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The nuts and bolts of parts inventory management

The parts and service department can be one of the most profitable areas of a dealership — or it can be a drag on financial performance. The difference often amounts to how well parts inventory is managed.

Various factors go into improving the management of your parts inventory. One of the most important is eliminating or minimizing variances between the actual parts on the shelves and the parts that your inventory management system says are there.

WHEN PARTS INVENTORY = CASH

Inventory is sometimes referred to as "cash on the shelf" — and that's exactly what it is. Each item ordered and stored in a parts bin represents a financial investment by your dealership. Once you view your parts inventory this way, you'll start to look at variances in a whole new light.

An example illustrates the true cost of these variances. Suppose your dealership maintains $400,000 in parts inventory and you discover a 10% variance between parts in stock and parts indicated in your inventory management system. At first glance, you might think, "Ten percent? That's not too bad."

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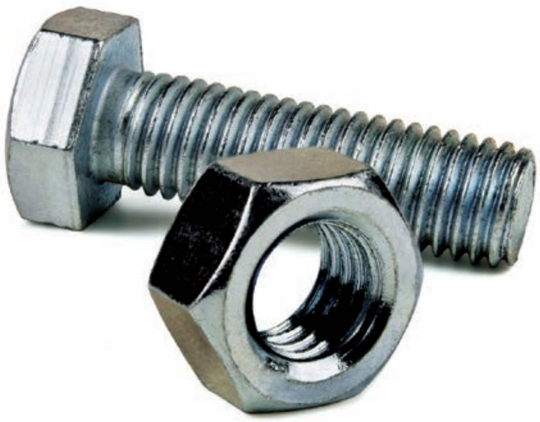
Now let's assume you realize a 35% gross profit margin on parts. In this scenario, you would need to have more than $114,000 in additional parts sales (40,000 / .35 = 114,286) to make up this $40,000 variance in inventory. You also would



take a cash flow hit of $40,000 because you paid upfront for the parts you stock in inventory.

Determining the extent of the variance, assuming there *is* a variance, requires conducting a parts inventory at least annually. Ideally, the inventory will be conducted by an outside consultant or auditor. In addition, you should also periodically do random bin counts. By performing cycle counts on a monthly basis, you can conduct a complete inventory check approximately every quarter.

WHAT CAUSES VARIANCES?

There are many potential causes of parts inventory variances, such as:

- Shrinkage due to loss, expiration and theft by employees,
- Broken or damaged parts that aren't promptly returned to the manufacturer for credit,
- Sloppy storage practices, such as not placing parts in the proper bins or just leaving parts lying around on the shop floor,
- Failure to update the inventory management system with accurate data reflecting on-hand inventory that's actually in stock, and
- Errors in recording parts on repair orders or parts tickets.

Minor variances aren't uncommon, but how much variance is too much? In general, if the variance between on-hand inventory and the items recorded in your inventory management system is 5% or higher, you should probably find out why.

Based on your discoveries, you can then take corrective action to eliminate or reduce variances and improve overall parts inventory management. Possible steps might include the following:

Establish firm inventory management policies and procedures. These should dictate how parts are ordered, received and entered into your inventory management system. Also, purchase orders should be carefully matched to all items received in the parts department.

Monitor obsolete and slow-moving parts. Reduce your investment in parts inventory by tracking aging schedules and the movement of all items through the department. Return slow-moving parts to the manufacturer to receive a credit or sell them wholesale.

Send back warranty parts and core returns promptly. Get returns back to the manufacturer as quickly as possible. Also, make sure they are properly entered and reconciled in your inventory management system.

Be proactive in guarding against employee theft. Parts are in high demand among thieves because they're easy to sell and convert to cash. Therefore, you should store all parts inventory in a secure and locked area after hours. And make sure purchase orders are filled out completely and include a corresponding parts ticket.

You also should segregate duties among parts department employees. For example, assign different employees to order and receive parts and manage inventory.

KNOW THESE INVENTORY MANAGEMENT KPIs

Understanding several key performance indicators, or KPIs, can help you improve management of your parts inventory. Pay especially close attention to these three parts inventory KPIs:

1. **Gross inventory turns.** This will tell you how many times your parts inventory turns over in a year. To calculate, divide the annual cost of parts sales by your total parts inventory.
2. **True turns.** This will tell you which parts sales are coming from your existing stock. To calculate, divide the annualized cost of parts sales, less emergency purchases and customer orders, by your total parts inventory.
3. **Fill rate.** This will tell you how much of your sales are coming from inventory as opposed to non-inventory parts that have to be special ordered. To calculate, divide the annualized cost of parts sales, less emergency purchases and special orders, by the cost of sales plus lost sales.

REAP THE BENEFITS

Your dealership can enjoy many benefits by improving management of your parts inventory. Discuss these and other inventory management strategies with your parts department manager today.

3 ways to guard your dealership assets

You've worked hard for years to make your dealership a success, and you don't want an event like an adverse lawsuit settlement to gobble up your assets. Conversely, in case your business fails, you don't want creditors wielding claims on those assets.

Not to worry: You can take proactive steps to protect what's yours. Consider these options.

1. A FAMILY LIMITED PARTNERSHIP

One asset-protecting vehicle worth exploring is a family limited partnership (FLP). In a typical scenario, you transfer assets to the FLP, and as its General Partner you have discretion over how the assets and income are distributed. You then gift or sell limited partnership interests to your children or other family members. A common application is to transfer assets such as marketable securities and the real estate on which your dealership is located to an FLP.

The agreements are typically written with asset protection in mind, for the purpose of keeping the underlying assets safe from creditors. Also, if the FLP is properly structured and administered, the assets gifted or sold will be removed from your taxable estate. And transfers of FLP interests might be eligible for minority interest and other discounts.

There are some drawbacks. Your franchise agreement may restrict transferring ownership interests in your dealership operations. Also, you'd need to be cautious when signing bank or creditor guarantees — they could undo the FLP's protective quality.

2. A CRUMMEY TRUST

Another vehicle to consider is a trust — in particular, a Crummey trust. If you gift assets to someone else, such as your children or other family members, the assets will, generally, no longer be vulnerable to your creditor claims. But you may not want to gift assets outright. Instead, you could transfer those assets to trusts for your family members. This allows you to retain a degree of control over their access to the funds *and* provide a measure of protection against their creditors.

Normally, gifts to trusts aren't eligible for the $14,000 (per recipient) annual gift tax exclusion, because transfers must be of a "present interest" (meaning the recipient has immediate access to the funds) to qualify. But in a Crummey trust, after each gift to the trust is made the beneficiaries are allowed — for a limited time — to withdraw the funds.

This withdrawal right allows the gift to qualify for the annual exclusion. You don't have to use up any of your lifetime gift tax exemption (or pay gift taxes) on the transfers. Plus, the assets, along with any future appreciation on them, are removed from your taxable estate.

Once transferred, though, you won't have access to the assets. And there's a risk that the beneficiary will take out the funds during the withdrawal period.

3. AN OFFSHORE TRUST

You can set up a trust in a foreign country with more favorable asset protection laws than in the United States. Offshore trusts are typically funded with cash or readily movable securities, rather than real estate. Bear in mind that even if the assets are offshore you are liable for paying taxes on the trust's income. And the trust assets can still be subject to gift or estate taxes.

Offshore trusts offer protection from U.S. legal judgments and discourage litigation because of the expense and difficulty in pursuing a case under foreign jurisdiction.

On the downside: The costs to set up and administer offshore trusts can be high, making them a sensible choice only for individuals with sufficient net worth and risks of claims and lawsuits to warrant the expense. Because these trusts often face IRS challenges, be sure to get solid legal and tax advice.

STUFF HAPPENS

No business owner thinks a life's work of asset-building could be destroyed by a legal settlement or creditor payments. But things like that do happen. Make sure you are prepared if such events come your way.

Talkin' 'bout my generation

The challenges of managing diverse age groups

Many dealerships employ workers from across the generational spectrum. This often ranges from Baby Boomers to members of Generation X, Generation Y (or the Millennials) and now Generation Z.

Managing a workforce with a wide range of ages requires flexibility and skill on the part of your dealership's management team. If you're successful, you can boost employee morale and create a more pleasant and productive work environment for everyone.

DEFINING THE GENERATIONS

Definitions vary slightly, but the U.S. Chamber of Commerce Foundation defines today's generations as follows:

- Members of the Baby Boomer generation were born from 1946 to 1964.
- Members of Generation X were born from 1965 to 1979.
- Members of the Millennial generation were born from 1980 to 1999.
- Members of Generation Z were born after 1999.

Certain stereotypes have been associated with these generations. For example, Gen Xers are sometimes considered to be slackers and Millennials are sometimes thought of as needy. But successfully managing employees across generations requires putting aside broad stereotypes like these.

Don't assume that employees fit a certain personality profile based simply on age. Instead, get to know each of your employees individually to better determine "what makes them tick."

Here are some more suggestions for managing diverse generations of employees in your dealership:

Recognize and reflect value differences. Misunderstandings and conflicts often arise due to value differences between managers and employees of different generations. For example, many older managers expect employees to be willing to do "whatever it takes" to get the job done, including working long hours. However, many younger employees place a high value on achieving work-life balance.

When possible, Baby Boomers and Gen Xers who are managing younger employees should try to be flexible when it comes to scheduling. But this doesn't mean young employees shouldn't be required to work hard. The key is to find the right balance so that work is accomplished satisfactorily and on time, and young employees feel like their values are being respected.

Maximize each generation's strengths. Different generations tend to bring their own strengths to the workplace. For example, many younger employees have strong computer and technical skills, while many older employees have valuable industry experience, wisdom and insight.

Try to create situations where employees from diverse generations can work together on teams and share their knowledge and strengths with each other. In doing so, encourage them to communicate openly and honestly and to be willing to learn from — instead of compete with — each other.

Adapt your management style. Millennial and Generation Z employees simply can't be handled effectively in the same way that Baby Boomers and Generation X employees are. This means that you and your managers must learn how to adapt your management style to fit employees of these generations.

For example, many Millennials and Gen Z employees like, or even expect, to receive regular feedback about their performance, as well as public recognition and praise when they've done well. While most Baby Boomers and Gen Xers also enjoy positive performance feedback, they may also derive personal satisfaction from a job well done.

Employees from different generations also tend to have their own views of company loyalty. Many younger employees, for example, are more loyal to their principles and their co-workers than they are to an organization, while many older employees feel a greater sense of company loyalty. Keep these and other differences in mind when managing employees across generations.

Recognize the generations' diverse views toward compensation. While money is valued to some degree by employees across generations, younger employees tend to prioritize salary less than older workers. For example, according to a study conducted by the National Association of Colleges and Employers, a high salary ranks just fifth on the list of motivating factors for Millennial employees.

BOOSTING WORKPLACE HARMONY

Meet with your managers to discuss how you can put strategies like these into practice. Their observations are sure to add insight. Addressing the issues may result in a more productive and harmonious workplace.

Construct social-media-savvy customer surveys

It's easier than ever today for people to praise or criticize the products they buy and the companies they purchase from. With online review sites like Yelp and Angie's List and social media platforms like Facebook and Twitter, all it takes is a click of the mouse to share your opinion with hundreds or even thousands of people.

Given this, some dealerships are rethinking the way they construct and deliver customer surveys. Their goal is to design surveys that reflect changing customer behavior patterns when it comes to providing feedback.

SHORTER IS BETTER

A key strategy is to shorten customer surveys. Since there are so many outlets for sharing their opinions, many customers are unwilling to spend time answering long surveys with dozens of questions.

Often, the customer's mindset is to get in and out of the survey as quickly as possible — for example, within one to two minutes. If a survey has more than four or five questions, it'll be difficult to complete it that quickly.

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Another strategy is to ask at least one or two open-ended questions. While this will lengthen the time required to complete the survey, it will allow customers to elaborate on their dealership experiences if they want to. Make open-ended questions optional so customers don't have to answer them if they prefer not to.

DISTRIBUTING SURVEYS

Since most people today are accustomed to providing feedback online, it's usually smart to distribute customer surveys electronically. This can be done via email or text or by directing customers to a dedicated survey page on your website.

You also should think about how to respond to survey feedback — customers often receive replies from businesses they critique online. If they have legitimate complaints or criticism, reply with an apology and offer to try to rectify the situation, if possible.

If their comment is complimentary, reply with an enthusiastic "Thanks for the positive feedback!" This will let customers know their input has been received and is appreciated.

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Paul A. Cerrone, CPA, MST, CVA, managing partner, is an ADP Certified CPA with more than 30 years of experience in serving automotive dealers. He specializes in helping clients minimize taxes, maximize profits and achieve their business and personal financial goals. Paul can be reached at 508-845-7600 or pcerrone@cgscpas.com.

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