and still expectations are raised. To some these programs along with stair-step programs seem unreasonable and suspect factories selling vehicles to competing dealers at different prices. If you believe you are not being treated equally and fairly, put it in writing to your factory.

If you believe there are any errors or inaccuracies in this or any issue of this newsletter, please email Carl or Neil with your comments: carlswoodward@cpaauto.com neilf@msco.net

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