On the road to recovery

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The picture for automotive dealerships is murky. Car sales are falling on the back of the economic downturn, fuel prices are still at historically high levels and the public is turning to lighter vehicles that deliver lower profit margins for manufacturers and dealers alike.

While some dealers are attempting to blame the global financial crisis for their business woes, Graham Killer, Director, recovery and reorganisation services at leading accounting firm Grant Thornton Australia, calls for dealers to seize the opportunity to halt the downward trend in profitability.

As an experienced advisor to automotive dealerships, he understands their concerns in the present market while acknowledging that recent economic events have dampened business investment, consumer spending and investor confidence.

Mr Killer maintains, though, that some businesses have cost themselves profit opportunities over the past five to seven years due to a lack of strong management focus. In today's trying market, such strategy shortfalls are translating into fragile bottom lines.

"A number of dealers effectively didn't have the right practices in place," Mr Killer tells Esanda Acceleration.

Three key areas to watch:

1. Stock management
2. Expense controls
3. Employee incentive plans that align with dealership goals and profitability

While blue-chip dealers will continue to be highly profitable over the next 12 months, Mr Killer says others should respond quickly to market conditions. According to official VFACTS data released by the Federal Chamber of Automotive Industries, new vehicle sales for March slumped 17.1 per cent compared with the same month a year earlier.

Manufacturers are clearly feeling the pinch, with hundreds of staff losing their jobs at Ford Australia and component companies such as Unidrive and PBR International also shedding workers.

Mr Killer says decisive and informed action is required to negate the effects of the crisis.

> *"The key to this market is the dealers' ability to adjust quickly to the changing conditions and then they'll continue to be profitable unless their site is significantly over-capitalised."*

Taking stock

One of the biggest issues for some automotive dealerships, according to Mr Killer, is poor stock management. A tendency for manufacturers to flood the market with vehicles is of particular concern during periods of slow sales. If dealers are overstocked, wholesale financing costs blow out and profits erode.

Mr Killer notes that some dealers are still battling to clear stock with 2007 plates, putting the heat on inexperienced salespeople who may not have the appropriate training to convert sales opportunities into the car being driven out of the car yard. Mr Killer sets some important guidelines for his auto dealer clients. Dealers should aim for a maximum stock holding of new and used cars equivalent to 45 days based on future forecast monthly sales projections.

This requires a detailed analysis of stock flows and a clear knowledge of the types of vehicles that the particular dealership actually sells. IT software tools or a basic spreadsheet can be used to track the type of vehicles the dealership has been selling.

A number of dealers don't actually review what they are selling as opposed to what they have in stock.

> *"Having the right product mix and purchasing the right vehicles is extremely important."*

He urges dealerships to apply another strict rule of thumb: if a used vehicle has not sold after 90 days, it should be wholesaled. Some car yards, he notes, have stock sitting on the yard for longer than six months. "Now that is just poor management," Mr Killer says. Selling old stock is not difficult if vehicle prices are regularly reviewed and the stock matrix is right.

Mr Killer explains: "If you consider a used car at 30 days and 60 days and you reprice it to the current market, then that vehicle will sell. But a lot of dealers do not reprice for the current market as they are concerned about what the vehicles owe them … They need to be very proactive in monitoring their stock and adjusting their pricing."

Controlling cash

The Australian automotive market is not alone in facing difficulties. In the United States; Ford, General Motors and Chrysler are looking to refinance massive debts, prompting the extraordinary circumstance late last year of their respective CEOs – Alan Mulally, Rick Wagoner and Bob Nardelli – agreeing to accept an annual salary of just $1. The outlook is also bleak in Britain, where job cuts are being announced despite carmakers receiving a £2.3 billion support package.

Given the turmoil, controlling expenses within automotive dealerships is ever more important. Mr Killer says some dealers are making the mistake of spending more money on advertising in the present market in the hope of propping up sales.

"What they should be doing is reducing their advertising spend and understanding the return they actually achieve." That means targeting websites or publications that deliver demonstrable returns from ads. Why advertise used vehicles on all websites – and paying for the privilege – if one site consistently outperforms the others?

According to Mr Killer, the key expenses for all dealerships are interest, wages, rent and advertising. To maximise financial returns, he says a change of management and staff utilisation is often required. For instance, he recalls one dealer bringing in a new finance and insurance manager, resulting in a rise of gross finance income from $30,000 to $70,000 per month.

> *"If you get the right culture in a dealership, it changes the bottom line straight away."*

It is also vital to examine all other aspects of the business and to track and review performance. Many dealer principals do not, for example, properly manage their service or parts operations. Some dealers may have four or five months' worth of parts in stock, when one month is the optimum holding period.

Rewarding good staff

Another key strategy for success is aligning staff incentive plans for all departments with the goals of the dealership. With many dealerships needing to de-stock, Mr Killer says it is crucial for management to give sales staff motivation to shift stubborn stock, otherwise there is a risk of bringing new vehicles into the dealership when the emphasis should be on moving stock already in the yard.

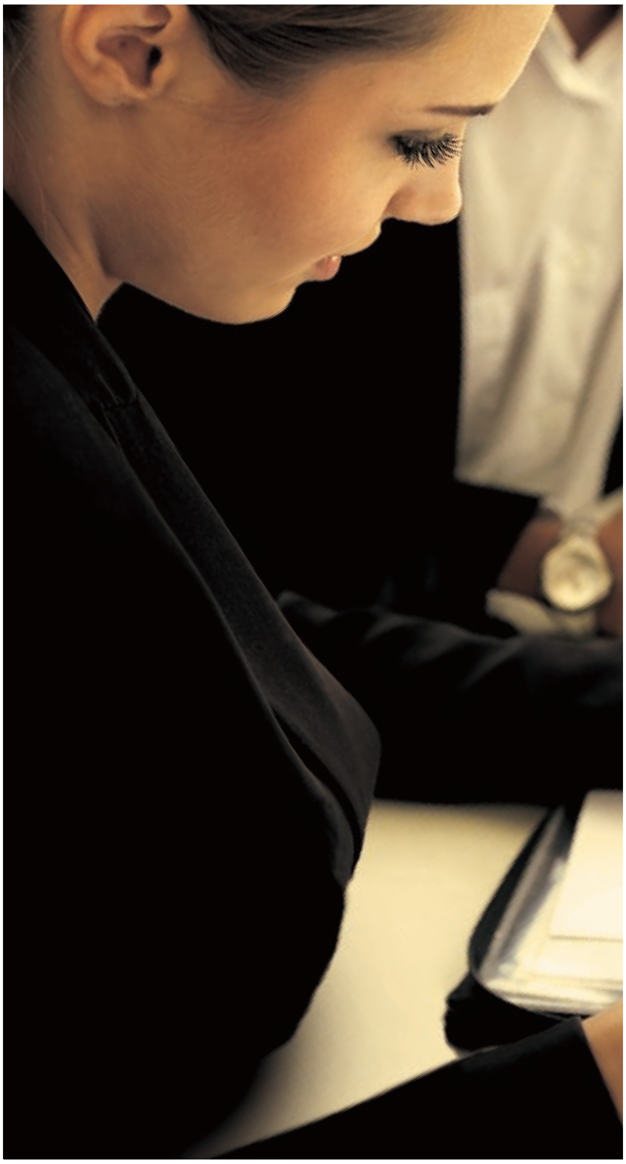
"If you've got the right policies in place, you would not be in this overstock position," Mr Killer says. "That comes down to the effective training of your staff."

Mr Killer advises a two-pronged approach: reward quality employees who perform well and, likewise, resist the temptation to reward underperformers. It may seem like an obvious rule, but it is not always followed.

While most salespeople can sell a vehicle in a boom market, it takes skill to consistently convert browsers into buyers in an economic downturn. Mr Killer adds that it is often counter-productive to promote an excellent salesperson into a managerial position for which they may not be qualified.

The other unpalatable issue to confront is retrenchments. No one likes firing staff, but tough markets often call for tough decisions. Mr Killer says sales teams must be restructured to reflect new sales volume expectations. The FCAI is forecasting total new vehicle sales of about 880,000 units this year, down on the 1 million-plus results of 2007 and 2008.

"Dealerships need to respond to those adjustments," Mr Killer says. "And no doubt, given we are in a market that has decreased by 17.1 per cent (in March), we need to have a decrease in the amount of sales staff." As a guide, he says if a dealership forecasts to sell 60 units a month, it should assign a maximum of four salespeople to the task. For 45 units, three salespeople should be suffice. Getting the ratios right can make the difference between a good and bad year.



Preparing for the year ahead

The exit from the Australian market of major overseas automotive financiers has put pressure on many dealerships. Mr Killer says well-run, viable businesses will continue to get finance, while the ones that are not may struggle.

Managing risk and day-to-day business activities has never been more important. Poor controls and poor paperwork typically results in a dealership that does not understand a slump in performance until it is too late. The best dealerships track their operations daily and forecast forward projections for sales and profitability during the month. Less-diligent dealerships expose themselves to rapid sales fluctuations.

Mr Killer says: "Then you end up with that overstocking issue … If you are bringing cars into stock based on historical data rather than forecast data, you are going to put yourself in an overstocked position again."

Australian consumers over the past 12 months have continued to move away from large new cars to light and smaller vehicles. This shift is significant because dealers generally receive greater gross profit per vehicle for larger vehicles.

"So not only are the units falling but the average gross per unit is falling," Mr Killer says.

With used cars, he says dealers can still expect to make $2500 to $3000 per vehicle, "but that is provided you have current stock. If it's three or four months old the return will be lower". While veteran industry players have been through downturns such as the 'recession we had to have' under then Treasurer Paul Keating in the early 1990s, the next generation of dealer principals who are taking the helm may not have been through such testing times.

Mr Killer is encouraged, though, that many younger dealer principals are not too proud to seek external advice. "That's a good change that's happening."

Regardless of experience, Mr Killer says dealers must have the capacity to make the tough calls.

"This is about being flexible and agile enough to have the right processes in place to change quickly."

Tips for success in 2009
1. Align employee incentive plans to dealership profitability
2. Focus on good managers and hold them accountable
3. Track performance daily
4. Review your customer contact strategy
5. Tighten stock management
6. Align stock mix to sales
7. Review each department in detail
8. Adjust expense base for falling volumes
9. Do not over-advertise
10. Make the hard decisions

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