Aftermarket Management

Keep your eye on the ball

By KELLY MATHISON

When it comes to parts and service departments, there is no shortage of metrics to watch so it's hard to narrow it down to only one.

To use a sports analogy, a successful baseball team must do many things well to win. When asked to narrow it down to *the most important thing*, some may say you must "keep your eye on the ball," which is a self-explanatory truth. However, it's not just the duty of the manager or a coach but every player on the team. A successful dealership is like a successful sports team – not only should the manager be keeping his/her eye on the ball but so should each team member.

Aftermarket absorption

Helping your employees understand absorption is a great place to start to get your team to focus on the big picture.

The parts and service departments are generally positive cash generators, meaning they generally bring in more cash monthly than they pay out or tie up in inventory.

Often, when a wholegoods deal is completed, it causes a negative cash situation. For example, you sell a new unit and take a trade. The manufacturer takes the cash proceeds, then floorplans the trade. Often the freight, pre-delivery, set-up, and delivery to the customer is covered by the dealership. Furthermore, any costs incurred in reconditioning the trade are tied up internally, resulting in a negative cash position.

Aftermarket contribution margin dollars are generically defined as: parts and service revenues, minus variable expenses (sales minus cost of sales).

In basic terms, the contribution margin reveals how much of a company's aftermarket revenues will be contributing to the company's total fixed expenses.

The contribution margin is also a key component in calculating a company's break-even needs.

The aftermarket absorption rate is the percentage of dealership expenses covered or absorbed by the gross profit generated from aftermarket sales.

$$\frac{\text{Total dealership fixed expenses} + \text{Interest}}{\text{Parts gross profit \$s} + \text{Service gross profit \$s}}$$

Example:

$$\frac{\$3{,}300{,}000 + \$200{,}000}{\$1{,}200{,}000 + \$1{,}100{,}000}$$

= 65.7 percent absorption rate

The following are the average North American dealership absorption rates as reported in the WEDA *Cost of Doing Business Study* (CODB).

2014	68 to 71 percent
2015	60 to 61 percent
2016	63.95 percent
2017	61.17 percent

The goal is to have parts cover 50 percent and service cover 50 percent to provide 100 percent absorption.

Why is this important?

Achieving 100 percent absorption allows you to meet monthly commitments. Plus, it makes your business more resilient to wholegoods' sales fluctuations, price changes and pressures. It can also relieve the stress of having to liquidate stock or take bad deals just to generate cash.

Depending on your current situation, reaching a 100 percent absorption goal may be a three- to five-year plan.

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The first step is to understand what level of revenue your aftermarket needs to generate to cover overall expenses. In the previous example, we showed a dealership would need to generate an additional $1,200,000 in aftermarket margins, a very tall order.

Breaking it down further, it would require:

- $2 million in additional parts sales at 30 percent margin = $600,000
- $1 million in additional service sales at 60 percent margin = $600,000

Possible solutions might include:

1. Adding additional technicians could conservatively create an additional $165,000 in annual labor sales plus an additional $100,000 in annual parts sales per technician. If the work is available and your current infrastructure will allow, this is an excellent way to increase revenue without increasing expenses.
2. Increasing parts margins, labor and nonlabor margins, parts turnover, and reducing work in process (WIP) are all instrumental in increasing overall contribution margin dollars.

Obviously, none of this will happen overnight. But once your managers and employees understand the ultimate goal, they can go to work on finding solutions.

Expense control, the other side of the coin

Many managers feel they have little control of expenses or feel the little things won't have an effect. The following examples may help managers understand how keeping an eye on the little things can make a huge difference.

According to the CODB study, North American ag dealerships reported an average Net Operating Income (NOI) of under 2 percent.

At 2 percent NOI, how much more does the dealership have to sell to cover the following:

$1.50 in wasted postage?	$75
$600 in mobile phone/data overage charges per year?	$30,000
$100 in excess monthly vehicle costs? ($100x12 =$1,200)	$60,000
$40,000 additional annual salary?	$2 million

6 ways to improve Aftermarket Absorption

1. Include aftermarket absorption calculations in your annual budgeting process.
2. Ensure you are sharing your financial metrics and goals with your management team.
3. Ensure your managers clearly understand their own department's metrics and goals.
4. Ensure managers have a firm understanding about metrics and goals of the other departments.
5. Challenge your managers to look for opportunities to work cooperatively to increase performance across all departments.
6. Ensure all managers understand the effect of expense control and challenge all staff to look for ways to control waste

As you can see, controlling expenses can have a huge effect.

A participant in one of the Dealer Institute's Aftermarket Management modules reported that after sharing this information with his team, they renegotiated their telephone contract and found annual savings of over $6,000 across their two-store operation.

How do we get there?

The first step is to understand your current state. Once all managers clearly understand the fixed expense level of the operation, a goal can be set as to the percent that is expected to be covered by the aftermarket. From there, detailed action plans can be made to take advantage of the opportunities. Normally, a mix of sales and revenue goals coupled with expense controls will be required. WED

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