Revenue Guru

The Profit-Filled Back End of Velocity

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8/26/2011

Now that dealers have near-real-time transparency into the marketplace with tools like vAuto, they are able to turn their inventory faster and increase their total gross profit from the front end of their vehicle sales. Any number of books, whitepapers, blog posts, and news articles have been written about this subject. This paper sheds new light on the increased number of back-end opportunities that come with a velocity approach and how to maximize the profit potential associated with more unit sales.

Clearly, faster inventory turns result in more back-end opportunities. A dealer carrying an average inventory of 100 vehicles moving from a 45-day turn rate to a 30-day turn rate will see an increase in sales of 50% (from 800 per year to 1,200 per year, a 400 unit increase). The more back-end opportunities a dealership has, the more valuable it is for that store to sharpen their skills, improve their processes, and make sure they have a complete product mix with all the training necessary to sell the right products to the right shoppers. Below is an example of the financial impact from both front- and back-end velocity. Profit more than doubles, with 78% of the improvement coming from the back end.

Example of Velocity Implementation on Front and Back End

Inventory Turn Rate		45 Days		30 Days		Change
Vehicle Unit Sales Per Year		800		1200		400
Gross Profit Per Unit	$	2,000	$	1,750	$	(250)
Total Annual Front-End Gross Profit	$	1,600,000	$	2,100,000	$	500,000
Annual Back-end Opportunities		800		1200		400
Backend Gross Profit Per Unit	$	800	$	2,000	$	1,200
Total Annual Back-End Gross Profit	$	640,000	$	2,400,000	$	1,760,000
Total Annual Gross Profit	$	2,240,000	$	4,500,000	$	2,260,000

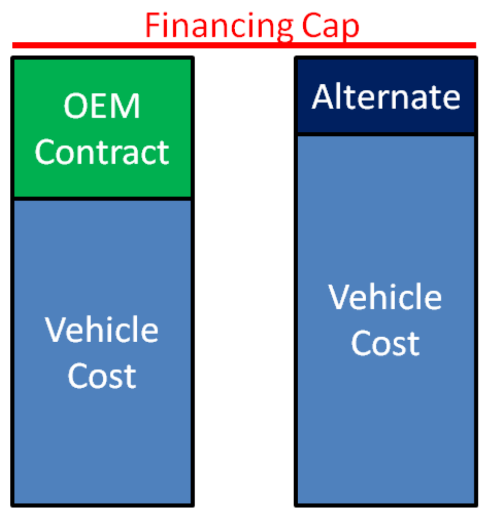
Note that this example only deals with used vehicles. Additional benefit can be found by applying the same principles to new vehicles. Dave Smith Motors is not only the top Dodge, RAM, Chrysler, Jeep dealer in the world, they are the top Mopar Accessory Dealership in the world for the past five years in a row.

This paper will touch on new vehicles as well as used. It is difficult to market and run a store with two distinct pricing strategies. Generally speaking when a dealer recognizes the need to turn used vehicles faster, the same approach should taken with new vehicles. If the store advertises used vehicles with little or no negotiation room, the same approach should be taken with new vehicles. Just as with used vehicles, new cars with low Market Days Supply should be priced at a higher Price To Market. Back end opportunities often require different products, but the purpose for having a complete product line is the same.

Dealers executing on the velocity model to turn inventory faster and reduce risk are generally seeing a substantial profit improvement. However, failure to execute on the back-end is likely leaving most of the profit potential on the table. Investments in training and systems for back-end performance make far more sense when unit sales are high. But the best news is that some of the back-end changes, like service contracts, require no financial investment at all. I've talked to dealers who swear to me that investing in vAuto and reading Velocity and Velocity 2.0 by Dale Pollack saved their business. My message to those dealers now is, "You don't know the three-fourths of it."

Service Contracts

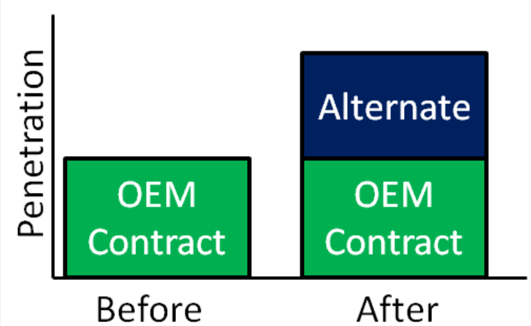
Service contracts are the primary source of dealer income on the back end. This has dried up for some dealers as new-car warranties have become longer and some used vehicles are covered under manufacturer certification programs; however, there is still plenty of back end business to win with the right training and the right set of products.



Savvy dealers sell the OEM contract when they can, but have alternative products to sell when they cannot.

New Cars

Many new vehicles come with 100,000 mile powertrain warranties. However, the powertrain is a rapidly diminishing source of concern for shoppers. Improved vehicle quality helps shoppers feel confident about the reliability of their powertrain. Often, the greater concern is over interior features and control modules that seem to be proliferating with each model year. Often times, the first repair order is on a sensor or module the owner never heard of before. Service contracts that wrap the powertrain warranty with a certified level of coverage are often a low-cost way of providing this extended level of coverage. Dealers offering service contracts that wrap the powertrain coverage of electronics, ABS braking systems, air conditioning, steering, suspension, and fuel systems find tremendous improvements in service contract penetration. Dealers with new-car penetration rates of 30% often they are able to achieve 50-60% penetration with a full line of solutions.



Service contract penetration on new vehicles can double without cannibalizing OEM contract sales.

The manufacturers products are understandably the first choice of many dealers. However, the credit crunch and the increased number of shoppers with weaker credit are pinching many of these OEM contracts out of the deal. There simply isn't room for anything that expensive in the financing. Having less expensive options in the product portfolio can increase penetration without cannibalizing sales of OEM contracts.

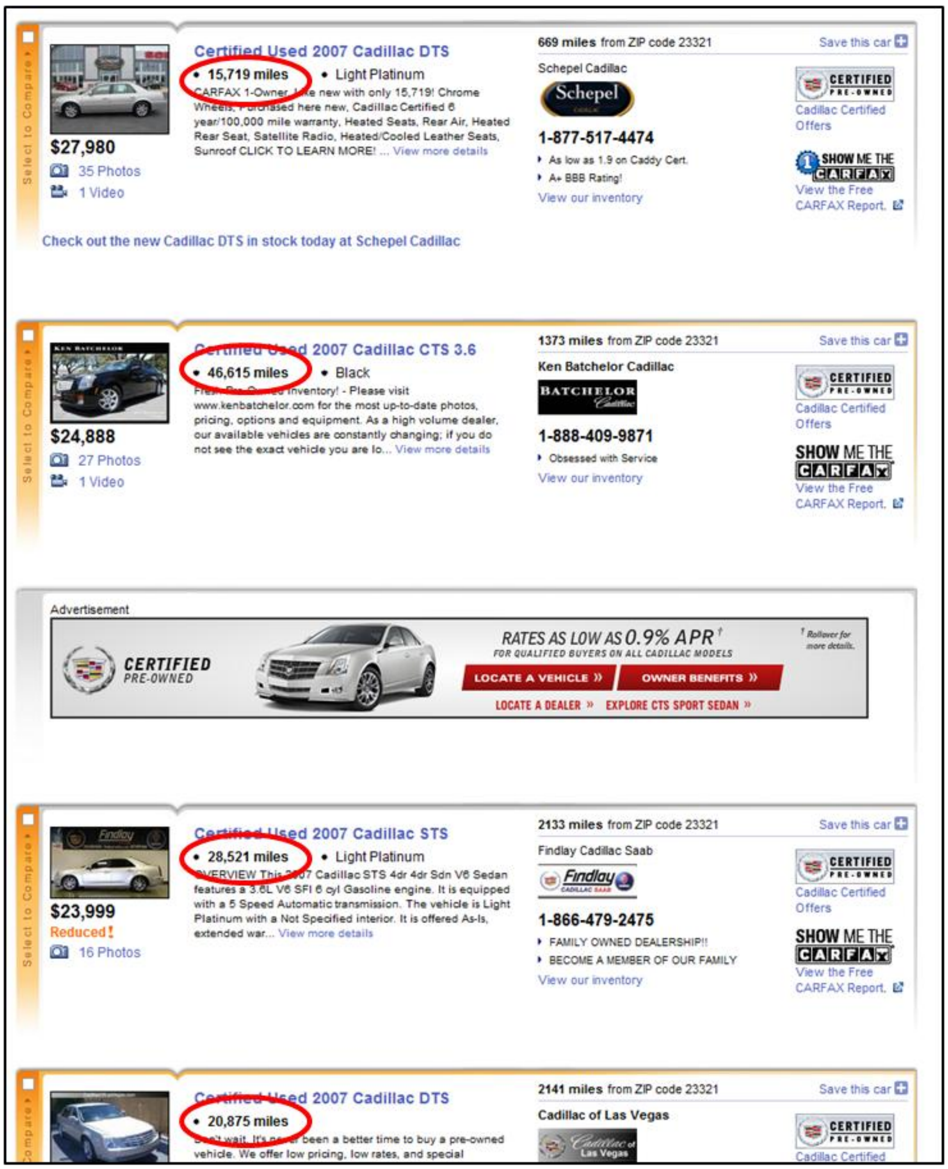
Makes with 100,000 Mile Powertrain Warranties

Buick	Dodge	Hyundai
GMC	Chrysler	Kia
Chevrolet	RAM	Mitsubishi
Cadillac	Jeep	Suzuki

Certified Used Cars

Because many of the online shopping sites like Cars.com and AutoTrader.com only list used vehicles as certified if they are manufacturer certified, there can be a substantial sales advantage to certifying those vehicles that qualify. Certified vehicles often turn faster and deliver a higher gross on the front end. The challenge is extending that gross on the back end.

Some of the used-vehicle certification warranties are excellent, covering up to 100,000 miles. The challenge comes with low-mileage vehicles 3 or 4 years old. The certified warranties will expire many years before the vehicle reaches 100,000 miles or the financing is paid off. This simply is not acceptable to many certified shoppers. The graphic below was taken directly from AutoTrader.com on August 17, 2011. It shows a number of examples of certified 2007 used vehicles with less than 50,000 miles.



J.D. Power and Associate's certified vehicle studies consistently showed the warranty components of certification to be the most important to shoppers who bought certified used vehicles. For the vehicles above, the warranty that comes with certification is nearly useless. Fortunately, certified rider programs exist to extend the years of coverage. These programs can help close deals as well as generate new back end income.

Pre-Owned, Non-Certified Used Vehicles

There are at least a dozen experienced, stable companies offering service contracts for pre-owned, non-certified used vehicles. For some stores, these contracts are the bread and butter of the F&I department. The irony is that many dealerships are far better at negotiating with consumers to expand their back-end gross than they are with the service contract providers. In a previous paper*, Dealers Are Finding New Profit Potential in Service Contracts*, I focused on the price dealers pay for not regularly shopping service contract providers.

Simple economics dictate that as vehicle reliability increases, the cost of service contracts should decline or the components covered should increase, or both. That simply isn't happening when dealers idly use the same provider for years without listening to competitive bids from other providers.

Every dealer recognizes they need to know the market before stock their used-vehicle inventory. It is simply not possible to move more units for more total gross without being cognizant of the Cost To Market, Price To Market, and Market Days Supply. Dealers don't want to own used cars. They want access to gross profit potential, as much per unit as possible. Service contracts don't require any inventory. The return on investment is incalculable because there is no investment. As great as that is, it does not take away the need to know the market on the buying side and load your team with the mix of contract options that will maximize total back end gross.

There is an investment in time involved with comparing the wholesale prices of various service contract providers. In many cases, there is no substitute for booking out examples of some common situations. It is not uncommon to find prices varying by hundreds of dollars per sale. This equates to many thousands of dollars per month in additional back-end gross, before anything different or additional is sold. Savings found on the buying side of service contracts are found money that can go straight to the bottom line.

Other F&I Products

The mix of financing products is something most stores seem to manage fairly well. Doing so is essential for maximizing sales and retaining good sales people, not to mention enhancing back-end profits. Less attention is generally given to theft protection, gap insurance, and other back-end products. Although financing rates are becoming heavily regulated in some areas and monitored across the country, less challenges exist with these other products.

If penetration rates are not as high as they could be, additional training will generally deliver a high return on investment. On the front end, the vehicle enhances the shopper's quality of life as a provider of positive benefits. Most back-end products are negative eliminators. Achieving maximum gross is not so much about selling the features of the product as it is selling the negatives they take away. Sell the burglar and they will be begging for the burglar alarm.

Accessories

Bar none, every other durable goods industry sells more accessories as a percentage of the total product price than auto dealers do. New products are helping dealers increase accessory sales an average of $600 per unit. A dealer moving inventory faster will have more opportunity to capitalize on accessory sales.

Credibility is a key ingredient to obtaining accessory sales before the aftermarket stores and websites have an opportunity at the sale. Because the Velocity model relies on documentation -- rather than negotiation -- dealers employing this strategy have a fantastic opportunity to pickup accessory sales as well. The idea behind price discrimination is to charge more to those who can and will pay more. The transparency of the internet has dealt a blow to price discrimination, but opens the opportunity to achieve the same objective by adding high margin accessories.

Dramatic improvement is accessory sales generally requires three elements:

1. A sales system that involves technology to demonstrate the products and assist in the selling
2. Training of those who will sell the accessories
3. A compensation plan that gets the full support of Sales, Service, and Parts.

Plans that provide a 10% commission to any person selling the accessory and a profit split between Sales, Service, and Parts Departments are proving successful in numerous stores.

Putting It All Together

Service contracts, other F&I products, and accessories each offer fantastic profit potential as unit volume goes up. Changes to the product mix of service contracts available often results in $20,000 to $30,000 per month in back additional back-end gross profit. Changes in training and product mix often improve profits from theft protection, Gap insurance, and other back-end products thousands of dollars per month. The proper accessory sales system is yielding $600 per unit in additional revenue with incredible profit margins.

The number of dealers will continue to decline over time, and the largest dealers will become even larger. However, great dealers are not just winning business from other dealers. They are taking it from neighborhood and online accessory stores. They are taking it from thieves in their area. Nationally, auto theft is down 40% since 2003. Great dealers are keeping service away from Manny, Mo, and Jack and keeping it in their bays with service contracts that wave the deductable when using them. They are keeping this service business longer with rider programs that extend vehicle certification benefits and other creative, new product. They are benefit from all these benefits even as they increase back-end profits with more service contract penetration, and still maintain their OEM service contract penetration.

When systems are in place to extract all the gross profit that is possible, dealers are able to advertise more aggressively. The benefits of advertising products like AutoTrader.com's Alpha and Cars.com's Premiere go up as unit sales go up. There can only be one Alpha or Premiere dealer in a market per brand. The dealer who can afford to pay the most for this advertising is the one who can not only stock and sell the most vehicles but profit the most from each sale. These are just a few examples of how the savviest dealers will continue to get bigger at the expense of those unable or unwilling to adapt.

Let the naysayers talk about a race to the bottom. Total velocity is about selling more units, reducing risk, and not only earning more total front-end gross profit but more total profit on a per-unit basis. Expanding consumer shopping radii extend the promise of continued growth for years to come for those willing to price their core product right and expertly add as many high-margin back-end sales as possible. The bottom is not the issue. The question for dealers looking at their business from a broader perspective is how high both total profits and per-unit profits can go.

Sponsor

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Continental Warranty offers the most diversified line of back-end products for auto dealers, bringing more profit potential from every new or used vehicle sold. Dealers employing a velocity pricing strategy are finding Continental Warranty to be their most profitable ally.