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USED CAR Dealer



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By Scott Bates, CPA

TIDY UP

**A Clean, Efficient Operation
Can Provide the Structure Necessary to Succeed
in the Highly Competitive and Regulated BPH Market**



There are three major advantages to Buy Here-Pay Here dealers establishing a strong partnership with their CPA firm: maintaining compliance on bank financing, filing an accurate and clean tax return and operating at a profit.

When those three advantages are realized, the dealership is set up to sustain cash flow and avoid costly penalties from state or federal agencies like the IRS.

That, however, does not always happen. So let's take a look at some common accounting mistakes made in BHPH dealerships in the areas of discounting, reporting, remitting sales tax and customer service, and how to add more structure to efficiently scale up your operation.

Used cars are in high demand – and not just by people with no credit or bad credit. Debt-averse consumers of all stripes are shopping a wide variety of used inventory, online or with their favorite dealer.

Subprime lenders also view used cars as a hot commodity and have become strong competitors of BHPH dealers and their related finance corporations.

As the industry saying goes, “Now is the best time” for BHPH dealers to make sure their systems and records are efficient and clean to compete in this competitive landscape.

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Why is that important? A clean and efficient operation allows dealers to more easily document and satisfy bank financing terms during an audit. They can plan ahead and file an accurate tax return and remit accurate sales tax. They can also attract and keep more customers in vehicles for a longer period of time.

Problems with accounting or collections or sales tax remittance often don't come to light until an audit or tax return preparation. That timing may lead to a costlier process to fix problems, including potential penalties by the IRS, state department of revenue or even the Consumer Financial Protection

Bureau.

With a few hours a month – and the right knowledge about which data to record and which reports to review – your dealership can be efficient, competitive and scalable.

Here are some ways to add structure to your BHPH operation.

LEVERAGE YOUR DMS

One of the common questions we hear from BHPH dealers is, "Am I doing the accounting correctly?"

While most BHPH dealers have very robust dealer management systems to track inventory, sales and customer accounts,

they must consistently input the right data to leverage the software's functionality.

Among the problems we often see in dealer reports when working with clients are improper setup of the chart of accounts, incorrect discounts recorded in the book of notes and inaccurate deferred income (which impacts accurate sales tax remittances).

If the dealer has an RFC, we find notes are improperly recorded when passed back and forth between the dealership and the RFC after sales and repossessions.

Inaccuracies can lead to tax noncompliance and penalties in addition to inaccurate financial statements.

There are few shortcuts in setting up a DMS. Ideally, the staff is properly and frequently trained on better ways to use the system. And there are standard forms that can be used as templates and customized to simplify documentation and reporting, such as sales applications, F&I forms and disclosure forms.

Sometimes the standard forms are just fine to start with, but as the dealership grows, the staff might prefer customizing the reports for easier review and decision-making.

The system should be reviewed monthly or quarterly for any recording errors or miscalculations, which will save the dealership time and money when it's time to remit/file taxes or report to financing partners.

COLLECTIONS BEST PRACTICES

Collections best practices are designed to increase the number of payments received on every contract, increasing cash flow and potentially increasing sales from referrals.

The key is to make your payment a top priority in the mind of the customer, specifically because customers trust and perceive that your dealership is willing to work with them to find a solution.

Nothing can really motivate a customer to pay for a car except a strong relationship. That approach is harder than billing and repossession – it takes a different mindset among your collections and service staff – but it can be efficient if you establish a positive rapport and understanding from the beginning of the transaction.

Your process and paperwork should be consistent and clean every time, no matter who is closing the deal. Emphasize that you expect payments on or before the agreed due dates.

If you can, set up an electronic funds transfer with customers around their payroll time. You can't require it, but you can make it attractive by offering a discount.

Outline the process of what will happen if they can't pay on time, and talk through what happens if the car malfunctions or they need to refigure the payment terms due to a change in circumstances.

Establish a clear process for

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communicating, which in some cases may be opt-in text messaging. You can now use SMS for automatic payment reminders, service reminders and late payment notices.

In any and every case, keep the lines of communication open.

Follow up with a check-in call. Congratulate customers on their purchase and ask them if they have any questions. Make it clear that your team is there to help, so their first contact with you is positive rather than a delinquency call.

Provide clear contact information for customers to reach their "account rep."

Results show a strong closing process with full disclosure followed by a welcome check-in call reduces the need to chase down payments and increases the number of payments made.

Of course, that won't happen on every transaction. There will still be repossessions. But dealers can reduce the chances. A full inventory of cars is not what you want.

Deal with service issues quickly. One of the biggest reasons customers stop making payments is a problem with the car. Make it clear during the closing process that any issues with the car will be handled, whether through a limited warranty or a service call.

Depending on the issue and timing, work out how the customer will participate in paying for the service. Calculate the cost

of the repair against the benefit of more monthly payments, and often the benefit is on the side of more monthly payments and a happy customer willing to refer your dealership to friends and family.

Keep in mind your inventory is not your biggest asset. Your portfolio is the golden egg. Accounts need to be worked every day by collections – don't just wait for the phone to ring.

A 30-day past due notice equals four to six missed payments. If you have 100 accounts, a good rule of thumb is to have four collections staff and one part-timer in the wings to pitch in when necessary.

BUDGET AND EXPENSE OVERSIGHT

The tried and true formula to increase profitability is to increase revenue or reduce expenses. Is your dealership as profitable as it could be? How do you know?

You can compare your dealership to other BHPH dealers and against industry benchmarks. If you discover you are receiving less gross profit per car than the industry benchmarks, you might be leaving money on the table and it could be time to reassess your plan – or plans.

BHPH dealers need several plans to oversee their budgets because it is such a cash-intensive business. Your plans should include:

- Six to 12 month revenue plan.

- Expense plan.
- Profit plan.
- Cash flow plan.

In your cash flow, for example, if you are budgeting a \$1,500 average in down payments but are really averaging \$700, you will run out of money to buy more cars. If you're budgeting your expenses based on that cash flow, your budget will quickly be off.

In your revenue plan, are you projecting net new account growth or is it going to shrink? The more mature a portfolio gets, the harder it is to attain new growth – for example, 20 paid off, 20 charged off, 40 loans a month equals zero growth.

Some dealers choose to chase aggressive sales without considering if the deal is a good one to put on the books. Charge-offs will eat up profitability more than any other expense, and it is usually a self-inflicted expense due to poor deal structures and underwriting.

Poor deal structures and underwriting sometimes stem from a lack of training among your staff. Dealers should consider staffing and proper training as investments in gross profit rather than as expenses.

Too few or untrained staff leads to shortcuts and mistakes. As you gain productivity from staff and consistency in deal documentation and communication, you can increase your gross profit per sale.

Plan your expenses in advance as you do your revenue projections. You should know

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your expense per car sold, including closing and underwriting costs, staffing, service and follow-up care and collections.

Are you a start-up dealer? Do it right the first time.

If you are not doing everything you can to be the BHPH dealer of choice, it might be time to ask the question: Why should the market allow your business to exist?

In this very consumer-driven market, cars are commodities. Start-up dealers should not operate as BHPH based on a few self-financed used cars. It is too expensive a proposition and too regulated without a clear business and community purpose.

Are you fulfilling an unmet need? Are you offering a wide selection? Do you accept trade-ins? Are you a fair dealer with a service focus? What is different about your dealership that will build a solid foundation for referrals?

Many new business owners begin with a business plan, usually to satisfy requests from banks or partners. But a plan is also good for the owner to outline the exact research, steps and benchmarks to support success.

After writing the plan, expect to make changes along the way. You don't have to follow things that aren't working. You should also anticipate what-if scenarios and be ready with alternative steps.

Some key performance indicators for start-up dealers include:

- Customer visits/calls per day to sell one car.
- Gross profit per car.
- Net income projections (gross minus expenses per month).
- Cash on hand (2.5 times monthly expenses recommended for 2017).
- Retained earnings (to put back into cars rather than bank financing).

Following a few KPIs can help you measure whether the dealership is on track or if it will run out of money. KPIs can also help you monitor and identify unnecessary expenses or staffing issues.

At first, start-up dealers wear all the hats. They buy the cars, manage the books, sell the cars, communicate with customers and collect payments.

When it's time to hire some help, dealers usually hire office support staff to answer phones and handle repetitive processes. Then comes a salesperson or someone in collections.

Before hiring, dealers should understand what they do best and where their time should best be spent for the benefit of the business. Hire employees who are strong in key areas to balance the dealer's strengths and skills.

As you hire more people, you will need clear, repeatable processes to keep the business operating smoothly even if you're not there all the time. For example:

- What is the process for purchasing?

Reconditioning?

- What is the process for taking in trades, selling and delivering and servicing vehicles?
- What is your process for accurately remitting sales tax?
- What is your collections process?

A process manual should be part of every independent used car department and should be used for training and a backup plan if a key employee isn't available to perform the tasks. Once created, it needs to be updated annually or as necessary to remain relevant.

Like any business, a Buy Here-Pay Here dealership is created to serve a market demand and make a profit for its owners. It can also have the side benefits of creating good jobs and helping others keep theirs by providing reliable transportation.

The pressure to succeed is higher as competition increases, but the most successful dealers put the right tools and safeguards in place to scale up and build a positive reputation. ■



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