



## **AUTOMOTIVE SALES MODEL**

Think piece on the future of automotive retail vehicle sales at a time of change.

### **THOUGHT STARTERS**

- ASIC view of finance and insurance commissions as well as warranty and car care products.
- ASIC view on Point of Sale Exemption vs Finance Broker Licensing.
- Factory/distributor perspective & impact on dealers' business model
- The current (and historical) automotive dealer business plan
- Dealer business behaviour – some, not all, need addressing especially in finance, insurance and aftersales items. (warranty etc)
- Margins
- Customer perspective
- Consumer Affairs view
- How it is today – and has been for decades.

### **About the Author**

Tony Carter has worked in the automotive industry for 44 years. He holds a motor dealer license in Western Australia to facilitate his business, Brokerage WA and is a member of MTAWA. The business is set up to represent clients who do not want to, or do not have time to engage dealers directly in the purchase of a new or used car. He also holds a Credit Representative License for purpose of assisting clients with finance on vehicles. This license is accountable under full finance broker license conditions.

Tony sits on the Motor Vehicle Industry Advisory Committee to the Minister (Dept of Commerce) and a Councilor in WA for the Finance Brokers Association Australia.

### **The Current Model**

As motor dealerships – franchised dealers – are set up, they will clash with both consumers and authorities such as ASIC and Consumer Affairs. Not because they are crooks or are operating outside of any “normal” parameters.

The issue is complex and will take some explaining however for the moment please accept this is not a piece designed to be anti-dealers. They, like all legitimate businesses, are entitled to make a profit and a healthy return on their investment.

So, why all the angst? Why is it the majority of consumers, leaving business out of it for now, dislike the thought of having to go through the arduous process of buying a new car? Why is that agencies such as ASIC enquire into aspects of the industry and point out some glaring anomalies?

Hopefully by taking time to read this article you will start to see that all is not ok in motor city or buyer land.

So, let's go right to the heart of the matter and consider some basic facts – numbers if you like because statistics are a good basis for discussion.

Population in Australia	approx.	23,130,000
Number of car manufacturers represented (franchisors) in Australia		66
Number of cars sold new each year – using last 3-year average.		1,100,000

NOTE: Around 150,000 to 200,000 of these are registered “demo units” forced by franchisors to enhance their “share of market” – something they hold very dear to their purpose. More on that subject later.

Average Dealer Net Profit expressed as % of Turnover	NP:TO	2% - 3%
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NOTE: This is not a typo – it is fact. Sure, dealer TO is high – the unit cost of a car is average \$35,000 so the turnover can be circa \$50,000,000 to \$100,000,000 depending on dealer size and franchise. When dealing with Averages remember the range of profit % is anywhere from + 5% to -5% across the total dealer population.

By way of perspective, CarSales.com.au has NP:TO of => 32%. Their unit sale price is probably closer to \$300 however their volume is massive as they hold major control of the new & used car advertising in Australia.

Ok – enough for facts & figures. Time to look at a fictitious dealership representing a common brand of motor vehicle and some of the requirements placed on them by the franchisor.

To apply for a franchised dealership, the individual or company will require:

- Land of suitable size and location to satisfy the franchisor. Say cost or value of \$10,000,000
- Building – preferably a purpose built building – to entirely suit the franchisor, down to the light bulbs. To meet all franchisor, council and business needs cost of around \$12,000,000
- Initial inventory of; New cars, used cars, spare parts, oils and other general items will see a further \$8,000,000 to \$12,000,000 – so if we use a mid-point inventory is \$10,000,000

So to open the doors on day one fully stocked and ready to sell cars our fictitious dealer has invested or borrowed \$32,000,000.

If you take \$32,000,000 at sound investment rate in the current market of say 5% the annual return would be \$1,600,000. Compare that to 2% net Profit of a \$50,000,000 turnover and the return is \$1,000,000. This assumes a franchise not in crisis. Could easily argue the investment of \$32,000,000 and the associated risk of employing 50 to 70 people, having to live by franchisor rules and be scrutinized by consumer agencies; is simply not worth it. Ok, so the property will appreciate in value and borrowings can be had through highly competitive financiers who are chasing added income via finance on cars sold at retail; however, that is balanced against a property that is not able to be used for much more than a motor dealership and a risk on inventory that depreciates over a short period.

Anyway, forgetting all that, we decide to invest and open the doors of our new XYZ Franchise. What do we need by way of departments and how do they work?

The design of the business is such that all departments are budgeted for profit and some of that profit can/will be made by internal sales – EG: Service Department will prepare and fit accessories for New Car Department; a service done at a profit. This adds to the cost of sales for New Car Sales Dept. resulting in their price needing to increase to the consumer to cover costs.

## New Cars Sales Department

Targets are set by the Franchisor as well as the overall dealership management. The primary objective of New Car Sales Dept. is to achieve or exceed franchisor targets.

NOTE: I mentioned earlier about the franchisor's primary objective being market share. Sales volume = market share. The greatest pressure of all is on sales volume to maintain the dealership franchise agreement.

The Dealer Agreement contains everything the dealer shall provide by way of facilities and services, inventory levels and agreement around achieving sales volumes measured by volume, share of market in the dealer's prime marketing area and how this is compared to other same franchise dealers within the regional/metro area and/or the national achievement. Fall below the expected numbers and the dealer is in trouble. In addition to the need to meet numerical targets there is an expectation of service standards that exceed 6 Star. The franchisor views Customer Satisfaction (CSI) as the ONE element that makes them stand apart from their other franchise competitors. It is therefore possible to achieve the numerical targets and fail on the CSI targets. Interestingly; if you make everything URGENT, nothing is urgent. Is this the same for CSI? If everyone achieves MAXIMUM CSI, then the "advantage" is lost and dealers remain under pressure to create the point of difference.

The Dealer Agreement also sets out what the franchisor will do for the franchisee however it is never as easy for a dealer to hold a franchisor accountable as it is for a franchisor to hold the dealer to account. EG if a franchisor produces and delivers a car the public do not want – because it is ugly or simply is a poor design/engineered car, there is no compensation to the dealer and the loss on inventory can be immense. Further losses occur when poorly engineered cars end up in dealer service departments and franchisors cover well below fair actual time spent diagnosing and repairing. Pressure to perform for both the franchisor and client satisfaction create massive pressures on dealer profitability.

Given this costly and somewhat tenuous agreement you will not be surprised to hear that it is for a fixed term and if at the end of that term the dealer does not "meet the requirements" of the franchisor they can simply terminate the agreement based on it being at an end. There is no requirement to offer a renewed agreement.

Pressure? – sure is. This is the one thing in the back of every dealer's mind. Will I be able to do enough to keep the franchisor happy and for me to get another 5-year agreement?

That pressure flows to the New Car Sales Manager and the New Car Sales Staff.

Guess where all this pressure ends?                      With the consumer in a win/lose contest.

Guess what is the outcome of the majority of new car sales departments? New cars sold at little or no Gross Profit – that is GROSS PROFIT, the bit BEFORE the expenses. A lot of dealers are in real loss in sale of new cars before they pay staff let alone pay all departmental expenses incurred as a direct result of the sale activity.

Where does the money come from? Other operating departments need to be excessively profitable to make up for the initial loss incurred in New Car Sales. Figures of \$600,000 LOSS Per Annum in New Car Sales is not uncommon.

### **Used Car Sales**

No franchisor here – you would think. The franchisor expects the dealer to represent the brand in both new & used. A number, not all, require dealers to include significant pre-sale checks and then offer term warranties to create “XYZ Certified Used Cars. This adds to cost of the inventory that competes with a massive private sale sector – mainly through CarSales.Com.au – and independent used car operators.

Used cars is a true market place. The value of a car is subjective based on one person’s view of that car on the day it is purchased. The cheaper they buy the greater the chance of meeting the market price and selling at a profit.

Once assessed, reconditioned and prepared for sale the dealer objective is to sell at a reasonable gross profit. Experience shows the current average gross profit on the car itself is between \$1,800 and \$2,500, provided sold inside a 45-day window. As time goes by the car loses value against current values. With inflation as low as it is this is an accelerated depreciation and it is not uncommon for dealers to suffer \$1,000 to \$3,000 loss on an individual unit dragging the overall average gross profit down.

At \$1,500 per car sold it takes a lot of volume to create a stand-alone profitable used car outlet.  $\$1,500 \times 65 = \$97,500$ . This hardly offsets the loss making New Car sales.

So, where is the profit??

### **After Care Sales.**

To ensure profit opportunities are kept out of the basic car sale process dealers separate the sale of a new or used car sale from the sale of “other items”. These can range from floor mats to corrosion protection packs to warranty extensions, window tint and others. Whatever fits on a car or is a service to a car where there is significant profit opportunity. Remember – there is little or no profit in the car sale itself so this becomes a necessity.

The “process” is where customers have angst. Having endured two or more hours to buy the car they then get introduced to a person whose sole job is to sell After Care products. The client at this stage is relaxed and has their mental guard down. The car is bought and this is just a few “necessities”.

Average profit targets her, per car sold, is between \$750 and \$1,000.

Assume a used car sale at \$1,500 and add the \$After Care \$750 and profit in sale is now \$2,250.

### **Finance & Insurance.**

This is the opportunity for significant profit based on the need created to get finance resolved to allow delivery of the car just purchased. Remember emotion is high in the purchase and the client is eager to get it finalised and to get this process over.

Dealers at present are working on a Flex Commission basis whereby they share in the interest charges. EG if "base or buying rate is 5% and the "sell" the finance at 10% then the dealer receives a percentage of that interest represented by the difference between 10% and 5%. Anywhere from 65% of the \$ value in the interest to 85%. Based on average loan values around \$28,000 and term at 5 years the income per finance transaction is \$3,000 or \$1,200 per car sold.

Assume the \$2,250 profit after Car and After Care plus the \$1,200 from Finance we now have \$3,450

Insurances now add another element – and if financed into the contract they boost amount borrowed by some thousands of dollars based on products purchased.

- GAP – protection from difference between insurance payout and finance payout in total write off.
- Loan Protection Insurance
- Extended Warranty.
- Comprehensive Car Insurance. This is the only mandatory policy (if financed) and the lowest profit.
- Tyre & Rim Insurance against broken rims – not scratch damage.

Combine all and look to an average result and the dealer is looking to achieve another \$500 to \$1,000 commission on sale of insurances.

Back to the growing total sale gross profit. We were at \$3,450 after finance added. Now add insurances at say \$750 and the total per car sold goes to \$4,200.

If the dealer sells 50 New Cars and 65 Used Cars = 115

$$115 \times \$4,200 = \$483,000$$

If average cost of units sold is \$28,000, invested cost of sale is \$3,220,000. This represent 15% Gross Profit on cost or 13% on sale price.

This is fair and reasonable. 15% Gross Profit in many businesses would be considered a disaster however the motor industry can make this work. Especially when you add in profits from Service and Spare Parts operations albeit these have been negatively impacted by changed (extended) service schedules, capped price service charges and less parts required.

So, back to the issue at hand. Dealer profits in the sale of Finance, Insurance and After Care.

If the law changed tomorrow and dealers either were unable to sell Finance, Insurance and/or After Care products or had restricted profit potential; the whole equation would need to alter.

Some buyers would be better off however others would pay more by virtue of fact dealer must get to 15% GP on Sale to be viable. **Price of new & used cars will rise.**

### **Franchisor / Dealer Relationship**

This then places dealers at odds with their franchisor. Higher priced cars, to protect profit margins will result in lower volume throughput. Market share will be determined by the “best car” more than the “best price”. In time this will work its way out as franchisors determine their offering in Australia based on their ability to produce quality and desired cars. Will make for difficult times initially – years – and a number of dealers may fold up with significant loss of funds and jobs.

End result in the long term will be a public obtaining quality cars but at a higher overall cost. Those paying cash will pay more for their car and those on finance will pay no less than in the past as the saving in finance will be reflected in price of car.

### **Solutions?**

What is the solution without disruption to markets, employment and overall stability in an industry?

Work on behaviour. As with all measured statistics there are outliers – the extremes of the spectrum. These need to be removed from some dealers’ operations.

Education of the public about what is fair and reasonable and the truth about credit is a start. Industry Associations and Finance companies play a part in this activity and it needs to be industry funded. Either through a franchisor levy per car sold or in association fees levy.

Limits on commission earn \$ or % for sale of all insurance products. Sufficient for reasonable profit but competitive in the market.

Punitive measures including name and shame those dealers acting outside an agreed Best Practice Code.

Consumers bringing examples or complaints about unfair and unreasonable practices need to be supported by having contracts reversed and rewritten at no expense to them with finance company acting in their best interest and costs met by offending dealer.

Decision of Dept Consumer Affairs around Australia to be final.

- License all Finance Officers under a modified Broker license system
- Covering finance of vehicles sold by their immediate employer (PAYE only)
- Not as onerous as open Broker license however requires Cert IV or better, annual PD points for training and accountability to outcome of any complaint.
- Potential is loss of license for repeat or excessively poor behaviour.
- Hold both the (licensed) finance officer AND the employer liable in the event of Best Practice Code breaches and/or any gross misconduct relating to finance/insurance contracts.

- Penalties to range from fine – individual and corporate - through to suspension of finance license for a period of 1 month to permanent ban – apply to both Licensed Finance Officer and the Corporate entity employer tied to sale of car.
- Dealers electing to use Fully Licensed Finance Brokers in place of employee finance officers to have same system apply to both the contract Broker and themselves.

In effect allow the industry to self-regulate and hold all parties accountable.

Motor Dealer are entitled to a profit like any other well-run business. Nobody can argue the quantum of \$ earned PROVIDED the dealing in motor vehicles and allied finance, insurance and other sales is FAIR and REASONABLE.

Consumers need to accept there is a cost to owning a motor vehicle, that dealers do not have massive starting profits in every car sold and that PROFIT is not a dirty word.

**Tony Carter**

**Brokerage WA**

[Tony.carter@brokeragewa.com.au](mailto:Tony.carter@brokeragewa.com.au)

M: 0418911220

MD25569

CRN483249