

Micro and Macro Don't Mix

Yet dealers tend to live in one world, think in another

By Phil Villegas

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Last month, I recommended that dealers look beyond the monthly cycle reporting. This month, I'll tell how to do that.

Here's a basic example of the disadvantages of the monthly approach: a dealership sold 80 new and 40 used vehicles, and had a departmental gross profit of \$100,000 in October. In November, it sold 60 new and 30 used vehicles at another gross profit of \$100,000.

Most dealers looking at this would say one of the following:

- "They were probably low on inventory in November, so they were able to hold some of the gross."
- "The general manager has a rainy-day fund to even out the months."
- "They may have had a new model introduction so they were able to get the sticker price on those cars in November."
- "They had to blow-out most of their used inventory in October and took a hit."
- "There was an aggressive manufacturer incentive in October, so they were able to under-allow on trades and then pick up the gross in November with the sales of the trades, essentially extending one good month into two."

The possibilities are endless and circumstances like this are not unusual from one month to another at dealerships.

While many dealers will not analyze their operations in such a simplified manner, the overall approach to monthly fluctuations in volume and profitability are essentially the same: applying a micro look at a macro environment.

If we take the Wal-Marts, Walgreens and McDonald's of the world, a monthly reporting cycle makes complete sense. These are over-the-counter retailers who have diversified products and services.

With dealerships, a micro-type analysis can only be beneficial once the greater macro environment is truly understood.

The dealer environment is unique because the product-to-consumer cycle is really closer to 120 days, and not a month. Unlike other retailers who can benefit from just-in-time inventory from an assortment of vendors, dealers are constrained both in the type of vehicles they can retail and the time in which they can get them to market.

Once a car is ordered, it can take typically take 8 to 12 weeks for delivery, and another week to get front line ready. The car could stay on the lot 60 days. It takes 10 days to collect most of the funds.

If there are customer rebates and incentives, it can take an extra 30 to 60 days to collect those funds. If there was a trade, whether that vehicle is auctioned, wholesaled or retail, the results of that sale are directly related to the sale of the original new car.

By no means can retail automotive sales be considered over the counter. Yet dealers have been applying an OTC model, even though the fundamental nature of our business does not truly operate within this monthly cycle.

Things were once quite different. In the 1970s and 1980s dealerships began embracing large inventories and volume selling as a standard business practice. Before then, dealers maintained a balanced sales mix of service, parts and vehicle sales.

Dealers would typically maintain a low quantity of

available models, and customers were accustomed to placing orders and waiting several weeks for their vehicles to arrive. In the past, the greatest exposure a dealer had was from slow parts and service business, not from a bloated inventory or oversized property.

So while the dealership business has evolved over the last 30 years to become a major retail force, the method by which most dealers manage and evaluate their operations has not evolved with it.

The macro environment which dealers retail new vehicles today is more like commodities brokering than OTC retail.

The best dealers, much like the best commodities brokers, are able to forecast the future market environment and either load-up or hold-off on purchasing on inventory.

However, the biggest difference between the commodities broker and a dealer is how they manage the purchasing and selling of that inventory. For brokers, in its most basic form, the price is determined by supply and demand.

For dealers, it's primarily driven by supply, while demand is typically a secondary concern.

A sales manager usually handles the purchasing and evaluation of demand. While they may be very good at what they do, their decision-making is unfortunately framed around a monthly cycle, and not a quarterly, semi-annual, or annual perspective.

Dealers don't need to change how they do business. They need to change how they evaluate their business.

In my days in the car business, a great dealer told me what he considered to be a best-kept secret: "As a dealer, your profit or loss is made when you buy the car, not when you sell it."

So dealers should focus on the management of inventory and sales cycle. Consider the following:

- On a semi-annual basis, dealers should review manufacturer product releases and vehicle availability to enable them to properly forecast future sales and gross profit expectations.
- New vehicle inventory lines should be managed by model and not collectively as car and trucks. Dealers

need to understand their inventory's days' supply by model in order to better forecast future orders and manage current supply.

- When analyzing month-end reporting, dealers should ask the controller for a rolling 90-day average and cumulative analysis for all vehicle sales, gross and variable expense line. The goal is to step beyond the month-end detail to see the bigger operational picture.
- Consider only paying sales staff a pre-determined flat fee on new vehicle releases or hot products. Sales pay plans were not conceived with "order taking" in mind, and paying additional gross or artificially allowing unit sales to count towards bonuses is not truly equitable.
- Track market share against local competitors on both a monthly and year-to-date basis. While the general market will fluctuate, a dealer's market share should remain relatively consistent.

If dealers buy into the micro analysis over-the-counter concept, they should first fully embrace the macro environment of their businesses.

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