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NEW AND USED AUTOMOTIVE INDUSTRY:

AN INDUSTRY PROFILE

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#### INDUSTRY AND BUSINESS ENVIRONMENT

##### Trends Affecting the Industry

The largest group of car buyers are the baby boomers, the age group currently between 25 and 43. According to predictions by the NADA they will buy 50% or more the new cars in the next two decades. It is estimated that by the year 2000 that baby boomers, will head over 60 million or 57% of all households in this country. The Project 2000 Committee estimates that, despite the rising costs of living, the dollars spent on new vehicles will increase from the 7.3% level of total household expenditures in 1960 to 11% in 1992. The greatest impact of this is that the baby boomers seem to prefer imports to domestic cars [SEE EXHIBIT 1]. In 1973, imports controlled 13.5% of the market. By 1983, that number had risen to nearly 26%. Current figures show the market share of imports to be over 32% and continuing to rise [SEE EXHIBITS 8 & 11]. This poses

a problem to the traditional dealer carrying only one domestic brand (i.e. Ford, Chevrolet, Chrysler, etc.). As a result, dealers, finding it increasingly harder to sell only one brand of automobile, are expanding to two or more dealerships or even operating several franchises from the same location.

In their book, *Betting on the Franchise*, J. Ferran and Jake Kelderman suggest that dealers can expect the following trends to affect them:

- \* Less impulse buying
- \* Less response to novelty, change and variety
- \* More focus on quality, durability and appropriateness
- \* More trade-offs of time and convenience to get a good buy
- \* Less store loyalty as the consumers seek to "beat the system" in the distribution area
- \* More loyalty to a group of brands, but with selective behavior from product to product
- \* More time and money spent at home
- \* A pride in discipline and a willingness to forego present whims for future benefits
- \* An increase in personal responsibility for making the right choice and less reliance on protection from government and others; and an emphasis on local products, brands and spokespeople.

The last, ten years, from 1979 to 1989, have proven to be quite a roller coaster ride for dealers [SEE EXHIBIT 4]. For example, local new car sales fluctuated greatly just in the two years between October of 1987 and October 1989 [SEE EXHIBIT 6]. The average net profit before taxes in 1979 was approximately 2.5% of sales. By 1981 that number had dropped to 1.16%. and 4000 dealerships had folded. By 1987, however, profits reached a high of 2.16% of sales. In 1989, with profit before taxes at a dismal 1.3% of sales and falling, the shadow of a recession in car buying loomed dark and ominous. The average gross profit as a percent of sales also indicates a bleak outlook [SEE EXHIBIT 5]. In 1988 the top 100 megadealers in the U.S. controlled nearly 13% of total new car sales. It is estimated that if current trends continue, up to 25% of those megadealers will go out of business (Spinella, 1988).

#### Current State of the Industry

The new and used car industry in the U.S. is composed of 25,500 dealerships owned by 17,800 dealer principals, quite a change from 28,350 dealerships owned by 25,100 dealers in 1979 [SEE EXHIBIT 2]. The recession of the early 1980's prompted a number of more stable dealers buy those dealerships which were in financial trouble. Currently, nearly half all dealerships are a part of a chain of two or more dealerships, and nearly 20% are part of a chain of four or more dealerships. The total industry sales in dollars in 1988 (the most current available data) were \$303,235,000,000. In terms of unit sales, the approximate number of new vehicles sold were 15.5

million. The breakdown of sales by department are [SEE EXHIBIT 3]: service and parts,- 14.3%, used vehicles -22.8% and new vehicles -62.9%. The average price of a new vehicle was \$14,100 [SEE EXHIBIT 12] with .3% operating profit, and the average number of new cars sold per firm at approximately 600 [SEE EXHIBIT 13]. The total average percentage of operating profits by department are, used cars -29% new cars -20.7% and parts and service - 50.3% [SEE EXHIBIT 15].

The average new-car dealership in the United States increased total sales from \$6.1 million to \$12 million between 1982 and 1989. During that same period of time total net profit before taxes increased only slightly overall from 1.3% to 1.7% of total sales. The total expense of selling a new car has risen from \$891 in 1984 to \$1226 in 1988, an increase of 38%. The amount of gross profit per new car has risen by \$186, not nearly enough to offset the \$335 increased cost in selling the same car. According to the most recent data available, current profits have fallen back to 1.3% of total sales and continue the downward trend. [SEE EXHIBIT 4 & 5]

#### The Legal Environment

The biggest legislative concern of dealers currently is Clean Air and other environmental bills.

"Clean Air legislation will have a "wide-reaching effect on automotive servicing, says one dealer. That means, he says, cost for new equipment and technological training." (Sorge, 1990)

Environmental bills raising the standards of items such as auto emissions and waste disposal increase costs, not only to the automakers, but to the dealers as well. For example, disposal of tires is a major issue that faces the dealers of today because many landfills are no longer taking them. Dealers must invest in new equipment and personnel training whenever a new environmental bill becomes law. For example, because of the 194 Hazardous waste tax, dealerships have acquired the technology for the service department to recycle used oil rather than incurring the cost of disposing of it.

#### Industry Problems

Manufacturers currently offer special discounts to fleet purchasers which allow them to buy the cars cheaper than a dealer can. Automakers currently subsidize each of these vehicles an average of \$1,750. The fleet purchasers, at a pre-determined point in the life the car (i.e. 25,000 miles) the vehicle may be repurchased by the automaker at a percentage of the original cost. The problem most often attributed to this is new-vehicle substitution. Another option for the fleet buyer is to send the vehicle to auction. According to Project 2000 Redux, part 2:

"... the bid prices can sometimes get so low on the newer buy-back vehicles (because of an excess in inventory) that they

significantly lower the residual value of the older vehicles put through the auction by the large corporate fleet companies." (p. 37)

The percentage of used vehicles coming from factory auctions and retailed by dealers has increased from 7% in 1984 to nearly 15% in 1988. Project 2000 Redux, part 2, states that:

"The Project 2000 Committee believes that until the automakers realize the folly of their two-tier pricing system:

- \* The number of vehicles going into the auto rental business will continue to increase.
- \* Automaker subsidies to the rental companies will likely continue. Japanese automakers with transplant operations have all indicated they will be more active in the fleet business. Toyota, for instance, hopes to dedicate one of its transplant production to fleets.

\* Auto actions will proliferate to handle the growing volume of newer used vehicles coming from rental fleets. NADA analysts believe that, unchecked, as much as one-half of all domestic auto production could eventually find its way through this secondary distribution network." (P.37)

The industry problem which is of biggest concern to the dealers is floorplanning costs. Floorplanning, basically the agreement between the automaker and the franchise on how the inventor will be financed, interest rates, etc.

"The overall concern for all dealers, regardless of franchise, is the skyrocketing cost of floorplanning. ...Ray Green, president of the NADA:... `The manufacturers and the dealers both have an obligation to the product, and (the manufacturers) should share some of the cost of having (the product) on hand. Currently, the dealers do the whole thing. There should be a floorplan-assistance program going for as long as the product is in inventory.'" (Sorge, 1990)

### Franchise Opportunities

There has recently been a number of new franchises available, mostly foreign. For example, the nameplates of some newer franchises include: Lexus, Infinity, Hyundai, Geo, Acura, Suzuki, and Eagle. Initially many of them required a sizeable capital investment (new building, etc.). The dealers often did not like the idea of such a large capital investment (often \$3 million +) but had no choice if they wanted to keep the franchise.

### Current Trends

The most overwhelming trend in the industry is the move toward the "megadealership." The megadealer is a result of the previously

mentioned trends affecting the industry and the boom in car sales 1983 to 1988. Instead of owning one or two dealerships the megadealer may own as many as ten or more often located near one another, but just as often located in different states. Dealers with excess capital during the recent boom expanded to be able to appeal to a larger market and to achieve economies of sale in areas such as advertising. Many of these megadealers incurred debt in hopes of taking advantage of a continued boom. As a result, those dealers became highly leveraged and many have over extended themselves financially. This condition magnifies any cash problems in a downturn in the economy as has happened over 1989 to 1990. One outgrowth of this trend is the development of the auto mall, which may have one or more dealers with many makes under one roof in an effort to provide shoppers with a wide range of choices in a centralized complex. The common location hopefully reduces costs, increases "traffic flow," and results in greater sales per firm.

#### New Technology

As the U.S. continues to move toward an information based society the dealers must be prepared to move with it. Already some auto makers and dealers are advertising with a computer disk packet where the customer can view the car at home or his/her PC, make choices on options, and eventually order the car. Research is under way to create a scenario such as this one the March 1990 issue of Wars's Auto Dealer:

"2002- A customer walks into a Honda showroom. No models are visible. Instead, a salesperson takes him to Viewing Room 1. There, a holographic image of a 2003 Accord is displayed. At the customer's direction the salesperson keys different colors, options and features into the image. The customer gets the "feel" of the car through a simulation suit. Using Electronic Data Interchange (EDI) links, an order is sent to the Ohio factory and financing is arranged through the customer's bank. The car is delivered within a week. Skyhigh floorplanning expenses are merely a bad dream." (p.23)

### SMALL BUSINESS FACTORS

#### Startup Information

At the NADA convention, whenever there is a new franchise being offered, whether domestic or foreign, there are long lines of dealers ready to take advantage of the opportunity, regardless of price. Because of the intense interest and high price, it is next to impossible to start a business with a new franchise. The most reasonable and most available way to become a dealer is to buy an

existing franchise. The price of an existing franchise varies greatly depending on location, inventory, product lines, service facilities, and the amount of "blue sky." Blue sky is the term used to describe the good will attributed to the franchise and can go into the millions of dollars.

Another issue relating to startup deals with minority ownership of an auto dealer. There are financing and training opportunities available for minorities and women from all three of the domestic auto makers.

"Since 1980, according to figures compiled by the National Association of Minority Automobile Dealers (NAMAD):

\* Ford's black dealerships have grown from 19 to 248.

\* Chrysler's increased from 7 to 81.

\* General Motors went from 63 to 103." (Jackson, 1990)

These numbers are small, however, compared to "more than 10,000 GM dealerships, 5300 Ford franchises, and 5400 Chrysler outlets."

(Jackson, 1990) This represents an opportunity for those who qualify and are willing to take their chances in the current environment. Because of the current environment, however, caution should be exercised in evaluating the opportunity. There has been speculation that the automakers are not giving enough money to start a successful dealership. All the factors must be carefully weighed including "the inability to get loans and hiring and keeping a professional staff." (Jackson, 1990)

#### Licensing

License requirements vary from state to state. An example of what it takes to obtain a dealer license in Ohio is in exhibit 16. Information on any state or local licenses or permits required in Ohio can be obtained through the Ohio One-Stop Business Permit Center at 1-800-248-4040. Other states should have similar agencies.

#### Model of the Average Dealership

Currently the average dealership looks something like the following:

Net Sales	\$12 million	
Gross Profit	\$1.7 million	
Operating Expenses	\$1.6 million	
Operating Profit	\$96,000	
All Other Expenses (net)-	\$36,000	
Profit Before Taxes	\$132,000	
Sales From New Cars	\$7.6	million
Sales From Used Cars	\$2.7	million
Sales From Service and Parts	\$1.7	million
Inventory Turnover	5.6 times/year	
Cost of Advertising	\$160,925	
Annual Payroll	\$919,000	

Assets	
Cash and Equivalents	\$178,200
Trade Receivables (net)	\$290,400
Inventory	\$2.2 million
All Other Current	\$211,200
Fixed Assets (net)	\$333,300
Intangibles (net)	\$19,800
All other Non-current	\$49,500

Liabilities	
Notes Payable - Short Term	\$1.7 million
Current Mature- L/T Debt	\$46,200
Trade Payables	\$194,700
Income Taxes Payable	\$16,500
All Other Current	\$211,200
Long Term	\$277,200
Deferred Taxes	\$3,300
All Other Non-current	\$49,500
Net Worth	\$782,100

Given the indicators of a possible recession, these figures become very important. That is, where a particular dealer is in relation to the industry norm could indicate success or failure. The reaction of dealers could be similar to that of the local dealers in the Cincinnati market as summarized in a recent article in

The Cincinnati Enquirer:

- "\* Fewer new cars on their lots.
- \* More emphasis on selling used cars.
- \* Greater reliance on parts sales in their service departments.
- \* More efficient advertising." (Jackson, 1989)

### Financing

In order to start a new dealership from ground up one must count on financing at least \$3 million for a location (property and building included). In addition, the initial inventory cost would be approximately \$2.2 million. The financing arrangements for the inventory would be made through the floorplanning agreements with the automaker. The cost operations for one year, on average, is \$1.6 million with a slim .8% operating profit. Total approximate startup costs vary between \$5 - \$8 million.

Financing can come from a number of sources, personal savings, a bank one does business with, or an outside investor. Regardless of the initial investment, however, the greatest challenge is to

manage the finances efficiently. In an industry where business is usually either very good or bad it is essential to effectively manage the cash flow. Cash flow, as defined by the NAPD is, "the movement of funds into your dealership to purchase the inventories, services, and supplies needed to run your operation" (NADA 1981). For example, cash enters the dealership through the following:

- \* inventory
- \* fixed assets
- \* factory advances
- \* short or long term loans
- \* factory incentives.
- \* services
- \* stocks and bonds
- \* notes receivable
- \* customer deposits

Cash leaves the dealership through the following:

- \* trade receivables
- \* advertising
- \* taxes
- \* loan and interest payments
- \* investments
- \* salaries
- \* supplies
- \* mortgages
- \* expenditures
- \* other expenses

The break-even point for dealership vary according to location, size of the dealership, amount of owners equity, floor planning, etc. A break-even point is the amount of revenue which covers all costs, both variable and fixed costs.

"It is very useful for the investor and the management to know what the break-even point is, and whether it will be easy or difficult to attain. It is also very desirable that your projected sales be sufficiently larger than the break-even sales so that small perturbations in the ventures's performance do not produce losses. You should prepare a break-even chart and discuss how your break-even point might be lowered in case you start to fall short of your sales projections." (Timmons 1985)

## Marketing

The typical customer going to buy a car is expecting the stereotypical "shady" car salesperson. Probably the biggest marketing challenge to any dealer is to overcome that stereotype. If at any time during selling process the customer becomes

disgruntled he/she can most likely drive a relatively snort distance to another dealer, possibly dealing in the same models. The market in general is saturated and in some cases over saturated with dealers, new and used, domestic and foreign. Far example, the Cincinnati market alone has an estimated 100 dealerships altogether (Jackson, 1990). In this type of environment, success may well hinge on offering something of greater value to the customer. This could be anything from special financing to extended service warranties.

From the manufacturer's perspective, the most commonly used tool to circumvent the stereotype problem and to promote the desired image is the use of famous spokespeople in advertising. For example, Cadillac uses Arnold Palmer, who happens to be the nations biggest megadealer as well as a professional golfer, and Mazda uses the honest a witty approach of James Garner. From the local dealer's perspective, the use of cooperative advertising, coupled with exceptional service, low financing, and personnel training combine to overcome the stereotype of the "shady dealer" image.

As a result, in the competitive market of today, dealers strive to keep customer satisfaction ratings high and financing low. In response to the current economy, a local trend emphasizing used car sales is to offer a 30 day "no questions asked" return Period on the purchase of a used car by some dealers. Many dealers also use direct mailing as an efficient form of advertising and promoting their service and parts departments.

#### Management

One of the greatest problems with personnel in dealerships today is lack of training. In the effort to expand, many dealers promoted top salespeople to sales managers, and top sales managers to general managers. In the process the idea of training seemed to be lost. As a result, many problems were created which might otherwise have been avoided. "An inexperienced salesperson will lose eight to ten sales per month and could cost the dealer \$30,000 to \$40,000" (Maynard, 1990). As put another way, a well-trained salesperson has a greater potential to return the cost of training in higher sales for the dealer.

The organizational structure of the dealership is also important. If the firm has a defined structure then operations tend to run much smoother because everyone has a specific duty to perform and specific people to report to. Exhibits 9 and 10 give examples of typical organizational structures in small, average, and large dealerships. For further information on specific duties of each part of the organizational structure of a dealership, see Job Descriptions published by the NADA.

#### Business Plan

A business plan is important for any business to survive. As the Cheshire cat in Alice in Wonderland once said, "...if you don't know where you're going, it doesn't matter how you get there." In other words, goals and objectives and a plan to reach them is essential. A business plan provides a point of reference to measure progress, and check points to determine daily operations. The plan should begin with a mission statement to define the goals and objectives of the firm, and to be the guiding principal on which the firm is built. Following that should be an internal and external analysis of time organization. A thorough analysis of the internal and external environment can be accomplished through a S.W.O.T. analysis (strengths, weaknesses, opportunities, and threats) of the firm. When the S.W.O.T. analysis is completed, a set of strategic alternatives should be listed and examined. This is a list of possible strategies, both long term and short term, which may be utilized by the firm in order to achieve its goal. Having accomplished that, the alternatives should be thoroughly evaluated and the best one selected. Once the best strategy is selected, then a set of action plans should be drafted and set into place to follow it. One of the most important steps in the business is establishing the evaluation and control measures. Evaluation and control procedures should be adopted to insure the action plans are carried through. Every three years, or so, the entire business plan should be revised according to the changes occurring in the environment. Remember to focus on long term objectives as well as short term ones.

#### CONCLUSION

Over the life of the automotive industry, the industry has changed as much as the product. Success as a dealer depends on being able to change as the industry changes. It is almost certain that another recession will occur, however, when it will occur is much less clear. Some predictions tell of continued growth into the 1990's while others paint a less than rosy picture. Regardless of what may be predicted, it is always wise to be prepared for the worst. So, what will it take to weather another recession in the automobile industry?

- \* New car sales: less than 60% of total revenue.
- \* Service/Parts: more than 7% of total revenue.
- \* All dealerships concentrated in one or two economically sound states.
- \* A 5% decline in new car sales dollars not greater than 2.5% of total sales dollars." (Spinella, 1988)

In summary, dealers in the highly competitive new car market need to be sensitive to local market conditions, industry trends, economic issues, environmental issues, and personnel needs in order to be successful.

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