POWER STEERING

Steering your dealership to higher profits

A publication of Woodward & Associates
Consultants to the Automotive Industry

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The first two months of the year, January and February 2021, have started extremely good based on pre-tax net profits. Though total dollar sales might be down slightly from the average month in 2019, the pre-tax February profit margin on the enclosed survey approximates 3.2%. In years before 2020, this profit margin was on the 2.3 – 2.5% range for several years. For 2020 as reported by the NADA, this pre-tax profit margin approximated 3.6%. The month of March 2021 as of today, March 29, 2021, might end up being the best month ever for new vehicle dealers from a profit perspective.

Factory Interest Credits

Most factories reimburse/pay dealers for floor plan interest expense. These interest credits often amount to several hundred dollars per new vehicle based on the number of days the factory reimburses the dealer and the amount of the factory invoice. Some factories pay these interest credits when the new vehicle is purchased, while there are other reimbursement plans vary as to when the credits will be paid. Most factories have on the monthly dealer financial statement a FLOOR PLAN INTEREST CREDIT account. It used to be that several factories did not have this separate FLOOR PLAN INTEREST CREDIT account. Some dealers are paid these interest credits when the new vehicle is purchased and the dealer is to credit this separate account. Other factories have this floor plan interest credit applied to an interest profit account the month the vehicle is purchased or the next month. This is not good accounting and makes the month many vehicles are purchased look too good from a profit perspective. We suggest dealers set aside these up-front floor plan interest credits and wait until the vehicle is sold before crediting floor plan interest expense. You might confirm with your office staff when they are putting these credits into income compared to when the new vehicle is sold.

New Day's Supply

New vehicle day's supply used to be reported monthly by Automotive News. However, this changed when several factories refused to share with the public their monthly sales of new vehicles to just reporting these unit sales quarterly. With quarterly reporting it is not possible to have monthly day's supply reports. We went through a sample of our dealer's February 2021 results, which include the number of new vehicles in stock at the end of February 2021 along with the number of new retail units sold in February 2021. As you can see in the enclosed survey, the average and median day's supply of new vehicles in stock as of February 2021 approximates 78-80 days based on retail sales for the average dealer of 54 units. We realize most dealers have less new vehicle inventory, but with the level of sales down in February the day's supply might seem a normal day's supply, but with fewer new in stock.

"Growth is never by mere chance; it is the result of forces working together."
- James Cash Penney

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Factory Measurement Metrics

As we often write, most factories measure the performance of their dealers on a regular basis. We suggest dealers review at least quarterly the following metrics: new vehicle sales effectiveness, customer service index (csi), and service department index. We believe dealers should make a real effort to improve their scoring if they are in the bottom 20% for any of their metrics. Some factory representatives have said that if a dealer is in the middle, say at 100%, this is only a "C". This shows ignorance on those factory representatives. As we have written in the past, sometimes the factory metric is wrong or misleading. We recently asked for the new vehicle sales efficiency score for one of our larger import dealers. This dealer had received a score through November 2020 of 92 where 100 is the baseline. We asked the dealer to obtain from their factory the score for all dealers in their region. The factory at first said it did not exist. We knew it did. The dealer asked again and surprise, the requested scores for all dealers in their region appeared. Below is a summary of the new vehicle sales efficiency report for the eleven months ended November 2020 for this dealer's region:

- Total dealers	75
- Average sales effectiveness	158
- Median (middle) sales effectiveness	144
- Highest dealer score	372
- Lowest dealer score	54
- Our (large) dealer	91

If the average dealer is really 158 when the base should be 100, this might be the best region in the nation for this franchise. Doubtful. How can the average be so high? It makes the entire report suspect. You might ask your factory in an email (in writing) to send you a report of all dealers in your region, dealers' names removed, the sales effectiveness scores for 2020. You might learn something reviewing this report, or learn the factory report is "suspect". If this report is "suspect" then what other factory reports are "suspect"? Feel free to email the report to our office and we will give you our comments.

Parts Physical Inventory

We have seen a trend this year of dealers performing inhouse or third-party parts physical inventories that are incomplete. When doing these inventories, coordination needs to be done with the accounting department. Too many times these inventories are only compared to the parts pad and not compared to the accounting department. This can make the parts physical worthless as your accounting records would not tie to either the parts physical or parts pad and you would not know how to accurately adjust the accounting records. In the future, be sure to have the accounting department be involved with parts physicals. They will need to reconcile items posted in parts but not accounting or vice versa before the physical begins. Additionally, we recommend during these physical inventories that you identify obsolete parts as well and junk/sell the old items and write it off for accounting/tax purposes.

Hard Packing of New and Used Vehicles

Packing inventory is a useful tool to ensure gross profits on new and used vehicles are accurate (or understated), and to motivate salespeople / managers to maximize gross profits on each unit. However, the accounting is typically done incorrectly. If you hard pack a new or used vehicle, you immediately debit the vehicle (increase the cost) for the pack and credit pack reserve (balance sheet). We commonly see that inventory is hard packed, and by the end of the month the credit is taken into income, regardless of whether the unit is still in stock or not. In other words, your store may pack each unit $1,000, but there is no reserve on the balance sheet for the $1,000 and instead it was taken into income; so you may have already recognized profit on a vehicle that has not sold. This prematurely recognizes the income of the pack (think Enron). We recommend to everyone to compare the pack balance (credit) on their balance sheet at the end of the month compared to what the balance should be. By not doing so your profits could be overstated, and you could have overly compensated employees on this false profit.

Bank Statements and Cancelled Checks

At least quarterly we receive a phone call from a dealer who is concerned no one is looking at their checking account and/or they want someone to look at it besides their office manager / controller. The easiest way to do this is to have your bank mail you (or email you) a copy of the monthly statement with a copy of all the checks. We recommend the dealer spend 15 – 30 minutes a month looking through any outgoing items in your checking account and asking your accounting department for support. This would include any ACH's and checks that do not look familiar to you. This lets the accounting department know you are looking and will give you a better grasp of items coming out of the account.

Internal Controls for Cash

Here are some of the easiest internal controls for cash that should be done at your dealership:

1. Make sure all checks written are electronic and physically written out of your DMS. If checks are handwritten, they can be manipulated later.
2. Make sure it is required that 2 signatures are on every check. Be sure you know who the two individuals are. We have found that even with this, banks still allow at times checks to clear with only 1 signature or no signatures (or sometimes with wrong signatures). Test this at your dealership to see what happens. If they allow it to clear, this bypasses the internal control. Discuss it with your bank.
3. Be sure to have restrictions on outgoing ACH's. Many banks now have features that allow you to determine who can ACH and the max amount that can be taken out for each individual / company. We recommend only allowing financial institutions like floorplan provider, auctions, and the government to ACH.
4. Have a much more restrictive policy on wiring cash funds. There should be two parties involved, one setting up the wire and the other approving it. The dealer likely should be the one to approve it.
5. Lastly – insure it. Even with great internal controls, theft can still happen. Spend 30 minutes a year with your insurance agent to discuss items that would be un-insurable and figure out if there are ways to insure it (for a reasonable cost).