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Winter 2019

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See the big picture

Improve dealership performance with benchmarking

Successful dealerships tend to keep close tabs on their finances and operations by measuring and monitoring certain performance metrics. Doing so helps managers spot trends that could negatively impact performance and make adjustments before it's too late.

But these metrics have little meaning when viewed in isolation. A basis of comparison is needed to provide context and relevance to the numbers.

BENCHMARK AGAINST PERFORMANCE STANDARDS

The process of comparing financial and operational performance to an objective standard is referred to as benchmarking. Performance comparisons can be internal — such as against previous months, quarters or years — or external, such as against other similar dealerships.

Benchmarking enables active oversight and assessment of your dealership's overall performance. And this leads to higher sales and profits! It also can help identify unusual financial activity and spot potential fraud. In addition, benchmarking can help pinpoint underperforming employees and departments and take steps to boost their productivity.

CHOOSE YOUR METRICS

The first step in performing a benchmarking initiative is to decide which metrics to focus on. The following are some sales metrics that are often measured and monitored in each dealership department:

Days supply of inventory. This will tell you how many days of capital are tied up in your vehicle inventory. If it's too high, you could pile up increased carrying costs in the form of higher floor plan expense. If it's too low, you might lose sales opportunities because of the lack of vehicle selection. The formula:

Cost of goods sold /
Average inventory x 365

Average vehicles sold per salesperson. This will help you gauge the performance of each member of your sales team. If it's too high, you might need to hire more salespeople to handle excess customer traffic. If it's too low, you may have excess salespeople who aren't busy enough. The formula:

Retail vehicles sold /
Average number of salespeople

There are also F&I metrics:

F&I penetration rate. This will tell you how many vehicle sales included an F&I component, such as a service and maintenance contract. If it's too high,

KEEP AN EYE ON THESE 3 DEALERSHIPWIDE METRICS

In addition to department-specific metrics, you may also want to measure and monitor some overall dealership financial metrics. These could include:

Total gross profit per employee. Labor is usually one of a dealership's biggest variable expenses, so this is an important metric to keep an eye on. It could help you determine whether your dealership is over- or understaffed. Certain positions won't be appropriate for this metric.

Return on assets (ROA). Assets include receivables and vehicle and parts inventory; computers, equipment and fixtures; and real estate. ROA will reveal how efficiently you're using these assets to generate net income.

Return on equity (ROE). This is a measurement of profitability in relation to the owners' total investment in the dealership. It will show you how well you're using investment capital to grow income.

your salespeople could be using overly aggressive tactics, which could result in high F&I chargeback rates. If it's too low, your salespeople may not be selling F&I products effectively. The formula:

F&I contracts sold /
Total retail unit sales

Net F&I income before compensation per retail unit sold. This metric indicates how much income you are making on your F&I products after chargebacks per retail unit sold and will help to identify pricing strategies, as well as higher than normal chargeback numbers. The formula:

Net F&I income before compensation /
Retail units sold

And here are some parts and service metrics:

Labor hours per repair order. This will tell you how many labor hours are being sold per repair order. If it's lower than the benchmark, there are potential service sales that are being missed. The formula:

Total labor hours /
Total repair orders

Percentage of nonstock parts held in inventory. This will tell you how many special-order parts you carry in stock compared to standard parts. If it's too high, customers may not be returning to have service work completed. If it's too low, your parts department manager could be returning stock parts before customers return for service work. The formula:

Nonstock parts inventory /
Total parts inventory

With the appropriate metrics in hand, the next step is to compare your metrics to relevant benchmarks. Start with internal comparisons. For example, how does your current days supply of inventory compare to such inventory in the same period a year ago? Or how does your current F&I penetration rate compare to last quarter's rate?

Then compare your metrics to relevant industry standards, such as similar-size dealerships that sell comparable vehicles. Your accounting firm or a Dealer 20 Group is one good source for this kind of data. State and local dealer associations, NADA and your manufacturer may also be able to provide relevant benchmarks for your dealership.

A VALUABLE EXERCISE

Benchmarking is a valuable exercise for helping dealerships improve financial and operational performance. Plan a meeting with your managers to discuss how you can put benchmarking to work at your store.

Executive compensation requires careful decision-making

Dealership owners, understandably, want themselves and top executives to be compensated fairly for their work, results and interest. So how do you achieve that goal without attracting undue IRS scrutiny and claims of inappropriate compensation?

START WITH THE BASICS

Compensation is affected by the amount of cash in your dealership's bank account. But just because your financial statements report a profit doesn't necessarily mean you'll have cash available to pay owners a salary or make annual distributions. Net income and cash on hand aren't synonymous.

Other business objectives — for example, buying new equipment, repaying debt and sprucing up your showroom — will demand dollars as well. So, it's a balancing act between owners' compensation and dividends on the one hand, and capital expenditures, expansion plans and financing goals on the other.

C CORPORATION CHALLENGES

If you operate as a C corporation, your dealership is taxed twice. First, business income is taxed at the corporate level. Then it's taxed again at the personal level as you draw dividends — an obvious disadvantage to those owning C corporations.

C corporation owners might be tempted to classify all the money they take out as salaries or bonuses to avoid being double-taxed on dividends. But the IRS is wise to this strategy. It's on the lookout for excessive compensation to owners and will reclassify above-market compensation as dividends, potentially resulting in additional income tax as well as interest and penalties.

The IRS also monitors a C corporation's accumulated earnings. Much like retained earnings on your balance sheet, accumulated earnings measure the buildup of undistributed earnings. If these earnings get too high and can't be justified as needed for such things as a planned expansion, the IRS will assess a tax on them.

KNOW YOUR FLOW-THROUGH

Perhaps your dealership is structured as an S corporation, limited liability company or partnership. These are all examples of flow-through entities that aren't taxed at the entity level. Instead, income flows through to the owners' personal tax returns, where it's taxed at the individual level.

Dividends (typically called "distributions" for flow-through entities) are tax-free to the extent that an owner has tax basis in the business. Simply put, basis is a function of capital contributions, net income and owners' distributions.

So, the IRS has the opposite concern with flow-through entities: Agents are watchful of dealer-owners who *under*pay themselves to avoid payroll taxes on owners' compensation. If the IRS thinks you're downplaying compensation in favor of payroll-tax-free distributions, it'll reclassify some of your distributions as salaries. In turn, while your income taxes won't change, you'll owe more in payroll taxes than planned — plus, potentially, interest and penalties.

BEWARE OF EYEBROW-RAISERS

Above- or below-market compensation raises a red flag with the IRS — and that's always undesirable. Not only will the agency evaluate your compensation expense — possibly imposing extra taxes, penalties and interest — but a zealous IRS agent might turn up other challenges in your records, such as nonsalary compensation or benefits.

What's more, it might cause a domino effect, drawing attention in the states where you do business. Many state and local governments face budget shortages and are hot on the trail of the owners' compensation issue, and will follow federal audits to assess additional taxes when possible.

WHO ELSE IS INTERESTED?

Other parties also might have a vested interest in how much you're getting paid. Lenders, franchisors and minority shareholders, for instance, could think you're impairing future growth by paying yourself too much.

Plus, if you or your dealership is involved in a lawsuit, the courts might impute reasonable (or replacement) compensation expense. This is common in divorces and minority shareholder disputes. In these situations, you'd be wise to consult an attorney early in the compensation decision-making process.

FOLLOW THE REGULATIONS

When setting executive compensation, you want to be aware of all current IRS regulations and other applicable requirements. Talk to your CPA about how federal and state laws will affect your compensation decisions.

Sales strategies

Could "no-haggle" selling be right for your dealership?

In recent years, some dealerships have adopted a "no-haggle" or one-price model for selling vehicles. This has been in response to several factors, including greater transparency of vehicle prices afforded to customers by the Internet and the general dislike many customers have of negotiating car prices with sales personnel.

For example, it's easier today for car buyers to locate information about vehicle prices online, including dealer invoice costs. This has removed some of the pricing leverage that most dealerships had in the past.

IMPROVING CUSTOMER SATISFACTION

Some dealerships that use a no-haggle selling model have realized several tangible benefits. One of the biggest is increased customer satisfaction. A growing number of buyers don't want to go through the traditional price negotiation process when buying a car. This is especially true for many women and Millennials.

According to the Rikess Group, a retail automotive consultant, women buy more than half of all vehicles, while Millennials purchase nearly one-third of all vehicles sold. As a result, up to two-thirds of car buyers could be willing to pay more for a simple and transparent sales experience that doesn't include haggling, the Rikess Group concludes.

The consultants also found that dealerships that adopt no-haggle selling also tend to get better online customer reviews. For instance, before visiting dealerships, many car buyers first check out Yelp, Google or another business review website to see what others have to say about them. One-price dealerships often receive higher customer reviews because of what many customers perceive to be a less stressful and more pleasant buying experience.

No-haggle selling also can help dealerships attract and retain a younger and more diverse sales force. Many young people today aren't interested in a job where they're expected to haggle with customers over every sale. The one-price model frees up salespeople to serve in more of a consultative role with customers.

BOOSTING THE BOTTOM LINE

Some dealerships that have adopted a no-haggle selling model have been able to improve their financial performances. This starts with higher gross sales.

According to some reports, many car buyers who prefer the no-haggle purchase process to the traditional process of vehicle negotiation are indeed willing to pay a higher price in exchange for this faster, simpler and more pleasant experience. In Autotrader's *Car Buyer of the Future* study, for example, more than half (54%) of car buyers said they'd buy from a dealership that offers a better car-buying experience vs. one with a lower price.

Using a no-haggle model also can help reduce selling costs. For example, one-price dealerships are often able to hire less-experienced sales managers who don't have high-level negotiation skills, because there's no price negotiation. Some dealerships the Rikess Group has worked with that use a no-haggle model have reduced their sales staff costs by up to one-third.

Dealerships that adopt no-haggle selling tend to get better online customer reviews.

Finally, adopting a no-haggle model can boost F&I sales. Many customers are more open and receptive to the F&I menu presentation if they haven't just gone through a grueling negotiation over the vehicle price.

SWITCHING TO NO-HAGGLE SELLING

Transitioning from a traditional price negotiation model to a no-haggle model requires a commitment to building a culture of transparency throughout your dealership. Not all salespeople and sales managers will be receptive to the switch. You may have to replace some of them with new employees who have the right attitude and skill sets for one-price selling.

For instance, the sales manager's job at a no-haggle dealership isn't to work with salespeople in negotiating the best possible price for a vehicle. Rather, it's to train and develop salespeople who can help customers find the best vehicle for their needs and complete transactions with little or no assistance.

Of course, one-price selling isn't the right sales model for every dealership. But, if you decide to stick with the traditional negotiation model for selling vehicles, be aware that some of your competitors have likely adopted no-haggle selling.

To better compete with them, you should strive to create the best customer experience you can in your dealership. This includes helping customers feel comfortable throughout the negotiation process by trying to make it as nonthreatening and nonconfrontational as possible.

COULD YOU BENEFIT?

Many different factors will go into determining which sales model is the best one for your store. Talk to your department managers about whether your dealership could benefit from no-haggle selling.

Why you should retain old insurance policies

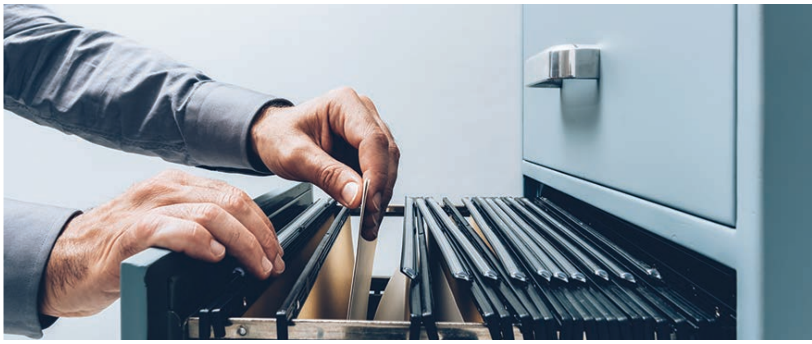
After insurance policies expire, many dealerships just throw away the paper copies and delete the digital files. In certain situations, though, you may need to produce these policies even after the coverage period has expired.

EMBEZZLEMENT AND EMPLOYMENT PRACTICES

A good example of this occurs in cases of employee embezzlement. Employee dishonesty (such as embezzlement) is sometimes covered under a commercial crime or theft policy. However, embezzlement often isn't uncovered until years after the crime has taken place.

For instance, suppose that, during an audit, a dealership learns an employee was embezzling funds three years ago. However, the insurance policy that covered this theft has since expired. To receive an insurance payout, the dealership may need to produce the policy documents to prove that coverage was in effect when the crime occurred.

Also consider employment practices liability insurance (EPLI). These policies protect dealerships from employee claims that their legal rights have been violated. Sexual harassment is one type of violation that's covered under most EPLI policies, but sexual



harassment claims can sometimes arise years after the alleged crime occurred.

If an employee complaint of sexual harassment arises after an EPLI policy has expired — but the alleged incident occurred while coverage was in effect — the dealership may have to produce proof of coverage to receive a payout.

BETTER SAFE THAN SORRY

You can't necessarily rely on your insurer to retain expired policies or readily locate them. It's better to be safe than sorry by keeping old insurance policies in either paper or digital format even after they've expired. This is the best way to ensure that you'll receive insurance payouts for events that happened while coverage was still in effect.

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Proven expertise in helping dealerships build success

In automotive accounting, as in other specialized practice areas, experience matters. That's why dealerships throughout Massachusetts turn to Paul A. Cerrone, CPA for their tax, accounting and auditing needs.

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- Gift and estate planning
- Representation before tax authorities

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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