

1-2020

Automotive Dealership Management Fundamentals

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AUTOMOTIVE DEALERSHIP MANAGEMENT FUNDAMENTALS

By Dr. Kendrick W. Brunson & Steve Barnes

January 2020

INTRODUCTION

The purpose of this guide is to provide for automotive dealership managers a fundamental guide of how the American automotive dealership industry functions. The information in this guide was derived from notes and video recordings of experts in the industry who were managers within the Hendrick Automotive Group during this same BUSI 370 class taught in the spring of 2017. Appreciation is extended to those who contributed of the valuable experience they have gained over the years and specifically to Mr. Rick Hendrick for allowing these managers to contribute to this body of work.

The guide is divided into seven chapters that correspond with the modules for the online version of Liberty's BUSI 370 course, Dynamics of the American Automotive Dealership Industry. However, students can also use this text in the residential version of BUSI 370 and as an additional reference guide for the other four courses that supplements resources provided for those courses.

The content of this guide covers background information that explains where the automotive industry has come, suggests where the industry may be going, and covers the major functions and departments within most dealerships. The focus of the discussion will be from three perspectives: (a) the original equipment manufacturer (OEM), (b) the dealership to include its employees, and (c) the customer.

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CHAPTER ONE

BACKGROUND INFORMATION

In the beginning, mankind used beasts of burden to help transport from one place to the next either for personal means (single rider on the back of the animal), family transportation via a carriage drawn by one or more animals, or cargo via the wagon pulled by one or more animals. This was the form of transportation for most of mankind's existence until the Industrial Revolution. The amazing transformation from the use of beast to machine within a relatively short span of time is embedded in the history of the automotive vehicle industry.

History of the Automotive Industry

The idea of a self-propelled vehicle dates back to the 15th century with Leonardo da Vinci. Ideas for propulsion included mounting windmills on carts (Valturio, Genevois), large clockwork engines (de Vaucanson), air pumps (von Guericke), condensation of steam to create a vacuum (Papin), steam turbine (Verbiest), coal-gas engine (Lebon), and hydrogen gas (de Rivas)¹.

¹ Encyclopedia Britannica, retrieved June 25, 2017 from <https://www.britannica.com/technology/automobile/History-of-the-automobile>

Steam Engines

In 1769, Nicolas-Joseph Cugnot of France invented the first automobile run by a steam engine. It would run for 20 minutes at 2.25 miles per with four passengers aboard. After building up sufficient steam again in 20 minutes, it could continue on its journey. In other words, with this automotive vehicle, the passengers could travel a grand total of 1.5 miles each hour. This technology was developed further in Great Britain as the precursor to the steam locomotive trains. However, much public resistance built up against the noisy machines that destroyed roadways for pedestrians and horse traffic. Eventually, the steam engine propulsion system was discontinued for automotive vehicles produced in Europe for a time. The shift went to other parts of the world and focused on a lighter steam-powered vehicle. In 1900, 1,000 Stanley Steamer

vehicles were produced in the United States. One of these “steamer” vehicles achieved the world speed record in 1906 at 127.66 miles per hour.

Electric Motors

“At the beginning of the 20th century, 40% of American automobiles were powered by steam, 38% by electricity, and 22% by gasoline”¹ (p. 2). The electric car appeal was the avoidance of the noise, vibrations, unreliability of gasoline-powered cars, and the complications of the steam-powered cars. Electric cars promoted instant self-start, silent operations, and minimal maintenance. The first American battery-powered car was built in 1890 but only achieved a speed of 14 miles per hour. In 1899, an electric automotive model developed by Jenatzy exceeded 60 miles per hour. The problem with the electric car today was realized back then with the lack of available charging stations or but also with unreliable electricity in the homes then. One of the inventions that contributed to the demise of the electric car previously was the electric starter for gasoline-powered vehicles that replaced the dreaded hand crank required to start the gasoline engine.

Gasoline Engines

In 1885, Karl Benz created the first internal combustion engine whereby a magnetic field was created to propel the engine connected to the drive shaft. The following year Gottlieb Daimler created his version of the gasoline-powered vehicle. The four-stroke principle, used in most engines today, was designed by Alphonse Beau de Rochas in 1862. The four-stroke principle consists of (a) intake where air and fuel mixture is drawn into the engine, (b) compression of that air-fuel mixture, (c) power from the explosion of the compressed air-fuel mixture forcing the piston down, and (d) exhaust where the piston pushes out the burned gases. The first successful American gasoline-powered car was built by the Duryea brothers in 1892-93.

Henry Ford’s Contribution

Prior to Henry Ford’s mass production of the Model T, most consumers of automobiles were from the upper income levels of society. Even before Ford created the Model T, he had

produced eight other versions of cars, most of which were rather expensive. Ford's vision was that Americans needed and wanted an inexpensive and easy-to-maintain reliable form of transportation. The original price of a Model T Ford in 1908 was \$850 (equivalent to over \$21,500 in 2017 dollars), had a 20-horsepower, 4-cylinder engine with top speeds of 45 miles per hour on 13-21 miles per gallon. Later, the Model T sold for \$260 (equivalent to under \$6,600 in 2017 dollars) when mass production met demand². Between October 1908 and May 1927, Ford built and sold 15 million Model T vehicles. More importantly, Ford's contribution was to make the automobile available to most of the American consumers, a dynamic that continues today where most American households own or lease more than one vehicle.

² Ford Motor Company Media Center, retrieved on June 25, 2017 from <https://media.ford.com/content/fordmedia/fna/us/en/news/2013/08/05/model-t-facts.html>

Major Eras of the Industry³

The major eras of the automotive industry are divided into six distinct shifts of automotive vehicle design and consumer adoption.

The *Veteran Era* defines the original inventive time period when technological innovation was focused on the new mode of transportation designed to replace the horse. The Veteran Era officially began in 1888 and lasted until 1904. Most of the focus was on design of the vehicle components and the type of power that would fuel the engine.

The *Brass (USA) or Edwardian (Europe) Era*, 1905-1914 at the beginning of World War I, produced an expansion of models from which consumers could choose. The reference to the Brass Era by Americans was due to the widespread use of brass as a lightweight metal used in the vehicles of that era. Inventions were introduced like the variable-speed transmissions, safety glass, independent suspensions, etc. By the end of this era, there were an estimated 65,000 vehicles on the road. During that same year, there were 7,171 accidents and 168 deaths, 75% of which were pedestrians being struck by cars. In the next decade, the number of fatalities by automobile accident had risen to 170,000.

The *Vintage Era*, the period of time after the first world war until the beginning of the Great Depression (1918-1929), brought more enclosure to vehicles and the addition of the windshield as a protection from the natural elements, which was needed because of the increasing speed provided by automotive vehicles. Inventions included the automatic transmission, disc brakes, rear motors, fuel injection, seat belts, etc.

The *Pre-War (World War II) Era* from 1930 until 1939 provided a focus on style and performance of vehicles. The trunk at the rear of the vehicle for storage became the normal function on cars. By the 1930s, most of the mechanical technology that exists today had been invented. Front-wheel drive was re-introduced as an option to the more standard rear-wheel drive of the times. Fenders were integrated onto the body of the vehicle and the vehicle was fully enclosed.

The *Post-War (World War II) Era* production from 1946 until 1988 was an expansion of options for consumers. Running boards were eliminated. The concept of changing body styles annually became the trend. Foreign imports from Japan and Europe began to compete successfully against the American “Big Three” automotive manufacturers with higher quality and lower priced vehicles than the American brands.

The *Modern Era (1989-current)* provided a focus on adding technology & eco-value to automotive vehicles. In recent years, increasing standardization through computer-aided design has contributed to technological advancements. All-wheel drive has joined front-wheel drive designs, diesel engines, uni-body construction, etc. The designs have expanded from coupes and sedans to hatchbacks, sport utility vehicles, minivans, etc. Fuel efficiency and engine output have recently dominated the design of vehicles. In addition, the higher costs of gasoline and diesel fuels, combined with the desire of a significant portion of the automotive vehicle consumer market to “save the planet”, have produced the re-emergence of electrical propulsion and the introduction of hybrid technology vehicles³.

³ Wikipedia, History of the automobile, retrieved on June 25, 2017 from https://en.wikipedia.org/wiki/History_of_the_automobile

Effect of the Automotive Industry on the U. S. Economy

The key players in the American Automotive Industry consist of the original equipment manufacturers (OEMs), their suppliers of components that are assembled by the OEMs, the dealerships, service shops, parts stores, collision centers, etc. In May 2017, OEMs accounted for 943,700 jobs; motor vehicle and parts dealers accounted for over 2 million jobs; automotive dealerships accounted for over 1.3 million jobs for a total of approximately 4.3 million jobs⁴. Automotive dealerships are one local business franchise model that continues to provide to the local economy. Approximately 15% of all state and local taxes are generated from automotive sales⁵. An average of 47,000 new cars and trucks are sold every day by approximately 18,000 OEM-branded vehicle dealerships in the U.S.

⁴ Retrieved on June 25, 2017 from <https://www.bls.gov/iag/tgs/iagauto.htm>

⁵ NADA, 7 key facts about automotive retail, retrieved on June 25, 2017 from <https://blog.nada.org/2016/12/23/7-key-facts-about-automotive-retail/>

RELATIONSHIP BETWEEN CONSUMERS AND AUTOMOTIVE VEHICLES

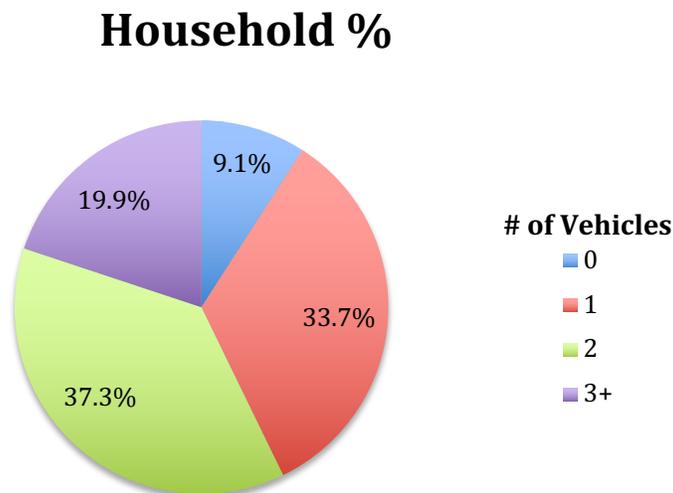
According to the U.S. Department of Transportation, about 88% of individuals 15 or older are reported as drivers. There is an average of 2.1 vehicles per household, 1.2 vehicles per licensed driver. Single-family households average one vehicle, 2-member families average two vehicles, and households with seven or more members average 2.8 vehicles⁶. Households with less than \$25,000 income are almost 9 times more likely than households with incomes greater than \$25,000 to possess no vehicle. Households living in rented residences are almost 6 times more likely than non-renter households to possess no vehicles. Households in urban areas are more than twice as likely as households in rural areas to possess no vehicle. In summary, number of drivers with annual incomes over \$25,000 who own their residences and live in rural areas are the target market segments for automotive dealerships.

⁶ U.S. Transportation Statistics (2001) retrieved on June 25, 2017 from https://www.rita.dot.gov/bts/sites/rita.dot.gov/bts/files/publications/highlights_of_the_2001_national_household_travel_survey/html/section_01.html

Oak Ridge National Laboratory as part of U. S. Dept. of Energy CTA.ORN.L.GOV (2014) Transportation energy data book (collection of spreadsheets) retrieved on June 25, 2017 from <http://cta.ornl.gov/data/chapter8.shtml>

Figure 1 shows the breakdown of household percentage that own vehicles in the United States in 2014.

FIGURE 1: Number of Vehicles per Household



Source: Oak Ridge National Laboratory. (2016) *Transportation energy data book*. 35th Ed. Table 8.1. Retrieved from <http://cta.ornl.gov/data/chapter8.shtml>

There were over 258 million personal vehicles in the U. S. (2014) with 57% being cars or station wagons, 21% being vans or SUVs, and 18% being pickup trucks. Ninety-one percent of American adults use their personal vehicles to commute to work; 5% use public transportation to commute to work regularly. Households with incomes greater than \$100,000 have an average model year of 5-years old while households with incomes less than \$25,000 have an average model year of 10-years old.

Why do American consumers purchase a product that represents the second largest investment in the household budget? Why do they trade vehicles so often? To answer the first question, one could posit that the automobile provides freedom. Rather than rely on someone else's schedule as in mass transportation or even for ride-sharing alternatives like taxicabs or UBER drivers, the individual with the car keys and a tank full of gasoline or a fully charged battery can go where he or she wants to go and when. The fact that there are so many brands, models, colors and styles sold every year suggests that individual preferences of design also matter. Some TV ads for an insurance company suggest that many automobile owners even name their vehicle to suggest an intimate relationship with it.

The answer to the second question of trading often is due in part to the human desire for having new things periodically combined with the gradual deterioration of the automobile components over time requiring replacement of the vehicle someday. Another factor is the easy financing made available through the automotive industry to bring that “someday” closer to reality today. After all, there is no down payment and only so many dollars per day to ride in a new vehicle, even if that vehicle is pre-owned.

Therefore, the question becomes, “Will the current consumer demand for automotive vehicles ever fully decline?” The answer for now appears to be “No” although the form in which the vehicle may be used could change. The next section will provide a brief discussion of the future trends that exist at the time of this publication. Students are encouraged to examine future trends via the Internet at the current time of the class assignments.

FUTURE TRENDS OF THE INDUSTRY

Disruptive Innovation

Disruptive innovation is defined as the process that produces a product or service resulting in new market opportunities and value propositions that displace, to some extent, the existing market opportunities and value propositions. Therefore, the primary question for this section is, “What products or services exist or are being discussed at the time of this publication that could bring disruptive innovation to the automotive industry?” A secondary question would be, “What effect might that disruptive innovation product or service have on dealership sales?”

Autonomous Driving Vehicles

The concept of vehicles driving without the aid of a human being has been envisioned for many years. Until recently, the concept was not feasible because the technology did not exist to facilitate the vision becoming reality. Now with GPS and multiple computers with high-speed processing power onboard many newer vehicle models, various automotive manufacturers (Ford, GM, Honda, Tesla, Apple, Google, etc.) are moving toward not only having prototypes on the

road but also the mass production of autonomous-driving vehicles. Even ride-sharing companies like UBER and Lyft are partnering with OEMs that have declared they will be building these vehicles to obtain a fleet for the ride-sharing companies' needs. The promise of the new technology is higher safety from computers having faster reaction time than humans and able to more accurately predict the behavior of other cars within close proximity of the autonomous-driving vehicle.

One problem with wholesale adoption of the autonomous-driving vehicle will be the degree to which the driving consumers are willing to trust the vehicle keeping them safe. There have already been high-profile deaths in vehicles because the drivers gave over complete control and did not stay engaged in the traffic around them. One driver was allowing his Tesla Model S to autopilot on a Florida highway when he was fatally injured because the sensors did not "see" the white semi-tractor trailer while heading into bright sunlight. Another example was a pedestrian who was killed because the database in the autonomous system was not current about the crosswalk approaching and the pedestrian darted in front of the car in a low-light condition. Today's Tesla autonomous models require the driver to touch the steering wheel periodically to keep the driver engaged in the process.

As previously stated, one potential future application will be for ride sharing services like Uber or Lyft, etc. The attraction to these companies is to substitute having to pay a human driver on commission with paying, in essence, a robot to drive the cars in a supposed safe manner. Much debate is occurring among various governmental agencies concerned with the safety of both the passengers in the autonomous vehicles and those drivers and passengers in nearby vehicles in addition to pedestrians. The other question to be answered is, "What portion of the American automotive vehicle owners actually want to surrender their ability to drive the vehicles as they prefer?" This technological application ultimately may only appeal to a niche market consisting of commuters and ride sharing target market segments.

App-driven Ride Share Services

For many years, public transportation was limited to mass transit (trains, buses, subways, etc.) or to personalized transit for hire in the form of taxicabs or limousines. In 2011, in San Francisco, UBER was launched as an alternative to regulated taxicabs and limousines. Its value proposition was the blending of smartphone apps technology with physical vehicles to connect drivers and passengers. The company business model also removed the need to pay for the ride in cash or even credit card transactions with the driver but rather allowed the UBER members to pay through the app. One of the early complaints from UBER passengers was the inability for them to tip the driver through the app. When Lyft was introduced to the market in the summer of 2012, it included the ability to tip the driver in the app. Both companies offer various levels of service based on the type of vehicle being used (e.g., newer model cars, highline level of cars, etc.).

What remains to be determined is the survival of these newer ride-sharing services given that taxicab companies and local municipalities that derive revenue from regulated cab companies are increasing legal and regulatory pressure on the upstart ride-sharing service companies. In addition, some passengers are claiming that they were sexually harassed or worse by their drivers. The original price points for UBER and Lyft were competitive with taxicab services but lately have become higher priced, especially during surge times when demand for rides exceed supply. The primary selling point that these ride-sharing companies still offer is the convenience of not having to “hail a cab” and hope one will stop for you but rather know that a driver has committed to a ride for the passenger and will arrive shortly. The passenger also has the ability to review the safety and customer service ratings from prior passengers to determine if the passenger wants to accept the driver who has offered to give the ride.

Alternative Fueled Vehicles

Much talk and research have been devoted to manufacturing vehicles that are powered by fuel other than gasoline or diesel. From the historical section, the original vehicles were powered by some of the same sources being developed and used today (e.g., electric, hydrogen, etc.). One of the first transitions from traditional gasoline or diesel-fueled vehicles was hybrids where a

battery was the primary source of power unless acceleration was needed. The result was lower fuel consumption and more miles per gallon performance achieved. The all-electric battery vehicles have experienced mixed results with Tesla being one of the first successful companies to produce an electric car that can provide the equivalent distance on a single charge (about 300 miles) that a gasoline vehicle can provide on a tank of gas. The challenges facing Tesla and other electric vehicle manufacturers are the price tag of the vehicles, the availability of charging stations outside of the home, and the length of time required to recharge the vehicle.

Even with the federal government providing significant subsidies for the purchase of an electric car and income tax incentives, the price of most electric cars today is beyond reach of the majority of the American car-buying public. With the limitations of locations for recharging outside of the home, the current electric cars are being used primarily for transportation near the car owners' residences and workplace, and not used for "road trips" of any significant distance. Even if charging stations were along the "road trip" route, the time it took to fully recharge for another 300 miles would require an overnight stay (about 9.5 hours at 240 volts). Today, "super charging stations" that can give a fast, full recharge in 75 minutes at 480 volts, are being installed in locations around the country.

The newest alternative fuel vehicle in development is the hydrogen (H₂) vehicle. Toyota has been developing the technology for over 20 years and offers the Mirai model⁷. The Mirai vehicles have full speed capabilities as a gasoline-powered vehicle and only require a few minutes to refuel, about the same amount of time as its gasoline-powered alternative. The main problem for the hydrogen vehicles is similar to the electric vehicles (EV) in that there currently are a very limited number of hydrogen refueling stations (36 in the U.S. as of 7/1/2017 with 33 of them in CA and one each in CT, MA, and SC compared with over 16,000 electric charging stations)⁸. The primary exhaust of a hydrogen-powered vehicle is water (H₂O), which is as safe for the environment as the EV, however, unlike the EV, the hydrogen vehicle is not recharged by the electric grid, which often is powered by coal, potentially harmful to the environment.

⁷ Business Insider: 10 Hydrogen-Powered Cars retrieved from <http://www.businessinsider.com/10-hydrogen-powered-cars-photos-2016-10/#1-toyota-has-been-working-on-hydrogen-powered-cars-the-longest-having-put-23-years-into-the-technology-here-we-see-its-hydrogen-car-the-toyota-mirai-1>

⁸ U.S. Dept. of Energy: Alternative Fuels Data Center retrieved from https://www.afdc.energy.gov/fuels/stations_counts.html

The primary competitor to alternative fuels has been and continues to be the gasoline-powered vehicles. With current energy policies of the federal government to increase the amount of domestic oil extraction and thus reduce the importing of oil, the prices of gasoline are relatively low in comparison to recent decades. With the documented abundant supply of oil in the U. S. and around the world and, with the mass availability of gasoline refueling stations throughout the U. S., the risk of running out of gasoline is rare. The key concern by some for using gasoline-powered vehicles is the alleged effects that gasoline exhausts (CO₂) have on the natural environment. Though there is no existing historical scientific evidence of the “greenhouse effect” on the natural environment, many consumers are convinced that using gasoline harms the environment and are making their purchases of automotive vehicles based on those perceptions. Regardless, automotive manufacturers appear to be embracing new sources of power for their future vehicles such that the use of gasoline or diesel to power automobiles may be on a declining slope of adoption for the future.

New International Markets

At the time of this publication, the fastest growing and largest potential market of automotive vehicles is in China. This is due in part because much of the world’s manufacturing capacity in many industries is being produced in China resulting in growing prosperity for both production workers and their managers. The other obvious reason is the number of potential consumers in China with an adult population over 937 million compared with the U. S. adult population over 249 million. In 2014, there were 258 million vehicles in the United States compared with 154 million vehicles in China. Two years later, China vehicles had grown by 40 million compared with U.S. growth of less than 10 million. Because of this potential market size and using the concept of short supply lines, many automobile manufacturers (OEMs) from all of the primary countries of origin (U.S., Germany, Japan, Korea, etc.) are setting up production plants in China, which creates more high-paying jobs and thus more potential Chinese consumers who can afford to purchase the product they make ⁹.

⁹ Statista.com

The top 10 growth markets of 2017 are as follows:

<u>2019 Rank</u>	<u>2018 Rank</u>	<u>Country</u>	<u>Sales \$B</u>	<u>AGR</u>
1	1	China	\$20.37	-9.4%
2	2	United States	\$14.11	-1.3%
3	3	Japan	\$3.66	-1.2%
4	4	Germany	\$3.30	4.7%
5	5	India	\$2.46	-14.0%
6	6	United Kingdom	\$2.36	0.1%
8	7	France	\$2.20	0.2%
7	8	Brazil	\$2.17	7.5%
9	9	Italy	\$1.77	-0.8%
10	10	Canada	\$1.67	-3.7%

Source: Focus2Move. (2020). *Global auto market: The top 100 countries ranking in 2019*. Posted on December 1, 2019 in *World's Top Markets*. Retrieved <http://focus2move.com/world-car-market/>

Note that the only change in position of world ranking from 2018 to 2019 was a swap between France and Brazil. The top 10 countries on this list are the same countries in the 2016-17 list illustrated in the previous edition of this textbook. A notable difference in this current table is sales for all countries are lower except for Brazil, which maintained the same sales revenue levels. The countries listed in the top 10 are exhibiting signs of the Maturity Stage of the Product Life Cycle in market sales growth. For an automotive OEM, the key for discovering where sales opportunities exist would be to search for countries where disposable income is increasing significantly for the general population and where the country offers the infrastructure (roads, refueling stations, etc.) to support the use of automotive vehicles by consumers of those markets. This proposition is based on the assumption that mankind, regardless of culture, has a similar desire to possess an automotive vehicle as citizens of the Top 10 list above.

CHAPTER ASSIGNMENTS⁹:

1. Conduct your own research into the history of the automotive industry and discover what interests you most about the early inventions of the machines.
2. Research about the conflict between horse and mule owners with the early automobile owners. What were the primary motivations for the fast adoption of the automobile in lieu of using animals of burden?
3. Discover the motivation behind Henry Ford's establishment of the assembly line as a means to increase production and eventually lower costs. How has the assembly line changed in recent years?
4. Research various eras of the automotive industry that interest you most. Which one or two eras was/were your favorite and why?
5. What is your observation of the relationship between man and machine when it comes to the automobile? Why does it exist? What are the primary motivators for the relationship?
6. Research the current new concepts of automotive vehicles at the time you are reading this textbook. What are the new concepts? What needs are they fulfilling? How successful do you think they will be in the future? What concepts do you think will come next?
7. What sources of power for automobiles are being developed now at the time you are reading this textbook? Which of these new sources of power do you think will become commercially adopted by the industry and consumers, and why? Which will not, and why not?
8. What new international markets are developing at the time you are reading this textbook? Why have these markets evolved? What form of automobiles are being sold in these new markets and why? What needs are being met there?

⁹ McKinsey & Company, 2016, **Disruptive trends that will transform the auto industry**, retrieved June 25, 2017 from <http://www.mckinsey.com/industries/automotive-and-assembly/our-insights/disruptive-trends-that-will-transform-the-auto-industry>

Brauer, K. (Jan. 19, 2015) **Top 10 advanced car technologies by 2020**, retrieved on June 25, 2017 at <https://www.forbes.com/sites/kbrauer/2015/01/19/top-10-advanced-car-technologies-by-2020/#4e24ab706705>

CHAPTER TWO

CRITICAL SUCCESS FACTORS OF THE AUTOMOTIVE INDUSTRY

When analyzing the automotive industry, one needs to consider the three primary stakeholders involved in the dynamics of the industry: manufacturers (OEMs), dealerships, and customers. From the manufacturer and dealership perspective, many of the success factors are the same: sell more units, sell the units sooner rather than later, sell at a profit that sustains the growth of the enterprise, and provide the quality and excitement around the brand that can result in loyal customers being lifetime customers.

Where differences may occur are in the details of how the automotive vehicle is delivered to market. Manufacturers will want to use the most efficient means to produce the vehicles so that costs can be minimized and the ability to earn profits can be maximized. Manufacturers also need to determine well in advance of a model year what consumers will want in terms of future design, colors, technology, comfort, etc. based on today's market research. How many units need to be produced to satisfy market demands in the future so that excess inventory can be minimized? Manufacturers also want to maintain positive and productive relationships with their franchised dealers to optimize the number of vehicles moving through the distribution channels in favor of their brand over competitive brands. Manufacturers want to learn from the dealerships in the local markets what the customers are saying they want.

Dealerships seek the ideal of long-term relationships with customers. Research has shown that retaining loyal, satisfied and even delighted customers is far less expensive in promotional spending than trying to attract new customers to the dealerships. To be effective in establishing long-term brand loyalty to the dealership requires offering what the customers expect in terms of service quality (doing the job right the first time), meeting appointment deadlines as promised, treating customers with respect, offering value in sales, trades, and service, etc. In addition, dealerships need to realize that they cannot satisfy all consumers' preferences and therefore dealerships need to know which consumer profiles constitute the target market demographic for

the dealership's brand and then seek to maximize the market share of the target market segment over the competition within the target geographical radius of the dealership.

Each customer first seeks a dealership that can offer his or her unique preferences of vehicle by brand, size, color, style, safety requirements, performance, reliability, fuel efficiency, etc. Does the dealership have sufficient inventory of the desired vehicles or the ability to obtain the preferred vehicle within a desire timeframe? Is the dealership eager to make the vehicle purchase affordable and able to complete the sales transaction quickly with the least amount of stress? Is the sales process non-intimidating? Where there are multiple choices of dealerships capable of offering the unique profile of vehicle preferences, customers then seek those dealerships that provide the qualitative aspects like attractive atmosphere, friendly employees, quality performance of the service department, and reputation of the dealership's relationship with other customers. Where all three stakeholder relationships contribute to each other in a significantly positive manner is where one will find a successful dealership.

U.S. DEALER FRANCHISE SYSTEM FUNDAMENTALS

In the United States, a unique business model exists in the sales of new automotive vehicles. This model is the United States Dealer Franchise System. Under this system, only authorized franchise dealers are able to sell a given brand although often multiple brands may be sold on the same dealership lot. The Dealer Franchise System does not apply to pre-owned vehicle sales, only to new vehicle sales. The unique qualities of the pre-owned market will be discussed in a later section of this textbook.

ROLES AND RESPONSIBILITIES OF MANUFACTURERS

In the relationship with dealers, the manufacturers are the dominant participant. Manufacturers ultimately determine which dealerships will receive the inventory of new vehicles from the assembly line. Dealerships order from the OEMs specific volumes of inventory they desire; however, those dealerships that produce the most sales for the OEM will have a better chance to obtain sufficient inventory of vehicles they want. Those dealerships that have historically low sales numbers may not receive all of the vehicle inventory they request. The

relationship is a merit-based system dependent on past sales performance. Often, dealerships are required by the OEMs to take some inventory of less popular models in order to qualify for a larger inventory of the more popular vehicles. After all, if a dealership does not have sufficient inventory on the lot that customers seek, it does not have the opportunity for a sale, and customers may go to one of the competitors, in which case, the losing dealership has no opportunity to develop long-term relationships with that customer in the form of customer service. If the loss of sales continues, it will lead to a downward spiral of lost sales opportunities with fewer inventory units delivered by the OEM to the dealership lot until the fading dealership is forced to close and/or sell the dealership.

The manufacturer has the ultimate decision on which dealership qualifies to be the franchise owner within a specific geographic market area ¹⁰. Occasionally, manufacturers will require franchised dealerships to make capital investments to improve the store appearance with signage, building façade upgrades, showroom upgrades, etc. Franchised dealerships must comply with these mandatory upgrades or risk losing favored relationships with the manufacturers or possibly becoming disenfranchised as an authorized dealer of that specific automotive brand. To offset some of the capital costs to make these facility improvements, OEMs will usually provide some, but not all, financial support to reimburse the costs of renovation.

¹⁰ NADA.org, The value of the dealer franchise system retrieved from <https://www.nada.org/auto-franchising/>

ROLES AND RESPONSIBILITIES OF DEALERSHIPS

What the franchised dealership provides to the OEM is the local relationship with the customer base. OEMs are not involved with service after the sale; that is the role of the dealerships to include routine maintenance and warranty work. Dealerships provide the many tasks of working with customers to determine which vehicle would best meet their needs, taking customers on test drives, and completing all the paperwork required by federal, state and local governmental agencies for each vehicle sale. Manufacturers want to build the vehicle and be paid for it without being responsible for years of maintaining personal relationships with local customers. Dealerships succeed on building those long-term relationships with customers so the

two players (dealerships and manufacturers) have a mutual benefit in each player performing its role exclusively.

Recently, discussion has been circulating about OEMs using a direct delivery system like Carvana whereby consumers locate the vehicle they want through using the Internet, purchase the desired vehicle, fill out all of the documents required to complete the purchase, and have the vehicle delivered to a kiosk designated by the vehicle purchaser. Though this sales model has not been adopted generally by OEMs, one company, Tesla, has implemented such a direct distribution system for its vehicles. The benefit for the OEM would be to leverage brand loyalty of customers directly with the manufacturer and remove potential negative brand image caused by some franchised dealerships that are not performing in a desirable manner. The vehicles would be ordered through the OEM website, the vehicle would be manufactured, and delivered to the franchised dealership lot designated by the customer. The dealership would prepare the vehicle for customer pickup and/or delivery and process the documentation to close the sale. The obvious downside for franchised dealerships is the loss of sales revenue for the vehicle and lost opportunity to establish a stronger bond with the customer to lead to having the vehicle's service maintenance performed at the dealership.

Process for Acquiring a Dealership

There are two scenarios in which a franchised dealership is acquired. The first scenario is when an individual or investment group purchases a dealership from an existing franchise owner. Even in this scenario, the final decision belongs to the brand OEM to accept the new dealership owners. The OEM makes its determination from the information provided by prospective buyers in their respective business plans. When the purchase is from an existing dealership, the purchase price usually will include the value of all assets (real estate, buildings, inventory, etc.) and projected profits for a specific number of years agreed to by both seller and buyer.

The other scenario for purchasing a dealership is called an "open point" dealership opportunity. In this scenario, the OEM desires to place a new dealership in a specific geographical area, usually one that is growing in population of consumers loyal to the OEM

brand. The OEM will notify existing dealerships of its intentions and open the bidding for the right to become that franchised dealership owner in the proposed location. In an open point purchase scenario, the winning bidder will still pay for the total capital asset value of real estate, buildings, inventory, etc. but will not be required to pay for the multiple years of profits required when buying from an existing dealer. Therefore, the price of the “open point” dealership usually is lower than the purchase of an established dealership unless the established dealership owner is desperate enough to walk away from the dealership.

Process for Bringing Automotive Vehicles to Market

The process of building a vehicle and ultimately selling it begins with the OEMs determining many years in advance what future models will look like and what features they will have based on market research conducted in the present time. Typical design time can be as few as five years and as long as eight years prior to the vehicle model being produced for sale to consumers. When the new model year is approaching and pre-orders are being taken by franchised dealerships, manufacturers will inform the dealerships of the functions and features of the new vehicle models to include colors, all available optional equipment packages, and the wholesale price for the dealerships to purchase the vehicles. Dealerships will order in advance from the OEMs the desired quantities of each specific vehicle model and styles per monthly sales cycle. OEMs will then determine how much of each dealership order the OEM will fulfill in that monthly cycle and what other models the OEM may require the dealership to purchase in order to receive the desired quantities of the models ordered. Manufacturers are always requiring dealerships to purchase more vehicles than dealerships usually want to buy, especially among the slow selling models. However, dealerships recognize that, if they do not order sufficient inventory from the OEM, especially if an annual promotional sale on specific high-selling model vehicles is coming soon, the dealerships will not be able to take full advantage of the promotional sale. Knowing when traditional annual promotions occur from OEMs will often determine new-vehicle inventory purchase strategies by dealerships.

A method that a dealership has when accepting inventory that it does not want is to trade vehicle inventory with other dealerships. This method is called *dealer transfers* where vehicles

being unloaded by the OEMs on a particular dealership lot in markets where those vehicles do not sell can be traded with a dealership where sales for that specific vehicle type sells better. If a *dealer transfer* opportunity does not occur, the principle that “every vehicle will sell at some price” is applied even if sold at a loss so that more inventory of what does sell well can be acquired for the next monthly sales cycle. The average profit for the dealership on new domestic and import vehicles is \$200 per car; new truck profits are higher at an average of \$1,400 per truck. Even if the dealership loses profit on the sale of the vehicle to a consumer, *trunk money* incentives from the OEM can still produce a profitable transaction on that new vehicle and continue to promote good relationships with the OEMs for future inventory allocations. *Trunk money* is discussed in the next section of this textbook.

Financial Incentives

To encourage dealerships to buy more vehicle stock, OEMs offer financial incentives called *trunk money*. Trunk money consists of additional funds given by the OEMs directly to dealerships that directly affect the dealerships’ profit line. By comparison, OEMs offer *hood money* that are financial incentives directly given to customers who purchase the new vehicles that are covered by the *hood money* incentives (e.g., special financing terms, rebates, etc.). Dealerships do not receive any financial advantages from *hood money* other than what they make on the actual sale because *hood money* is passed straight through from the OEM to customers.

Examples of *trunk money* would be a check for \$1,000 to offset advertisement costs of the dealership or payment of the projected interest charges for the first 30 days of the dealership’s floor plan financing. Another incentive from OEMs to dealerships for slow-moving vehicle models is for the OEM to offer dealerships a price point reduction for those models – lowering the cost to purchase the model. The dealership can either pass along the lower price to consumers with the anticipation of increasing the opportunity of making a sale sooner or keep some of the additional profits from the sale dependent on the final price paid by the customer.

Many OEMs provide a Stair Step Program to determine how much *trunk money* will be distributed to various dealerships. The criterion of a Stair Step Program is based on how many cars each dealership sold in a given time period. More incentives per vehicles purchased in the current month will apply to the dealerships that sold the higher volume of vehicles in previous months. How a dealership uses that *trunk money* incentive varies – additional cash off the sale price of the vehicle to close the sale, more advertising to entice customers to the dealership lot, more compensation incentives to salespeople, etc.

On the other hand, *hood money* OEM financial incentives given directly to customers who purchase the qualifying vehicles, can include zero-percentage financing, no money down, take an extra \$2,500 off the sticker price, etc. Though dealerships do not benefit directly from these financial incentives to consumers because the money is passed directly from the OEMs through the dealerships to the consumers, dealerships appreciate *hood money* incentives if they contribute to a quicker sale and more of them. Between the two, dealerships prefer *trunk money* because of the direct benefit to the dealership's net profit.

Ordering Process and Payments

When the dealerships order the vehicles and the OEM accepts the order, a dealer code is assigned to each of the vehicles ordered. When the dealer code is entered into the management system at the OEM factory, dealerships will receive a report from the OEM stating which vehicles will be coming to their dealership lot and on approximately what date (usually within the next few weeks). Through a Dealership Management System (DMS), dealerships will be able to track the current status of the incoming vehicle (refer to Chapter 5 for more information on DMS systems). The vehicles are then produced on the OEM assembly line and shipped to the dealerships on or about the expected delivery date.

The OEM is paid within 15 days (draft period or float) after the vehicle dealer code is assigned to the vehicle and by the time the vehicle is completed on the assembly line. The payment is usually handled by the OEM financing company (e.g., GM Financial, American Honda Finance Corporation, etc.). Dealerships pay the OEM finance companies for the vehicles

by *floor planning* agreements with their partner financial institutions (usually local banks). *Floor planning* agreements are basically short-term loans and the financial partners expect to be paid in full within 45 days after financing begins. Interest begins to accrue daily on the first day the vehicle is financed. Many OEMs provide dealerships with some financial assistance through *trunk money* that covers the first 30 days of interest to help offset what is paid to the *floor plan* financial institutions. Therefore, those new vehicles sold by the dealership before payment is required for the *floor plan* financing can net additional profit for the dealership. By the same token, the total value of vehicles not sold by the 45-day payoff deadline of the *floor plan* financing must be absorbed by the dealership through other means of internal financing because the floor plan will be paid in full to the financial institution to avoid being in default.

Supply Logistics

When the new vehicle exits the assembly line, it is placed on either an open or closed truck carrier (closed being costlier and used often for more expensive vehicles) in route to the dealership lot. When the new vehicle arrives at the dealership lot, a dealership employee will inspect the vehicle and either accept it as ordered or document any noted concerns to the dealership management who will notify the OEM of the exceptions. If accepted without exceptions, the new vehicle is then prepared for sale by the dealership service department, an entry is made within the Dealership Management System (DMS) adding the vehicle to the existing dealership inventory. Photos are taken of the new vehicle to be entered into the dealership inventory on its website, and the new vehicle is physically placed on the dealership lot for sale.

Vehicle Categories

Automobiles are divided into four distinctive categories with each having its own characteristics in terms of relationships with the manufacturers and with the types of consumers who purchase vehicles within each category. The four categories are Highline, Domestic, Import, and Exotic. Each of the categories will be discussed separately.

Highline

Highline vehicles include BMW, Mercedes, Audi, Lexus, Infiniti, Volvo, Acura, Land Rover, Porsche, Jaguar, etc. Highline buyers purchase these vehicles as much for the experience of driving them as serving as a basic means of transportation. The most effective marketing strategies to Highline consumers are based on word-of-mouth among satisfied owners than by any other means. The main retention factor of Highline owners for a dealership is the Service Department even more than with other vehicle categories because Highline vehicle owners want to protect their investment with OEM certified technicians rather than trust the vehicle maintenance to independent garages. A trait of most Highline dealerships is the requirement by most Highline OEMs of franchised dealerships to provide an inventory of recent model-year loaner vehicles for customers to use while their Highline vehicle is being repaired.

Another important aspect for the Highline dealership is the OEM-required atmosphere in the showroom and on the dealer lot. The atmosphere must take into account lack of clutter, the right genre of music playing over the sound system in the dealership showroom and on the lot, and even the aromas emitted in order to meet the sophisticated expectations of discerning Highline vehicle owners. Most OEMs in the Highline category offer few variations of basic vehicle models and accessory options compared with other vehicle categories because most Highline vehicles come with most accessory options already installed. The primary decisions for the dealership to make in purchasing Highline vehicle inventory are how many of the various models and colors to order.

Domestic

The brands of the Domestic category are the basic Big Three from the United States: Fiat Chrysler Automobiles (FCA), Ford, and General Motors. One characteristic that is unique with Domestic OEMs when compared with Imports is Domestic's more "free flow" of options available when ordering new vehicles. Most imports have basic models with a few optional packages like the Highline category of vehicles, but Domestic OEMs provide many varying accessories and packages. This creates a challenge for Domestic-brand dealerships in inventory

control. Think of the process of managing Domestic vehicle inventory with all of the variable components that consumers may want on the vehicle. The inventory choices become wide but not deep and the requirement to locate the precise combination of vehicle model, color, and features desired by the prospective customer from other dealerships' inventories is increased. Though the complexities involved in managing Domestic vehicle inventory can be challenging, the primary advantage of Domestic category dealerships is serving the market segment who prefer "Made in the USA" products and thus are extremely brand loyal. More discussion is provided below on how the lines are blurring on what actually does determine Domestic vs. Import vehicles these days.

Import

The Import brands are many and come from countries of origin across the globe (Japan, Germany, South Korea, Italy, etc.). In the new global economy, American-branded cars are being assembled in China and Japanese-branded cars are being assembled in Kentucky. For example, Toyota builds most of its models in the United States. Kia splits 60% / 40% on where the cars are built to include in Mexico. The primary distinction that determines whether the vehicle is considered Domestic or Import is the location of the OEM corporate office. One of the major reasons for these assembly plant relocations to international locations is that automotive manufacturers want to build the vehicles close to the market in which they are sold. This strategy provides for short supply lines of finished vehicles to dealership lots within the targeted market. In a similar way, supply vendors that produce the components assembled by the automotive OEM usually have their manufacturing plants within a short drive to the assembly plant so that multiple shipments could be made to the assembly plant within one production day (Just-in-Time Inventory concept).

Going with a true import to international market strategy by an automotive OEM has significant challenges. For example, variations in currency exchange rates make it difficult for establishing competitive prices and net profits. Variables in the home economy and distant market economy may have a significant impact on affordability of vehicles and thus sales and production of those vehicles. Natural disasters like the tsunami in Japan affected supply channels

for the pigment used in the red paint of some vehicles and the rear entertainment center components coming from one source in the afflicted area of Japan. The Japanese tsunami supply channel disruption issue caused significant delays in providing finished new vehicles to the U.S. marketplace for a considerable time period. Since that situation occurred, the Japanese automotive company has built manufacturing plants in multiple diverse locations to source the components and remove the single point of failure in the supply chain.

The concept that American automobile consumers will only “buy American” is not as strong today as it was in the past. This has resulted in part because the quality of vehicles produced today vary little between brands. This was not the case back in the 1970s when imported cars were produced with much better quality and at more affordable rates than domestic vehicles. Although most new vehicles have consistent performance standards, some Americans still prefer to buy a Japanese car with a “J” in front of the Vehicle Identification Number (VIN) because they know that car was built in Japan by robots vs. in the United States with a combination of robots and human labor. Some consumers perceive that robots build a better-quality vehicle than when the human laborer is involved in the assembly process. An interesting fact is that the robotic assembly lines in Japan run without the overhead lights on because robots do not need to “see” what they are doing. In addition, the cost of the vehicles produced in Japanese manufacturing plants can be lowered by less electricity in the plants and by less labor costs from robots over human labor costs.

Exotic

The final category of automotive vehicle is the Exotic group. These vehicles are purchased by the “Top 1%” income bracket consumers who are buying or leasing the vehicles more for “eye candy” or “garage art” than to be a functional everyday driving machine. Brands included in the Exotic category are Ferrari, Lamborghini, Maserati, Bugatti, Rolls Royce, and Bentley. There are even Exotic models from within Domestic or Import category brands such as Acura NSX (\$200K-\$250K) and Ford GT. The purpose of Domestic or Import OEMs having an exotic model within their brand’s product line is to improve the image of the non-exotic vehicles within the brand product line and thus increase more sales of the standard brand models.

One of the criteria for determining whether or not a vehicle brand is Exotic, beyond the price tag of greater than \$200,000, is the limited production of those vehicles. For example, Ferrari only produces 2,500 cars per year for the United States market, one of the top consumer markets in the world. Another criterion is the horsepower placed in the engines of these vehicles and some components within the vehicle being custom built by hand. For example, a La Ferrari is worth \$1.5 million with a requirement for a third of the retail price as a down payment from the prospective purchaser before the first part is assembled on the purchased vehicle. The purchaser must travel to Italy with the second installment of \$500,000 to be fitted for the driver's seat that will be built to the desired shape of the customer. The final half million dollars is due upon delivery of the vehicle.

Those who obtain the more expensive Exotic brands usually lease them vs. purchase them because the owners are required to drive the vehicle less than 5,000 miles per year or pay a penalty of \$1-\$5 per mile of overage. These leases are close ended, meaning that the vehicle will be returned to the franchised dealership from which the vehicle was originally leased. The vehicle cannot be sold or leased to another party by the owner. The expectation of the Exotic vehicle customer is that he or she is leasing an investment that should retain value and provide the driver a sporty ride that is admired by his or her social circle during the time of the lease. Though devaluation of Exotic vehicles is rare, it can occur as evidenced by the recession of 2008-2009 when some Exotic vehicle investors lost half of the value of the vehicle when trying to unload it from their monthly payment budget.

For those consumers who want to possess one of the more expensive vehicle brands available on the market, the wait time could be up to four years before taking possession. Dealerships for Exotic brands are limited in number and strategically located near population centers where wealthy individuals live who have shown interest in possessing Exotic vehicles and along major highways near those designated population centers. The highway location is primarily to advertise the brand and to "tempt" others to drop by the showroom to just look at and dream about one day having one of the Exotic brand vehicles.

The primary target market customers of Exotic vehicles are in the Top 1% financial brackets, often of celebrity status – athletes, performers, etc. Word of mouth about the way in which these celebrities and wealthy were treated at the dealership is the predominant method of marketing the Exotic dealership. Often, these clients will travel across the United States from one coast to the other to purchase or lease from a dealership with whom they have a solid relationship. These customers share their positive experiences within their social circle while visiting the same islands or clubs around the world. It is not unusual for an Exotic dealership to receive a call from a new customer based on what that person heard in recent conversations with a longtime satisfied customer. Other forms of promotion to reach the primary target market segment include advertising in car enthusiast magazines and through sponsoring events at the local country club where a club member just sold his or her company. Exotic customers are looking for dealerships vs. the dealerships reaching out to them so the primary marketing strategy is to be where the buyers are looking.

The decision to place the Exotic dealership along a major highway near a populous wealthy area is designed to attract a secondary target market segment who are not among the Top 1% but maybe the Top 5% or 10% with disposable income who cannot afford the more expensive models. By positioning the Exotic dealership where it can be seen from the major highway, families often stop by on their way to their vacation destinations. One Exotic dealership general manager stated that, during the summer months, pre-teen and teen children traveling with their parents are one of the largest magnets to his dealership lot just to see and touch a Ferrari, for example. The sales strategy for this secondary target market segment is to “sell down” to a less expensive pre-owned model that the visitor might be able to afford with the anticipation of someday being able to afford the more expensive models – this is using the *power of aspiration* from the science of Consumer Behavior. In the meantime, the Exotic dealership has started a relationship with a new customer of the pre-owned vehicle that hopefully will last a lifetime.

For Exotic dealerships, *trunk money* is not provided by the OEMs as is done in the other three automotive vehicle categories because the demand for the vehicles is high already and the supply is purposively controlled to be lower. If the demand were to decline, for example, due to

economic conditions, Exotic OEMs would not lower prices but rather would lower production to maintain high value of their vehicles. The purpose of this production strategy is to maintain the investment levels of the OEM's and of the franchised Exotic dealership's existing valued customers. Another key difference with Exotic vehicle dealerships is that, unlike Highline dealerships, no loaner Exotic vehicles are provided. When the Exotic vehicle needs to be repaired, a car carrier is dispatched to the location of the vehicle and transported to the dealership at no additional cost and then returned to the location after the repairs are made. In this way, no mileage is added to the vehicle, which preserves the value of the lease contract in terms of annual mileage put on the vehicle.

Another key difference with Exotic vehicle dealerships is the mindset of the sales force. Rather than selling four vehicles in a typical day at a Domestic or Import lot, an Exotic salesperson may sell one vehicle in four months. This sales environment requires a different skill set and expectations of the salesperson. Regardless of the fewer number of potential sales closures, the Exotic salesperson still needs to meet and greet visitors on the Exotic dealership lot, to follow up on past clients, and to work the sales opportunity window when it is presented. The purpose of customer encounters remains the same in all categories, build relationships for a lifetime, especially with the primary target market segment of Top 1% individuals of an Exotic vehicle dealership.

Third Party Vendors

The final topic of this chapter deals with 3rd Party Vendors, those suppliers of goods and services to dealerships and ultimately the dealership's customers. In this section, two 3rd party vendor categories will be presented: (a) after-market products and services for sale to customers and (b) dealership management systems (DMS) used by dealerships to track status of various operational components. The after-market products can be offered by a 3rd party vendor or provided by an in-house Strategic Business Unit of the dealership. There is an historical economic model that suggests it makes more financial sense to use an in-house SBU when a dealership group has 8 or more locations. That is because the larger dealership groups can produce sufficient revenues above costs to be profitable. Smaller dealership groups would be

better served to outsource after-market products and service to 3rd party vendors. Approximately half of all dealerships use in-house resources and the other half use 3rd party after-market providers. The example of an in-house provider of after-market products used in this chapter is the Hendrick Automotive Group whose SBU for after-market products is called *AutoGuard*.

After-Market Products

The *AutoGuard* program includes protections like (a) extended repair service contracts, (b) roadside service, (c) oil change programs, (d) tire and wheel repair or replace programs, (e) car care system that applies a paint seal on the vehicle, (f) paint and dent repair, (g) excess wear and tear on leased vehicles, etc. In essence, *AutoGuard* is an insurance company that sells policies and pays out on those policies when the circumstances covered by the policies for a customer's vehicle are required. The primary purpose of the after-market products or services is to encourage customers to return to the dealership for their maintenance and repair needs vs. having their services performed by competitive private service shops. The statistics show that over 80% of customers serviced by a dealership will buy another car from that same dealership because of the relationship of trust that has been established through the service relationship.

Prices for the *Autoguard* products can be negotiated at the time of the sale of the vehicle except in states like Florida where regulations require dealerships to charge the same price to all customers. The goal for the dealership is not to make a high profit on these products but rather to retain customer loyalty. With the *AutoGuard* program, an average of 1.4 after-market products are sold per vehicle with some wide variance on which products depending upon the type of vehicle being sold or leased.

One of the benefits to the dealership for selling these insurance-like services is that the dealership collects the money paid for the services at the time of sale of the vehicle and pays out any claims in future years. With the cash on hand between the time of purchase and the time a claim is paid, the dealership can use that cash to fund capital growth programs like upgrading the appearance of a showroom facility or even purchase a new dealership without being required to

finance those programs through loans outside of the dealership organization. In essence, the *AutoGuard*-like organizations can serve as an in-house financial institution.

The key to a successful after-market product organization is managing the “loss ratios”. The loss ratio is the net payout of claims from each after-market product/service policy. For example, if the customer paid \$1,000 for the policy and a total of \$600 was paid in claims, the loss ratio would be 60% and the profit margin would be 40%. The best loss ratio in the automotive industry occurs with Import-brand vehicles (30%-40%) because of fewer claims for repairs based on an average better reliability of Imports over Domestic. Domestic-brand vehicles usually experience a 60%-70% loss ratio and are in the middle of the loss ratio range of vehicles.

The worst loss ratio occurs with Highline-brand vehicles because of the high cost of parts and labor to repair and maintain those vehicles in addition to funding the loaner vehicle fleet that is standard in the Highline category market. The key factor to remember in all vehicle categories, and especially the Highline vehicle category, is having the customer back on the lot for service maintenance of his or her current vehicle. This service department encounter provides another opportunity for the sales department to discuss the possibility of upgrading the customer’s current vehicle into either a new vehicle or a newer pre-owned vehicle in a non-confrontational environment. The customer came to the dealership lot, not to purchase a vehicle, but to maintain or repair his or her existing vehicle so the customer has less resistance to discussing with the salesperson the possibility of upgrading his or her ride, especially if the customer is facing significant costs in repairing the existing vehicle.

Dealership Management Systems (DMS) Vendors

In this section, dealership management systems (DMS) will be mentioned and defined. In Chapter 5, more details will be provided about how the system works and its contribution to the overall operations of the dealership. The departments within a dealership that connect to the DMS are Finance, Human Resources, Inventory Control, Service Department, Parts Department, and Sales Department. The primary functions of the DMS are to manage all aspects of the vehicle inventories (both new and pre-owned), parts inventories, sales and service transactions to

include compensation, and the financial reports generated from the activities being reported in the system. There are two primary vendors of DMS products in the automotive industry: Reynolds & Reynolds (R&R) and CDK (formerly ADP).

R&R offers DMS programs like *XtreamService*, a database-mining tool that pulls client information to look for clients that might qualify for a vehicle upgrade and *Elite*, a customer relationship tool. With the *XtreamService* DMS program tool, a Sales Manager who has an overabundance of new vehicle inventory needing to be sold by the end of the current month to meet OEM quotas can determine which of the dealership customers own vehicles that are needed in the dealership's pre-owned vehicle inventory. The Sales Manager would input a set of parameters into the *XtreamService* program based on pre-owned vehicles that sell well in the local market. The *XtreamService* program can then locate dealership clients who have those vehicles and the Sales Manager can offer those target clients a special deal for trading in their current vehicle for one of the overstocked new vehicles on the lot.

The *XtreamService* program can run an amortization report to determine the current payout of the client's vehicle and the amount of the estimated monthly payments for the new vehicle. The final report will include all dealership clients who own the needed vehicle. In communicating with the target clients, the Sales Manager and/or sales personnel can set up the financial arrangements necessary to close the deal for the client before the client visits the dealership lot. The capability of the *XtreamService* program allows for the Sales Manager to focus his or her efforts on those sales opportunities with the highest probability of closure vs. wasting time on situations that probably would not produce a likely sales opportunity and, at the same time, potentially avoid irritating dealership clients not in a good position to make a deal.

The CRM Tool provided by R&R, *Elead*, uses an application called *Xchange* that monitors dealership clients who are scheduled for routine maintenance or repairs in the Service Department. The program will identify any of those target clients who are in an equity position whereby what they owe on their current vehicle is less than what the car is worth in the market. Clients in positive equity positions have the opportunity to rollover the equity of their current

vehicle into a purchase of a new vehicle whereby the potential exists that payments may be about the same per month for the new vehicle as for the current vehicle.

Customers tend to be less stressed when visiting the dealership lot for a service appointment than they might be when visiting the lot to purchase a new vehicle. The system alerts the sales representative when a service order is opened in the dealership service drive for one of the clients identified by the CRM system as being a positive-equity client. The sales representative can approach the customer with the proposal while the customer is waiting for the service on his or her current vehicle to be completed. In addition to R&R's *Elead CRM* program, other CRM programs exist like "VinSolutions" that offers tailored marketing campaign messages directed at clients who currently are not doing business with the dealership. *Dealertrack* or *RouteOne* credit application tools can provide cooperating financial institutions with the information needed to set up a financing deal for a potential customer prior to the salesperson offering the proposal to him or her.

Another category of 3rd-party DMS programs focus on Inventory Management solutions of pre-owned vehicles resulting from sales of new vehicles. V-Auto, at the time of this publication, is the market leader (40%) of inventory management solutions. In addition, First Look and Max Digital Systems each have approximately 20% market share. These inventory management programs provide book values by Vehicle Identification Number (VIN) with much more details and are available electronically in real time. Information provided from the system include (a) recent auction values, (b) market pricing at retail, (c) Department of Motor Vehicle (DMV) values of popular models selling within a region, (d) past price points and the time it took the dealership to sell similar models in the past, etc. In addition, the dealership can use these 3rd-party inventory management solutions to determine where there are gaps in its pre-owned vehicle inventory that could result in missed sales opportunities and where to locate the pre-owned vehicles that could fill those gaps. Using these inventory management tools can improve speed of sales, inventory turns, and ultimately profitability for a dealership.

20-Group Network

Technically, 20 Group is not a 3rd party vendor of dealerships but rather is an external networking of dealership management teams to discuss best practices for their brand of vehicles. The goal of a 20-Group Network is to improve the performance quality of the OEM brand in the overall industry and market space. There are 120 such focus group networks located within the United States that are specific to OEM brands that do not compete in the same markets as the other members of the same 20 Group. Periodically during the year, 20-Group Network dealership members will meet for 12 hours to discuss best practices they have discovered that have led to more profitable sales for their dealerships. The OEMs sponsor these groups with the goal of increasing sales of the vehicles the OEMs manufacture.

CHAPTER ASSIGNMENTS:

1. Describe the critical success factors (CSF) from the perspective of automotive OEMs. Automotive dealerships. Automotive customers.
2. Describe the primary roles and responsibilities of the OEMs in relationship with the automotive dealerships.
3. Describe the primary roles and responsibilities of the automotive dealerships in relationship with the OEMs.
4. Describe the unique characteristics of Highline vehicles? Domestic vehicles? Import vehicles? Exotic vehicles?
5. Describe the purpose of after-market products provided by the automotive dealerships and/or 3rd Party Vendors. Why do customers purchase them?
6. Describe the benefits to the automotive dealerships for selling after-market products to their customers.
7. Describe the purpose and functions of a Dealership Management System (DMS).
8. Describe the purpose and benefits of a 20-Group Network of automotive dealerships. What does the existence of such groups tell you about the nature of the competitive environment among automotive dealerships?

CHAPTER THREE

VARIABLE OPERATIONS

FUNDAMENTALS OF VARIABLE OPERATIONS

There are three primary divisions of the standard automotive dealership that are covered in this textbook: Variable Operations, Fixed Operations, and Administrative Operations. The Variable Operations Departments consist primarily of New and Pre-owned vehicle sales in addition to the Finance & Insurance (F&I) department associated with each vehicle sale. The Fixed Operations Departments consist primarily of Service, Parts, and Collision Centers. Within the Administrative Operations are Accounting and Finance departments. A support group called the Business Development Center (BDC) covers both Variable and Fixed Operations in the areas of Sales and Service appointments with customers and will be discussed in a later chapter. This chapter is devoted to Variable Operations.

The term *variable* has been applied to sales because the success of the sales departments will vary from month to month compared with the rather steady or fixed level of appointments associated with service, parts, and collision center departments. In other words, the decision of consumers to purchase a new or pre-owned vehicle can be postponed resulting in variable flows of customer business. Maintaining one's current vehicle usually requires regular visits to the Service Department to protect the reliability of the investment resulting in more fixed number of visits to the dealership per year. Organizationally, the Finance & Insurance (F&I) Department is connected to Variable Operations because of the relationship it has to each sales transaction. However, in this textbook, F&I will be covered in Chapter 5, Administrative Operations. The discussion in this chapter will focus on New Vehicle Sales, Pre-Owned Vehicle Sales, and Business Development Center operations related to sales.

NEW VEHICLE SALES

As stated in Chapter 2 of this textbook, there is a unique franchise relationship between Original Equipment Manufacturers (OEMs) and the dealerships that sell the branded new

vehicles. Purchasers of new automotive vehicles must purchase from a franchised dealership of that desired brand and nowhere else. A dealership cannot just choose to order any automotive brand it wants to sell; it must apply to the OEM and be approved to sell its brand of vehicles with specific requirements established by the OEM by which the dealership must comply. Some of the requirements would be the appearance of the dealership buildings, site location approved by the OEM to include appropriate distance from other OEM dealerships, minimum number of service bays, etc.

From the customer's perspective, there is a debate emerging about why have a dealership in between the relationship of the OEMs and the customers. In fact, Tesla is one example of an OEM establishing its own dealership outlets except in states where laws prevent OEMs selling directly to customers. The benefits of having the franchise dealership system generally are viewed by both OEMs and dealerships as mutually beneficial. OEMs do not want to be bothered with purchasing real estate, investing in local storefronts, hiring employees to sell and service the vehicles, etc. OEMs would prefer designing and building vehicles and let the dealerships handle the local relationships. By the same token, dealerships do not want to be in the business of designing and building vehicles; they want to sell and service the vehicles through relationships with local customers.

The potential fracturing of the automotive dealership franchise system could occur if OEMs were allowed to deliver directly to customers through a 3rd party like Carvana that currently sells pre-owned vehicles only and delivers them to a car kiosk for customers to take possession. The movement toward more consumers performing their vehicle search on the Internet is causing the traditional OEM franchise dealership model to be re-examined. In the future, it is conceivable that OEMs could sell directly to consumers through the Internet and set up delivery of the vehicle to a local dealership that is conveniently located to the customer. This trend will be interesting to follow, and one would expect the dealerships to resist any efforts to change the current traditional franchise model.

Within the automotive sales cycle, the goal is to turn over new vehicle inventory at least 12 times per year. This is an aggressive inventory turn model when compared with other

industries. For example, in clothing apparel, a good inventory turn might be 4-6 turns per year. The automotive industry is uniquely focused on each month with its own distinctive sales cycle. Most automotive sales (35-40%) occur within the last week of the month because both OEM and dealership-sponsored advertising is increased during that timeframe to encourage potential buyers to visit a dealership lot. The myth among many customers is that new vehicles carry higher profit margins for the dealership than pre-owned vehicles, however the opposite is true. The average profit over cost per domestic and import new vehicle sale is only a few hundred dollars. Highline vehicles have higher profit margins and Exotic vehicles carry the highest profit margins in the new vehicle sales category. This profit margin from the sale to the customer does not include any *trunk money* received from the OEM for various incentives. The primary reason for dealerships being willing to accept low margins on the sale of new vehicles is to establish or maintain the long-term relationship with the customer through the service department and the parts needed for maintenance and repairs. Service and Parts sales are the most profitable SBUs in an automotive dealership.

Profitable dealerships are those that maintain high volumes of new vehicle sales even at reduced profit margins per new vehicle sale. Low-volume dealers eventually go out of business because they are unable to maintain sufficient quantities of desirable new-vehicle inventory from the OEM. The goals of the dealership with a new vehicle sale are varied:

- (a) To establish a long-term relationship with the customer through the Service Department,
- (b) To obtain profit from the customer on their trade-in,
- (c) To obtain financial incentives (*trunk money*) from the OEM, and
- (d) To maintain a good relationship with the OEM to receive favorable consideration in future inventory acquisitions.

With any vehicle brand, there are popular models and less popular models. One of the requirements of OEMs to dealerships is that the franchised dealerships must take a certain portion of less popular models to be eligible to purchase the more popular ones. A dealership in good relationship with its OEM can be in a better position competitively because the dealership has more of the popular vehicle inventory to sell than its competitors. The goal of the franchised new vehicle dealership is to avoid the downward spiral effect of selling fewer and fewer of

popular vehicle inventory until sales revenues do not support the overhead costs of running the dealership.

Part of the costs of running a dealership is how sales personnel are compensated. Most dealerships compensate based on a specific commission percentage rate for each vehicle sold. This method makes sense to most individuals who are in the sales profession and is easy to calculate for everyone involved. However, each compensation system has its positive and negative influences. While an easy to calculate system that rewards the top performers can lead to a positive result, the negative outcome could be the competitive war among salespeople to capture the most sales or a salesperson trying to sell the most expensive vehicle when the customer is not interested. In these situations, customers of the dealership may leave under the pressure and not return to the dealership. There is an adage that states, "One tends to get what one inspects and not what one expects."

An alternative compensation strategy used by some dealerships compensates sales personnel based on number of vehicle units sold regardless of the price tag of the vehicle. Though this might result in lower dealership margins on some vehicles, the concept is that the commissions will balance as an average amount in the long term. Using the unit sales commission system encourages sales personnel to attempt to sell the most units and thus align more with the dealership goal of maximum inventory turnover to be eligible next month to purchase more inventory from the OEM. To offset the competitive war scenario, many dealerships have a system of rotation so that every salesperson has the opportunity to interact with a customer. The exception might be when a salesperson already has an established relationship with one customer. Even then, the rotational system would adjust to ensure that all sales personnel have an equal opportunity to sell.

Supply chain of new vehicles.

Manufacturers use a seasonally adjusted annual rate (SAAR) forecast to determine how many vehicles to produce on a national scale, and dealerships use the same forecast data to determine how many vehicles to order from the OEM on a local scale. The SAAR forecast follows the

calendar year from January to December vs. using a brand model year of the OEM. Thus, comparisons of sales are made with the same time of year from previous years. The SAAR forecast is adjusted based on the following criteria: (a) state of the economy, (b) trends in household disposable income, (c) household budget categories in which consumers are spending their disposable income, (d) age of the automotive vehicles currently owned by consumers, and (e) estimates of when the aging inventory will be replaced.

Dealerships usually place their orders for new vehicles from the OEMs 6-8 weeks prior to the vehicle being ready to ship to the dealership depending on the unique delivery performance of each OEM brand. Manufacturers sell the vehicles at the same wholesale price to all dealerships regardless of level of relationship with dealers in an effort to avoid collusion, which is illegal. However, the number of units available to be ordered by the dealership will vary depending on the dealership's historical sales performance. Typically, a vehicle is not produced by the OEM until it has been ordered by a dealership except when the OEMs are in the *build out time* (usually in the spring of the calendar year) near the end of the model year so that OEMs can begin retooling for the next year's model. During the *build out time*, manufacturers pressure dealerships to take extra inventory on their lots to reduce the need to store the inventory on OEM lots.

As stated previously in this textbook, the dynamics of how dealerships order varies by vehicle category. For Highline and Import brands, the dealerships receive what they request in basic model packages and colors. For Domestic brands, there are many free flow items (variables) to be ordered with each basic model. Variables can include entertainment systems, navigation systems, performance packages, etc. With the variety of Domestic brand options, it can be more difficult for a dealership to locate the precise vehicle that today's information-savvy customer wants than it would be with Highline and Import brands. When a dealership does not have a specific model that a customer is requesting on the lot or on order from the OEM, one option for the dealership is to obtain the requested vehicle from a nearby dealership that does have that specific model with the requested color and packages. The transaction between dealerships is a swap of inventory called a *dealer transfer*.

Dealerships will be notified by the OEMs of the expected arrival date of vehicles that have been ordered, usually within days of the finished vehicle rolling off the assembly line. However, for vehicles produced outside of the United States, the delivery time could take up to 5-6 weeks after rolling off the assembly line to arrive at the dealership lot. The pending arrival of the vehicle by VIN will be entered into the local dealership management system (DMS) from the information provided by the OEM. Time between dealership orders and vehicle arrivals can be longer in the fall than in the spring seasons because of the factory *build out time* in the spring when the OEM has existing inventory on its lots. After the vehicle rolls off the assembly line, it is placed usually in an open carrier for delivery to the dealership lot. Closed carriers can be requested by the dealership, but this option is usually reserved for the higher value vehicles to protect them from potential damage in transit. Closed carriers are significantly more expensive in transportation costs than open carriers.

When the vehicles arrive by carrier to the dealership lot, a dealership employee will walk to the back of the lot where the newly arrived vehicles are sitting and inspect them for any damages in transit. The dealership employee usually is a designated *lot valet* or an *unemployed salesperson* – meaning one who is not currently working with a customer – or a service technician. If everything appears to be in order, the receiving employee will sign for the vehicle and the dealership now owns it. Some multi-location or *mega* dealerships use a centralized facility to receive all new vehicles for their multiple dealership lots. These centralized facilities are called regional Pre-Delivery Inspection (PDI) Centers. Typical duties of PDI Center employees are to (a) check fluids and brakes, (b) reconnect the battery cables that were disconnected in transit, (c) put 3-5 gallons of gasoline in the vehicle, (d) drive the vehicle to the assigned dealership lot to determine if there are any issues with the vehicle, and (e) clean the vehicle for display. OEMs typically provide *trunk money* to compensate dealerships for these duties.

In the DMS, a local dealership stock number is assigned, photos are taken from various angles of the exterior and the interior of each vehicle, the vehicle information is made available to internal employees through the DMS and externally to customers through the dealership's

virtual lots on its website. When the vehicle is sold and a customer takes delivery of it, the term used by dealerships is that vehicle is now *over the curb*.

In today's market, the advantages perceived by customers for purchasing new vehicles vs. pre-owned vehicles include (a) obtaining the new technology both in driving performance and interior functions of Internet-based services, (b) more favorable financing rates, (c) better safety features, (d) more fuel efficiencies, (e) use of hybrid fuels to "save the planet", and (f) the purchaser remaining stylish. The advantage of consumers purchasing pre-owned vehicles over new ones primarily involves affordability. The perceived disadvantage of purchasing pre-owned vehicles primarily involves concerns about the dependability of the vehicle based on how it was treated by former owners. Dealerships offer an answer to that concern through a program for Certified Pre-Owned (CPO) vehicles. With a CPO vehicle, customers do not sacrifice the security of their investment or peace of mind in terms of dependability because the vehicle comes with a warranty from the OEM. Another distinction between new and pre-owned vehicle purchases is that, with new vehicle sales, the variables are limited to the features of the vehicle itself. With pre-owned vehicle sales, in addition to the features of the vehicle, the purchaser needs to consider variables like the vehicle's mileage, age, service record, state of reconditioning, etc.

PRE-OWNED VEHICLE SALES

In the world of automotive sales, pre-owned vehicle sales occur far more often than new vehicle sales. In 2016, new vehicle sales were at 17.9 million units valued at \$112.54 billion (IBISWorld, 2017) compared with pre-owned sales at 38.5 million units valued at approximately \$738.7 billion (Edmunds, 2017). Of pre-owned sales, the majority (63%) are private sales between individuals vs. involving a business selling the vehicle. This ratio of pre-owned sales being dominant over new-vehicle sales is expected to continue into the future especially when considering the economic dynamic of college students having to overcome significant college debt before attaining a sense of affordability in a new vehicle. Current college students at the time of this publication are part of the Millennial Generation reported to have more than 83

million future automotive vehicle purchasers in the early stages of life, meaning multiple vehicles owned during their lifetime.

The choices that customers have when locating a pre-owned vehicle to purchase are (a) private sale between two individuals, (b) a franchise dealership's pre-owned vehicle lot, and (c) independent used car companies like CarMax (the market leader in pre-owned vehicle sales). Another pre-owned vehicle sales outlet is AutoTrader.com, an electronic mall, similar to Amazon.com but used by franchised dealerships and independent dealerships to promote the vehicles they have in inventory. Most pre-owned sales today are through a dealership vs. a private sale between individuals that occur on dirt lots, front yards, with friends and family members, and on Craigslist.org. Each pre-owned vehicle sales channel has its own strengths and weaknesses. Private sales tend to offer the better price points for vehicles through haggling of prices but present the greater risk of investment because vehicles sold in private sales rarely have any extended warranty protections. Both independent and franchise pre-owned sales companies offer Certified Pre-Owned vehicles and non-CPO vehicles that are late model vehicles.

Being a CPO vehicle indicates that it has been through many computer tests to ensure that the vehicle is eligible for an extended maintenance coverage in terms of months and mileage beyond any remaining original manufacturer's warranty. The number of months and mileage included in the extended warranty will vary by OEM brand. It is important to note the terminology here. Only OEMs offer *warranties* on vehicles and they cannot charge separate fees for extending the original *warranties*. Dealerships offer *Extended Service Agreements* (ESAs) that provide additional coverage beyond warranties for a separate fee on new vehicle sales and as part of the retail price on CPO vehicles. Most CPO vehicles will have a good CarFax record of no accidents or weather-related damage. Usually, CPO vehicles will have a set of new tires where non-CPO vehicles' tires are required only to meet the minimum tread standards of the state in which the vehicle was purchased. On average, a CPO vehicle's value is \$200 to \$2,500 over a similar vehicle not certified based on Kelly Blue Book values. The key consideration for customers when deciding between non-CPO and CPO vehicles is whether to invest the extra cost of the CPO vehicles to own potentially a better investment.

CarMax, at the time of this publication, is the #1 seller of pre-owned vehicles by a significant margin. The question is, “Why would an OEM-franchised dealership want to compete in the pre-owned vehicle market?” The main reason is that OEM-franchised dealerships want to offer *peace of mind* and long-term relationships with customers through the dealership’s service and genuine OEM parts departments. Another key reason for OEM-franchised dealerships to have pre-owned vehicle inventory on their lot is to attract loyal customers to trade their used vehicles for a new vehicle. Otherwise, dealerships would just exit the pre-owned vehicle business and sell only new vehicles under the security of the OEM franchise agreement. Another advantage is that pre-owned vehicles net higher profit margins than new vehicle inventory. Ways that OEM-franchised dealerships compete with CarMax is to provide lower interest rate financing through their OEM credit organizations. Dealerships offer the same quality of CPO vehicles as CarMax and allow customers the option of returning the purchased vehicle within a certain number of days for a full refund or exchange for another vehicle.

The dynamics of a dealership’s pre-owned vehicle inventory is different than its new vehicle inventory. As discussed previously, the pressure on new vehicle inventory is to turn it over monthly in order to qualify for sufficient inventory to sell in future months. For pre-owned inventory, depreciation of the vehicles begins the first day of ownership by the dealership and the value declines rapidly each day on the lot. By contrast, new vehicles do not depreciate in value. Therefore, pre-owned vehicle inventory sales priorities are based on first selling the vehicles that have been on the lot the longest (LIFO – last in, first out) to avoid further depreciation. By contrast, new vehicle-inventory sales priorities are based on first selling the vehicles that have been on the lot the least amount of time (FIFO – first in, first out) so that the dealership can profit from the unused 30-day OEM *trunk money* for reimbursement of *floor planning* interest rates.

It is important to recognize that selling any vehicle, new or pre-owned, should be prioritized for a quick sale. The point of the LIFO and FIFO illustration is that new vehicles do not depreciate so there is no hurry to sell on that criteria. What is important for new vehicle sales is to sell before the *floor-planning* bill is due with the financial institution and to take advantage of any unused OEM *trunk money* available as additional profit on the sale. The important priority

strategy for the pre-owned vehicle inventory is to minimize the loss of profit from depreciation of the vehicle's value and because pre-owned vehicles are usually fully financed by the dealership and not through lending institutions. This can be a strain on cash flow for the dealership. The most profitable number of days to sell a pre-owned vehicle, on average, is within the first 21 days in inventory.

When a pre-owned vehicle is being used in a trade for a new vehicle in the dealership's inventory, the pre-owned dealership manager needs to decide what to do with the pre-owned vehicle. To accept it into the dealership's pre-owned inventory is making a commitment to sell that vehicle quickly. As stated previously, most franchised dealerships self-finance pre-owned inventory as *frozen capital* until the pre-owned vehicle is purchased by either a customer or another entity. The pre-owned vehicle sales manager usually has a set of criteria for accepting a vehicle in inventory that is based on local market conditions for that type of vehicle. If the vehicle does not meet the dealership criteria, often the vehicle will be sold in auction or to other parties seeking to purchase pre-owned vehicles wholesale from dealership lots. In auction scenarios, when the dealership has taken an unattractive vehicle as a trade, it will bundle several vehicles, some attractive and some not attractive, to sell as a block lot. Another strategy used by dealerships is to pay cash to the purchasing party to increase the value of the deal for a pre-owned vehicle that has not sold within the time frame for profitability. The cash is usually funded from OEM *trunk money* reserves.

When a pre-owned vehicle is accepted into a dealership inventory, the pressure is on the Service and Parts departments to recondition that vehicle for sale as quickly as possible to maximize the window of profitable sales for that vehicle. To recondition a vehicle requires (a) changing out bad or questionable components, (b) detailing the car in terms of interior and exterior appearance, (c) taking photos for the pre-owned inventory on the dealership website, (d) writing descriptions for potential customers to read, and (e) publishing it on the website.

Normally, the repairs needed to recondition a pre-owned vehicle take top priority in the dealership's Service and Parts departments, sometimes after normal Service Department hours for retail customers. A fast reconditioning turnaround would be 72 hours, but some pre-owned

vehicles can take up to 12 days to be ready for sale. The longer it takes to finish the reconditioning of the pre-owned vehicle reduces the profitability window in half for those late turnaround vehicles. The average reconditioning costs for non-CPO vehicles is \$1,500-\$1,700. For CPO Domestic or Import vehicles, the average reconditioning costs are \$2,000 per vehicle, and \$3,000 per Highline CPO vehicle.

Until recently, determining the retail price for a pre-owned vehicle once was a matter of judgment by a pre-owned vehicle sales manager using a pocket version of the printed Kelly Blue Book. Today, in the Information Age, customers are more knowledgeable of pre-owned vehicle values. Therefore, pricing needs to be more market based and current. The tools available to assist the pre-owned vehicle sales manager today in pricing decisions consist of online data programs. Programs like *First Look* and *V-Auto* provide current sales data that include the price for specific vehicles and conditions of those vehicles currently for sale in a given market space. The time it takes to sell a pre-owned vehicle is divided into different *age buckets*. While each dealership may have different age buckets, a typical set of age buckets could look like: 1-15 days, 16-30 days, and longer than 30 days. When a pre-owned vehicle reaches the 30-day age on the lot, specific strategies are deployed to move the vehicle off the lot soon. These strategy options include selling to another dealership lot and drastically reducing the price to encourage an immediate sale.

BUSINESS DEVELOPMENT CENTER

Larger dealership groups often use a Business Development Center (BDC) in both variable and fixed operations. On the Variable side, customers who have been in touch with the dealership by either visiting a dealership store or interacting with the dealership website, will receive a follow up telephone call from the BDC Sales representatives. On the Fixed side of the BDC, customers wishing to make a service appointment will actually be calling the BDC Service representatives directly instead of the local dealership Service Department. BDCs can be physically located within a dealership store or set up in a regional call center.

The Sales side of BDC operations consists mostly of *outbound calls* to generate traffic to the dealership lot. Approximately 70% of contact information for sales calls derives from online shoppers and referrals from the OEM website. Another source of referrals comes from dealership-loyal customers who visited the service department of the dealership and were approached about trading in their current vehicle for a new one. If the customer did not purchase the new vehicle at that sales visit, a BDC Sales representative will reach out to the customer usually within 72 hours of the service visit to inquire why he or she did not purchase and what would it take for that customer to be open to a purchase. If the customer is open to pursuing a purchase conversation, the BDC sales representative will set up an appointment for the customer with one of the dealership salespeople on the lot – either the specific salesperson requested by the customer or a salesperson who would be available at the appointment time.

On average, 20% outbound calls from the BDC Sales representatives will actually reach someone on the first call. Otherwise, a message is left. The average length of an outbound sales call is 7 minutes. One in three contacts result in *come back* action (return to the dealership lot) from prospective customers. Some BDCs pay their representatives on straight salaries but performance based BDCs pay compensation based on the number of prospective customers who actually show up on the dealership lot for their appointments. For smaller dealerships, the costs of having a BDC usually do not support the benefits of maintaining one. Some dealership sales groups could support an economic model for having a BDC for sales appointments but prefer not to use them because of the belief that dealership salespeople will depend too heavily on the BDC to locate prospects vs. the salespeople *working the opportunity window* themselves. The sales managers of these non-BDC dealership groups want their sales personnel to be proactive in reaching out to the dealership's customers.

By contrast, the Service side of the BDC handles 97% of its traffic as *inbound calls* vs. outbound calls like the Sales side. The purpose of using a BDC on the Service side is to free up Service Advisors at the dealership Service Center from answering telephone calls so that the Service Advisors can be available to personally interact with customers who arrive for their service appointments. The other purpose for using a BDC to answer incoming service appointment calls is to reduce the frustration of customers from waiting for someone to answer

the telephone call or the annoyance of being transferred to a voice message center. The average length of a Service representative contact is 3 minutes. When a BDC Service representative does make an *outbound call*, it usually includes notifying loyal dealership customers of important information like manufacturer recall notices or special promotions being offered.

CHAPTER ASSIGNMENTS:

1. Describe the concept of the term “Variable” Operations.
2. Describe the value of the “Dealership Franchise” concept for:
 - a. Manufacturers
 - b. Dealerships
 - c. Customers
3. What is the value of not having a franchise dealer but rather having a direct market outlet between manufacturer and customers (e.g., Tesla, Carvana, etc.)?
4. Describe the unique characteristics of new-vehicle sales.
5. Describe the unique characteristics of pre-owned vehicle sales.
6. Describe the steps in the supply chain from the moment a new vehicle is ordered to the moment that it is ready for sale on a franchised dealership lot.
7. Describe the differences among OEM vehicle categories in terms of complexity of ordering new vehicles.
8. Where does someone go to purchase a pre-owned vehicle?
9. What are the advantages and disadvantages of each pre-owned sales outlet?
10. What distinguishes a Certified Pre-Owned Vehicle from one that is not? Why do purchasers pay more for CPO vehicles?
11. What determines whether a trade-in vehicle for a new vehicle on a franchised dealership lot will be entered into that dealership’s pre-owned vehicle inventory?
12. What options are available to a pre-owned sales manager to “dispose” of an undesirable trade-in vehicle?
13. Describe the steps involved in reconditioning a pre-owned vehicle for sale.
14. What benefits derive from a dealership using a BDC for *sales* functions?
15. What benefits derive from a dealership using a BDC for *service* functions?

CHAPTER FOUR

FIXED OPERATIONS

FUNDAMENTALS OF FIXED OPERATIONS

The term *fixed operations* is used by automotive dealerships to describe the three departments of Service, Parts, and Collision Centers. The term is derived from the fact that, unlike sales and the associated tasks of Finance & Insurance that depend upon customers' purchases of vehicles, *fixed operations* departments basically represent consistent business for the dealership. Vehicles need to be maintained on a regular basis and repaired on occasions. The variable part of *fixed operations* revolves around keeping customers loyal to the dealership. Successful dealerships attract and retain loyal customers who prefer to have their vehicles serviced at the dealership locations vs. using independent service centers. Even Collision Centers exist not because of customer preferences to delay until a more convenient time but because of the necessity to get the customer's vehicle back on the road as quickly as possible. This chapter will provide a description of each of the three major departments within *fixed operations*.

SERVICE DEPARTMENT OPERATIONS

Vehicles require maintenance on a regular basis in order to perform as designed. On average, a dealership may sell 300-400 vehicles per month but service 3,000-4,000 vehicles per month. Vehicle owners have choices of where to take their vehicles for service. Many manufacturers today have service programs built into the first 5,000-mile service appointments whereby the customer does not pay for the parts and labor to change the oil, top off fluid levels, adjust tire pressure, etc. The purpose of this OEM-sponsored program is to establish a habit of customers taking their vehicles to the dealership for service rather than using other service shops. For some vehicle owners, only "genuine" parts made by the manufacturer and service from OEM-certified technicians are acceptable. For OEM warranty repairs, only a franchised dealership is authorized to complete those repairs.

Alternative choices to dealership service departments are independent shops. The primary advantage offered by dealership service departments is having OEM-certified technicians working on the vehicles using OEM-certified parts. In pricing service, there is little difference between dealerships and independent shops. The primary advantage of independent shops, especially among name brand chain shops, is having more locations closer to where customers live than the dealership locations, which tend to congregate in high-traffic locations within a community. In addition, independent shops may be open at hours that are more convenient to vehicle owners than dealership locations. Some independent shops specialize in more routine jobs that are required more often (e.g., oil changes, lube jobs, tire rotations, and even wheel alignments). These independent service shops often would prefer more difficult repairs to be performed by someone else so the independent shop can handle high-volume, low time commitment services with technicians with lower certifications and thus lower hourly wages. Another function provided by all service locations is the state vehicle inspection where required. To compete, some dealerships offer free state inspections for their customers who purchase a vehicle from the dealership as an incentive to remain loyal to the dealership service department.

The keys to success for dealership Service departments include (a) performing high quality work the first time with no return visits by the customers for the same issue, (b) meeting commitments made for when the vehicle will be ready, (c) treating customers with courtesy and respect, and (d) fair pricing. Another incentive for keeping loyal service customers at the dealership is that 60% of dealership service customers purchase their next vehicles from that dealership.

Two support roles in the Service Department are Service Managers and Service Advisors. Service Managers typically were technicians at one time and chose to enter into a management role. Their primary functions are to ensure that technicians are productive and developing their skills to add value to the dealership's Service Department. In addition, Service Managers administer the workflow with the Parts Department. Service Advisors are the customer contact representatives who ensure that the service workflow is conducted effectively and efficiently and who serve as the point of contact with the customer informing him or her of the progress being made on the vehicle in the service bay and of any discoveries made that require customer

approval to proceed with the job. Unlike Service Managers, Service Advisors usually were not technicians in the past but have great *people skills* and *communication skills*. Technicians rarely talk with the customer but instead with the Service Advisor who communicates directly with the customer. Though Service Advisors typically were not technicians before, they still need to acquire enough knowledge about how vehicles function to be able to accurately inform the customer of any needed repairs. Often new Service Advisors will be assigned to various technicians to learn the basics the Service Advisor will need to be effective in communicating with customers.

The typical service process is as follows. The Service Advisor creates a repair order with what the customer said were the symptoms and complaints. Either a Service Advisor or a technician will connect the vehicle to a diagnostic computer and verify the stated condition of the vehicle as well as look for any unsuspected issues. That Service Advisor or technician will then determine which technician will perform the repair based on that assigned technician's skill level. The technician will communicate with the Service Advisor who will communicate with the customer via phone, email, text, or visit within the customer lounge. At some dealerships, if the customer agrees to wait longer, an employee or 3rd party vendor will wash and vacuum the car before the vehicle is delivered to the Service Advisor. After the work has been completed, the repair order will be given by the technician to the Service Advisor to complete the financial invoicing and payment. In dealership service departments, invoicing and payments can be handled by the Service Advisor or a cashier. The employee responsible for performing the invoicing tasks will ensure that all entries are correct and complete before having the customer pay for the work order and receiving the keys to the vehicle.

During the repair process, old parts will be removed and replaced with new parts. In the past, parts like alternators or transmissions would have been repaired by the local Service Department technician before being reinstalled into the vehicle. However, various factors have determined that simply replacing the old part with a new or manufacturer-reconditioned part is a better solution. Most OEMs have exchange programs with dealerships for new or reconditioned parts. These determining factors for replacing vs. repairing parts include:

- (a) The cost of labor devoted to repairing the part and not being available for the next service repair order,
- (b) The liability of the reconditioned part not failing in the future being on the dealership and the technician vs. the OEM that supplied the replacement part,
- (c) The limited number of technicians with the requisite skills to repair major parts, and
- (d) The faster turnaround speed of putting the vehicle owner back on the road.

In the 1970s, technicians were specialized, and it could take up to five technicians to work on a single car. That was an inefficient use of labor resources. Today, technology has aided in the diagnosis of the vehicle, usually performed by a master technician (Level A) who performs the diagnosis like a triage in the hospital and then sets up the proper level of technician to work on the areas needed for that car. The Level A technician is fully qualified to work on any repairs of a vehicle. The Level B technician is qualified to work on major engine repairs. The Level C technician typically works on shock absorbers, exhaust components, door locks, and other minor repairs. The Quick Lube technician is an entry level technician responsible for tire services, oil changes and other express service bay tasks. It is incumbent on the technician to obtain the training necessary to achieve higher levels of mastery in the craft or even to remain current in certifications.

Service technicians are paid by the dealership on a standard hourly *flat rate* that is based on the competency level. If the technician can complete the service job in less time than it is rated, he or she can move on to the next job and benefit from the extra earning potential. For example, if a brake job is rated at 75 minutes and the technician completes a brake job in 50 minutes, he or she is paid for the 75 minutes and can begin another job at its flat rate. Conversely, if the technician takes longer to complete the service job, the pay for that job will remain the same as rated. If the technician trades speed for accuracy in completing the task, the penalty will be the requirement of that same technician to fix any mistakes he or she made without additional compensation for doing so. Additionally, the dealership rarely pays for technician's tools; the technician does. Technician tool sets can cost in the tens-of-thousands of dollars if not more.

Dealerships encourage technicians to continue their training and some OEMs are pressuring dealerships to have all technicians at Level A, even though some technicians are content to remain at a lower level. The higher the level will earn the higher hourly rates for specific tasks. The balancing act for a dealership is to encourage technicians to advance and thus be paid more to retain quality technicians without moving them through the training too quickly that could lead to work performance quality issues. Another concern is that high-level technicians can be attractive to competitors that lure them away. Most training for technicians occurs in an online environment because technicians do not want to give up their productive hours during the day in the dealership while going through the training. Many dealerships enroll in the National Automobile Dealers Association (NADA) Academy whereby up to 50 employees can access training resources (e.g., video-based workshops, dealership guides, etc.) online.

In the case of Highline or Exotic brand dealerships, the customers are more demanding in terms of expectations of when parts should be available and service levels than Domestic or Import customers. Most Highline dealerships have a loaner car policy mandated by the OEMs to remain a franchised dealership. The Highline OEM usually subsidizes about half the cost of the loaner car fleet at a dealership while the dealership half of the cost is apportioned evenly among New Car, Used Car, Service, and Parts departmental budget centers. Loaner car policies can exist in some Domestic or Import but not as a general rule.

Some Domestic and Import dealerships have a rental car company located on the premises. If the customer purchased the after-market product sold by the dealership (like Hendrick's AutoGuard protection policy for standard maintenance and repair situations), the rental vehicle may be available at no additional cost to the customer. Another situation where the customer is not required to pay is if the problem is a drivability (collision) issue. In those situations, the insurance company pays for the rental car. Exotic franchised dealerships do not offer loaner vehicles but will pick up and return the vehicle to the owner using a vehicle carrier to avoid increasing the mileage on the odometer.

For fleet vehicles, the emphasis of the dealership Service Department is to place priority on getting the fleet vehicles in and out of the service area as quickly as possible. This emphasis is

not just because of the number of specialized vehicles (e.g., vans and trucks) with higher profit margins on the sales side, but the owners of the vehicles are experiencing financial losses when the vehicle is out of service. Some dealerships choose not to sell fleet vehicles because of the costs associated with the specialized needs of the service area (e.g., Truck service bays vs. car bays with heavier lifts and larger work areas). On the other hand, because many dealerships avoid fleet sales and service, those dealerships that cater to fleet vehicles can benefit in a profitable way. In one example in Georgia, a dealership has three of its 27 service bays dedicated to large fleet trucks. To give priority to technicians working on fleet vehicles, despite existing service work orders for non-fleet customers, the technicians may work on the fleet vehicles after normal Service Department hours at a higher wage in order to have the fleet vehicles available the next day if the parts are available.

PARTS DEPARTMENT OPERATIONS

The Parts Department of a dealership is the most profitable department in the dealership primarily due to the low labor costs involved and using standard retail pricing for parts on the repair orders from the Service Department. The primary customers of the dealership Parts Department are the dealership's Service Department with additional customers being local mechanic shops needing genuine OEM parts, Collision Centers, and even walk-in retail customers purchasing vehicle accessories that they can install themselves.

The key to success in a Parts Department is having the part needed now rather than later. In the past, Parts Department inventories were narrow but deep in that only standard replacement parts were kept in inventory with many units in stock to avoid running out of them when needed. If an unusual part was needed in a repair, the customer would be required to wait until that part could be ordered and delivered, possibly weeks later. In the past 15 years, with more efficient supply channel operations methods, Parts Department inventories are now wider in the variety of parts but with fewer units of the parts on the shelves. This is because resupply of parts can come within one day or even sometimes on the same day to the dealership Parts Department.

What determines which parts a specific dealership will carry in its inventory are historical data reports that provide trend analysis to help determine what needs to be stocked in the future. If a part is not on the shelf, someone in the Parts Department will create an order in the dealership inventory management system to alert the supply chain system of the need for that part. One supplier of parts might be the OEM Parts Distribution Center (PDC). Many OEMs have regional centers that can have the ordered part to the dealership no later than the next morning if the order is received by PDC's afternoon cutoff time (between 2PM and 5PM depending on the OEM). Even if the order is received after the cutoff time, the part can be at the dealership the next morning if the dealership is willing to pay an *expedite fee* of usually an additional 10% on the unit price of the part.

The larger dealership groups like Hendrick Automotive Group operate their own parts supply network. At Hendrick, there are two deliveries per day to dealership parts departments within a local region, one with an 8:30 AM cutoff time for morning deliveries and the other with a 12:30 PM cutoff time for afternoon deliveries on the same day. In addition to providing parts within the local area, Hendrick provides parts from its main distribution centers to the region. For example, Hendrick's Georgia dealerships receive 92% of their parts from the Charlotte, North Carolina distribution center. If the Georgia dealership submits a parts order by 5:00 PM, the part will arrive at the Georgia dealership lot by 5:30 AM the next morning, be checked in by 6:00 AM, and the technician will have the part when he or she arrives at work that day.

Time is money to a technician and waiting for a part means that technician cannot be paid for a repair order until the missing part arrives, and the order is completed and paid for by the customer. For some OEM parts distribution centers, it can take 2-4 business days to deliver the parts. For some Import OEMs, if the part is not in the distribution center, it could take weeks to deliver the part to the dealership from the OEM's international manufacturing site. In some cases, parts ordered from an OEM Parts Distribution Center cannot be returned to the Center for a refund; the dealership is required to absorb the cost and hope to find a need in the future through its Parts Department outlets.

The typical flow for a Parts Department repair order from the internal dealership Service Department is that, when the repair order is produced by the Service Advisor, it is printed in both the Service and the Parts departments simultaneously. Once the Master Technician (Level A) diagnoses the vehicle and confirms what is needed for the repair order, the technician will update the repair order into the DMS system. Someone in the Parts Department will pull the items from the shelves needed for the repair order. The list of parts needed for a service repair order is called a ***pick ticket***. The Parts Department employee will either deliver the needed parts to a central location in the service area or place them at the window that opens to the service bays for a service employee to pick up the order and deliver it to the appropriate service bay.

The assigned service technician or a parts runner will retrieve the parts and perform the work order tasks on the vehicle. In cases where an unexpected repair is discovered, the technician will put in a request to the Parts Department to determine if the needed part is in inventory and the associated price for the part. If the part is in inventory, the technician will have a ***parts runner*** go to the Parts Department window on the service-bay side of the shop and ask for the part. The ***parts runner*** will then deliver the part to the waiting technician. The technician will add the additional part(s) to the repair order ***pick ticket***. If the needed part is not in inventory, the parts ordering process will be applied. In some circumstances, the needed part may be available in a local retail parts store if not available in the dealership network within the desired timeframe.

The best customer of a dealership Parts Department is the ***back-counter Service Department***. The prices used in Parts Department transactions are almost always at full retail price. This is one reason the Parts Department is the most profitable Strategic Business Unit (SBU) in the dealership along with the low labor requirements. Typically, the markup price of retail parts is 40% over the wholesale cost. On the wholesale side for selling parts to Collision Centers, there is a 20-36% markup price over wholesale cost. Per governmental regulations, for a part to be considered ***Made in the USA***, for example, 75%-80% of the components in that part need to be built in the USA.

Independent mechanic shops typically use retail automotive parts stores for standard parts in lieu of purchasing parts from dealership Parts Departments, often because of the convenient

delivery services offered by the retail stores. However, when genuine OEM parts are needed, the independent mechanic shops will order from dealership Parts Departments unless they are purchasing in bulk quantities directly from an OEM Parts Distribution Center. NAPA and CarQuest are parts competitors to dealership Parts Departments serving primarily service independent mechanic shops and Collision Centers.

AutoZone and O'Reilly, etc. retail automotive parts stores typically service the end consumer's parts needs. To add value for the end consumer, retail automotive parts stores will offer services like installing the customer's warrantied battery free in front of the store or replace windshield wipers, which is a great marketing tool for Do-It-Yourselfers (DIY). The DIY market today is different than in the past when individuals would replace their own starters, alternators, etc. Today, most customers of retail automotive parts stores just want accessories that can be installed easily or oil and filters for the periodic maintenance. Ultimately, the dealership Parts Department does deal with the retail parts business for the end consumer but rather focuses on internal Service Department needs and wholesales to other mechanical shops and Collision Centers. Retail customers for dealership Parts Departments usually are DIY customers who are loyal to the dealership.

COLLISION CENTER OPERATIONS

Not all dealerships offer a Collision Center because of the different customer relationship focus and requirements of the Collision Center operations when compared with a dealership Fixed Operations Departments. At a Collision Center, the focus on relationships is with the customers' insurance companies rather than the customers. Typically, because of the pressure from insurance companies for Collision Centers to keep their prices competitive if they want to be a preferred center of the insurance company, the sales margins are low (average of 10%). For those dealerships that do have Collision Centers, the primary motivation is to maintain relationships with their loyal customers. Another benefit for a dealership to have a Collision Center is to provide another outlet for the profitable Parts Department.

The primary performance metric for Collision Centers is to be fast and accurate with the repairs because the entity paying the bill, usually the insurance company, wants to minimize the number of days necessary to pay for the rental vehicle used by the end customers while their personal vehicles are being repaired. Just to give a perspective, State Farm Insurance pays an average of \$1 million per day in rental vehicles for its clients.

The process of handling repairs on a damaged vehicle is as follows.

1. The vehicle is involved in an accident of some nature.
2. The owner of the vehicle, the claimant, files a claim with an insurance company, either his or her own company or the company of the person responsible for the accident. Filing with insurance companies accounts for 96+ % of all Collision Center transactions. Another 1-2% of the transactions occur when a private party pays. The owner may wish to avoid filing a claim and is willing to pay cash to avoid increased premiums, or a policy being cancelled, or avoiding an entry into the vehicle's CarFAX history for future resale purposes. The other 1-2% of Collision Center transactions are to repair dealership vehicles that may have been damaged in a storm, or during a test drive, etc.
3. The insurance company will arrange for a rental vehicle to be used during the repair time based on the policy held by the owner. Owners without rental vehicle coverage will pay for their own rental vehicle or make other arrangements for transportation while their vehicle is being repaired.
4. The insurance company will require the owner to obtain estimates from three different repair facilities pre-approved by the insurance company for having the repairs completed on the vehicle. It is worth noting that an estimate is not a guarantee of final costs because there could be hidden damages, to be discussed in more detail below.
5. The wrecked vehicle will be moved, if necessary, from where it was towed after the accident to the Collision Center that has been approved to perform the work order.
6. Upon arrival at the Collision Center, a Center employee will take photos of the vehicle to be provided to the insurance company or owner as documentation of the damages.
7. A Center technician or manager will write an initial estimate to the insurance company of the work that is expected to be performed.

8. After the responsible party for payment of the work accepts the initial estimate, the vehicle is thoroughly inspected by a Center technician. If any previously unknown problems are discovered in the thorough inspection, a supplemental order will be added to the original estimate.
9. The updated estimate with the supplemental order will be sent to the responsible party for payment of the repairs. If the final estimate is accepted by the paying party, work can begin on the damaged vehicle.
10. The parts that require repairs or replacement will be removed from the vehicle.
11. The replacement parts will be ordered from a Parts Department of a dealership or from another parts supplier.
12. Painting of damaged exterior panels is performed when the panels are disassembled from the main body of the vehicle with all connecting sections disassembled and placed together to blend the colors.
13. When all replacement parts are in inventory at the Collision Center, they are assembled on the vehicle. Approximately 90% of the time, the parts are replaced and not repaired for the same economic reasons given in the Service Department section of this chapter. Whether to replace or repair the broken part is determined by computer diagnostics in most of today's vehicles.
14. After all of the work has been completed on the vehicle, it is inspected by a technician to ensure that all parts are working properly, even those not involved in replacement.
15. The owner is notified throughout the repair process of the ongoing status of the repairs.
16. When the vehicle is ready to be picked up, the owner is notified.
17. When the owner arrives at the Collision Center, the Estimator will walk around the vehicle with the owner to confirm that the repairs have been completed to the owner's satisfaction.
18. The owner signs the release form that authorizes the Collision Center to notify the insurance company to release the funds for the repair order in agreement with the final estimate amount. If there were costs above the final estimate, the customer usually must bear those costs in order to receive the vehicle.
19. The time between when a vehicle owner drops off the vehicle for repairs and picks up the vehicle is called the *cycle time*.

The service environment at a Collision Center is different than at a dealership Service Department and thus a different skill set is needed for technicians working at Collision Centers. For example, Collision Center technicians must know how to weld, a task rarely needed in a Service Department at a dealership. Collision Center technicians need to be artists to ensure that seams are aligned and colors match, which takes more precision than is required of a service technician in a Service Department. The typical job responsibilities at a Collision Center include Body Technicians for the bodywork, Mechanical Technicians for standard repairs. Body Painters and Polishers, Prep Employees for interior cleaning, scraping, etc., Estimators, Quality Control Inspectors, and Detailers.

There is a movement among OEMs to install onboard computer technology that will notify an OEM call center if one of their brand vehicles has been involved in an accident. Toyota is leading the way in this movement with others potentially to follow. The Call Center representative will interact with the driver and passengers in the wrecked vehicle to ensure that they are OK or need medical attention. If the driver and passengers are OK, the OEM representative will ask if the vehicle is drivable or needs to be towed and if a police report of the accident is being processed. The representative will then recommend an OEM-certified Collision Center nearby for the vehicle to be taken.

The certification of the Collision Center by the OEMs is determined by past customer satisfaction indexes. Some OEMs use only their franchise certified dealership locations. Other OEMs, like German import brands, may partner with independent Collision Centers that meet the OEM's strict standards for quality work at reasonable rates. Another motivation for this new process of determining which Collision Centers are eligible for performing the repairs is that OEMs want original OEM parts to be installed into their vehicles to protect any remaining warranties or extended service agreements.

By OEMs interjecting themselves into the determination of which Collision Center to use, the insurance companies' roles in the traditional decision-making process are being minimized them to fear losing control in the process. In this new process, the insurance companies become more of secondary players as merely the financial arm and thus reduces the relationship

somewhat between the insurance companies and their customers. Without the factor of potential loss of relationship, as long as the OEM-certified Collision Centers meet the same standards as required by the insurance companies, why would the insurance companies object on behalf of their customers who pay the insurance policy premiums?

The issue is one of controlling the situation by controlling the cost decisions and potentially causing a rift between the insurance company and its customers when the Collision Center recommends one course of action and the insurance company desires a different, usually more cost-efficient solution. One strategy being adopted by some insurance companies to keep themselves as primary players in the decision-making process is partnering with dealerships to purchase replacement vehicles from those dealerships if the owner's original vehicle is totaled in value. Some dealerships attempt to satisfy the criteria for OEMs by stocking more OEM original parts and to satisfy insurance companies by working directly with them as primary participants in the repair process.

A key performance measurement for both insurance companies and vehicle owners is not having to return a vehicle for a repair the second time. It is as important as the *cycle time* it takes to return the damaged vehicle to the owner. Insurance companies use both measurements to certify Collision Centers approved for the insurance company's customers. Another key determinant of satisfaction for customers concerning a Collision Center is how much the Center keeps the customer informed of the progress on the vehicle with time estimates for completion of the work. The expectation for most consumers and insurance companies is that the vehicle will be ready for pick up within 1-2 weeks. Some work is outsourced to 3rd Party vendors where the vendor has the required expertise and can repair the damage quicker and for less cost (e.g., using Dent Doctor to repair hailstorm damage or having the certified OEM dealership Service Department perform a needed alignment).

CHAPTER ASSIGNMENTS:

1. Describe the concept of the term “Fixed” Operations and how it differs from “Variable” Operations.
2. Describe the key success factors of a Service Department.
3. Describe the responsibilities of the four levels of mechanical technicians.
4. What are the advantages of having vehicles repaired by dealerships? Disadvantages?
5. What are the advantages of having vehicles repaired by independent shops? Disadvantages?
6. What are the skill sets needed to be an effective Service Manager? Service Advisor?
7. Which vehicle brand category (Highline, Domestic, Import, Exotic) offers loaner cars as a policy when the owners’ vehicles are being repaired? Why do they have that policy?
8. Describe the key success factors of a Parts Department.
9. What is the typical parts inventory strategy today – deep and narrow or shallow and wide? What has occurred to make this current strategy feasible?
10. Who is the largest customer of the dealership Parts Department?
11. Why do OEMs insist on original OEM parts vs. other brands?
12. Describe the key success factors of a Collision Center.
13. Why do few dealerships offer Collision Centers?
14. Who is the primary customer of Collision Centers?
15. Why do vehicle owners choose to pay the Collision Center bill instead of filing an insurance claim?
16. Why are OEMs beginning to interject themselves into the decision of which Collision Center to use for vehicle repairs?
17. What actions are insurance companies taking to remain relevant in the decision-making process?
18. Which of the three Fixed Operations departments is the most profitable? Why?

CHAPTER FIVE

ADMINISTRATIVE OPERATIONS

FUNDAMENTALS OF ADMINISTRATIVE OPERATIONS

In addition to the primary departments under Fixed and Variable Operations, there are other departments that support the success of a dealership. In fact, without the administrative departments, issues like compliance with local, state, and federal regulations would be in jeopardy, bills would go unpaid, and cash flow would be mismanaged that could lead to the dealership closing. In this chapter and the next one, the Accounting and Financial departments will be discussed in addition to providing analysis of financial statements and ratios.

FINANCE & INSURANCE OPERATIONS

The Finance & Insurance agents (F&I) actually are assigned to the Variable Operations departments of both new and pre-owned vehicle sales. The F&I agent is the last person a buyer sees before being escorted to the recently purchased vehicle and driving it off the dealership lot. Though the discussion of the F&I functions could have been placed in Chapter 3 with Variable Operations, F&I serves as a liaison between the Sales operations and the Accounting Department. The concept of having an internal representation at the dealership that handles financing and insurance for the recently purchased vehicle began in Chicago in 1962 with Port Ryan & Associates, which is called AON at the time of this publication.

An F&I agent typically will handle 50-60 deals within a month. The primary goals of the F&I agent are to process the paperwork involved with a vehicle sale as quickly and as accurately as possible. The term *transparency* is used to describe clean, concise information so there is no ambiguity in the transactions that were made. Department of Motor Vehicle (DMV) forms need to be accurate in terms of Vehicle Identification Number (VIN), current odometer reading, customer information, etc.

The F&I agent or the salesperson will contact the purchaser's insurance company to ensure that the vehicle will be adequately covered before departing the dealership lot. If the customer is financing the vehicle from a sale or leasing the vehicle from the OEM, all the financing information on the contract must be precisely accurate – no room for error. It can be an unpleasant situation if the purchaser is required to return to the dealership because an odometer reading was off or one of the forms was not initialed or signed properly. In addition, OEM forms need to be filled out so that warranties can be honored on the specific new vehicle sale.

Another primary function that provides profit to the dealership and enhances an F&I agent's commissions is selling after-market products that protect the investment of the vehicle for the new owner. Such products include roadside assistance, extended service plans, paint protection products, etc. The average sale of after-market products and services is valued at \$1,300 per vehicle. In every dealership, the Accounting Department serves as the Compliance Department to review all paperwork prepared by F&I agents to ensure accuracy. Once the accuracy is confirmed, the Compliance Department will enter the information in the Dealership Management System (DMS). The Hendrick Automotive Group policy requires all Hendrick F&I agents to be certified by the American Finance and Insurance Professionals (AFIP) Association before one is permitted to work with customers on transactions. This requirement may not exist in other dealership organizations.

One of the key transactions performed by F&I agents is arranging financing of the vehicle for the customer. In the case of a new-vehicle purchase, the financing is often arranged through the OEM's financial company (e.g., Ford Motor Credit, GM Financial, etc.). For pre-owned vehicle purchases, the financing for customers is usually arranged by the F&I agent through one of the local lending institutions that the dealership uses to *floor plan* its new vehicles. The other alternative is when the customer purchases the vehicle through his or her own arrangements and provides the dealership with a certified check for the sale of the vehicle.

Often these days, leasing a vehicle is the preferred option for dealership customers. Lease contracts provide lower monthly payments than purchased vehicles because the vehicle lease is usually for a shorter time-period than a financed purchase and the returned vehicle will

retain sufficient market value to be resold for profit as a pre-owned vehicle upon its return to inventory. Residual Value methods for leases of new vehicles are determined by the OEM using 3rd party companies to estimate the value of a vehicle expected at the end of a lease.

In the past both open-end leases and closed-end leases were offered. Open-ended leases were established where the customer could purchase the vehicle at the end of the lease or walk away. Today, the closed-end lease is usually all that is available from dealerships so that the dealership can resell the pre-owned vehicle while it still carries a higher market value with lower mileage on it. The primary difference today is that the customer can still opt to purchase the formerly leased vehicle, but it is handled as a separate financial transaction with a new sales contract vs. executing a provision in the original lease contract. One of the drawbacks to leasing a vehicle is when the specified mileage limit in the terms of the lease is exceeded. There can be stiff financial penalties owed at the end of the lease when the vehicle is returned. These penalties help the dealership protect its projected market value in the vehicle.

ACCOUNTING DEPARTMENT OPERATIONS

As in all organizations, the Accounting Department is responsible for producing the financial reports that help operations managers determine how the organization is performing financially and for giving insights into where problem areas within operations may be occurring. In an automotive dealership environment, the primary difference for the Accounting Department is that monthly reports are actually full sales-cycle reports rather than another monthly chapter in the annual financial history of the organization. In the automotive dealership environment, there are 12 precise *sales cycles* in the year. Each new month begins another *sales cycle*. Therefore, the urgency of the Accounting Department to assemble its reports from the previous month's performance of the Variable and Fixed operations quickly and accurately is critical.

The Accounting Department typically allows four *business* days for the various operations departments to close their monthly billing from the previous month or otherwise they will be required to defer that billing to the current month billing cycle. The Accounting Department is expected to deliver its monthly financial reports within 5-8 *calendar* days after the

previous month has ended to the various dealership managers for them to review and to develop strategies for how to finish the last part of the current month with strong sales performance results.

The challenge for the Accounting Department to meet these deadlines is that the sales processes remain mostly in non-digital format, thanks in part to interfacing with various governmental agencies that still require paper forms. Though there is a trend toward more digitization of sales documentation, the governmental interface still remains an issue at this time. Fortunately, the Fixed Operations Departments usually are operating in a total digital environment through the dealership's management system (DMS), which reduces the risk of completing reports late.

When there are multiple dealerships within an enterprise group, aggregated financial reports are sent to the corporate management team for review. The aggregated corporate financial reports are handled by the Central Accounting Department. Central Accounting also provides consolidated financial reports to lenders that have financed the new vehicles through *floor plans*. Many dealerships self-finance pre-owned vehicle inventories and, therefore, require accounting reports to determine the financial performance of the pre-owned inventory. These financial reports ultimately provide insight for the pre-owned vehicle sales manager into which vehicles need to be removed from the inventory quickly. Another recipient group of the consolidated financial reports is the enterprise Finance Department. How the Finance Department uses the financial reports is discussed in the next section of the textbook.

Beyond providing financial reports, primary responsibilities of the Accounting Department also include providing counsel to the enterprise group headquarters top managers on how to minimize tax liabilities with various governmental agencies. The goal for the enterprise is to pay the taxes that are required but no more than is required to preserve maximum profits for the owners. Another function of Accounting is to work with various supply vendors (e.g., engine oil suppliers, parts suppliers, office supplies vendors, etc.) to aggregate volume discounts in an effort to reduce fixed costs for the enterprise.

The Accounting Department is responsible for meeting covenants with lenders of *floor plan* inventory. When a new vehicle has been placed in a *floor plan* inventory and has been sold, the lender of that *floor plan* financing is expecting to be paid for that vehicle within a few days of the sale. If that expected time-period is exceeded, the contract for that vehicle is said to be *out of covenant*. The time pressures that can produce an *out-of-covenant* situation include interruptions to completing all the F&I compliance forms or an error of even one line item on a form (e.g., odometer reading or license plate number, driver's license number, etc.). Ongoing communications between the Central Accounting Department, the dealership F&I agents, and the various *floor plan* lenders occur to ensure accuracy of the potentially hundreds of sales transactions being processed each month. In summary, sales transactional forms must be cleared through Accounting within a few business days.

Service repair orders do not require the same sense of urgency as vehicle sales because of the absence of financial arrangements with lenders and governmental forms being submitted. In addition, beyond the normal urgency of closing one month's total transactions, there is the requirement in Accounting to match all cost transactions with a revenue-producing transaction such as a sale (Matching Principle of Accounting). For example, a repair order that was completed by the dealership Service Department is considered to be a *Work-in-Progress* status until the repair order is closed in Accounting. As one might expect, there are multiple conditions that might cause a repair order to remain open across two monthly operational cycles (e.g., waiting on a part to arrive). Some repair orders are internal to the dealership such as the case when a used car is being reconditioned for inventory. If the Service Advisor forgets to close the repair order, it will lead to a delay in getting to Accounting.

FINANCIAL REPORTS

A key output from the Accounting Department is the production of dealership financial reports. Financial reports give clues to the financial health condition of the dealership. The primary financial reports are the same as in any industry: Income Statement, Balance Sheet, and Cash Flow Statement. The Income Statement provides a summary of all revenues and expenses associated with operating the dealership throughout the monthly/quarterly/annual time period.

The Balance Sheet provides a “snapshot” of current monetary values of Assets, Liabilities, and Owners’ Equity in the dealership. This snapshot is taken on the last day of the reporting period (month, quarter, or year). The Cash Flow Statement provides details of how the enterprise collected and dispensed with its cash (the *lifeblood* of the dealership) during the reporting period. Cash flow will be discussed in more detail in the next chapter of the textbook.

Income Statement

In Appendix A of this textbook is an excerpt of financial data from a Highline automotive dealership. It is used as an example in the following discussion of analyzing financial reports to determine the health of the dealership. First, we will examine the Income Statement. Notice that the categories of items are listed as Sales, Gross Profit, Selling Expenses, Operating Expenses, and Overhead Expenses. Notice also that each category is divided into the various revenue-producing business units within the dealership: New Vehicle Sales, Pre-Owned Vehicle Sales, Service Department Sales, and Parts Department Sales. In this example, there is no Collision Center associated with the dealership. The figures are in actual numbers and represent annual amounts vs. monthly amounts.

Sales

The first analysis to perform is the comparisons between the four business units. Though the New Car sales is larger in dollar volume, one would expect that result because of the retail dollar value per unit of new car sales vs. those of service and parts departments and even new-vehicle dollar values over pre-owned dollar values. To gain a better perspective of how well this dealership is performing in sales would be to compare this year’s sales values with previous years and with other Highline vehicle dealerships of the same brand and in similar markets. The measurement of sales revenues alone helps the dealership management team determine how effective its operations are in delivering value to the marketplace.

Gross Profit

The next section of the Income Statement is entitled Gross Profit. Normally, Income Statements have Net Sales/Revenues less Cost of Goods Sold equaling Gross Profit/Margin. In this example, the math has been performed already with only the gross profit shown. This is the standard reporting format for this dealership. To determine the Cost of Goods Sold would require subtracting the Gross Profit dollar value from the Sales dollar value. The Gross Profit measurement informs dealership management of how much contribution is available to the organization for its overhead costs. A financially healthy dealership will maintain a higher gross profit by both selling its products and services at optimum market prices and volume while ensuring that variable costs associated with inventories of vehicles, service tools, and parts are purchased at lowest cost to obtain the inventories. A helpful analysis would be to compare Gross Profits as a percentage of Sales to determine the contribution margin from the four primary business units. A secondary evaluation would be to compare the gross profit percentages of this dealership with the average gross profit percentages of the industry, specifically among Highline vehicle dealerships and even dealerships of the same brand.

Selling Expense

Selling Expenses could be considered another form of variable costs and includes items like compensation given to sales personnel and Finance & Insurance agents, delivery costs of inventory, advertising for the various departments, and *floor plan* interest costs for new vehicle inventory. The fact that the example dealership lists Selling Expenses as a separate category indicates the desire on the part of the management team to further isolate where costs are derived in order to manage for any deficiencies in these areas. Of course, the Accounting Department has reported on each of the items within the Selling Expenses summary account so the managers can micro-manage each contributing cost as needed. For comparative purposes, ratios can be made to determine percentages of Selling Expense (denominator) to Sales or Gross Profit (numerator) among the four business units and compare those results with industry and brand averages.

Operating Expense

The final two categories in the example Income Statement are Fixed Costs, those costs incurred whether or not an item is sold. The first category is Operating Expense. This category includes adjustments paid for by the dealership to satisfy policy claims (e.g., extended maintenance contracts, etc.), training of dealership employees, supplies, tools, equipment, uniforms, dealership vehicles, and other salaries or wages of employees not directly working on variable operations (e.g., customer service representatives in the service department or managers for Sales, Service, or Parts departments).

The analysis of Fixed Costs, Operating and Overhead expenses provides management statistics on how efficient the dealership is managing its assets. There are two primary methods to increase the Net Income of an organization – raise revenues and lower costs. Often there is not much control over lowering Variable Costs, however, more control can be taken over lowering Fixed Costs. The ratio to use would be the amount of Operating Expenses as the numerator and either Sales or Gross Profit as the denominator. If Operating Expenses are greater than Sales or Gross Profit, the *bottom line* will be a Net Loss and the ratio will be a factor greater than 1.0 in value indicating a need to raise revenues or lower costs.

Overhead Expense

The final Fixed Cost category is Overhead Expense. This category includes salaries and wages of mainly *front office* employees, payroll taxes and benefits programs for all employees, rent of facilities and equipment, advertising budget for the dealership, office supplies, utilities, insurance, etc. Normally Fixed Costs would not necessarily be allocated to individual business units but rather to the dealership at large. However, to determine if the *bottom line* for each business unit is positive or negative, a proportionate allotment based on amount of Sales for each business unit could be assigned. In lieu of using Sales as the determination of Fixed-Cost proportion allocations, one could use Gross Profit to allocate the costs by assuming that the SBU managers have little control over the costs of the vehicles purchased from the OEM. In the example Income Statement, if Sales was used as the determinant of Fixed Cost allocations, the

New Vehicle business unit would be assigned the largest portion of Fixed Costs and the Service Department would be assigned the smallest portion of Fixed Costs. If Gross Profit was used as the determinant, the reverse would be true where Service would be assigned the greatest portion and New Vehicles the smallest portion.

Balance Sheet

The Balance Sheet provides the dealership management team with a tool to determine how the sources of funds (Liabilities and Owners' Equity) are being used to fund (Assets). Students should recall the basic formula of Balance Sheet Accounting from previous Accounting classes: Assets equal (Liabilities + Owners' Equity). On the Assets side of the ledger, there are Current Assets, those assets that can be liquidated into a cash status within one year, and Fixed Assets, those longer-term assets used to sustain the operations of the dealership. On the *right side of the ledger*, Liabilities are divided into Current Liabilities, those liabilities that can be liquidated into a cash Asset status within one year, and Long-Term Liabilities (debt), those sources of funds requiring longer than 12 months to liquidate. Owners' Equity consists of the current cumulative dollar value of private ownership or of all stock values if publicly owned.

Current Assets

Current Assets consist of cash, contracts in transit, accounts receivable, and inventories. Because a Balance Sheet is a *snapshot in time* of the financial status of the dealership, transactions are always in a state of change. The *Contracts in Transit* category in the example Balance Sheet represents the value of recently sold vehicles whose sales contracts have not yet been finalized between the F&I agent and the Accounting Department with the lending institution holding the *floor plan* financing and with the various governmental agencies (e.g., tag, title, insurance, etc.).

The Accounts Receivable category in the example Balance Sheet is divided into its various components to provide dealership management sufficient details to analyze if a problem exists in those areas. Note the allowance for some of the Accounts Receivable not to be paid.

This figure is determined by historical transactions. Notice that the Inventories are separated into vehicles by category and supporting products like tires, parts, and even work-in-progress by employees. This last category would include service orders that have not been paid yet by customers for their vehicle maintenance or repairs. As before, the key measurements would be to determine how this dealership's ratios of each category to Total Current Assets compare with the average industry and brand ratios.

Fixed Assets

Fixed Assets are those items not for sale but rather are considered factors of production. These include the buildings occupied by the dealership, equipment used by the Service and Parts departments, furniture and fixtures of the buildings, and company-owned vehicles. The key measurements in Fixed Assets, besides comparing the ratios against average industry and brand ratios, would be to compare the ratios between Total Current Assets and Total Fixed Assets with average industry and brand ratios. The comparisons between the two Asset categories will provide dealership managers with information of how effective the tools of production are in creating Assets that can become cash within 12 months.

Current/Long-Term Liabilities

Moving to the other side of the Balance Sheet, Accounts Payable is part of the Current Liabilities and represents what is owed to organizations outside of the dealership. Examples of Accounts Payable would be paying back creditors for outstanding balances of ***floor plan*** finances, paying off lien holders of vehicles received in trades, paying off customers in cash as part of new vehicle sales, and paying license and title fees owed to state governments of ***contracts in transit***. These examples are related to sales transactions of vehicles.

In addition, Accrued Liabilities are classified as Current Liabilities associated with the dealership operations to include interest on loans, insurance, payroll and payroll taxes, pending employee bonuses, and pension fund/profit sharing payments. The final Current Liability category in the example Balance Sheet refers to vehicles in inventory for sale, demonstration

vehicles to be sold later, and rental/lease vehicles for loaners while customers' vehicles are being repaired. The other Liability component is Long-Term Debt, consisting of loan balances to financial institutions to fund the capital investments of the dealership that will not mature in less than 12 months.

Equity/Net Worth

The final section of the Balance Sheet to be discussed is Owners' Equity and Net Worth. In the example Balance Sheet, there is a category entitled Net Working Capital that consists of funds that have been set aside by the Finance Department for purchasing inventory in situations where cash flow is insufficient to make the necessary purchases for a dealership to remain open for business. The reserves are set aside for New Vehicle, Pre-Owned Vehicle, and the Parts Department. Without sufficient inventory to sell, valuable opportunities to make a sale are lost and affects not only current sales performance for the month but has long-range implications in terms of OEMs' inventory allocations in the future and the potential downward spiral of available sales opportunities.

In addition to allocating a portion of past profits to Working Capital, the other Owner Equity values include cumulative stock values less dividends paid over time plus net profits from the past year's operations. Note that the Net Profit figure in the example Balance Sheet does not match the Operating Profit/Loss figure in the example Income Statement because the Balance Sheet covers the entire dealership and the Income Statement was an allocation across the four listed business units (New Vehicle Sales, Pre-Owned Vehicle Sales, Service, and Parts) only.

FINANCIAL RATIOS

There are four primary sets of ratios used to analyze the overall performance of an organization like a dealership. They are (a) ***Profitability***, (b) ***Liquidity***, (c) ***Efficiency***, and (d) ***Stability***. Profitability ratios indicate whether a business can take in more revenues than it costs to run the enterprise. Liquidity measurements indicate whether the dealership can meet its short-term obligations without needing to borrow funds from outside of the dealership's operations.

Efficiency is an indication of how much productivity is derived from the dealership's Assets with the goal to minimize waste of those resources. Stability measurements indicate the overall financial health of the dealership for the long term.

The three primary *Profitability* ratios used are *Return on Assets* (ROA), *Return on Equity* (ROE), and *Profit Margin*. All three ratios use Net Income (bottom line) from the Income Statement as the numerator. Net Income is what is left over, if anything, from the annual sales revenues after all of the bills have been paid for the designated time period (month, quarter, or year). In *Return on Assets (Net Income / Total Assets)*, the Total Assets side of the Balance Sheet is used to indicate how much profit was made from all of the assets owned by the dealership for the designated time period. *Return on Equity (Net Income / Net Worth)* uses the Net Worth value of the *right side of the Balance Sheet* and excludes the Total Liabilities portion of the Balance Sheet. This measurement indicates the profitability to the Owners' investment whether they are privately owned or owned publicly by stockholders. The final *Profit Margin* ratio (*Net Income / Net Sales*) uses two components from the Income Statement only: Net Income divided by Net Sales to indicate how profitable the dealership was over the designated time period in its costs of operations. The advantage of using a ratio over just using the dollar value of Net Income is that one can compare the results of the enterprise equally with other enterprises using a percentage measurement.

There are two primary ratios used to indicate *Liquidity* of the dealership, whether or not it can meet its short-term obligations from internal operational funding: *Current Ratio* and *Quick Ratio*. *Current Ratio* uses *Current Assets* divided by *Current Liabilities* from the Balance Sheet. The word *current* represents those Assets and Liabilities that can be liquidated to cash within 12 months of the date the Balance Sheet data is published. The ratio should be a value greater than 1.0 if the dealership is liquid, the higher the number, the better the financial condition. *Quick Ratio* is a subset of *Current Ratio* in that the numerator consists of those assets that can be liquidated within 30 days vs. 12 months. The Quick Assets Ratio excludes inventories and includes Cash, Contracts, and Accounts Receivable less allowance for doubtful accounts. The result is a stronger test of *Liquidity* with the desired outcome of a number greater than 1.0 if the dealership is liquid, the higher the number, the better the financial condition. If a

dealership had a positive *Current Ratio* but a *negative Quick Ratio*, that would indicate too much dependence upon selling the inventory to cover the current liabilities.

The *Efficiency Ratio* uses Inventory Turnover rates as a measurement. To calculate Inventory Turnover, divide the **Current Inventory** units (located on the **Assets** side of the **Balance Sheet**) into the **Total Units Sold** for the year (located in the **Income Statement**). The ideal goal is for dealerships to turn over their entire inventory of new and pre-owned vehicles within a month. This is a more aggressive goal than used in other retail markets where four turnovers of inventory in a year or quarter might be the desired result. On the other hand, many items in a grocery store might turnover 30 times in a month. Inventory turnover rates for the example dealership is provided as a separate table of data in the Appendix. As in most cases, knowing the inventory turn rate for the dealership in comparison with other dealerships of similar brand or category, and with the industry, are key to understanding how effectively the dealership is purchasing the right inventory to sell in its market space. With each vehicle category, the expectations of inventory turn will vary. For example, the turn rate for Exotic vehicles will be very low but profitable. Turn rates for Domestic and Import vehicles should be approximately the same and larger than the Highline dealership used in the example. The good result in inventory turn ratios is a higher number than the average industry turn ratios.

The final financial ratio category is *Stability*, the ability to survive long term financially. The two primary ratios used for *Stability* are *Debt-to-Assets* and *Debt-to-Equity*. The *Debt-to-Assets* ratio uses the **Long-Term Liabilities** value divided by **Total Assets**. This measurement is an indication of how much value all assets the company owns is being financed by long-term debt obligations. Long-term financing of real property (e.g., land, buildings, and equipment) is normal. The warning signal to investors occurs when Current Assets are being funded by Long-Term Liabilities (e.g., when inventories are being funded by long-term financing, etc.).

The *Debt-to-Equity* ratio uses **Total Liabilities** (to include Current Liabilities) divided by **Owner Equity (Net Worth)** in the example Balance Sheet). This measurement is an indication of the balance between borrowing for assets vs. using past profits from operations to fund assets. A 50/50 *Debt-to-Equity* ratio is normally acceptable to investors to provide more

funding to the enterprise through debt, but greater than 50% existing long-term debt could provide a warning signal to investors that the enterprise is being over-leveraged and thus becoming more of a risky investment. On the other hand, if all assets were financed from profits and no long-term debt was in the portfolio, some stockholders would be concerned that the dealership was not taking advantage of leveraging *other people's money* vs. their ownership capital to fund Assets.

Trade Debt is based on a different principle than Consumer Debt. In Consumer Debt, the individual is acquiring an asset today on the promise of future earnings. Often the acquired asset depreciates in value to a zero value before the debt is paid and interest rates are higher than available in Trade Debt. In Trade Debt, the enterprise is borrowing cash at the available financial market rate and anticipating that it can use the cash to achieve a higher rate of return than what is owed to the lender. The major problem with Trade Debt is if the organization fails to sell the Assets in the marketplace before the debt is due.

DEALERSHIP MANAGEMENT SYSTEMS (DMS)

Previously, the Dealership Management System was introduced and briefly defined. In this chapter, more information is provided to explain how the DMS functions within the dealership operations. The DMS affects many functions of the dealership organization (e.g., Variable Operations, Fixed Operations, and even Administrative Operations). Accounting is the controller of the DMS information and produces reports from the system. A DMS contains all of the key data needed to know the status of dealership assets (Customer database, Financial, Human Resources, Service Department, Parts Department, and Sales Departments – both New and Pre-Owned, etc.). At the time of this publication, Reynolds & Reynolds (R&R) is the market leader of 3rd Party DMS vendors and will be used as an example in this discussion although there are other companies that provide various systems. In the following discussion, specific DMS programs will be described.

The R&R *Xtream* program is a database-mining tool that pulls dealership client information from previous sales transactions with the dealership. The database includes client

background information used to determine what clients might be in a positive equity position to sell their current vehicles for a newer model without significantly increasing their monthly payments. To use the *Xtream* program, the Sales Manager enters a set of parameters for vehicles needed in the *pre-owned* vehicle inventory and an inventory of overabundance of *new* vehicle models that need to be sold to meet monthly OEM quotas. The Sales Manager then uses the *Xtream* program functions to amortize the payouts of the current contracts held by target customers to determine which ones are the likely candidates to make a deal for upgrading to a new vehicle or a newer model pre-owned vehicle. Written correspondence in the form of a formal letter or an e-mail is generated by the *Xtream* program and is sent to the targeted customers offering the deal.

A similar DMS program is a customer-relationship management tool called *Elead*, which is an application of *Xchange*. In the *Elead* program, dealership clients who are having their vehicles serviced at the dealership will generate a query to the vehicle inventory system in *Xtream* and determine if any of the service customers onsite at the time are in a positive equity position on their current vehicles (they owe less than the current market value of their vehicle). Calculations are made to determine what the monthly payments would be for various vehicles in the new-car inventory after applying the accrued equity in their currently financed or leased vehicle. The goal is to approximate the current monthly payments with the value proposition of having a newer vehicle at about the same monthly cost as their current older vehicle. The ultimate goals are to meet OEM sales quota for new vehicle inventory and to keep satisfied clients loyal to the dealership.

Another set of 3rd Party software solutions used to determine the current market value of pre-owned vehicles within a specific geographic marketplace is called *Inventory Management* solutions. V-Auto is the market leader at 40% market share followed by First Look and Max Digital Systems at 20% market share each. Prior to these software solution programs being available, when customers came to a dealership lot to trade in or sell their pre-owned vehicles, the Sales Manager would reach for the paper Kelley Blue Book and guesstimate the value based on overall condition but not specific to the local market.

Today, that same Sales Manager obtains the VIN from the vehicle, and enters it into the Inventory Management system. The Sales Manager receives book values, auction values, and market pricing for retail transactions from similar vehicles within a designated geographic region within the past month or two. These systems also are capable of providing DMV values of popular vehicles, the dealerships' past performance with certain vehicle models, etc. From these data, Sales Managers can determine which vehicle models to acquire, which ones to take to auction, and which ones to not place into the dealership's pre-owned vehicle inventory. The data can provide a profile of vehicles needed in the inventory that sell well in the dealership's marketplace and by the dealership sales team, and where to find the vehicles needed in the inventory to sell. In other words, much of the guesswork has been removed from the process of acquiring pre-owned vehicle inventory, which can lead to better decision making and long-term profitability for the pre-owned vehicle sales department.

CHAPTER ASSIGNMENTS:

1. Describe the responsibilities of a Finance & Insurance (F&I) agent in a dealership.
2. Describe the responsibilities of a dealership Accounting Department.
3. How do the responsibilities of a Central Accounting Department vary from a dealership Accounting Department?
4. Describe the concept of *out-of-covenant* in relationship to floor plan lenders.
5. Describe the concept of *mechanic's lien* in the automotive dealership industry.
6. Describe the purpose and components of an Income Statement (Profit & Loss, P&L).
7. Describe the purpose and components of a Balance Sheet.
8. Describe the purpose and ratios associated with each of the four financial ratio categories. What do these ratios tell decision makers?
 - a. Profitability
 - b. Liquidity
 - c. Efficiency
 - d. Stability
9. Describe the functions of the various dealership management programs mentioned in this chapter.
 - a. *Xtream*
 - b. *Elead*
 - c. *Inventory Management*

CHAPTER SIX

FINANCIAL OPERATIONS

FUNDAMENTALS OF FINANCIAL OPERATIONS

The Financial Management Department of an automotive dealership, like most financial management departments, is responsible to the owners of the enterprise to ensure that the company has the capital resources necessary to sustain everyday operations and be in a position to take advantage of future opportunities for growth. There are many examples of companies that were profitable but went up for sale because they could not meet their cash flow needs to pay their debts. Cash flow is the *lifeblood* of any organization. Financial Management Departments that manage the dealership's assets wisely contribute to the success of the dealership's operations and the longevity of the enterprise. In this section, the discussion will include a review of the responsibilities of a Financial Management Department, the role of cash flow in an automotive dealership environment, and the specific lending tool of vehicle *floor planning*.

FINANCIAL MANAGEMENT DEPARTMENT OPERATIONS

Though the previously discussed role of Finance & Insurance agent contains the word *finance*, the F&I agent, who assists customers with the financing arrangements of the customers' vehicle purchase or lease, is part of the Variable Operations side of the dealership. The Financial Management Department itself is part of the Administrative Department of the dealership. The responsibilities of the Finance Department are described below.

The Financial Management Department works with the senior management team of a dealership to establish the level of initial capitalization needs for the dealership. Where there are multiple dealerships under one enterprise, the centralized Financial Management Department will help determine the initial capitalization needs for all dealership lots. Another way to express *initial capitalization needs* is the identified amount of working capital funding a dealership needs to start its operations until it can become self-sufficient from its monthly revenues to operate the dealership. After establishing the *initial capitalization* needs, asking for additional

capitalization is rare and indicates to the owners the potential of financial trouble for the dealership. Either the original formula used to establish the financial level was inaccurate or the dealership is not being a good steward of its assigned resources.

Initial Capitalization Responsibilities

Initial capitalization needs include sufficient funding for the new and pre-owned vehicle starting inventories, parts inventories, equipment for the service department and collision center if applicable and working capital to run the dealership operations for a period of months (1-3 months usually). For example, a dealership forecasts a cash need of \$2 million that they need to receive as a cash commitment from the enterprise owners. Their forecasted needs for initial parts inventory are \$500,000. The dealership forecasts \$600,000 in fixed assets (furnishings, office equipment, other equipment, etc.). The other \$900,000 of the \$2 million requested from the dealership management team represents three months of operational expenses (employee payroll, utilities, taxes, accounts receivable, etc.). Once the dealership has been capitalized initially, it is expected to be self-sustaining before the initial investment is spent and even grow the dealership's bank balance going forward through profitable management decisions.

Ongoing Financial Management Responsibilities

Another responsibility of the dealership Financial Management Department is to acquire and manage the real property upon which the dealership is situated (land and facilities). In a singular dealership, this function obviously belongs to the one Financial Management Department. In multiple dealership enterprises, the responsibility would be in the central Financial Management Department associated with the enterprise headquarters. Managing the real property assets includes managing any debt payments associated with the purchase of the real property assets. Decisions to upgrade facilities often is directed by the OEMs though sometimes the dealership may request of the OEM permission to independently perform upgrades. Often the OEMs will fund part of the upgrade costs with the dealerships being responsible for the balance of the costs. When to invest financial capital into expensive facility

upgrades is dependent upon the financial health of the organization, and the forecasted sales revenues based on economic and market conditions.

Financial Management Departments daily monitor the cash levels at each dealership using a cash flow management database system. With the pressure to make sales in Variable Operations each month of the year, and with the high volume of sales in many dealerships, the company cannot afford to allow cash flow problem areas to arise and continue unnoticed for an extensive time period. Early warning systems and vigilant management practices are important tools of the Financial Management Department to maintain a healthy financial status for the dealership. If problem areas are discovered, the Finance Department will communicate directly with the responsible Operations Managers of that dealership to discover what is causing the potential problem in cash flow and determine if the situation can be managed or if extreme measures are necessary to rectify the situation. The Financial Management Department can prescribe to the local management team solutions to fix the cash flow issues. For example, alternatives to providing more capital funding could include (a) better inventory control by the dealership Operations Managers, (b) better control over Overhead Expenses, (c) increasing Service Department productivity, etc.

When there is an indication in the dealership cash management system that a cash flow problem might exist, the Finance Department will conduct a review of the dealership's financial reports. Part of the review includes examining the *Contracts in Transit*. These are the contracts where a customer has purchased a vehicle and the dealership has not been paid yet because the process of completing the paperwork by the F&I agent or the processing of the paperwork by the Accounting Department is incomplete. Typically, the F&I agent has to complete all of the sales transaction paperwork and send to the Accounting Department. Accounting then has to process the paperwork with the various government agencies and with any *floor plan* lenders before finalizing the sale in the accounting records and releasing the funds to the dealership. These *Contracts in Transit* (CITs) are considered Accounts Receivable until converted into Cash Assets. If the number of days to complete the total process exceeds the target of 3 days and/or the number of CITs are growing beyond normal levels, cash flow is being restricted and must come from cash reserves to pay the dealership's financial obligations.

Another cash flow blockage can derive from the Parts Department maintaining excessive inventory. The remedy usually is to work through the existing inventory and reorder only standard parts until the cash flow problem is fixed. Often the cash flow blockage is attributed to an excessive pre-owned vehicle inventory. Unlike *new* vehicle inventory financed by the *floor plan* lender, *pre-owned* vehicle inventory typically was purchased out of cash reserves of the dealerships whose cash value are frozen until the vehicle is sold. The Financial Management Department will review the current pre-owned vehicle inventory to determine the value of pre-owned vehicle assets on the lot and the length of time each vehicle has been on the lot. If the authorized pre-owned inventory asset level is \$2 million and the current asset level on the lot is \$2.4 million, the Financial Management Department representative will insist that the Pre-Owned Vehicle Sales Manager reduce the inventory by \$400,000 within 30 days.

Typically, a *pre-owned* vehicle needs to be sold within 27-40 days after it is entered into inventory or it is deemed to be an *undesirable asset*. The *pre-owned* vehicles that have been in inventory for the longest period of time will be targeted for sale first either by sale to a customer or another dealership or an auction. The exception to the Financial Management Department requiring the dealership to sell the targeted inventory quickly would be if the dealership could show tangible evidence of a recent growth in pre-owned sales that have not been reflected in the monthly accounting reports. In those exceptions, the dealership might receive a temporary loan (infusion of cash) from the Financial Management Department to fund the forecasted growth.

In some of the cash flow problem situations, the Financial Management Department, whose responsibilities include managing the enterprise's treasury, can extend an internal loan to that dealership to provide additional cash to cover its current shortfall. The loan will be paid back with interest to the enterprise's treasury when the shortfall has been remedied. Though the interest is being paid from one unit of the enterprise to the other unit, the transactions are handled as if the loan originated from an external lender. Managers who have allowed their dealerships to get into a cash-deficient situation must be accountable for the costs of removing enterprise cash assets from interest bearing accounts and replace those lost earnings to the enterprise. Obviously, if a dealership operations manager continues to be in these deficit financial situations for any

length of time, he or she will not be a manager in the future. In rare occasions of dynamic growth, the circumstances may dictate that the dealership be granted additional capital investment to sustain through the rapid growth period of 1-2 months until revenues can sustain the dealership operations once more. The funds from the internal loan are wired by the Financial Management Department from the enterprise's treasury to the dealership's bank account.

Another responsibility of the Financial Management Department is to manage the relationships of all of the *floor plan* lender banks to include negotiation of financial terms and conditions. Whereas the Accounting Department has extensive contact with the *floor plan* lenders on a regular basis to ensure that contracts are paid on time and to communicate when an *out of covenant* condition arises, the Financial Management Department establishes who the lender banks will be and what those contractual arrangements will be between the banks and the dealership enterprise.

FUNDAMENTALS OF CASH FLOW

What is Cash Flow and why is it so vital to a dealership's operations? It has been said that "Cash is King" and that it is more critical than overall profitability. If an unexpected demand for payment should occur, how will the dealership pay for it? For example, with hurricanes that affected sections of the Southwest (Texas, Louisiana, etc.) and Florida in the summer of 2017, much property damage occurred. While some of the losses were absorbed by insurance policies, much of the financial loss was not covered. In these circumstances, the dealership is faced with having to use its cash reserves or having to borrow capital to rebuild its operations in order to earn revenues again.

Another example of needing Cash would be to have the resources necessary to take advantage of opportunities. During the recession of 2009, many dealerships could not sustain their operations when the market for vehicles rapidly and dramatically declined. Those dealership organizations with significant cash reserves were able to purchase for a bargain price the desperate dealerships that were in financial trouble. Had some of those dealerships for sale

managed their cash assets better, they could have sustained their operations during the recessionary economic times.

The keys of success in having a healthy cash flow operation are to sell what the market is willing to buy at the price that is profitable for the dealership through efforts to control the costs necessary to make the sales and to be paid by the purchasers in a timely manner for those sales. This phenomenon is called the *cash cycle*. A key concept for automotive dealerships is the *Velocity of Cash* principle that states one should strive to receive payments from a sale before the sales month ends. If the velocity of being paid (where all paperwork is completed and the floor plan lender is paid) is slow, the dealership is less able from a cash position to purchase additional vehicle inventory for the next *sales cycle*. Less inventory means less opportunity to make a future sale. If this trend continues, the dealership eventually will have insufficient attractive inventory to sell to customers and cover the Fixed Costs of the dealership, which could lead to closing the dealership. Remember that OEMs distribute their limited inventories of new vehicles based on past dealership sales performance. The OEMs want the best dealerships to sell the most vehicles. A standard of good *Velocity of Cash* is turning over new vehicle inventory within 27 days of the vehicle arriving on the lot and being paid on time for the sales transactions.

However, life has its challenges and there are situations that can occur for dealerships outside of their control that serve to freeze their cash flow. One primary example is when OEMs issue safety recall programs. Reputable dealerships will pull those designated recall vehicles from their customer accessible inventory, place a “Do Not Sell” sticker on those vehicles and place them on the back lot until the fix for the safety recall program has been manufactured by the OEM and inventory of the replacement parts have arrived in the Parts Department. Not only is that frozen asset of a new or even pre-owned vehicle not being sold, the dealership must use other cash from its reserves to purchase new inventory to replace the frozen inventory. When replacement parts do arrive in the Parts Department, the dealership must move quickly to place those vehicles back into customer-accessible inventory to be sold. The problem for dealership management is how to integrate the safety-recall service appointments without interrupting the flow of already scheduled regular customer service appointments.

In OEM recall situations, dealerships usually have their service technicians work overtime to manage the backlog of service appointments. Often the safety recall vehicles will be serviced after normal customer service hours. In addition, the dealership managers will complete the safety recall work based on the priorities of the actual repairs needed with the more critical safety and drivability repairs completed first. For example, air bag recalls on dealership customer vehicles parked in the back lot receive top priority primarily because the dealership customers affected by the air bag safety recall may be driving dealership loaner cars. The second priority is to fix the dealership pre-owned inventory to be repaired so that those vehicles can be placed into active inventory to be sold. The third priority is to handle customers coming in for the recall repairs. This follows the concept in the airline flight speech, "First, place the oxygen mask on yourself and then help others around you." Regardless of the priorities, the rules of engagement in safety recall circumstances is to repair the vehicles as quickly and accurately as possible so that they can be sold and thus restore the cash flow to the dealership. In some safety recall circumstances, the OEMs will provide financial assistance to the dealerships to offset any loaner or rental vehicles needed during the recall time period.

Another potential blockage to cash flow occurs when a New Vehicle Sales Manager determines that a vehicle would sell at a higher profit margin and sooner if it were to be accessorized from the original condition in which it was received into inventory. For example, mud guards, spoilers, tinted windows, upgraded floor mats, etc. may be installed on the vehicle. Before that new vehicle is available for sale to customers, the parts will be removed from the Parts Department inventory causing a freeze on those Parts capital assets in addition to the frozen asset of the vehicle itself. The vehicle must have the parts installed by the Service Department when there is an opening in the service bay schedule or when a service technician works on the vehicle in overtime. All of these costs are added to the vehicle unit. If it takes 100 days from when the vehicle was acquired until all the accessories are in place and the vehicle is sold, there are 100 days of frozen cash assets for the dealership.

Therefore, it is critical that all departmental managers within a dealership communicate with each other and with the General Manager to determine if accessorizing a specific vehicle at the present time for the dealership is the wise decision. If the dealership is experiencing good

economic conditions, then the decision may be to approve the project; if not, then the decision should be to either sell the specific vehicle as is. Because the decision will impact the managers of New Sales, Parts, and Service departments individually, making the decision jointly is important to maintaining healthy financial operations for the dealership.

VEHICLE FLOOR PLANNING

As discussed briefly in previous sections of this textbook, vehicle *floor planning* is a term used to describe the funding of new vehicle purchases by a dealership. Most pre-owned vehicle acquisitions are absorbed by the local dealership from its cash reserves. By contrast, new vehicle inventory is expected to be sold quickly. Therefore, the best plan for financing new vehicles inventory would be to use someone else's funding (3rd Party lenders) and to take advantage of the ability to *float* the debt (pay later when there is a chance that the sale can be made before the bill comes due).

The OEMs are paid when the vehicle is assembled and on its way to the dealership. Dealerships arrange with financial lenders, usually local banks or maybe OEM financial credit organizations, to purchase the vehicle by paying the OEM directly. On the day that the purchase is made by the *floor plan* lender, interest begins accruing on a daily basis. The *floor plan* lender arranges with the dealership on when the short-term loan is due, usually 45 days after the purchase by the lender from the OEM. Often OEMs provide dealerships with *trunk money* to cover up to 30 days of the daily interest charges due by the dealership to the *floor plan* lenders. This establishes a strong incentive for the dealership to sell the new vehicle quickly. If the new vehicle can be sold and the paperwork completed within 30 days, the *floor plan* lender is paid what is due and the dealership keeps any unused daily interest paid by the OEM through *trunk money*.

When a *floor-planned* vehicle is sold to a dealership customer, the typical arrangements with the lender is to be paid within 3-7 days of the sales date. The lender must be paid within the specified timeframe regardless of any delays by the dealership to complete the paperwork associated with the sales transaction. As stated previously, the time pressure is on the F&I agent

and the Accounting Department to complete the paperwork so that the funds are released to the dealership for the sale. If the dealership exceeds the designated grace period of closing the contract, it is considered to be an *out of trust* sale, meaning that the dealership must pay cash for the full amount of the new vehicle to the *floor plan* lender or be in jeopardy of defaulting on the loan of the vehicle. One *out of trust* contract is problem enough for the dealership but running high volumes of *out of trust* contracts can eventually lead to the dealership finding it difficult to obtain financial lenders at market rates. If the dealership wants to avoid defaulting on the *floor plan* loan, it will need to pay cash for the vehicle without being compensated until the sales contract documentation has been filed correctly.

CHAPTER ASSIGNMENTS:

1. Compare the responsibilities of the Financial Management Department with the Accounting Department in a dealership.
2. Describe the considerations that go into establishing initial capitalization needs for a dealership.
3. Describe the responsibilities of the Financial Management Department with real property assets of a dealership.
4. How does the Financial Management Department determine that a cash flow problem exists in a dealership?
5. What remedies does the Financial Management Department have to fix a cash flow problem in a dealership?
6. Why is cash flow more critical to the success of a dealership than profitability?
7. Describe the *Velocity of Cash* concept for automotive dealerships.
8. Describe the Vehicle Floor Plan concept.
9. Describe the *out of trust* situation with sales contracts.

CHAPTER SEVEN

MARKETING & SALES

FUNDAMENTALS OF MARKETING & SALES

For all the other operations that take place in a dealership, they have no function to perform if sales of the products and services do not occur. There are sales that take place in each of the Variable and Fixed operations: Service Department, Parts Department, Collision Center, and even the Finance & Insurance Department. Before the discussion of sales though, it is important to discuss how to attract customers to the dealership lot for sales, service, parts, and/or collision center. Marketing is the tool used to determine which customers represent the target market segment for a dealership and how to reach that target market with the right message and through the right media resources.

TARGET MARKET IDENTIFICATION

Marketers evaluate which consumers are purchasing specific products or services in the market. In their evaluations, marketers are looking for clues that can determine if there are common characteristics among the purchase groups called *market segments*. Characteristics can include *demographics*, *geographics*, *psychographics*, and even *geo-demographics*.

Demographic indicators are gender, age, educational levels, ethnicities, income levels, etc. *Geographics* is about regions of the nation, population densities, proximity to metropolitan markets, climate seasons, etc. *Psychographics* involves studies of consumer attitudes, learning styles, personal value systems, affinity groups, etc. *Geo-demographics* represents a more in-depth study of the combinations of consumers by market segment who live within a geographical area. One resource used in the geo-demographic studies is the PRIZM database now managed by the Nielsen Group¹¹. The more that a marketer understands about the characteristics of the marketplace served by the dealership, the more effective the marketer can be in reaching the market with solutions that meet the target market consumers' needs.

¹¹ Website Link: [MyBestSegments](#)

Fortunately, there are dynamic resources available to dealerships to determine market segments and what those segments are purchasing in the dealership's marketplace. One such resource is the Manheim Markup Report (MMR) that identifies who buys what vehicles in specific market areas. Another resource is the Urban Science report for the automotive industry that reveals the demographics of a marketplace and other forces that can affect sales (e.g., cost of fossil fuels in the area, governmental regulations, trends of ride sharing, etc.). These data can aid the dealership sales manager in forecasting which vehicles to place on the dealership lot and how many of each model, color, and accessories to stock in inventory.

OEMs use the various marketing research tools to forecast consumer demand to use in their future designs of vehicle models. OEMs are designing new models of vehicles 6-10 years in the future, long before those vehicles go into production. Not only do OEMs need to know what consumers will want but how many vehicles of a given model need to be produced to meet future consumer demand. Porsche's goal is to build one less vehicle than the demand in order to uphold brand equity (keep them wanting more). Being inaccurate in these forecasts can prove extremely costly to the manufacturers if they miss the consumer market's preferences (e.g., the Ford Edsel). To achieve forecasting accuracy requires knowing what consumers want based on today's purchases and being able to design the progressive stages of annual model improvements to the future 6-10 years. Another indicator of future consumer preferences comes from trade shows that reveal prototype concept models where the reactions from automotive enthusiasts can be collected and analyzed to determine if the OEM is on the right track or if some modifications are needed to please consumers with the vehicles of tomorrow.

When the various unique market segments of consumers who purchase specific products have been identified, the next stage of the market segmentation process is for the organization (dealership) to determine which of the segments it should pursue. The foundational assumption is that not all market segments would be practical to pursue given the limited resources available to the dealership. The dealership needs to identify the market segments that it should target for its marketing promotional strategies based on the following criteria:

- (a) **Size** of the market segment,
- (b) Expected **growth** rate for that market segment,
- (c) The **competitive** position of the dealership in that market segment,
- (d) The cost of **reaching** the segment (accessibility), and
- (e) The **compatibility** of the dealership's culture and brand image with the segment.

If the **size** of the market segment is small, it typically does not merit the expenditure of valuable resources to pursue because of the limited profit that can be made. An exception that might warrant pursuing a small market segment would be if it is connected socially to a more significantly sized segment, and if synergies could be established between the two segments through proper promotional messages and impact. For example, BMW acquired the Mini Cooper brand to fill in a gap of its existing full-sized vehicle product line. If the annual sales **growth** rate among the market segment is flat or declining, it may not be a segment to target, even if every other criterion is attractive, because the opportunity to make profits in that segment is dwindling.

The **competitive** position of the dealership within its market can enhance or obstruct efforts to reach its target market segments. If the dealership brand is a market leader, marketing efforts can thrive. If the dealership is a small competitor in the market, more funding will be needed to make a significant profitable impact with promotional investments. Another consideration in the competitive factor is the nature of the market's competitors. The term used to describe an aggressive **competitive** market is **red oceans** compared with **blue oceans** representing a less competitive market. In **red ocean** competitive environments, price wars typically occur, which have a negative impact on profits. To some extent, the franchise OEM model in the United States provides some geographical separation of the closest same-brand competitors. However, these traditional geographical boundaries may not be sufficient to ward off competitors in an Internet-based mobile society where customers can find a vehicle online and travel to the dealership that offers the best deal even if that dealership is located out of state.

Sometimes a deterrent to **reaching** a market segment is how accessible they are to any messaging that the dealership might provide. The less accessible they are, the more is required to spend in advertising dollars to reach them. One of the accessibility factors is when the last

vehicle was purchased or leased by the consumer. If a significant number of consumers purchased or leased a vehicle last year, it may be 3-5 years before they would be open to their next vehicle purchase unless a significant event alters the normal purchasing pattern of vehicle owners. For example, in the 2017 Hurricane Harvey destruction of the greater Houston, Texas area, many vehicles needed to be replaced. This was a boon for dealerships at the time but sets up a future period of time when vehicle sales will decline because many owners have the vehicles they need.

The last criterion for determining if a market segment is attractive enough to target is the *compatibility* of the consumers' needs with the dealership culture and brand image. Many automotive consumers are completely loyal to one brand of vehicle with the chances of a dealership from another brand enticing those consumers to switch difficult if not impossible (think of GMC vs. Ford, vs. Dodge trucks). Therefore, a Ford dealership should not consider expending much marketing efforts to win over GMC owners but rather focus on Ford-loyal customers and those who have not established a firm brand loyalty yet. Sometimes consumers can be convinced to switch automotive vehicle brand loyalties in circumstances where there have been persistent quality issues with an OEM brand. However, the more likely opportunity to create the environment where a consumer would switch from one OEM brand to another is through dealerships offering superior service and friendly employees.

CONSUMER BEHAVIOR

The study of consumer behavior (CB) involves analyzing the individual CB profile among the identified target market segments in combination with how consumers, as a whole, approach purchase decisions for the product category, in this case, automotive vehicles. The following discussion will elaborate on some of the considerations for consumer behavior analysis.

Consumer Behavior Profile

Consumers, as humans, basically have the same components within their profile; the components are just unique by their very nature. The three basic functions of a human consumer are the cognitive (thinking), affective (emotional), and conative (behavioral). The type of decision being made will determine which order these functions follow. The Cognitive/Affective/Conative (Think, Feel, Do) model is typical of most automotive purchases because of the amount of investment going into the decision. In this model, the consumer researches the options available, usually on the Internet, by evaluating the costs, the anticipated value, the features and functions of the vehicle, etc. The colors and design along with the perceived acceptance by peers will be motivated from the Feeling or Affective area. Finally, the visit to the dealership lot and the test drive will generate the Conative or Behavioral response. The other two models are rare but do occur on occasion. The Feel/Do/Think model would be associated with *muscle cars*, Highline, and Exotic vehicles. First, there is an emotional connection to the vehicle, then the test drive to confirm how it feels driving the vehicle, and then the signing of the contract. The Do/Feel/Think model is more of a characteristic of the impetuous individual regardless of vehicle selected – they just need a new car.

The components involved with the Cognitive realm of a consumer include (a) perceptions, (b) comprehension, (c) memory, and (d) learning styles. The characteristics normally associated with the Affective realm of a consumer include (a) Values, (b) Motivation, (c) Emotions, (d) Personality, (e) Self-Concept, and (f) Attitudes. Finally, the components associated with Conative include (a) Openness to attitude changes, (b) Interpersonal influence, (c) Culture, and (d) Situational circumstances. The automotive dealership manager needs to consider each of these components in terms of prioritizing what message to use in the dealership's promotional strategies that will attract target market customers to the dealership lot.

For example, in the Cognitive level of a consumer, the purchase of an automotive vehicle is critical because of the cost to the family budget and the value of the investment in the vehicle to be durable for the length of time required by the purchaser until another purchase is required.

The focus of messaging to the cognitive area of a consumer is to inform about the reasons why the consumer would purchase a given brand and model offered by the dealership.

From the Affective level of the consumer, the messaging would be one of persuasion to visit the dealership's lot and not the lots of the competitors. The dealership manager would use comparative advertising to indicate the virtues of its dealership over the downsides of the competitors' dealerships.

In the level of Conative behavior, the dealership manager would focus on reminder advertising to keep the name of the dealership and the brand of automotive vehicles in the mind of the consumer and to invite action by visiting the dealership lot sooner rather than later. Another promotional method to incite the consumer to purchase now and not later is to use special promotions with financial incentives. If consumers act now there is no money down, zero percent interest, payments not due until 90 days from now, drive the vehicle for 30 days and bring it back if they don't like it, extra cash off the sticker price, etc. The question becomes, "Who should be targeted with these messages?"

There are specific sub-components of the Three Levels of consumers that can assist the dealership manager in focusing the message even more narrowly for the target market consumers. For example, understanding why young single males prefer the *muscle car* genre or young *soccer moms* prefer the minivan or SUV can assist in the messaging used. The *muscle car* enthusiasts will be attracted to the accessories placed on those models in the dealership lot. Even if they arrive at the lot and cannot afford the price tag of the fully loaded muscle car at the moment, they may settle for a scaled-down version of the model instead. The *soccer mom* will enjoy the benefits of the foot-to-the-back-bumper feature that causes the lift gate to raise when the mom has her hands full of groceries. When the minivan first came out with both rear side doors opening, that benefit was featured in national advertising to demonstrate the ease of entry for all passengers when compared with the earlier model where only the curbside sliding door opened. The messaging needs to focus on the key features and functions that are relevant to the target market consumers' lives and reasons for purchasing the vehicle.

Another key area of focus on messaging to the target market segments of the dealerships is in situational circumstances. Included among those could be where the need exists to replace vehicles because of a natural disaster or a change in economic conditions – either up or down. Another circumstance could be the trend in gasoline prices or the advent of natural environmental concerns to “save the planet”. When predominant social, environmental or economic forces are driving consumer attitudes and behaviors in their purchase decisions, a savvy dealership manager will stock the vehicles that can be perceived by the target market to be solutions to the consumers’ concerns. In addition, the manager will ensure that the promotional messages within the region encourage target market consumers to come to the dealership lot for those vehicles that satisfy their perceived needs.

Consumer Decision Process

What stage of the decision-making process that a consumer is in to purchase an item (automotive vehicle) can determine the proper response by the dealership manager to the messaging of any promotional marketing campaign. The five steps of the purchase decision-making process are (a) needs recognition, (b) information search, (c) evaluation of alternatives, (d) purchase decision based on internal criteria, and (e) post-purchase behavior.

Today, many of the initial steps of the purchase decision-making process are conducted on the Internet before being acted upon at a dealership lot. In fact, some OEMs allow consumers to design the vehicle for themselves on their website or locate the vehicle already built that matches the consumers’ desires and transport that vehicle to a dealership of the consumers’ choice. With pre-owned vehicles, there are even companies like Carvana that will deliver the vehicle to a vehicle kiosk for consumers to retrieve their pre-ordered, pre-paid vehicle. For now, under the OEM franchised dealership model, this option is not available for new vehicles.

When consumers arrive on dealership lots, they often know what they want because they have studied the features and functions of the various vehicle models. The average information search by potential automotive vehicle purchasers is 15-18 hours before visiting a dealership lot. They know, through online databases like Edmunds, the vehicle retail price and how much the

dealership paid to have the vehicle delivered to its lot. These knowledgeable consumers often know what other consumers have said about the vehicle from customer reviews. The wise salesperson on the dealership lot will take into account this potential pre-condition and ask newly arrived customers on the lot what they have already determined about the vehicle they are seeking and how the salesperson can direct them to their ideal solution.

For those consumers who are in the process of searching the Internet for a specific OEM brand model, the wise dealership manager will use Search Engine Optimization keyword ads to attract consumers to the local dealership website and inventory of those vehicles. For consumers who visit the dealership's website, evaluation tools should be available to guide the website visitor through scenarios like availability of the vehicle even if it needs to be delivered from another dealership lot, pricing alternatives, etc. The website also should have an interactive chat room feature for someone from the BDC, for example, to answer the website visitors' questions and guide them to a scheduled appointment to visit the dealership lot. As in all sales transactions, the dealership representative needs to discover the criteria being used by the potential customer to make this specific automotive vehicle purchase. Finally, the strategy should be to follow up with the customers who purchased a vehicle after the sale, probably on more than one occasion, to ensure that the customers are satisfied with their purchase decision and to handle any issues that might arise in those post-purchase discussions. Establishing a positive relationship with potential lifetime loyal customers is always a good policy for building a residual customer base who could potentially purchase numerous vehicles for the dealership throughout a lifetime.

Marketing Promotional Media Strategies

The previous section was focused on consumer behavior and the influence of messaging to the target market segments of the dealership. This section is focused on the media that is used to deliver the promotional messages. There are three tiers of advertising in the OEM-franchise dealerships model: Tier 1 consists of national advertising paid by the OEMs; Tier 2 consists of regional advertising paid by dealer groups; Tier 3 is advertising paid by the local dealerships. The purpose of Tier 1 is to promote the OEM brands of automotive vehicles. Tier 2 advertising is

to promote the locations of dealerships within a geographical region. Tier 3 is to promote what a local dealership offers in terms of deals and customer relationships.

The standard media categories are

- (a) Broadcast (TV and Radio),
- (b) Print (Magazines and Newspapers),
- (c) Out-of-Home (Billboards, Transit Signage, sidewalks, sky banners, etc.),
- (d) Direct Marketing (Catalogs, Mailers, Telemarketing, Personal Selling, etc.),
- (e) Sales Promotions (Coupons, Rebates, Contests/Sweepstakes, Samples, etc.),
- (f) Public Relations and Sponsorship Programs,
- (g) Digital Marketing (Emails, Datamining, Social Media, Viral Marketing, etc.), and
- (h) Alternative Marketing (Product Placements, Events, Point-of-Purchase Displays, etc.).

The concept for dealership managers is to integrate the media categories that best fit the target market segments' spaces where they go to get information, be entertained, and to socialize. The dealership manager cannot choose all media outlets because of limited resources and because some media outlets do not attract the dealership's target market. On the other hand, the dealership manager should not choose just one media outlet because of the potential synergy among multiple media outlets that can reinforce the dealership brand identity in different ways and from different angles. Studies have shown that a minimum of three exposures to a message is required before consumers pay attention to a message and as many as 10 exposures before those same consumers take the action of purchasing.

Typical media purchases by local dealerships for Tier 3 ad spending include TV, Radio, and even newspapers. The focus on TV advertisements is the local news programming in the morning and late evening, and sports programming at any time. These options provide the opportunities for the largest reach and most frequency to see the ads by the target market. In addition, these programs experience the lowest avoidance of programming (DVR zipping and zapping of ads) so viewers are more likely to see the paid ads. The target age cohorts for TV and Radio are 18-24 and 55+ because consumers between these two age brackets are more focused

on the actual deals and offers at the time they need a vehicle than on the overall “Come on down today” message. Often the audio portion of a TV ad is repeated on the Radio to reinforce the memory recall of what the consumer saw on TV. The primary component of the messaging on the TV ads should be the dealership’s website URL where viewers can check out a deal being offered. Studies show that 80% of all viewers have a device in their hands that can access a website to further review what they just saw in the TV ad.

The method used to measure the effectiveness of an advertisement (broadcast, print, etc.) is to compare the adjusted rate of sales after the ad or event is first presented and up to 90 days afterwards, though usually 30-60 days afterwards. The amount of sales revenues last year at the same time of the year is compared with the sales revenues this year at the same time with adjustments for any unusual differences in external situations that might also have an effect on the sales. In Internet measurements, the “open rate” and the “bounce rate” are measured to determine the effectiveness of a digital message. The “open rate” measures how many visitors clicked on a web link to view a message. The goal is for 15-20% of visitors to open the website and a good ad can produce 50-70% “open rate”. The “bounce rate” measures how many visitors abandon the website after entering it without clicking on additional links within the dealership website (they bounced out).

A common use of Tier 3 advertising by local dealerships is through combining Radio advertising with a special sales event at the dealership. Usually there are free food and beverages, entertainment, giveaways, chances to win a free car while being broadcast via a local radio station with local personalities or maybe even using a national celebrity. These are some of the methods used to attract customers to a dealership lot but closing the deal on the lot is the critical result that is desired.

SALES STRATEGIES

As stated previously, many customers in the Information Age come to the automotive dealership lot with much of the purchase decision already made. In the past, the salesperson was the source of information about the vehicles on the dealership lot but now customers usually are

that source. Therefore, the role of the salesperson becomes one of more a facilitator to assist the informed customers in locating the specific vehicle that will meet their specific needs. The following sales model provides a structure for the various phases of the encounters between salesperson and customer on a dealership lot.

Automotive Sales Process Model

In this section, the Automotive Sales Process stages are described. The first eight stages include research findings of the average stress level of customers for each stage on a scale of 1-10 where “1” is a very low stress level to “10” represents a very high stress level. This sales process is just an example. Some steps can be interchangeable. (e.g., Trade Assessment, Presentation, Demo, and Service Tour may be interchanged depending on the customer.)

1. **Welcome:** The salesperson approaches the customer to introduce himself or herself and welcome the customer to the dealership. Other introductory conversation occurs to initiate the relationship and to attempt to produce a calming atmosphere for the customer. However, this stage is one of the highest stress stages at an average value of “8”.
2. **Vehicle Selection:** At this stage, the salesperson transitions from personal greetings to discovering what vehicle is preferred by the potential customer and for what purposes the vehicle will be used. This also is where the salesperson asks about the information search that the visitor has performed to date. If the customer has not performed much of a search, the salesperson will ask more questions to narrow the vehicle selection choice. If the customer has performed a search, the salesperson will ask questions to verify if the perceptions of the customer are accurate or if there are misinterpretation of the facts about any vehicle. The average stress level in this stage is “6.5”, some reduction but still above the midline.
3. **Trade Assessment:** The next stage is where the salesperson asks the visitor about if he or she will be selling his/her vehicle as part of the new vehicle purchase. This allows the salesperson to involve the pre-owned sales management team early so that the evaluation

process of the vehicle owned by the potential customer can begin. The salesperson and customer will physically walk around the customer's vehicle in an effort to help assess the vehicle condition. Then the salesperson will introduce the visitor to the pre-owned sales manager who will take the keys to inspect the visitor's vehicle. This evaluation process will be occurring while the visitor and salesperson are exploring the new vehicle inventory so as to not delay the overall sales process. This stage also has a "6.5" average stress level.

4. **Presentation:** This stage is an attempt to narrow the choices of the visitor to one or two models for consideration. At this time, the salesperson should not discuss every feature and function about the vehicle but rather explore the most relevant points for the potential customer based on what was shared in the earlier stages of the information discovery process. The stress level at this stage is one of the two lowest levels at "2.5" average stress on a 10-point scale.
5. **Demo (test drive):** Now is the time to allow the potential customer to actually experience how the vehicle performs. Some salespeople actually drive the first half of the test drive and explain some of the features and functions of the vehicle while doing so. Using this approach, builds expectations on the part of the potential customer; it could also build frustration. Then the potential customer drives the second half of the test drive. Many salespeople prefer allowing the customer to drive during the whole demo. The stress level for this stage is slightly elevated at an average of "3.5".
6. **Service Tour:** Upon return to the dealership lot, salespeople often guide the potential customer on a tour of the service facilities and introduce the Service Advisors to the visitor. The Service Advisors describe how they will be taking care of any vehicle purchased from the dealership. This stage is focused on building long-term customer relationships and to allow more time for the evaluation of the visitor's pre-owned vehicle value. The average stress level for this stage is "3.5", partially because of the expectation of what is to come.

7. **Write-Up:** In this stage, the salesperson invites the visitor into the office to present the numbers in the initial offer to include the sales value of the visitor's vehicle. The salesperson also needs to determine which vehicle the potential customer would like to purchase or lease. If the customer is interested in proceeding with the deal, the salesperson begins to fill out the information needed for the contract. The salesperson may ask the prospective customer if he or she would like a snack or beverage while the salesperson leaves the office to obtain the value of the customer's vehicle. The average stress level for this stage is "8.5".
8. **Negotiate:** This stage is where the salesperson returns to the office space with the final numbers of the proposed contract price for the vehicle sale, the value of the trade, the amount of down payment that will be made and what the monthly payments will be. Either the customer will agree, and the process continues, or the customer will balk, and negotiations may begin between potential customer, the salesperson, and maybe the sales manager to determine if a deal can be made that day. Part of the negotiations may include discussion of a different vehicle that would meet the affordable payments criteria of the prospective customer. The stress level of this stage is high at "9". In essence, the stress levels in Stages 1-8, when displayed as a graph form the shape of the letter "W".
9. **F&I Paperwork:** In this stage, the salesperson will deliver the customer to the Finance & Insurance agent who will go over the forms that need to be signed and ensure that everything on the forms are accurate and agreed upon by the customer in the deal. The salesperson has departed and instructed the detail shop to prepare the newly purchased vehicle for the customer to drive off the dealership lot. The F&I agent will attempt to sell additional services to protect the customer's investment in the vehicle like extended service agreements, roadside maintenance, paint protection, upgraded floor mats, etc. When all paperwork has been completed, the salesperson will be called back to pick up the customer.
10. **Delivery of the Vehicle:** The salesperson probably has pulled the vehicle up to a nearby door where the customer has been seated with the F&I agent. The salesperson will have

the customer walk around the vehicle to ensure that it is in excellent condition and ask the customer to sit in the driver's seat of the vehicle. Either the salesperson or, in some dealerships, a concierge will instruct the customer on key functions of the vehicle's dashboard and instruments. The key is for the customer to drive off the dealership lot with that "new car" feel and good feelings about his or her experience with the dealership. So, the question remains, "What qualities are in a successful salesperson in the Information Age?"

KEY SUCCESS FACTORS FOR SALESPEOPLE IN INFORMATION AGE

1. Be a problem solver not necessarily the source of information.
2. Perform the gap analysis of what the customer knows vs. what he or she does not know to make a decision.
3. Be transparent with no hidden agenda but to assist the customer in meeting his or her needs.
4. Move the sales process along as quickly as possible for today's busy pace.
5. Meet people where they are and not where the salesperson thinks they should be.
6. When the gap is known that separates the customer from making a purchase decision, know how to resolve the gap.
7. "Shine the light". Tell people what is going to happen next, do it, then recap about what was done, ask if further is needed before moving on.
8. Relate to the customer's needs. Visualize customer's situation to help close the deal – what matters to them in their current life cycle (e.g., pregnant mother with 2 in tow, etc.)
9. Present information in small parts; explain what will be happening next
10. Remind customers of the benefits (good things) about purchasing this new car
11. Remember that dealerships do not mind potential customers' web search; dealerships just want their lots to be where the searchers end their search.
12. Be a Hunter vs. a Farmer in customer sales. Hungers aggressively pursue sales transactions; Farmers build long-term relationships.

CHAPTER ASSIGNMENTS:

1. Describe the concept of market segmentation.
2. Describe the concept of target market selection.
3. Search the Internet for some of the reports available to dealerships to know their target market characteristics.
4. What makes a market segment attractive?
5. Describe the three primary areas of a consumer's behavior profile: cognitive, affective, conative.
6. Describe how messaging should be used to impact the identified target market segments.
7. Describe the customer decision process as it relates to purchasing automotive vehicles.
8. Describe the three tiers of advertising for the automotive industry.
9. Describe the various media options used by dealerships in their local Tier 3 spending.
10. Describe the stages of the typical sales process on a dealership lot.
11. Describe the stress levels associated with each stage of the sales process.
12. What are key success factors for salespeople in today's Information Age?

APPENDIX A: DEALERSHIP FINANCIAL REPORTS

<u>Income Statement:</u>	<u>Highline</u>
Sales	
New Vehicles	\$87,252,211
Pre-Owned Vehicles	\$65,979,293
Service Department	\$11,183,983
Parts Department	\$14,862,640
Total Sales	\$179,278,127
Gross Profit	
New Vehicles	\$3,016,985
Pre-Owned Vehicles	\$3,347,480
Service Department	\$7,272,540
Parts Department	\$4,824,471
Total Gross Profit	\$18,461,476
Selling Expenses¹	
New Vehicles	\$438,302
Pre-Owned Vehicles	\$1,835,630
Service Department	\$1,408,871
Parts Department	\$1,062,697
Total Selling Expenses	\$4,745,500
Operating Expenses²	
New Vehicles	\$1,240,161
Pre-Owned Vehicles	\$1,042,933
Service Department	\$1,672,568
Parts Department	\$842,539
Total Operating Expenses	\$4,798,201
Overhead Expenses³	
New Vehicles	\$1,390,983
Pre-Owned Vehicles	\$990,587
Service Department	\$1,898,740
Parts Department	\$970,798
Total Overhead Expenses	\$5,251,108
Total Expenses	\$14,794,809
Operating Profit/Loss	\$3,666,667

Balance Sheet**Highline**

Current Assets	
Cash	\$4,955,758
Contracts in Transit	\$4,332,960
Total Cash & Contracts	\$9,288,718
Service & Parts	\$944,776
Rental Vehicles	\$99,144
Wholesale/Dealer Transfer	\$1,688,462
Warranty Claims	\$117,386
Pre-Delivery Service	\$23,826
Vehicle Incentives	\$762,940
Bonuses: Service, Direct Mktg., Techs	\$869,122
Less: Allowance for Doubtful Accounts	(\$127,079)
Net Customer/OEM Receivables	\$4,378,577
Finance/Insurance Co. Receivables	\$291,796
Total Receivables	\$4,670,373
Demos (7 units)	\$355,220
New Vehicles (215 units)	\$10,637,623
Pre-Owned Lexus (60 units - 2 @ 60 days+)	\$350,689
Pre-Owned Cert. (105 units - 13 @ 60 days+)	\$2,716,873
Pre-Owned Other (103 units - 8 @ 60 days+)	\$1,719,495
Other Vehicles (141 units)	\$5,006,744
Total Vehicle Inventory	\$20,786,644
Tires	\$63,622
Parts & Accessories	\$861,292
Gas Oil & Grease	\$21,265
Work in Process - Labor	\$7,288
Other Inventory	\$31,841
Total All Inventories	\$21,771,952
Prepaid Taxes/Insurance/Advertising/Other	(\$10,201)
Total Current Assets	\$35,720,842
Fixed Assets	
Buildings & Improvements	\$36,436
Service Equipment, Parts & Accessory Equipment	\$1,125,451
Furniture, Signs, Fixtures	\$83,981
Company Vehicles/Leaseholds	\$273,196
Total Fixed Assets	\$1,519,064
Advances to Employees/Other Non-Franchise	\$635,062
Assets	
Total Other Assets	\$635,062
Total Assets	\$37,874,968

Balance Sheet**Highline****Accounts Payable**

Trade Creditors	\$2,816,842
Vehicle Lien Payoff	\$1,373,883
Cust. Payoff/Advance Pay from OEM	\$137,950
License & Title Fees	\$24,569
Total Accounts Payable	\$4,353,244
Interest	\$20,312
Insurance	(\$71,527)
Payroll	\$123,727
Payroll Taxes	\$1,204
Sales Taxes	\$308,854
Employee Bonuses	\$546,068
Pension Fund/Profit Sharing	\$18,633
Total Accrued Liabilities	\$947,271
New Vehicles & Demos Finance	\$12,080,402
Rentals & Lease Vehicles	\$4,128,235
Total Current Liabilities	\$21,509,152
Other Notes & Contracts	\$945,497
Total Long-Term Debt	\$945,497
Total Liabilities	\$22,454,649
Inventory Reserve - New	\$263,019
Inventory Reserve - Pre-Owned	\$131,509
Inventory Reserve - Parts	\$25,133
Net Working Capital	\$419,661
Capital Stock	\$14,335,584
Dividends	(\$5,763,716)
Net Investment	\$8,571,868
Net Profit	\$6,428,790
Total Net Worth	\$15,003,658
Total Liabilities & Net Worth	\$37,874,968

NOTES:

¹ Selling Expenses include: Sales Comp, Delivery, F&I Comp, Dept. Ads, Floor Plan Interest

² Operating Expenses include: Policy/Claims Adj., Training, Outside Services, Freight, Supplies, Small Tools, Laundry, Uniforms, Equipment, Dept. Vehicles, Other Salaries/Wages

³ Overhead Expenses include: Rent & Equipment, Admin. Wages/salaries, Payroll Taxes, Employee Benefits, Pension Fund/Profit Sharing, Dealership Advertising, Office Supplies, Utilities, Insurance, etc.

<u>Inventory Turns</u>	<u>Highline</u>		
New Car Sales Units	New	Used Retail	Used Wholesale
January	100	104	90
February	116	126	83
March	164	145	136
April	142	130	86
May	165	175	79
June	141	113	106
July	162	136	78
August	143	124	115
September	138	98	69
October	139	108	86
November	159	116	90
December	209	168	109
Annual New Car Sales Units	1,778	1,543	1,127