AUTO FOCUS

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The "how to" of inventory management

Unclaimed property
It's not a matter of "finders, keepers"

Retooling pay incentives

GEFFEN MESHER
& COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS CONSULTANTS

For more information about the ideas presented in this newsletter, or to help answer a specific question you may have, please contact one of these experienced CPAs in our Automotive Dealership Group at 503.221.0141 or 800.819.0141

- Billy Morgan, Jr.
- Stan Geffen
- Preston Byrd
- Doug Lovett
- Dave Porter
- Steve Wilcox

Are you lost without a business plan?

Create a "map" to navigate your way

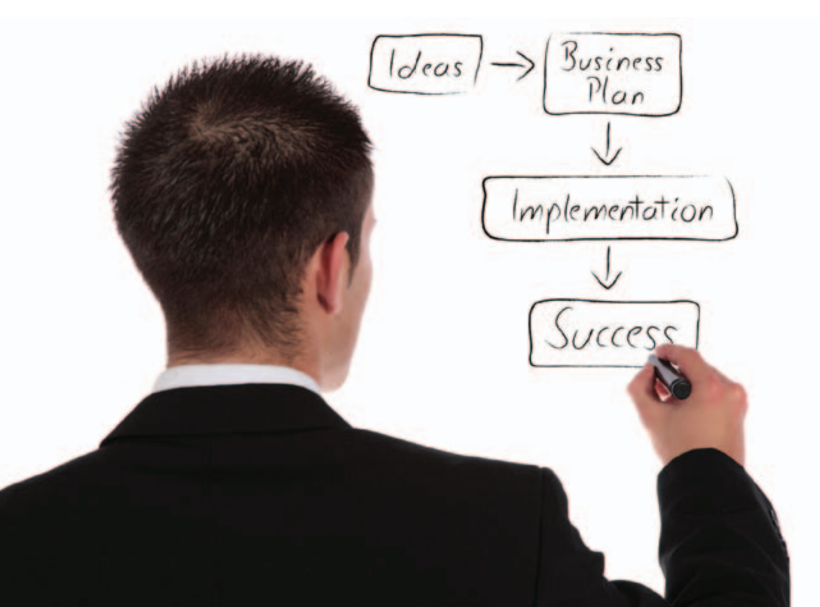
When is the last time you really thought about your dealership's goals? If it's been awhile, now is the perfect time to put pen to paper and map out a formal plan for the next five to 10 years. Maybe you want to retire in five years. Maybe you see yourself becoming the largest Toyota, Audi or Ford dealership within a 50-mile radius. Maybe you're thinking about acquiring another franchise.

The fastest route from point A (where you are today) to point B (where you see your dealership in the future) is a straight line. If you're operating without a formal business plan, you're taking the long and winding road — as well as some frustrating detours — on your journey.

Why you need a plan

The "maps" discussed here go by many names, including business plans, forecasts and budgets. Whatever format you choose, your objective should be to create a management tool that tests whether your goals are realistic and maps the route to achieving those goals.

Business plans serve a purpose beyond your personal use as a dealership owner. Factory field representatives and lenders view auto dealers with formal plans as more organized, less risky business partners. With manufacturers looking to constrict their franchise networks and lending still tight, formal planning may give you a leg up on the competition.



What's in a plan?

If you haven't formalized your plan, now is a great time to start. The year end performance recap provided by your factory field rep in January or February provides a good launching pad for business planning.

The type of "map" and level of detail may vary depending on your dealership's size, goals and with whom you plan to share the information. Most plans include a mock-up of future performance presented in a format similar to that of your financial statements.

In other words, you should have a projected balance sheet, income statement and statement of cash flows. You may not realize it, but the three financial statements flow into one another. Net income and changes in balance sheet items, for example, flow into the statement of cash flows.

What about assumptions?

Your operating results in the plan will be driven by a number of assumptions. For instance, based on market trends, you might assume that sales of a fuel-efficient model will increase 20%, while sales of a gas-guzzling V-8 will decline 15% over the next five years. You also might assume cash deficits will be covered by draws on your credit line.

Excel spreadsheets often are used for business planning. They enable you to change one assumption and then see how that change filters through the three financial statements. But it's imperative that your assumptions be reasonable. You can assume, for example, that you'll sell an average of 60 new units per month. But if the most you've sold recently is 40 per month, does your assumption *really* make sense?

What else can you add?

Some plans also include a sensitivity analysis, which identifies the variables with the biggest effect on your bottom line. Others provide three scenarios — best, worst and most probable cases — to give your plans greater perspective.

If you expect lenders, managers or prospective investors to buy into your business plan, include verbiage on your strategic direction, industry outlook, market analysis, anticipated changes in operating efficiency and management team. Be realistic.

A concise, well-written executive summary is another key element of an effective business plan. It will grab the reader's attention, especially when you're communicating with time-crunched lenders and factory reps.

Who's your guide?

At times, everyone gets lost and needs to ask for directions. This is true whether you're on a road trip or operating an auto dealership. And an accounting professional can help you map out your dealership's future. ■

Review, revise, repeat

Once you put together a forecast, budget or business plan (see main article), what's next for your auto dealership? Too often owners shove their plans into a desk drawer and fall back into the routine of managing by gut instinct. But you'll get more mileage if you compare actual performance to your budgets on a monthly basis.

Identify discrepancies between actual and budgeted results, and evaluate the underlying causes. Perhaps your plan's underlying assumptions are flawed or overly optimistic. Or perhaps someone on your team isn't following the plan — for example, they may be overspending or underselling. Use your findings to revise your plans — and employee behaviors — going forward.

If you treat business planning as a learning process, you'll gain a deeper understanding of how your store runs and, in turn, your forecasts and budgets will become more reliable and meaningful. Spot-on business plans impress lenders and factory reps, which may entice them to do more business with you.

The "how to" of inventory management

Inventory is your most valuable asset. It also uses up most of your working capital. Carry too much, and you risk cash shortages and astronomical interest charges on your floor plan and line of credit. Carry too little, and you risk losing business to competing dealers and independent service stations.

Many dealerships order vehicles, parts and accessories using gut instinct. But more scientific techniques for managing inventory can minimize inventory carrying costs.

Pull, not push

Start with an honest evaluation of your relationship with your franchisor: Is the factory pushing you to accept vehicles you don't want — say, a large quantity of undesirable models or colors? Does your dealer operations manager aggressively talk you into buying parts and accessories every time he or she visits?

Manufacturer relationships call for both give and take. Sure, everyone has to accept some less-than-desirable items allocated to them by the factory. But stores with high volume, strong Customer Service Index ratings, and amicable relationships with factory representatives have the greatest leverage and are rewarded with the option of building more of their own vehicles.

Whenever possible, try to order the inventory you want (a "pull" ordering system) rather than accept every item the factory "pushes" onto you.

Find the method to the madness

Manufacturers have used cost accounting to improve operating efficiency for decades. Only recently have dealerships begun to look at their businesses in other terms:

Product-by-product margins. Analyze your gross profit for each product line, and stock more high-margin items. Accessories — navigation and tire package upgrades, for instance — are known to be moneymakers. Fuel-efficient new and used cars also sell for more today.

Before eliminating unprofitable products, evaluate why margins are low. For instance, a Nissan dealer discovered he was losing money on new Jukes, a hot new model with limited availability. Turns out, his salespeople were selling Jukes below invoice, because his pay plan offered bonuses based on volume, not gross margin.

High demand, limited supply models *should* bring a premium price, if your salespeople know their stuff and your pay plan motivates the right behaviors.

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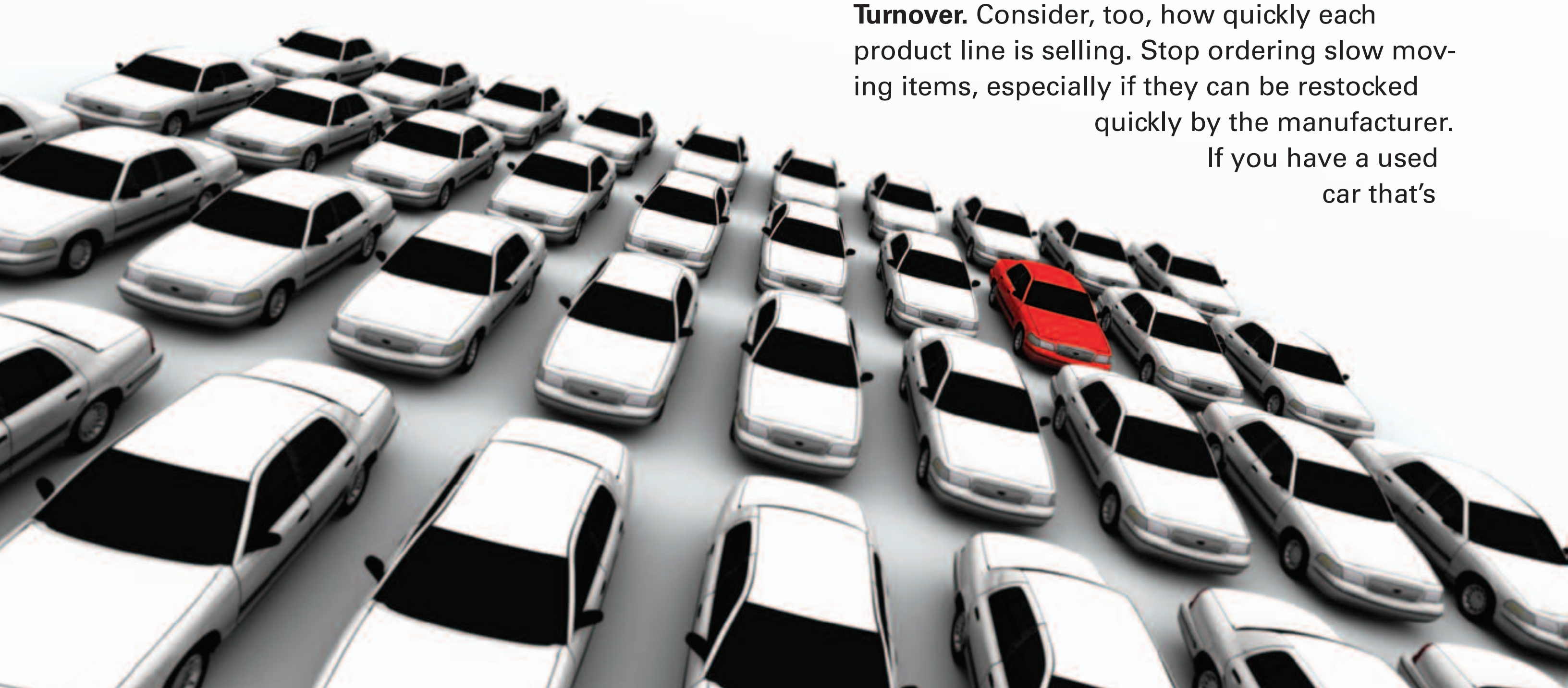
Product mix. Next evaluate whether your product mix is sufficiently broad and in tune with consumer demand. New car buyers often access online inventory lists and contact a store that has their new vehicle specs already on the lot. Foster your relationships with neighboring dealers to expand your inventory base. If you can swap with another store quickly, you may prevent lost sales just because your inventory is lean.

Also stock a sufficient supply of aftermarket parts in addition to OEM parts. You may lose service revenues to independent service shops if you don't offer cheaper fixes using generic aftermarket parts to customers after their warranties expire.

Turnover. Consider, too, how quickly each product line is selling. Stop ordering slow moving items, especially if they can be restocked quickly by the manufacturer. If you have a used car that's



been on your lot longer than, say, 45 days, it may be time to discount the sticker price or sell it at auction.

Whenever possible, return excessive supplies of slow moving parts and accessories to the manufacturer. Often factories allow some returns within a prescribed time frame.

Reorder point. Estimate a reasonable reorder point for every inventory item. That's the quantity level that triggers a new order. Reorder point is a function of your volume and the purchase order lead time.

If you install 25 air filters each week and it takes two weeks to process an order of filters, for example, you'd reorder anytime there are fewer than 50 filters on the shelf.

Retake your inventory

When sales are down, every sale must count. Inventory carrying costs include interest, storage, insurance, obsolescence and pilferage. These can quickly add up. With less working capital tied up in inventory, you'll need to borrow less and possibly have more cash for rainy day projects, such as sales training or remodeling. Imagine the possibilities! ■

Unclaimed property

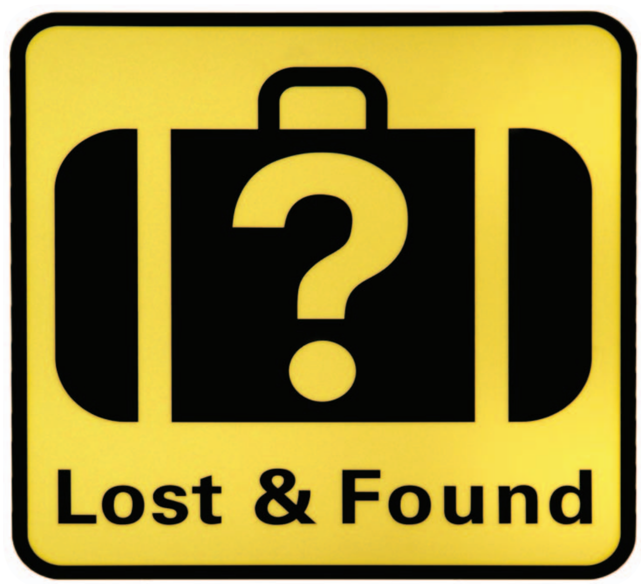
It's not a matter of "finders, keepers"

Every dealership has assets that are in a kind of limbo — long-forgotten checks to customers and other valuables that no one else has claimed. While your business may be giving little thought to these financial assets, the state you operate in may recognize their value and try to collect this "unclaimed property."

Unclaimed property isn't revenue

Unclaimed property at auto dealerships typically includes unclaimed payroll checks, uncollected customer rebates, F&I product cancellations, accounts receivable credit balances, customer overpayments and buyer deposits that dealers are legally required to return.

Many businesses, including dealerships, have improperly treated unclaimed property as a type of revenue, which can lead to inflated income statements. But unclaimed property generally shouldn't be treated as income either — the property should be remitted to the state after being unclaimed for the statutory period of time.



The length of the "dormancy" period — the time between the last contact with the owner and when the property must be relinquished to the state — varies from state to state and from asset to asset. In most states, it's the business's duty to try to find the unclaimed property's owner.

Annual disclosure may be necessary

Virtually every state has a department that holds unclaimed property in safekeeping. If the state can't locate the owner after making reasonable efforts during the dormancy period, the property reverts to the original owner's resident state.

In many states, businesses are required to file an annual report disclosing that they're holding unclaimed property.

In many states, businesses are required to file an annual report disclosing that they're holding unclaimed property. They generally must identify the property, reveal the original owner and supply the dates of when the property became payable and when the last transaction with the owner took place.

Businesses also typically must maintain related records for three to five years after the property is reported and may face monetary penalties if they fail to meet the reporting requirements, pay the state or turn over the property. Fines can be high, such as $25,000 plus 25% of the value of the property, or more.

Some states have provided amnesty programs as an incentive for complying with unclaimed property rules. An amnesty program might, for example, waive penalties for first-time filers, businesses that missed reporting deadlines and businesses that have been inconsistent in their reporting. Penalties and interest also are typically waived for holders of unclaimed assets that voluntarily come forward.

Ask for assistance

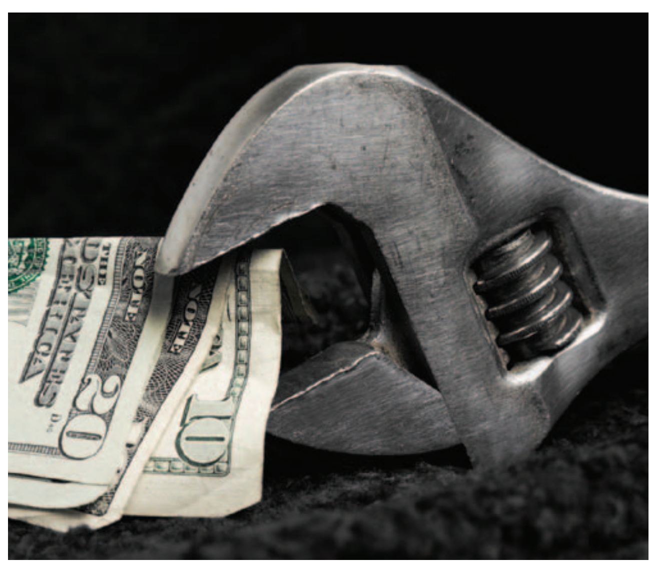
If your dealership has unclaimed property, and you aren't sure of the regulations in your state, contact your CPA. He or she can help make sure you're protecting your assets by obeying the rules. ■

Retooling pay incentives

All pay plans *should* be effective — they need to attract, retain and motivate a talented team. But many fail to meet these objectives. Have your pay plans kept step with changes in the labor market in recent years?

Choices on the menu

Auto dealerships can choose from a menu of pay plan options, including base salary, commissions, bonuses and spiffs, which are extra incentives (often an immediate bonus) for, say, the salesperson who generates the highest margin sale or the technician with the highest proficiency rating each month.



No universal formula works for every dealer. What will succeed at your store depends on what motivates your staff; your product line and strategic objectives; Customer Satisfaction Index (CSI) scores; manufacturer prerogatives; your turnover rate; and other operating traits.

Evaluation advice

When evaluating your pay plans, consider these six ideas:

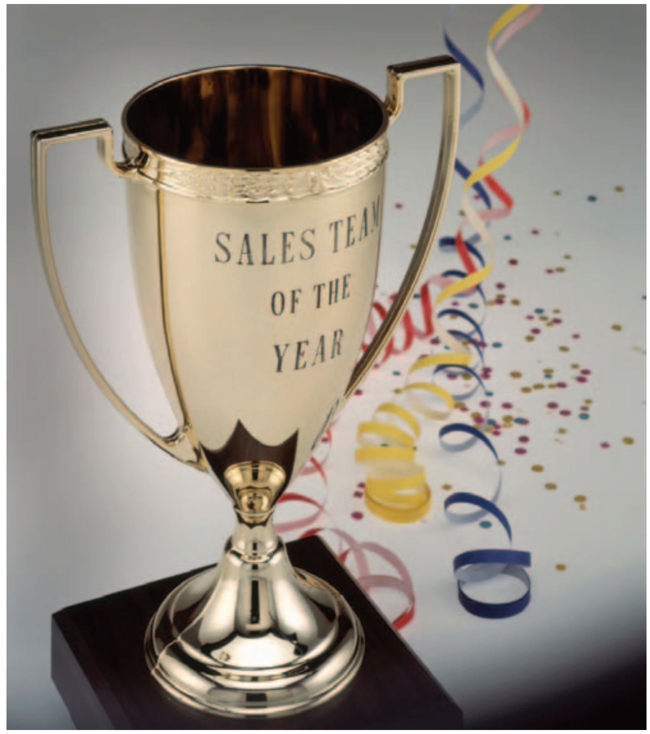
1. Establish pay amounts by position. Determine what you think a specific job should pay, and construct your pay plan to allow the employee to reach or exceed that number if they do a good or superior job.

2. Keep it simple. Pay plans become convoluted over time, as more bonuses and spiffs are added to the mix. To streamline yours, pretend you are a prospective employee. After your initial interview, could you explain to your spouse how and when you'd be paid? Unpredictable, confusing or unrealistic plans are unlikely to attract the family-oriented workers you want.

3. Consider a base. Weak new vehicle sales and lackluster margins may cause top salespeople to defect to other industries. So, the custom of paying a straight commission may no longer be realistic. Instead, in addition to commissions, many dealers now provide a small base salary, which is often based on margins and bonuses, and linked to volume or customer satisfaction scores.

4. Align your plans with your business strategy. Your pay plans should reward the behaviors you desire and what the factory is seeking, such as higher margins, volume and CSI scores. Tie compensation into desired behaviors. If you want more extended warranty revenue this month, for example, offer a $250 bonus to the *salesperson* who closes the most deals that include extended warranties — not just to the F&I manager.

5. Think beyond new and used vehicle sales. Service is your bread and butter. Think of your service personnel as "salespeople" for parts and labor revenues. Modify their pay structure to include a commission on both labor and parts per vehicle



serviced. You also might include proficiency and efficiency spiffs, such as a $100 gift card for the technician with the highest customer service rating or shortest turnaround time each month.

6. Put it in writing. Effective pay plans are detailed in formal contracts. If disputed, judges and arbitrators tend to presume an employee didn't agree to an unwritten rule or unsigned document. Contracts should define the basis for calculating commissions and bonuses, specify timelines, and allow for deficit carryforwards and error corrections.

Also, never underestimate the value of noncash perks, such as extra time off, tickets to sporting events and birthday luncheons. Noncash perks and simple owner recognition create a friendly, family-like atmosphere that keeps employees around for the long run. Plus, noncash perks are often less expensive.

Talk it over

Discuss your pay plans with your CPA, who likely assists other dealers and sees what works well in their stores. A new perspective may be the biggest boost to creation or revisions of your pay plans. ■

GEFFEN MESHER
& COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS CONSULTANTS

888 S.W. 5TH AVENUE, SUITE 800
PORTLAND, OREGON 97204

TELEPHONE: (503) 221-0141 (800) 819-0141
FAX: (503) 227-7924
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