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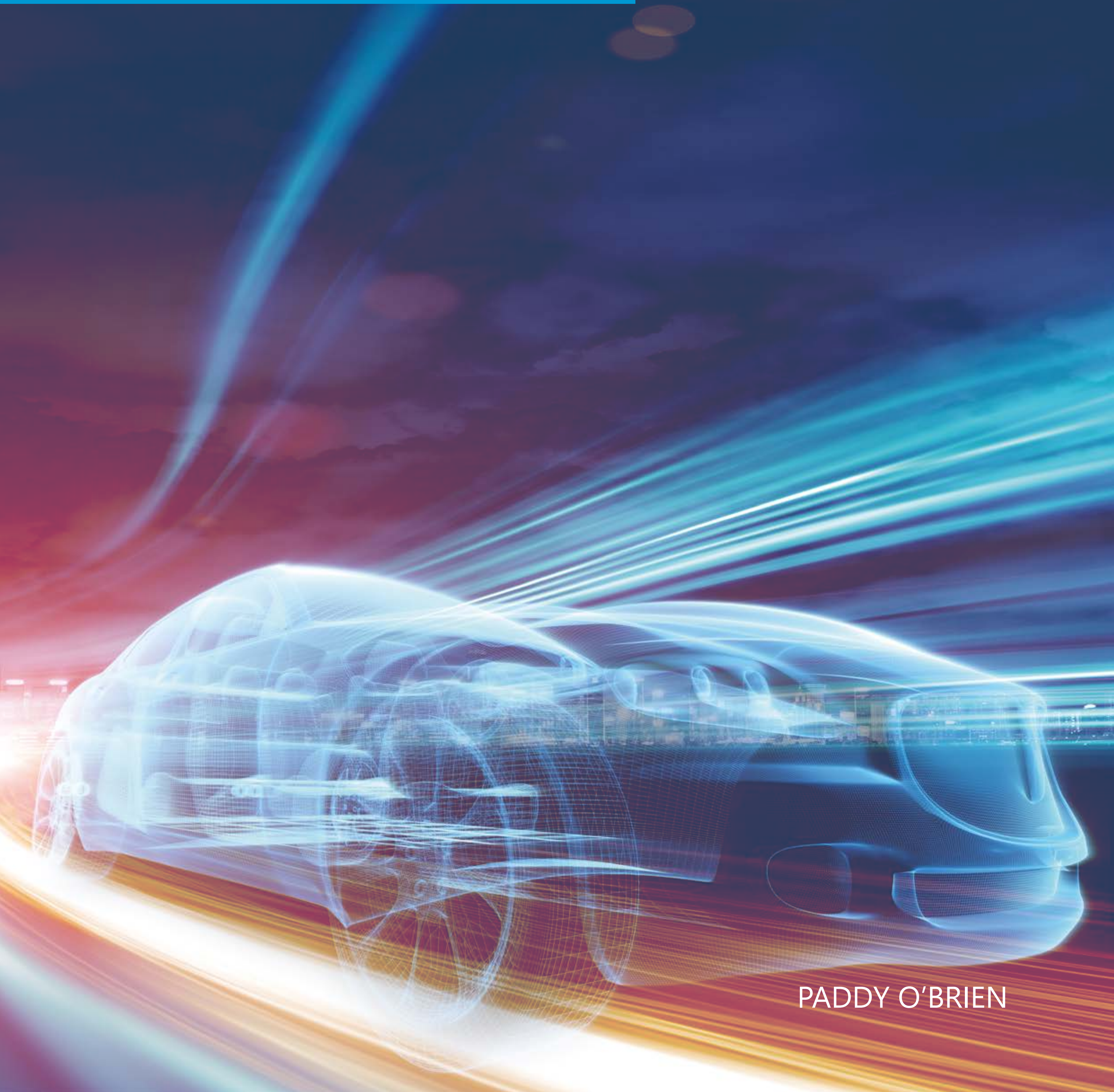
MRA

THE CAR DEALER'S GAME CHANGER



PADDY O'BRIEN

MRA THE CAR DEALER'S GAME CHANGER

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FOREWORD

It is indeed pleasing that from within the ranks of MSXI a very unique and world class 'performance model' for dealers should have emerged. Having gathered and disseminated financial data for thousands of auto dealers across many countries, it has become abundantly evident that those that sustainably succeed are those that generate healthy and consistent returns over time.

Until now, the challenge of adopting a return on investment has been overshadowed by the lifelong habit of monitoring only the return-on-sales equation. But as the industry has consolidated and more professional entities and conglomerates have entered the auto-retail arena, so has a greater level of science become the imperative in measuring business outcomes.

Globally, dealers are being asked to invest more and more capital in order to meet factory stocking targets. As such, many dealers have revised their strategies to assess returns against levels of capital employed rather than merely against the sales generated.

Despite these challenges, best-practice dealers and dealer groups continue to generate impressive returns because they demonstrate exceptional levels of discipline and professionalism, exploiting every opportunity the dealership offers.

For auto makers, the necessity to have sustainable dealer networks goes without saying, and our model is perfect for assessing such viability and sustainability for an investor.

It is our sincere hope that the MRA methodology as outlined in this book, supported by the various examples of successful auto-retail operations from eighteen countries around the world, serves to inspire all readers to review their way of managing an auto-retail business. After all, every business needs to review its practices to ensure that the key performance drivers are given focus and that each operation remains efficient.

I would venture to say that this book, more than any other, focuses on the drivers that produce the most critical business results and presents a clear picture of what a car dealer should be doing in order to extract the best returns from a retail operation.

We are delighted to present this well-tested model to auto dealers everywhere.

Fred Minturn

Chairman of the Board
MSX International

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THE ORIGIN OF THE MRA PERFORMANCE MODEL

Introduction

The decision to write this book was spurred by the continued success of an exclusive group of highly motivated and successful car dealers from various parts of the world. In each case, these dealers have achieved a high level of excellence because they have pursued a personal *vision* and placed a strong emphasis on *goal setting*. They have also considered the impact that the key drivers of performance have on the results of their automotive retail operation. With a high sense of *self-belief*, these selected dealers have persisted over an extended period in honing their business models and have developed steadily and even spectacularly upwards.

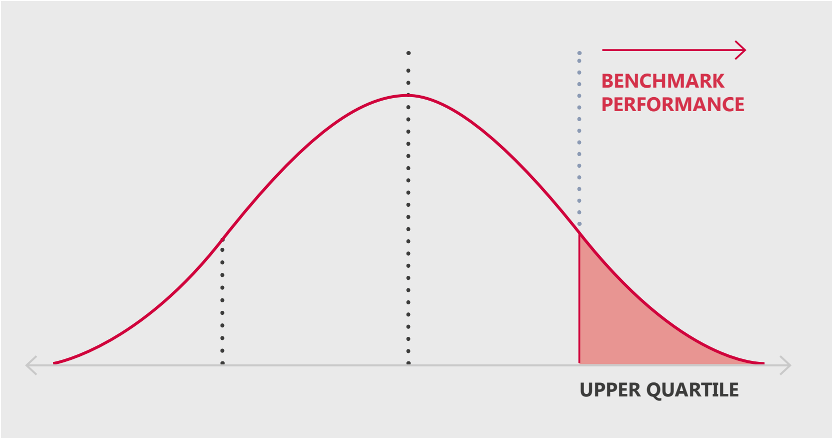
For most dealers, the very thought of 'business models' and 'goal setting' extends no further than the budget and daily bookkeeping. Planning seems tedious and far less exciting than simply responding to the challenges that the automotive industry never fails to present day after day. In short, most car dealers seem content to put their heads in the sand whilst riding the industry's 'wave of disruption', responding to the excitement of 'fire-fighting' from one event to the next.

This book has not been written to enhance the reader's understanding of financial accounting but rather, it sets out to emphasise the key drivers of performance in a planning model that has yielded high levels of success for more organised dealers. Invariably, these key drivers are indicated in the financial accounts because the numbers always tell the story. Surprisingly, there are only a few performance drivers that really matter. When given focus and when forcefully pursued, however, these few drivers have made a profound difference to the performance results of well-run dealerships everywhere.

As consultants that have gathered, collated and disseminated financial data for over two thousand five hundred dealers across three continents, the data we collected has enabled us to isolate and observe the 'best of the best' and to illustrate cases of exceptionally well-run dealerships. Each dealer represented in this book has succeeded in generating a spectacular return of five or more times greater than the **cost of funds (cof)** from the substantial investments made in their respective businesses. The reader will be introduced to each of these highly impressive operators, all of whom use the unique Sewells MSXI MRA performance model for analysing and judging during their decision making.

In no instance did any of these selected dealers simply 'stumble across' the path to success. It invariably occurred because the dealer in question had *planned* to improve with an attitude that good was not good enough. These successful dealers thought that more was possible as they strategized and steered their focus of attention over time. The leader in each instance displayed an ability to envision excellence and executed a well-devised and disciplined plan to support that vision.

Introduction



It is quite likely that the automotive retail industry has been analysed and benchmarked more than any other industry. Most dealers are challenged by their respective manufacturers to target key metrics that are usually set as the norms for a particular sector, brand type or country. For the most part, these metrics represent the average level reflected across any brand or category of dealers.

This book's focus is to highlight **best practice** examples that are usually set at the upper quartile of performance, in order to highlight the true potential of a well-run auto dealership. In other words, this upper quartile point highlights the **benchmark** for a particular key performance indicator.

In Olympic Games parlance, mediocrity has no place, and this book assesses the performance of 'world class best practice' among those dealers who, like top athletes, consistently attain 'high performance' returns that are well above industry averages.

Considering the substantial investments required in a modern franchised retail business, the performance levels highlighted will reflect near optimum performance in business results. Whenever challenged to estimate the optimum potential of their own business, most dealers tend to underestimate the potential that can be generated from a highly tuned modern dealership. Most dealers are locked into a mindset that inhibits their ability to think openly and creatively beyond those indicators provided by manufacturers and other industry specialists. These indicators usually show mediocre performance levels that may even be stifling creativity.

The cases in this book display dealers who, like finely primed Olympic athletes, have gone to extreme lengths to *fire on all cylinders*, to *bullet-proof* their businesses and to generate high levels of **energy** from their operating assets. These three key drivers are given equal focus in order to produce the best business results. In each case, the dealers bring a strong belief that greatness can only be possible when every department and every person is giving their very best.

With this in mind, this book's intention is to tap into the extremities of potential and to deal with what is ultimately possible no matter where a dealership may exist. But the *attitude* of the owner or general manager presents the biggest obstacle in 'raising the bar' for the business. Intriguingly, most dealers simply believe what they *want* to believe.

Convincing a car dealer that his or her business is running below its optimum level of performance can be quite challenging, especially when the optimum level of performance is driven by the dealer's own opinion of what represents 'true potential' in business results. But the power of personal attitude prevails in most cases.

THE PUNJAB EFFECT

Intriguingly, many dealers harbour an unwavering belief that, for whatever reason, 'things are *different* in our market'. Having worked with or addressed hundreds upon hundreds of dealers in over thirty countries, our consulting activities have helped us to conclude that the convictions of dealers from country to country is strongly driven by a sense of 'our own uniqueness'.

In the burgeoning market of India, performance groups (dealer comparison groups) were introduced to enable newly appointed franchise dealers the ability to compare performance levels and business results. During one such early performance group workshop, one of the participants, whilst learning about the MRA model, politely asked, 'Do you know where the Punjab is…?' The facilitator responded as best as he could by answering that he believed it was in the northwest of the country. 'That's right' retorted the dealer, 'well I'm even further north than that. I'm against the Himalayan Mountains in Chandigarh and things don't work that way up there'. When asked why this might be, the dealer proceeded to explain the uniqueness of his market, including the complexity of accessing his location by both road and rail. The facilitator responded by asking the dealer what the cost of funds (**cof**) was in Chandigarh. 'Eleven and a half percent…' came the reply. When the other dealers present were asked the same question, the identical lending rate (11.5%) existed in Mumbai, Chennai, Hyderabad, Bangalore and Delhi. In fact, the same rate applied across all of India.

As a result, the facilitator was able to make the dealer realise that no matter how unique the circumstances might be in any particular market, the most fundamental consideration should be to outperform the bank's lending rate in order for the business to be sustainable. Everything starts from this crucial point of understanding, and to make this sustainability real, a target of two to three times the **cof** (2–3 × **cof**) should be aimed for as a minimum **return on the funds employed (ROFE)** in the business. This will unfold further later…

Our experience has shown that this example of 'This won't work in the Punjab because we're different…' is equally heard in all parts of the world. The expression 'we're different…' might therefore be described as an attitude rather than a fact.

With this background and with the emphasis on **cof**, all the reasons why things cannot change falls to the side. For the most part, uniqueness of a market is merely an excuse, not a reason for poor performance. What is relevant is what needs to be done to get to the required level of return that will result in a healthy gap between the **cost of funds** and the returns in the business. All strategies should aim at this crucial objective. Twice the **cof** should be the minimum and three to four times the **cof** should represent the *dream*. Ideally, the vision of achieving this comfortable level of return should underpin all thinking and planning.

The more popular form of success celebrated by dealers from many countries tends towards unit sales and net profit percentages. More professionally run public groups would tend to look at more elaborate versions of returns, whether that be return on assets (**ROA**) or **ROFE**, as the means of judging success. In fact, in any professionally run auto retail business, one or other form of return on investment (**ROI)** would invariably apply in one form or another. Intriguingly, the majority of independent dealers use net profit to sales (**ROS** or **PBT**%) as the means of measuring success, ignoring the assets or funds employed in the business.

This leads to a situation where a dealer, celebrating the record sale of three hundred or more cars per month, may be confounded when other critical numbers in the accounts are highlighted and it is discovered that this top-line emphasis suddenly translates into a rather dismal return. In these times, because of high property costs and the high levels of investment required to run an auto retail operation, funding considerations and the returns generated by such funding should be considered more than either unit sales or net profit.

Because investors always have a range of choices, car dealers should be measured by the way they energetically convert things that can be controlled (the assets) into sales and, ultimately, into attractive returns. Assets that are employed in the business are controllable factors that require the regular attention of the dealer. The MRA performance model, as presented in this book, integrates the key measures into a simple equation that will become extremely familiar to the reader. The model takes into account the most crucial measure, the **return on operating assets employed (ROOA)**. The greater the understanding of the model, the more sense is made of the need to take operating assets into account. If this return is inadequate when compared with the **cof**, shareholders may be tempted to invest their funds elsewhere in order to improve returns.

THE ORIGIN OF MRA

The saying goes that to be a good teacher, coach or consultant, one must have the ability to listen, especially when in the presence of the industry's best brains. There are inevitably lots to listen to and to learn from. It was out of this ability to comprehend what clever people were articulating that MRA ultimately emerged and grew.

> *'The top line of the accounts describes the effort that has gone into the creation of sales. The quality of those sales is told on the gross profit line… so you can never regret building quality into every transaction and it shows in your gross profit percentages'.*

Most experienced business-minded people will simplify their philosophies in a way that a manageable number of principles drives their everyday actions. Here are some typical examples:

One is, 'Forget about everything else, bank twenty-five cents on the dollar and you'll be amazed at how well you do…'

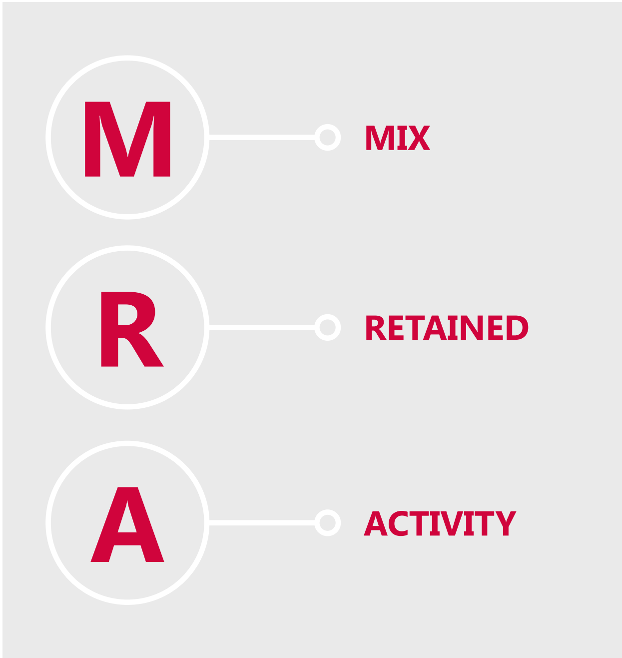
Another such comment could be 'Smart operators know that more turns equals more earn…'

Common sense comments such as these have been heard and considered over the years, leading to the agreement of what really drives the financial performance of the auto retailer. The conclusion is that there are only three such drivers that exceed all others, and these are:

1. Get the business MIX right to ensure that all cylinders are firing simultaneously (M).
2. Ensure that a healthy proportion of the gross profit is RETAINED on the bottom line (R).
3. Generate a high level of ACTIVITY (**energy**) in converting assets into sales (A).

Setting these key drivers aside, it is necessary to agree on what constitutes the ultimate measure of success. The more professional opinions have all agreed that some form of **return on investment (ROI)** is the best way to conclusively assess the performance of an auto retail operation. This should not come as a surprise considering the high levels of investment in operating assets needed to fund a dealership. Most of this investment is in the assets employed in the business, and so logic would follow that a **return on operating assets (ROOA)** philosophy would most appropriately represent the ultimate measure.

With all of this in mind, the emergence of MRA was rather deliberate in its arrival as a tool to enhance decision making.



Introduction

Analysing the three key drivers independently, the M factor proves to be a reliable predictor in the relationship between gross profit (GP) and net profit (NP). The higher the rate of gross profit, the more likely the **PBT% (profit before tax)** will also be higher. This theory was tested and confirmed within the Sewells MSXI database (chapter 2) where higher GP% results proved to be substantially more profitable than those with lower GP% results.

The second key driver, the R factor, takes into account the ability to **retain** the highest proportion of gross profit as possible. The R factor was isolated as being important as time went by, and dealers were encouraged to concentrate on the relationship between net profit and gross profit.

Thirdly and finally, emerging from the many debates and discussions about asset turns and the value of energising precious retail space, the final piece of the puzzle came to be. Along with the other two drivers, benchmarks emerged and were used to encourage higher levels of **activity** (asset turns), or the A factor.

The observation was that as each of these levers were given focus and pushed farther, an improved business result was achieved.

If an epiphany is the best way of describing the emergence of MRA, then it happened when it became apparent that the winners of the South African Business Person of the Year were consistently producing exceptional results when measured against not just one or two, but all three of the key drivers—the MIX, the RETAINED and the ACTIVITY. It helped that winners were ultimately judged by the returns they were generating on the operating assets employed **(ROOA)** and eureka! It all came together.

It had taken years of contemplation and a great deal of muddling before the code had been cracked. While considering the combination of getting all three drivers in relation to one another and in relation to the ROA end goal, the slicing and dicing of these numbers soon began to make sense. The outstanding performers had emerged because they had exceptional GP percentages, invariably greater than 17%, because they were retaining greater than 30% of their gross profits for the net profit line. Additionally, they were running their businesses at exceptional levels of activity with more than 9 turns, which resulted in an ROA of more than 60%. This began to get the creative juices flowing... 'what is it that these high-performing dealers are really doing differently to achieve these spectacular returns?'

Thus it was that the inter-relationships between these key numbers had caused the penny to drop. The typical winner emerged with a 17% to 18% (M) in addition to a 30% to 35% (R) and an activity level of 9 turns (A) all of which combined in a spectacular ROOA of 50% and greater.

In laying the pieces out on the table, the MRA equation emerged 'like a phoenix rising'.

In an MRA equation, the drivers could be denoted simply as M × R% × A = X. An example is 17 × 30% × 9 = 46. With the participation of willing dealers, the formula was tested repeatedly until it was concluded that the key lies in giving independent attention to each key driver in order to improve the overall objective of greater returns on the assets employed.

Place each driver under the microscope for independent inspection. Take your mix, whatever it may be, and tweak it. Take your activity and tweak it. As you will see, the tiniest of tweaks can potentially make a massive difference to the returns made in the business.

SWITCHING FROM CONVENTION

In 1968 at the Olympic Games in Mexico City, the Oregon-based American Dick Fosbury radically redefined the techniques for competing in the high jump event. Up until then, athletes had contested by either straddling the bar, or using the age-old upright-scissor method, both of which required a double leg movement. Fosbury stunned everyone that year with a revolutionary technique of his own, jumping head first and backwards as he arched his back and kicked his legs simultaneously skywards to set a new Olympic record by clearing 2.24 meters to win gold. Four years later at Munich, 28 of the 40 finalists in the men's high jump had adopted his technique and today everyone uses his extraordinary method.

An exaggerated illustration perhaps, but MRA as a formula for 'raising the bar' and breaking new records in automotive retail performance conjures up such a visualisation. You need to 'open your mind' and challenge even the approach and visions of the best practice examples in this book, but more than anything, you need to be willing to challenge your own methods and approaches.

At this stage, you are encouraged to consult just two values from your most recent set of financial accounts in order to assess the status of your own business results. The first value is your annualised profit before tax (**PBT**) and the second value relates to your **total current assets**, which is in your balance sheet. When you have these two values, you must equate them so that the annual profit is expressed as a proportion of the current assets (Annual **PBT** divided by **total current assets** multiplied by 100). This calculation expresses the extremely important **ROOA** equation. If yours is at 30% or more, that is good by universal norms. If it is at 40% or more, that is *very good*, and if it is at 50% or more, your performance represents the *world-class best practice levels*. If your result is below 25%, there is work to be done and the contents of this book will diligently guide you along the path to achieving world-class results.

According to our data, those that produce an **ROOA** of 30% or more are among the 75th percentile in the distribution of worldwide dealers. As a leading global consultancy firm, we have met many of these 'best in class' operators from all over the world. In particular, those that have adopted MRA as a planning technique have achieved startling improvements in their business results.

Olympic athletes are not struggling with the basics in their sport. There is no getting to the top of sporting greatness until the athlete attains levels way beyond the basics, adjusting those critical refinements that make a significant difference to the athlete's performance. The high-performance athlete's key skills have been internalised, leaving the coach and athlete to focus on those tiny adjustments or 'tweaks' that impact on exceptional performance.

Like the Olympic athlete, though, this book calls on the reader to invoke change by considering what might be possible in the broadest sense. Rather than worrying about the peculiarities of your own marketplace, the guidelines contained herein implore you to shut off your current perceptions, focus on stretching your potential as a dealer and take your performance to the highest level.

The components of what it takes to perform at these impressive levels is divided between the softer elements, such as leadership, vision and motivation, coupled with the execution of well-devised plans that take the harder operational aspects into account, such as expense control and asset management. This, in turn, all culminates in the integration of these key factors into one neatly conceived equation (MRA) that holds the key to exceptional returns in automotive retail on a balanced basis.

Before drilling down into the business or using the MRA model as a means of analysing results, it is worth noting that there are dealers that work very enthusiastically and naturally with numbers, whilst others find it difficult and even wasteful to analyse key trends. This difference is as much personality related as anything else, and the next chapter will draw the distinction between those that do enjoy working with statistical data, numbers and trends (the scientists) and those that do not enjoy working with such trends, numbers and data (the artists). Using the extreme attributes of these two opposing personality types has indeed proved to be more than interesting.

Chapter One

ART VERSUS SCIENCE

RICHARD EVANS & JULIAN CLEMENTS

RICHARD EVANS

JULIAN CLEMENTS

Unlike the major groups that tend to analyse results and performance indicators inside and out, the independent dealers tend to rely on their *sense* of trading and selling cars. Many will talk openly of their ability to 'sniff out a deal', which is indeed an art.

However, there are also those independents that rely more on checks and balances and these operators are more likely to seek out and use reliable data to support their decision making. The statistics confirm that those that focus on the key metrics will tend to outperform those that only count the deals they have done.

One needs to distinguish between those independent operators that hide themselves behind computers and spreadsheets and those that balance analysis with on-the-floor operating. In other words, balancing art and science in running an auto retail business is critical.

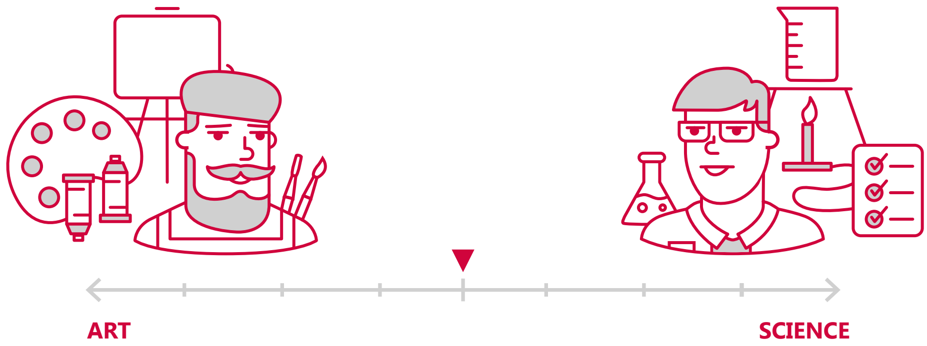
Way 'down under' on New Zealand's North Island, there are two such dealers who have found this balance and consistently perform with exceptional levels of excellence. In both cases, their total gross profit (the business mix) is targeted in the high teens (18% or more), they both target and retain greater than 35% of this gross and in both instances they manage their assets jealously. As a result, these exceptional dealers achieve returns ranging between six and eight times the cost of funds, leaving the majority of their fellow New Zealand dealers in their wakes.

Not far from the Bay of Islands lies the city of Whangarei where Richard Evans, dealer principal of Mark Cromie Holden (GM), truly gets the best out of every inch of opportunity in the business. Instilled with an ROI mentality, Richard rigorously focuses as much on the expenses and assets as he does the sales and gross profit results, which is why his consistent results raise the eyebrows of his fellow Kiwi dealers. He is all over the key numbers and allows nothing to slip by unnoticed.

The high gross profit levels Richard achieves emanate from his exceptional performance in used cars coupled with an obsessive focus of attention in putting quality into every deal. The results speak for themselves. Every single customer transaction crosses his desk, and the sales team knows better than to present him with any 'skinny deals'. The credibility he enjoys from his fellow dealers can be attributed to his exceptional grasp of all aspects of the dealership, including the financial numbers that he relies on to unveil the reality in each department as he addresses each manager with true authority. MRA has given Richard a fresh approach to performance evaluation and now conversations with his managers are confined to those indicators that influence business results.

At the Bay of Plenty on the eastern side of the North Island, we find the city of Tauranga. As dealer principal of Ebbett Tauranga, Julian Clements has steadily gained the respect of his fellow dealers across the nation. This respect has grown from his results that have steadily caught the eyes of all involved at both the factory level as well as with other GM dealers. When Julian was introduced to the MRA model, he was immediately interested. He possesses a keen eye for detail and numbers are a true passion for him. As a result, Julian immediately adapted his existing plans to align with the MRA model and has been 'tweaking' the key variables in the business ever since. All of a sudden, he was able to implement his plans into a simple equation and express them in a way that has seen the growth in returns escalate by 40% in the short space of two years (March 2016 to March 2018). Julian feels that there are still many improvements he can make using the MRA model now that he has isolated and enhanced the key drivers.

Car dealers everywhere can learn from these two exceptional operators.



At an intuitive level, the key distinction for differentiating the two opposing styles of managers is to view them on the 'art versus science' continuum. Generally, artists tend to be more passionate and thus driven for the most part by feelings and opinions. Scientists on the other hand tend to deal with facts, relying instead on thinking and planning. This form of stereotyping has strongly influenced the way that the behaviour of dealers has been assessed all over the world, and it has proved intriguing to use this phenomenon as a basis of comparing one dealer with another. This approach has assisted in illuminating the reasons why one dealer may produce exciting returns whilst another may not succeed as well.

With the emphasis on financial returns throughout this book, the very measurement of results in itself implies a degree of science, particularly given the need to analyse financial data in order to get to a result. But any extreme leaning towards either science or art is considered undesirable as will be seen. The key lies in balancing the mind and attitude by blending art and science in the way the business is run and managed.

The innate passion that propels most dealers tends to come from the heart and shows an artistic leaning. This can be unhealthy when excessively applied in the workplace. Too much passion, like any overdose, can be unhealthy, particularly since the extreme artist has a tendency to be on the chaotic side. The more innate the artistic tendencies, the more likely they are to emerge in the real world as an untamed force. Like a painter, a work of art is a function of the mood and style of the leader. The automotive industry is a thriving environment for certain personality types, particularly those with a preference for disorder, and these types are attracted in droves.

As a consequence, there are very few dealers who work in an organised way with a business model, and this sets them apart from those who give importance to the long term and the general planning process. Let us examine these two extremes.

THE ARTIST

In its extreme form, the dealership influenced by the artist relies mostly on opinions... especially the dealer's *own opinion*. The dealership run by an artist can usually be recognised by the flaunting appearance of flags, extravagantly large signage, billboards and colourful displays. Typically, this extreme artist style will tend to promote the business with 'loud' advertising, often claiming to have the best deals in town. Such artists also create lots of excitement, and consumers are often strongly attracted to their facilities. In line with true retail philosophy, there is nothing better than a bustling store. But in the artist's world, not everything is necessarily 'good news'. Going along with all of this excitement, one often finds chaos behind the façade... and chaos brings its own challenges because the consequences of chaotic decision making often comes at a cost.

The world of the artist is characterised by 'ups and downs', driven mostly by strong and weak months of sales because the dealership usually has a hefty reliance on promotions and discounts to generate vehicle sales. Pushing the blame onto someone else is often the way to deal with failed choices.

On the positive side, the artist is usually creative and can work a deal on a note pad. The artistic dealer can produce promotions that excite the shoppers, typically retains key phone numbers and key records, will have a keen sense of the stock by car type and can explain where the keys are to the three oldest used cars on display. Incidentally, nobody else in the dealership is likely to have the faintest idea where these precious keys might be stored.

For the most part, the artist will solve performance problems with an attitude of 'we must sell more cars', and the urgency is invariably focused on ensuring that this main strategy is given the bulk of attention. A 'push' concept therefore applies most predominantly, and the world of the classic artist is high energy but usually wasteful.

THE SCIENTIST

At the opposite extreme is the scientist, which is typically a character that relies on facts, recording every expense and asset on digital registers and flow charts. The scientist's showroom is often bland and sterile. Discounts are structured and monitored by a documented process. Everything is neatly organised and tightly controlled. Scientists make much slower decisions due to the lack of natural intuition and the fear of being wrong.

As statistics show, sports science has been successful in improving the sporting excellence levels. Record after record has been broken largely due to improved techniques and refinements to the overall approach of the athlete. These statistics have isolated the key drivers and revealed the key competencies of top players, including the number of passes, goal assists, tackles and whatever else that seems to make the biggest difference to the overall results. Fans can use these results and assess performance levels of their heroes from the statistics. Sports coaches correct low performance levels by 'crunching the numbers' to tell the most profound aspects of the story. Coaches track trends and can regularly be seen making notes or recording facts on keyboards and cameras as the athlete is performing. Rather than shifting the blame, the scientist tend to say, 'I should have thought of that...'

Brad Pitt was nominated for an Academy Award in the movie 'Moneyball' wherein the caption for the movie stated 'It's unbelievable how little we know about the game we have been playing all our lives'. That also says a lot about the way we run the car business. The movie depicts a baseball coach's switch from 'gut feeling' to scientific analysis of every play, and the positive effects are dramatic.

Whether artist or scientist, old habits die hard — there is only a small amount of converts because of the ease of being stuck in your old ways. Most stick to what they know, as though they have some need or right to cling to what they have always been doing.

There are those who think very rationally about what they are doing and how they might improve and those that would rather not analyse their actions too much because rational thought is hard and not nearly as pleasurable as operating from the heart with passion.

Similarly, the financial numbers of auto retailers tell the story of their performance. Whilst most dealers will read this data, interpreting the data is where the essence of the problems and opportunities lies when it comes to enhancing performance. Numbers can confuse, and our facilitators have listened to dealers' explanations relating to the reasons for monitoring certain numbers.

Just as two scientists gazing through the same microscope can draw two separate conclusions, so too can two dealers draw differing conclusions by looking at the same set of financial numbers. It depends on the initial reason for looking at numbers. What do you consider important numbers to assess when reading the financials of your dealership?

The scientist is usually characterised by early warnings during the month, when the trends clearly indicate a need for actions to stem any downturns. Last minute activities of the scientist are less likely, less hectic and less pressured.

However, the obsessive scientist is often beset by 'analysis paralysis', where thinking can get locked.

BLENDING ART WITH SCIENCE

Interpreting is one thing, taking appropriate actions and executing creative solutions is quite another. Sitting at a computer will not correct the problem, and neither will frantic running around to 'sell more cars' when it is too late in the day. What is remarkable with the high-performing dealer is the balance between art and science. The balanced dealer draws conclusions based on facts and uses creative ideas to alleviate the pressure with time in hand.

Flare and creativity are valuable attributes, but if they are not used in a productive plan, the risk of being helter-skelter and ineffective arises. Effective teams are often a healthy mix of creative thinkers and planning-related thinkers, helping blend these critical attributes. Achieving excellent results can only emerge over time, so time horizons and key milestones all go towards moving in a positive direction.

The best-practice businesses have all evolved and improved over time, and they never get complacent or lethargic. Improvement is an ongoing phenomenon, as shown by the Toyota Motor Corporation with its Kaizen philosophy.

Equally important, **balancing** the dealership should not be forgotten. This means that all departments should be operating at optimum potential and embracing the concept of lifetime relationships with vehicle owners.

It is time to drill down into the details, explore ways of improving the balance in a dealership and enhance **gross profit** contributions and dealership returns.

Chapter Two

THE IMPORTANCE OF BALANCE

MARK PALMER & JASON GORDON

GM Holden in Australia has a high proportion of its dealers participating in biannual comparison groups that they refer to as Business Development Groups. The best performing of these groups draws the bulk of its inspiration from two of its high performing members, Mark Palmer from Inverell in NSW and Jason Gordon, from Gatton in Queensland. Both of these exceptional dealers produce returns greater than six times the **cost of funds** in Australia.

Mark Palmer is highly regarded by his peers because he is so consistent with his results. His gross percentage is constantly around 20% and he retains 35% of it, operating at a magnificent net-to-sales level of 7% and generating an overall return on the assets employed of greater than 40%. He demands that every department in his business should 'pay' and he harbours a stringently disciplined **ROI** mentality.

In describing his approach, Mark Palmer likens himself to an airline pilot explaining that any pilot works with a 'flight path', never relying on chance to get from point A to point B. According to him, a pilot would never announce to the passengers that 'we hope to land somewhere near Singapore and see what happens...' The pilot is very precise on the objectives and the means of getting there. As such, Mark daily lays out his plan and manages every element of what it will take to arrive at the destination. He also believes fervently in beginning with the end in sight (the return) and working backwards from there. This is where the MRA model kicks in to assist with the execution of his plan.

MARK PALMER

JASON GORDON

Jason Gordon has improved his results steadily and consistently over a six-year period. Inspired by the need to balance his business, he attributes his success to the time he spends equally with each department. During this time, Jason carefully sets and monitors key targets that ensure that gross profits contribute to the overall numbers in a healthy and balanced way. Cutting the number of measurables down to only the essentials is where the secret lies for Jason. Daily reviews of these key numbers ensure that all managers have a 'finger on the pulse' at all times.

When visiting both of these great businesses, it soon becomes apparent that department managers are fervently devoted to targets relating to the key drivers. They both subscribe to the notion that '...the more you turn, the more you earn...' and the energy in both cases is abundantly apparent. Skinny deals in neither vehicle sales nor service are tolerated, and discipline prevails as a deep-seated value in their businesses with a crystal-clear picture that success is reflected by the gross profit percentage.

With an ethos in both cases that *gross profit sets up net profit*, Jason and Mark have ensured that their success commences with ensuring the balanced performance of their dealerships — reflected by high gross profit percentages ensuring that net profit values are given the best possible chance to flourish.

Financial textbooks will explain that the top line in the Profit and Loss (P&L) Statement represents the **sales** recorded.

This **sales** line is sometimes also referred to as **turnover** and other times as **revenue**. All three terms mean the same thing and indicate the value of the sales activities generated by the company in any given period. For our purposes, we will consistently use the term **sales** to describe these top-line activities.

Most dealers understand this and also understand that cost of sales (**COS** or **COGS**) needs to be deducted from this top line before we arrive at the all-important gross profit (**GP**) value. There are very few dealers, however, that see the true importance of **GP** which lies in expressing this **GP** value in proportion to the **sales** generated via a **gross profit** percentage (GP%) on the Profit and Loss Statement. Oddly, American dealers seem to place little value in this ratio, and yet it says so much about the dealer's strategy with regard to the **mix** of business, and therefore the amount of contribution from all departments across the dealership.

Whilst measuring the top line (**sales**) and the bottom line (**profit)** is important, it is not nearly as important as measuring the two lines that appear between these two lines in the accounts — the gross profit and the expense values. Profit can never be influenced or affected in a vacuum. Chapter Five will show the dynamic interaction between the gross profit and expenditure lines that causes the profit result to occur as it does. When one randomly compares dealers on the gross profit line (refer table 2.1 below), it will be apparent that the variance from one dealer to another can be quite vast. Note that on the third row, the dealer on the left has a GP% of 10.71%, the second dealer is at 21.70% whilst the third dealer is at 14.15%. Pause and ask yourself *why* this variance might exist. We have asked this question hundreds of times, and you may be amused to know that the most common response is '...because the first dealer is over-discounting'. Whilst this may be the case, it is not the major reason for the difference.

So what is the answer...?

TABLE 2.1

Why is one dealer as low as 10.7% whilst others are at 16% or more?

SUMMARY

	DEALER 1	DEALER 2	DEALER 3	DEALER 4	DEALER 5	DEALER 6
SALES	848,994	884,735	564,114	2,179,633	1,569,039	1,356,303
GROSS PROFIT	90,929	191,948	79,838	359,219	256,198	222,595
GROSS PROFIT % (MIX)	10.71%	21.70%	14.15%	16.48%	16.33%	16.41%
EXPENSES	82,842	142,027	71,844	289,017	191,208	174,781
NET PROFIT	8,087	49,921	7,994	70,202	64,990	47,814
NET AS % OF GROSS (RETAINED)	8.9%	26%	10%	19.7%	25.4%	21.4%
NET AS % OF SALES (PBT)	0.95%	5.64%	1.42%	3.24%	4.14%	3.53%

GETTING THE MIX RIGHT

With *new vehicles* producing single digit gross percentages and the *service department* producing gross percentages eight or ten times greater, row 4 (table 2.1) is immediately indicating that the **mix** of business of the dealership at 10.7% is skewed strongly towards vehicle sales, whilst the contribution of aftersales appears almost irrelevant. As the reader will come to appreciate, this question of balancing the dealership by getting the business mix right is the first step in ensuring an exceptional business result in automotive retail. This **mix** is indicated by the GP%, which in turn represents the first of three key parameters, the **mix** represents the difference between those that build sustainability in the business and those that do not.

These variances in levels of TGP*% have been extracted from data collected from some two thousand dealers across nine countries, and the differences from one country to the next is as varied as one might expect. The most significant variance across the regions in which we operate lies in the fact that, at this point, the pre-owned and service aspects of dealer operations across Asia Pacific has yet to mature. As a consequence, the more developed markets of Australia, South Africa and New Zealand show much higher levels of TGP%. At the opposite end and with lower GP margins are the underdeveloped markets across India, China and Southeast Asia.

The range in new vehicle GP% across these nine countries varies from 4% to 7% at the lower end (the more mature the market, the lower the GP%) to between 8% and 9% GP% for *new vehicles* in the less mature markets. This is largely explained by the fact that in the emerging markets, the opportunities for incremental sales and GP generation have yet to be realized, and the less developed markets continue focusing on selling new cars.

The opposite occurs in the *service department* in the more mature markets, largely because of higher levels of **efficiency** and **productivity** as well as higher labour rates. *Service GP%* ranges from the mid- to the high-sixty-percent levels whilst in less mature markets these levels will tend to be in the mid to high fifties in percentage terms. Notwithstanding the differences in the mature European, Australian and North American markets or less mature markets of Asia Pacific, the difference in the business **mix** holds good when one compares the front-end led skinnier operations to the aftersales led and more balanced and greater gross profit contributors within the dealership.

A well-balanced dealership that is ‘firing on all cylinders’ will always produce an overall TGP% that is at least in the mid to high teens for the dealership.

Becoming a well-balanced dealer occurs by design, not by accident, so we are talking about *strategy* when considering balance in the dealership. It is more a matter of choice whether the dealership gains a higher or lower TGP%, and it commences with the desire for life-time relationships with vehicle owners. The sale of a car should represent the *beginning and not the end* of the relationship with a customer.

* Total Gross Profit Percentage

In each instance in this book where an example of a dealer's exceptional performance is referred to, it represents a well-devised plan implemented over time without exception. These dealers strive for balance in the business and generally retain a continuous-improvement mentality that seems never-ending. Dealers that achieve consistently high levels of performance are usually monitoring a plan that is in pursuit of a *vision*. In the case of well-balanced businesses, this philosophy extends across all departments including *new vehicles, pre-owned vehicles, service* or *parts*.

True balance can only exist when all of these departments are contributing at their highest potential. Wherever this occurs, TGP% is at the higher levels of greater than 17%. This extremely important concept of balancing the business comes about because in the *new vehicle* department, gross profits are healthily contributing when they are greater than 7%. In *pre-owned*, they are healthy when greater than 13%; in *service* greater than 65% and in *parts* greater than 27%. If all these conditions are met, then each department is contributing substantially to the recovery of the total operating expenses of the dealership.

From another angle, excellent balance is depicted when the demands on the departments call for 100 / 100 / 100 strategies, or perhaps not considered by most is the sensible strategy of 50 / 50 / 50. These are strategies representing an equal number of new and pre-owned retailed vehicles per month that match the daily repair orders (customer paid R/O's) in the *service* workshop. Strange but true, in every instance where such a plan exists there is a healthy, well-balanced TGP% and almost invariably a healthy **ROOA**. Such is the importance of considering **balance** when developing plans to improve returns. *New vehicles* sold should be matched to *pre-owned vehicles* sold, and both of those should match the daily repair orders in the *service* workshop. When these three factors are all performing at this balanced level, the dealership will generate healthy returns.

Another form of balance exists in the strategies of operators that become obsessive about ensuring that the *operating expenses* are recovered or **absorbed** from the GP contributions from all departments except *new vehicles*. The moment the total costs have been recovered from all departments other than new vehicles, the dealership will be on solid ground, particularly when these stronger contributions come from those departments that generate higher gross margin percentages.

Whilst it is highly inappropriate to consider business **mix** in isolation, it remains nevertheless the paramount consideration in planning a balanced and successful dealership. MIX is the first of the key drivers of business results. The reason for starting with this particular driver is that it is perceived as the starting point for enhancing the business results in the dealership. Even though this might be the point of departure, it will be shown that MIX interacts in a very dynamic way with the other key drivers.

Getting the dealership to 'fire on all cylinders' represents sound business planning and inevitably requires an active stance by the dealer in order to improve TGP percentages. You may wonder why this should be, so let us examine the evidence.

INDICATORS OF BALANCE PER DEPARTMENT

Because of the varying levels of gross profit margins emanating from each department, it is important to understand how the MIX can be enhanced in each department. Let us deal with them independently:

New Vehicles

In the *new vehicle* department, balance exists when there is a healthy blend of retail cars sold relative to fleet, a fair blend also of entry level cars relative to higher priced sedans blended with a fair mix of SUV vehicles relative to pick-ups. When the TGP% of the department is above 6.5% we are usually well balanced in new vehicles.

Pre-owned Vehicles

In the *pre-owned* department, balance first exists in the ratio between retail and wholesale deals concluded, as well as between higher priced and lower priced vehicles, SUVs and other utility vehicles. When the TGP% of the department is in double-digit numbers, we usually have balance in the *pre-owned* department.

Pre-owned vehicle reconditioning needs to be taken very seriously as a vital part of the vehicle mix. It can either add to, or detract from the quality of the vehicle and therefore the margin. The way the vehicle is priced after reconditioning will ultimately determine the margin and this important factor needs to be taken into account in calculating the selling price. Just as pre-owned vehicle pricing is something that can be controlled, so too is the determination of pre-owned margin. The size of the margin is therefore entirely in the hands of the dealership management. Although market forces will obviously play a role, the judgement regarding the way cars are bought and sold (acquisition price versus selling price) requires a healthy combination of both art and science. The best practice exists where the desirable average margin is pre-determined, ensuring that the price causes the desirable margin to be achieved.

Ancillary products and services

Balance in the dealership is greatly enhanced when attention is focused on products such as finance and insurance as well as car care related products. In the case of finance and insurance (F & I), the efforts in this area are best monitored by measuring the penetration of vehicles financed. It usually shows a healthy balance when this penetration percentage exceeds forty percent of retail deals concluded for both the new and the pre-owned departments.

Car care products such as alarm systems and window tinting enjoy more attention in some countries than in others. Nevertheless, where they are popularly included, such as in Australia, they add icing on top of each deal. Those dealers that dedicate specialist sales consultants to this aspect of their businesses tend to do much better than those that leave it in the hands of vehicle sales consultants.

Service

Service is the juiciest of all departments when it comes to balancing the dealership and increasing the GP% result. It lies in the balance and mix of technicians where we look at the ratio of skilled (qualified) to semi-skilled (apprentice) techs.

When the proportion of semi-skilled technicians exceeds 30%, this will generate a higher GP%. We also need to weigh the relative balance of work being done between customer paid work, warranty work and internal work. Another consideration is the proportion of work being done inside the workshop relative to work being outsourced (sub-let). Repeat work or unsold hours can have a horrendous impact on the balance in the *service* department.

The aspect in *service* that has the most decisive impact on the GP% is unapplied time (unsold hours). When time is available and not being sold, you have an irrecoverable problem. Well-balanced service departments should attain a TGP% level exceeding 65%.

Parts

In the *parts department*, our sales mix is affected by the combination of parts sold to the workshop, parts sold to the trade and parts sold over the counter. Each of these three categories of sales comes at a different margin and the parts department is well balanced when the TGP% exceeds 26%.

WHAT THE STATISTICS INDICATE

It had become more and more apparent over time that those dealers with higher TGP%, in other words those that are better balanced than others, were putting themselves in a stronger position to produce sustainable and healthy profits and returns.

To substantiate the point, we tested the following hypothesis –

> *'Dealers that have more balanced businesses will tend to produce better returns than those that are not as well balanced in their businesses'*

The Sewells MSXI database was used to isolate 1,285 dealers from the more mature markets of Australia, New Zealand and South Africa. This was done because the emerging markets of Asia Pacific, as of 2016, were still less developed in the areas of *pre-owned vehicles* and *aftersales*.

For the purposes of our test, we clustered all of those dealers with gross percentage levels of between 11% and 13.99% (389 dealers) in one group to assess the average profit before tax (PBT) at the 'skinny end' of the data. At the opposite extreme, we assessed all of those dealers at the 'bulkier end' of the distribution, extracting all dealers between 17% and 19.99% gross percentages (273 dealers).

The results across these mature markets clearly showed that in the skinnier cluster (<14% TGP), the return on sales (PBT) percentage was 1.17% at the median point. On the other hand, the median point of PBT in the bulkier cluster (>17% TGP) was 2.52%, indicating a profit performance that was 115% better than in the skinnier cluster. Obviously, when dealerships play the game by hovering around the lower end of the TGP spectrum, high returns are more difficult to come by, whilst profits are easier to achieve in the case of dealerships that are 'bulked up' and more balanced. Getting the dealership into this healthier state is all about personal choice and strategy.

MIX GUIDELINES & BENCHMARKS

Benchmarks will tend to vary from country to country. In the classical sense, unlike a dealer standard, a benchmark should be dynamic, changing as market forces and dealer strategies change. The following guidelines provide an indicative view of the mix benchmarks which apply universally.

	OVERALL	NEW	USED	SERVICE	PARTS
GP% SALES	16.6%	6%	11.5%	66%	28%
HEALTHY BAND	15 – 17.5%	5.5% – 7.5%	10% – 13%	64% – 68%	25% – 28%

MIX MANAGEMENT

The volume segment can bring large components of fleet sales, so the dealership mix can become thin if one does not manage and exploit the other segments of the business. You should attempt to recession-proof the business by placing a stronger emphasis on fixed operations. However, it takes a lot of focus and should be seen as a strategy to bullet-proof the business (refer chapter 3).

INCENTIVES THAT DRIVE BALANCE IN THE BUSINESS

To affect balance in the organisation, we recommend both financial and non-financial rewards. Key performance areas are usually identified at the beginning of each year, and using various multi-factor performance indexes, one is able to isolate three or four key performance attributes to achieve in the upcoming year. In this way, one might weigh the KPIs differently so that the incentive tactically matches and drives the desirable behaviours you may wish to achieve. In this regard, MRA plays a healthy role in determining which of the key drivers are best focused on to give impetus to these desirable behaviours.

In Sewells MSXI, we have used benchmarking as a means of effecting stepped change and continuous improvement in the business. It is a ‘kaizen type philosophy’. It started out when we categorised the individual departments within the dealerships according to size and then according to performance levels. We were looking for the bronze groups to go to silver, the silver groups to go to gold and the gold medallists to become superheroes. In keeping with this concept of continual education, overseas study tours have brought very positive results.

SOME PRACTICAL WAYS IN WHICH MIX CAN BE IMPROVED

While there is no single magic formula when it comes to improving gross profit in a dealership, there are a number of areas that can be considered. The following table of ideas is not intended to be conclusive, but rather provide a set of thought starters for those wishing to address this key issue.

CONSIDERATIONS FOR IMPROVING AUTOMOTIVE RETAIL MIX

OVERALL DEALERSHIP | **NEW VEHICLES** | **USED VEHICLES** | **SERVICE** | **PARTS**

What is each department contributing to the whole? More fixed ops equals higher TGP% .

What level of discounting is taking place?
What are the controls and policies that help us retain margin?
Is all service work being properly costed?
Are pre-owned cars being priced correctly?

Are we selling what we like selling or what the market wants?

Who controls the negotiations and what are we willing to give away to do a deal?

How much opportunity are we allowing to escape through sublet? What is our level of sublet mark-up?

What is our mix of parts business to the trade, to the workshop, over the counter?

How well is the process managed? Are we taking time to build value in the deal?

Who is responsible for setting trade-in prices? What is the policy?

What is our mix of service business? i.e. internal, warranty, retail, fleet?

Are we putting visible prices on retail parts or allowing clients to negotiate?

Are we building additional gross through F&I and aftermarket?

How productive are we? i.e. hours available versus hours worked?

Are we managing our inventory and taking obsolescence into account so that we avoid distress selling?

Are we working hard to sell high margin vehicles?

Are we making sure we cover ourselves adequately for any reconditioning that needs to take place?

Are we taking time to up-sell? Are oils and consumables being included at the right level of GP%?

Are we incentivising our managers and front-line staff to achieve the mix we have targeted?

Is our new retail / fleet balance healthy? What is our retail to wholesale balance in pre-owned?

Have we set absorption targets to recover expenses adequately?

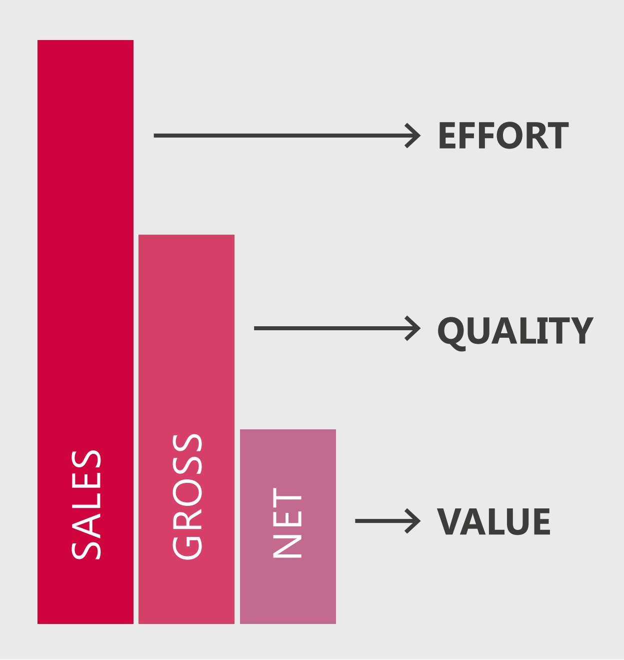
GROSS PROFIT DENOTES QUALITY

Whilst the sales line in the accounts gives a clear indication of the *effort* that has gone into achieving targets and growing the business, the gross profit line indicates the **quality** of those sales. It can categorically be stated that our 10.7% TGP dealer highlighted on table 2.1 appears keen only to secure the sale and there is little **quality** evident in the transactions concluded at this dealership. In terms of language, the fourth descriptive of '**quality**' has been introduced to help with the understanding of what gross profit actually contributes to the business result.

GROSS PROFIT = MIX = BALANCE = QUALITY

In short, high levels of GP% (>16%) indicate in a highly reliable sense that the business has good balance, that it is firing on all or at least most cylinders and that a great deal of focus is being placed on adding incremental opportunities onto each transaction with a customer.

THE SALES / GROSS / NET DYNAMIC



HEAT UP THE COFFEE

The more comfortable and amenable a modern dealership is, the better. Vehicle owners should feel 'at home'. Once this feeling has been instilled, it becomes much easier to discuss what the dealership stands for and what it offers the vehicle owner by way of comfort and safety through the lifetime of the vehicle. So 'heat up the coffee' and take time to sit with customers to properly assess needs and provide mutually beneficial solutions. The same opportunities exist at the service inspection lane as in the showroom.

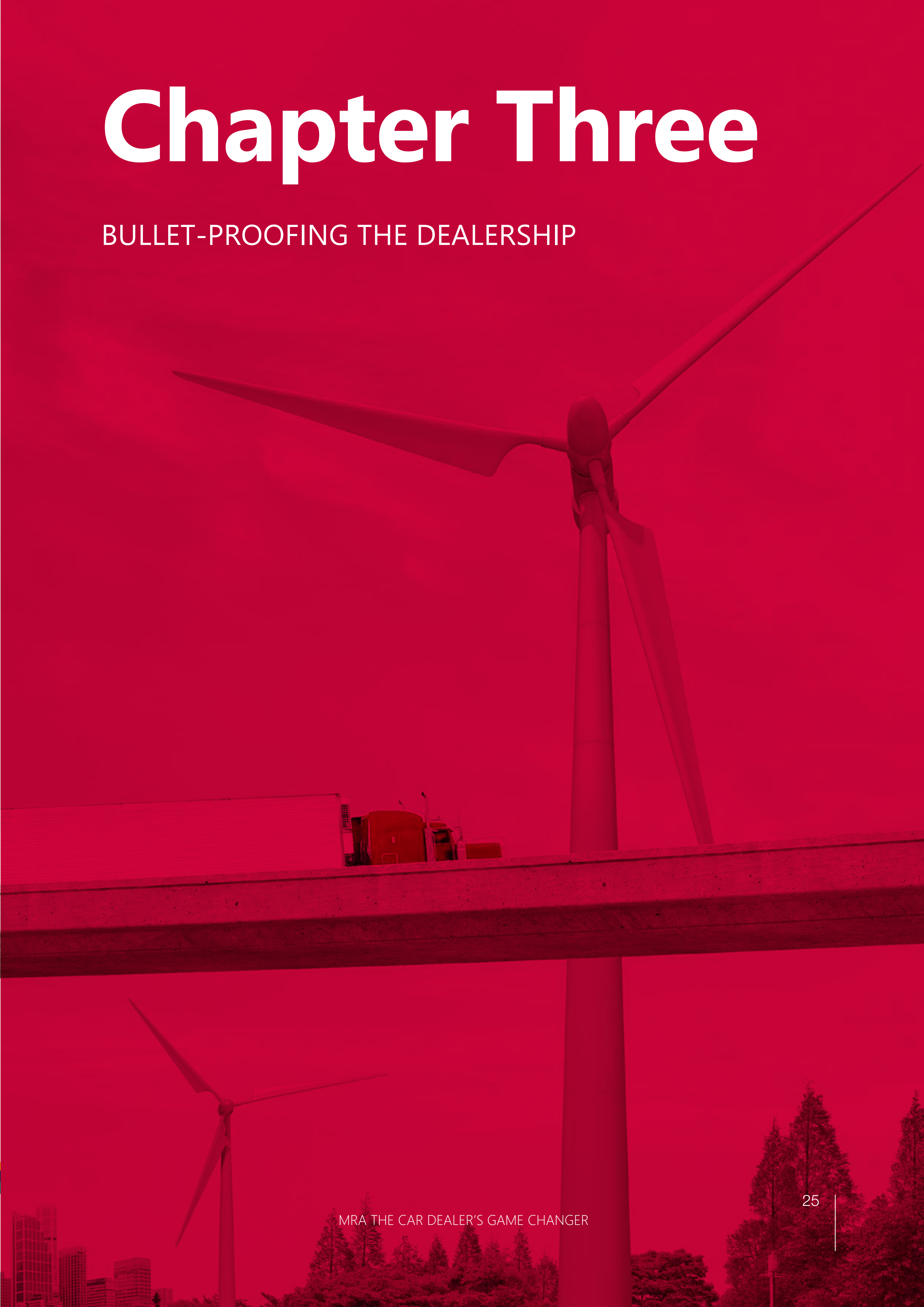
Per the research, it is reasonable to conclude that high gross profit percentage dealers seek more ways to transact with their precious customers. It is worth repeating that *the sale of a car marks the beginning of a relationship, not the end of the relationship*. Any incremental sales created, whether in the areas of finance and insurance, accessories or workshop upsells, all add to the all-important gross profit percentage of the dealership. That means that the quality of each transaction is improved and vehicle owners' perceptions of the dealership experience are positively influenced.

Always look for and consider **incremental sales** opportunities. In your quest to be profitable you need to seize every opportunity to build gross by absorbing and exceeding expense levels so that you can retain as much of the gross as possible for the bottom line.

In an interesting way, we will now see how **bullet-proofing** a dealership serves as a sound strategy and safeguards the business from turbulent changes in the marketplace.

Chapter Three

BULLET-PROOFING THE DEALERSHIP



CARL ATKINSON

CARL ATKINSON

At the junction of East Colonial Drive and the Greenway in Orange County Orlando, you will find Greenway Ford, a state-of-the-art car retail haven that runs like clockwork. More than a dealership, Greenway Ford is an experience to be remembered. Once having entered the estate, there is no turning back.

President and CEO Carl Atkinson has long been a believer that their unshakeable ability to adhere to sound expense controls is the core of their success. As a result, the consistency of their business to **retain** 35% of their gross profit has rendered Greenway truly 'bullet-proofed'. Couple this key strategy to an impressively well-balanced contribution from all departments resulting in a generous TGP of 17% or more, and it is no wonder they consistently see profits of 7% PBT and better.

Carl and general manager Lee Mitchell take great pride in the quality of their people and readily attribute their success to the consistent performance of the Greenway Ford team. Margin protection is fundamental to their business and no opportunity is overlooked in building quality into every customer transaction.

Add to all of this the devotion shown by the managers to extremely well tested and highly polished business processes across all departments and the realisation of why key targets are met on a 'clockwork' basis soon becomes apparent.

Disney World is not the only place worth visiting whilst in Central Florida.

Having facilitated performance groups across nine countries for over twenty-five years, Sewells MSXI consultants have observed that dealers generally are far more familiar with units sold than they are with total gross profit values or even expense levels in their dealerships. If a dealer is to be successful, life can be made a lot easier when the key numbers (expenses and gross profits) are given equal attention when evaluating the results and the potential of the business. Until the expenses are firmly embedded in the thinking of the dealer, it becomes a 'hit and miss' game. The smarter operators are always better at weighing expense considerations and developing plans to reduce or absorb these expense targets.

In the examples that follow on page 28, we are illustrating an Australian dealership using Australian dollars (AUD) to identify key pointers. To gain an early appreciation of the state of the business, we concentrate initially on the four key numbers only. At what point then, are we able to judge whether the dealership under assessment is in good or bad shape?

Whether you have ever considered the relational aspects of critical numbers in assessing your own dealership or the numbers of someone else's dealership, the key numbers to assess are the following:

- Total Sales
- Total Gross Profit
- Total Operating Expenses
- Total Current Assets

It is important that the period under assessment should be the same for all key factors.
It does not matter whether we assess a month, a quarter or a year as long as the period is the same for all four indicators.

In turning to our real life Australian example, let us now extract these numbers and see if we can make sense of them. One by one, here are the values drawn from the year-end (annualised) results of the example dealership.

The numbers have been rounded up to the nearest thousand for ease of calculation:

- Total Sales $487,500,000
- Total Gross Profit $70,690,000

Before we move any further it will help the learning of the reader if you calculate the GP ratio based on what you now have before you.

You are correct if your answer is 14.5% (TGP / Sales) and you should pause now and reflect on what you know thus far about MIX. You are encouraged to look at numbers with a contemplative sense of 'hmmm' because that is the way that a good consultant would approach any analysis. The 'hmmm...', or contemplative approach, is intended to foster your curiosity. On this basis, we already know that at 14.5% the dealership is out of the 'skinny' zone but still with room to improve.

Remember that when it comes to gross profit we are dealing with the business **mix** and by achieving this ratio of 14.5% you have just identified the 'M' piece of the MRA equation. It is reasonable to conclude that the dealership is more front-end biased with insufficient contribution from aftersales.

Then we extract the Total Operating Expenses:

- Total Sales $487,500,000
- Total Gross Profit $70,690,000
- Total Operating Expenses $57,542,000

Now we are getting somewhere! Try to inhibit your tendency to immediately calculate the net profit value — hold off on that temptation and rather calculate the **split** of **total gross profit** between what proportion is represented by expenses and what is retained of the gross profit for the bottom line. The result should show Total Expenses as being 81.4% of the **total gross profit**. Banks as well as various other corporations around the world refer to this crucial ratio as 'cost to income'.

Put another way, operating expenses are *burning up* 81.4% of the gross profit and this brings forth the 'hmmm...' factor. Importantly, do we consider this result of 81.4% expense to gross profit to be good or bad? We will soon find out.

Once we have the *expense* value, we can also deduct this value from the gross profit to calculate the **PBT** achieved. To avoid any arguments about funding matters, let us include interest in the *expense* value in calculating **PBT**. In this case, $70,690,000 minus $57,542,000 equals the total net profit of $13,148,000. If you now calculate this as a proportion of the gross profit, it represents the inverse of expense to gross at 18.6% (100 minus 81.4).

We can now draw some interesting conclusions from the numbers as given:

- Total Sales $487,500,000
- Total Gross Profit $70,690,000
- Total Operating Expenses $57,542,000
- Total Net Profit $13,148,000

If you managed to hold off on your natural inclination to calculate the Net to Sales (**ROS**) ratio and have calculated rather the Net to Gross ratio (18.6%), you will see that you are **retaining** 18.6% of the Total Gross Profit for the bottom line. The "R" in MRA is calculated by splitting gross profit into *expenses* (81.6%) versus whatever is **retained** (18.6%). In this case the split is 81.4 / 18.6 and the **retained** portion therefore equals 18.6%. The other way of dealing with it is to express this **retained** value as a fraction **0.186**.

Go ahead and follow your natural inclination to calculate Net as a percentage of Sales (Total Net Profit / Total Sales) — well done if your result is 0.02697 or 2.7% (rounded up).

Now clear your calculator and multiply the MIX or TGP percentage of 14.5% established earlier by the RETAINED value of 18.6% (14.5 × 0.186) and do not be shocked to discover the result equivalent to the Net to Sales value of 2.7% (2.697 rounded up). This happens because there is a *cause / effect relationship* between the business MIX relative to the amount **RETAINED** that determines the PBT percentage. In this case the **PBT** = 2.7% was *caused* by the combination of the mix 14.5% and the retained 18.6% (14.5 × 18.6% = 2.7). The *cause / effect relationship* is intrinsic.

In the same way, we can analyse every department but that will come soon.
The MIX multiplied by the RETAINED or in other words ***(M x R)*** *will equal the PBT% value.*

Dealers should be aware that worrying about Net to Sales percentages is an irrelevant concept. The key drivers of M and R should be given more time and effort, given that they ultimately *cause* the net profit result.

Concentrate rather on creatively building gross profit and managing expenses and the net profit result will take care of itself.

FAILING TO 'SET THE BAR'

For whatever reason, dealers are either reluctant to or fail to pre-emptively determine appropriate financial targets based on expense structures. Without necessarily knowing it, the dealer has the power to set a net profit goal and to set up the levels of performance that will turn that target into a reality. In this regard, the budgeting process is less than ideal because gross profits and expenses are frequently moving targets. Frankly, quarterly projections work far more powerfully than budgets. The smarter among the strategic thinkers would therefore commence with a retained proportion in mind when setting targets — typically a target of 80/20, 75/25 or 70/30, or whatever level is considered appropriate by the dealer. We have seen the impact that the MIX of business can have on this result, but as you have also seen, the RETAINED aspect is equally important.

Once the dealership has established a consistent pattern, both the **mix** and the **retained** should become familiar metrics. If a dealer is consistently achieving a mix of 15% (TGP) and consistently achieving a **retained** of 15% (split 85/15) then the **PBT** result will be a consequence of these two factors 15 × 15% = 2.25% Net. Only then can the tweaking of key numbers commence in any meaningful way.

Leaving this vital aspect of the business to chance makes no sense.

*If bullet-proofing or 'recession-proofing' of the dealership is of consequence, then it is worth noting that an **80/20** split is a good result, a **75/25** result is very good and at **70/30**, the dealership is truly **bullet-proofed**.*

TAKE CONTROL OF THESE KEY DRIVERS

This chapter contained a lot of information, and it might be a good idea to reread it twice or more. It seems the difficulty of grasping this vital concept of 'what drives returns' stems from the fact that many fail to examine the relational aspects of key numbers. In this case of Expenses to TGP, the more consistently these numbers stack up in the dealership accounts from month to month, the easier it is to understand the direction as a business. Just as you might know that you **grossed** at 16%, you should know that you **retained** 20% and these two numbers will result in 3.2% (16 × 0.2 = 3.2 net). Once the dealer has this level of feel for the business, it becomes easier to 'set the bar' and to meaningfully target the desired PBT%.

Let us take another example. In a random dealership, the operating expenses are $580,000 and the TGP is $680,000. This means that the Expense to TGP ratio is 85% (580,000 divided by 680,000). In other words, 85% of the **gross** is being burnt up by the **expenses**. Expressed another way, it also means that we are retaining (**R**) 15% (0.15) of the gross profit as net profit (Net/Gross). If we now wished to improve the SPLIT to 82/18 against the expense level of $580,000 my target Total Gross Profit would have to be re-set to $707,000 which is a matter of dividing the **expenses** by the Targeted SPLIT (580,000 / 82%).

Now, discussions between the dealer and the management team should revolve around creative ways to generate the additional $127,000 in gross profit ($707,000 minus $580,000) in order to improve this retained value. The less we have to rely on selling more vehicles, the more quality we will add to the business. *Parts, service* and *pre-owned* are where the hidden treasures will invariably lie.

'RETAINED' DEFINED

RETAINED can now be defined as the amount of Total Gross remaining after deducting the *expense* value from the *gross* value. In other words, how much of the *gross* is attributable to expenses (the running of the business) and how much *profit* have we retained after taking the *expenses* into account. We need to ensure that the ratio of RETAINED to gross is maximised across all departments.

Look at:

- Expenses as % of gross profit (overall and per department)
- Net profit as % of gross profit (overall and by department)

Remember this:

This is a key measurement of management efficiency, particularly because management usually has more control over operating expenses than they do over revenues and even gross profits.

When viewed over time, the **split** ratio can tell you if management can afford to expand operations without dramatically increasing expenses. For example, if sales were expanding from year to year and the split ratio were improving, it would mean that the key drivers were changing favourably.

An example of how this works would be the following:

Gross Profit = 100, Expenses = 80, Net Profit = 20

The split therefore is 80:20

That is a split of 80% (0.8) and a retained proportion of 20% (or 0.2 when expressed as a fraction)

A further example (with more realistic numbers)

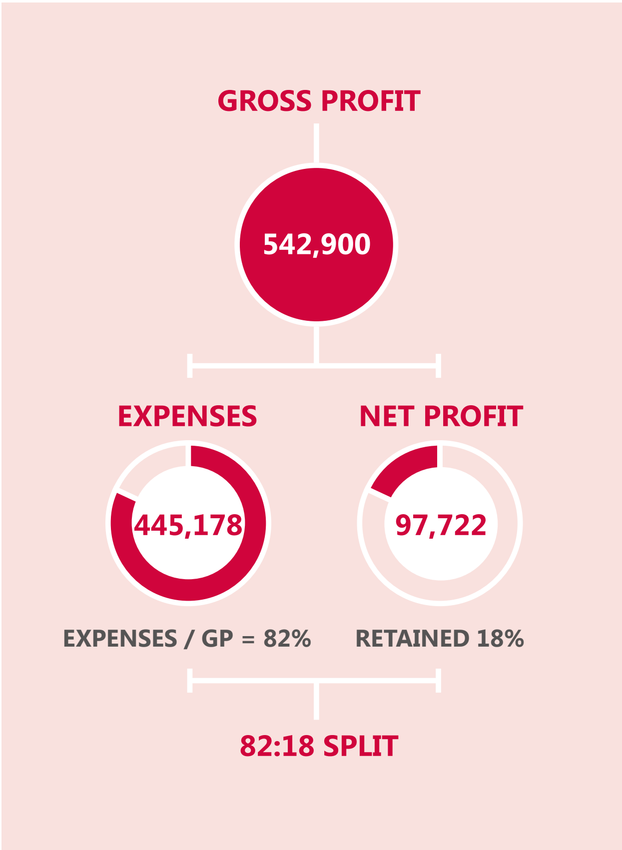
Gross Profit = 542,900

Operating Expenses = 445,178

Net Profit = 97,722

The Expense split is 82:18
(445,178 divided by 542,900 = 82%)

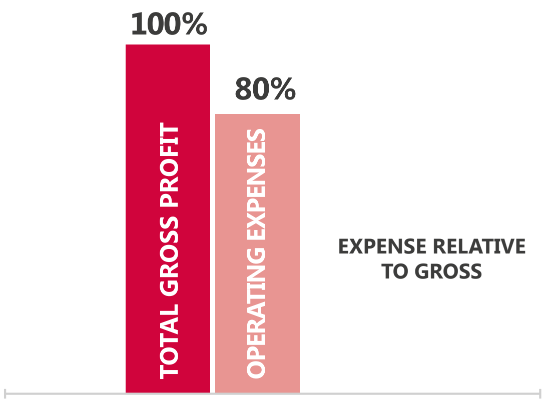
That is a split of 82% (0.82) expenses
and a retained proportion of 18% (or 0.18)



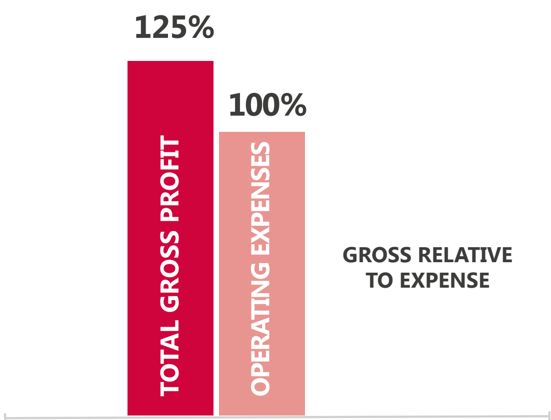
ABSORPTION

The most effective way of 'setting the bar' for the appropriate levels of SPLIT in the dealership and indeed in any department is to pursue the age-old strategy of absorbing the operating expenses through the gross profit contributions of the various departments. This approach ensures that there is something left over to be retained on the profit line. The total absorption, therefore, needs to exceed the total operating expenses of the dealership for any overflow (retention) to take place.

This is best explained by using the SPLIT combination best suited to the dealer (the split the dealer believes to be possible). Perhaps we should commence with a simple split of 80:20, which visually might be shown as such:



So when we refer to an 80:20 SPLIT, it means that the expenses are 'soaking up' 80% of the Total Gross Profit of the dealership. However, by inverting the 80:20 equation and dividing 100 by the 80 (100 / 80 = 125), this shows these exact numbers now represented in another way so that the gross profit represents 125% of the expenses as illustrated below:



The same logic could be applied where the desired SPLIT is targeted at 75:25 which, when inverted, becomes 100 / 75 = 133. This means that to achieve a 75:25 SPLIT and retain 25% of the gross, we need to absorb 133% of the expenses. Once the dealer grasps this concept, it becomes easier to target, or 'set the bar', both for the dealership as well as for each department.

In used cars, where we might aim at a split of 80:20, the department needs to achieve a gross profit amount representing 125% of the department expenses (100 / 80 = 125). In the service workshop, where we might aim at a split of 70:30, we will need to 'set the bar' to achieve a total service gross profit representing 145% of the department expenses (100 / 70 = 145).

The best way of dealing with **absorption** is to target the various departments in order to engage all parties and get the focus of 'bullet-proofing' aligned. Typically, the targets should be equitably shared, but in whatever way it is broken down, the non-new vehicle contribution should reach 90% if the dealership is to be 'bullet-proofed'.

Here is a suggested example:

USED VEHICLES (SECOND GROSS)	25% to 30%
SERVICE TOTAL GROSS	35% to 40%
PARTS TOTAL GROSS	20% to 25%
TOTAL NON-NEW VEHICLE CONTRIBUTION	**80% to 95%**

DEALING WITH NEGATIVE NUMBERS

Where expenses exceed gross profit

Dealerships or departments experiencing losses would face a negative RETAINED proportion. In other words, their SPLIT would indicate that they are spending in excess of 100% of their gross.

Calculating this would be as simple as the following

Gross Profit = 595,200

Expenses = 624,960

Net Profit (-29,760), meaning a net loss of $29,760

The Expense split therefore is

105: -0.05 (624,960 / 595,200 = 105%)

Remember the split factor must always total 100%, that is 105% + (-5%) = 100%

RETAINED GUIDELINES & BENCHMARKS

The **RETAINED** represents that proportion of gross profit that converts into net profit. It is an indicator of gross profit and expenditure management. The key measurement is net profit as a percentage of gross profit (net / gross). Here are some guidelines from the Sewells MSXI stats:

	OVERALL	NEW	USED	SERVICE	PARTS
SPLIT	80% / 20%	90% / 10%	80% / 20%	75% / 25%	70% / 30%
NET:GROSS *(as a fraction)*	0.20	0.10	0.20	0.25	0.30

IMPROVING RETAINED

Whilst the **retained** will invariably be affected by any changes in the dealership's **mix** of business, this factor should never be a passive element in the dealer's attempts to improve results. It should always go hand-in-hand with the dealer 'setting the bar' at the desired SPLIT level and *working the numbers* to get to this desired level. Before anything else, expense cuts via the removal of waste (what Toyota in Japan refers to as **muda**) should be considered in conjunction with creative plans to improve **sales** and gross profit results. Improving business results is a push-pull phenomenon.

It is worth repeating the guideline that a split of **80:20** is always going to bring a good result. **75:25** is certain to bring a *very good result* and **70:30** will render the dealership as *'bullet-proofed'*.

CONSIDERATIONS FOR IMPROVING RETAINED VALUES

OVERALL DEALERSHIP	NEW VEHICLES	USED VEHICLES	SERVICE	PARTS

What are the levels of gross profit being attained across the dealership?
Remember that RETAINED and MIX are inextricably linked. In other words a higher level of gross at the same level of expenditure will result in an improvement in 'RETAINED'
Is each department targeted to absorb their share of recovering the Operating Expenses?

How have expenses been allocated (apportioned) across all departments?
Is it a fair reflection of the resources being deployed or is one department carrying a disproportionate level of the admin expenses?

How are expenses being managed?
Are we taking advantage of any synergies and efficiencies that might exist?
Are we reviewing expenses on a regular basis to ensure that they are in line with budget?
Are there any annuity based expenses that we could review or ask suppliers to retender for?
Are there any hidden expenses? Are we attacking the waste (muda) in each department?

Are we incentivising our managers to achieve our desired levels of retained per department?

Are we aware of any purchasing efficiencies that may exist for items such as consumables?

What level of floor plan interest are we paying?
Is this something that we can control by reducing stock to realistic levels?

A FINAL WORD ON RETAINED

If you are not banking at least twenty cents for each dollar generated in gross profit in the dealership (80:20 split) you are not thinking 'sustainability'. 'Set the bar' accordingly.

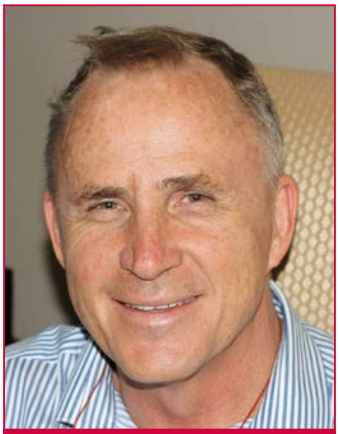
The next chapter will examine the third and final element of the **MRA** equation, which is indicative of the energy level in the business. It shows the ability of a dealer to turn assets into sales and reflects the **activity** levels — the '**A**' factor or turns throughout each department in the dealership.

Chapter Four

BEEFING UP THE ENERGY LEVELS

FRED WHELPTON

For anyone in the industry seeking 'world class best practice', it is highly recommended to visit the NTT Group in South Africa.



FRED WHELPTON

Fred Whelpton is the sole proprietor of the NTT Group, South Africa's largest privately owned dealer group. After completing an MBA in his early years, he joined the marketing department of the Toyota Motor Corporation as a management trainee. After serving five years and learning about the industry, Fred got 'itchy feet' and was given an opportunity to show his capabilities when he partnered with auto retail doyen of the time, Hugh O'Mahoney, in acquiring a rural Toyota dealership two hundred and fifty kilometres north of the bustling metropolis of Johannesburg.

Fred's prowess soon enabled him to acquire nine Toyota country dealerships, by which time he was able to release himself from his co-owners and boldly set off on his own. The rest is history, and today, Fred's NTT Group comprises thirty-two dealerships both rural and metro, covering five franchises in two Southern African countries.

There is no doubt that his entry into the retail arena was a significant and impactful move and he is beyond any doubt the most successful automotive retailer in that country. Whilst others have found ways to diversify their wealth and their interests, Fred has continued to expand his own operations by focusing exclusively on his own operations, trusting his ability to outperform any other investments. With an average return ranging between six and eight times the cost of funds rate, nobody would argue with his logic. Fred's level of self-belief is truly extraordinary. Fred's MRA model is 'watertight', and whilst the naysayers who first started to notice how professional an operator he is tended to ascribe his success to Toyota, he has since silenced all critics by achieving the same results in his Nissan, Volkswagen and Audi operations because he knows what he wants in each key parameter and accepts nothing less.

Remarkably, Fred achieves an MRA result made up loosely of a MIX of 17%, a RETAINED of 35% (0.35) and an ACTIVITY of 8.5 × turns. His winning formula can be represented as 17.0 × 0.35 × 8.5 = 50. Each of these numbers are given a high level of focus.

Fred's operation includes three exceptional dealerships that have consistently achieved and even exceeded the magical 70% ROGA mark. As such, since the inaugural NADA Businessperson of the Year award in 1996, Fred and his team have ranked among the finalist nominees every year, winning the prestigious award on fourteen occasions.

Far and wide, Fred is admired by all that encounter his exceptional company. His central philosophy is to ensure that the business *fires on all cylinders* and is well **balanced** with the expenses solidly absorbed. No matter which part of the country Fred may acquire a business, his model is imminently transferable, and he has proved that in both town and country operations. 'When a man can trade with discipline and discretion, he is ready for bigger things in our company'. As such, Fred has seldom made an acquisition without having one of his own highly charged managers to promote as dealer principal in the newly acquired entity.

Having examined the MIX and RETAINED factors, there is one final key driver that will reveal the true picture of whether a dealership is being well or poorly managed. In any form of retail, inventory should energetically be *converted into sales* that are in turn *converted into receivables* that ultimately converts into cash that is available to acquire *more inventory*. This means *more sales* so the retail wheel keeps 'spinning and spinning'.

The more this wheel turns and the quicker it turns, the better. We refer to the turning of the operating assets as representative of the ACTIVITY in the business. Thus, the 'A' emerges as being the third and final factor in the MRA equation. It also explains the derivation of the appropriate accounting label **turnover**, which is an oft-used substitute for **sales** or **revenue**.

ACTIVITY in this sense goes beyond mere stock turns. In its broader sense, it comprises the *total* **sales** of the dealership relative to the **total current assets** and includes receivables, cash etc. For the entire dealership, activity is calculated by the formula: Total annualised **sales** divided by **total current assets**.

ACTIVITY can also be defined as the 'surge of throughput' generated by the operating assets employed. In practice, these operating assets are largely represented by stock as well as the debtors or receivables. There are other current assets in the balance sheet such as cash and work in progress (WIP). The ACTIVITY for the average auto dealership ranges from between 6.5 to 8.5 turns per annum. This result is entirely dependent on the attention given to activity by the dealer principal.

KEY MEASUREMENTS OF ACTIVITY

- Overall asset activity (annualised sales / current assets)
- Days stock (new / used vehicles and parts)
- Debtors days
- Return on stock invested
- Return on operating assets

Do not forget that when monthly purchases are equivalent to the average inventory it represents twelve turns. It is expressed by number of times (purchases divided by inventory multiplied by 12) per annum. Stock turnover ratio indicates the number of times the stock has been turned over annually and reveals how efficiently the firm manages its inventory. This ratio indicates whether investment in stock is within appropriate limits or parameters.

Modern professionally run dealerships recognise the preciousness of retail space. Therefore, the importance of rapid stock turns has taken on a new importance. 'The more you turn...the more you earn' is an ethos that is echoed everywhere.

ACTIVITY *is a key component of the MRA model and serves as the final piece that drives the MRA result.*

ACTIVITY GUIDELINES AND BENCHMARKS

ACTIVITY represents how well the business is managing its current assets or working capital. This metric specifically excludes fixed or long-term assets such as land, building and equipment as essentially the task is about generating activity with those operating assets that are relatively liquid in nature.

As provided earlier for MIX and RETAINED, the benchmarks below are indicative and should be adjusted based on market conditions.

	OVERALL	NEW	USED	SERVICE	PARTS
ASSET ACTIVITY	×8	45 × days stock-holding	45 × days		35 × days
HEALTHY BAND	7 to 9 turns	40 – 50 days	40 – 50 days	Minimise come-backs and work-in-progress	30 – 40 days

WAYS OF IMPROVING ACTIVITY

While ACTIVITY is largely about effective asset management, there are a few areas worth considering when looking to improve this key area of importance.

ACTIVITY MANAGEMENT

Bidvest McCarthy Automotive is a leading group in South Africa. CEO Steve Keys (page 43) hits the nail on the head in saying, 'When the economy tightens, it becomes imperative to **sweat your assets** to get your activity levels up, particularly when your mix is going to be impacted by discounting in the market and manufacturers start forcing stock down your throat causing distress selling to happen in the market. The real way to control the results and the returns you get out of the business is through tighter asset management. Manage the balance sheet hard and manage the business almost like a private equity investment where you manage it hard for cash, which has always assisted us in continuing to generate the right levels of return out of a reduced asset base. As a consequence, earnings and returns are held up to the best of our ability.'

Steve went on to say, 'Balance sheet management is about discipline and the management of detail. It is something that does not happen on its own, it has to be driven, and the management team in Bidvest McCarthy's has given affect to the tactic very well. In recent years when the market (not earnings) has either flattened or in some cases contracted, we have managed to generate an awful lot of cash and it positioned us to act when the market started moving up because we had a strong balance sheet with cash on hand where we could focus on acquisitions'.

CONSIDERATIONS FOR IMPROVING AUTOMOTIVE RETAIL ASSET ACTIVITY

OVERALL DEALERSHIP	NEW VEHICLES	USED VEHICLES	PARTS	SERVICE
Considering the vital relationship between operating assets and turnover, are we measuring the asset turns (ACTIVITY)?	Are we measuring Stock Days & Stock Turns?			Do we work hard to minimise work-in-progress?
Do we have any operating assets that are not working for the business e.g. excess cash?	Are we constantly monitoring stock ageing?			Do we have measures in place to drive 'fix it right first time' initiatives?
Do we encourage visual stock management i.e. management by walking around?	Do we pay attention to vehicle displays and merchandising i.e. move vehicles around, specials of the week, etc...?		Do we market retail parts aggressively?	
Do all our managers understand the cost of the stock that we have on hand? Do we take into account the preciousness of retail space?				
	Do we have specific plans for specific vehicles?		Do we categorise parts into movement categories?	
	Do we order vehicles according to a formalised stock policy or do we tend to order on gut feel?		Do we constantly monitor our parts ordering parameters?	
		Do we have a formalised over-age stock policy in place i.e. 30/60/90 days with write downs?	Do we have a formalised stock obsolescence policy in place i.e. returns, write-offs?	

CONSIDERATIONS FOR IMPROVING AUTOMOTIVE RETAIL ASSET ACTIVITY (CONTINUED)

OVERALL DEALERSHIP	NEW VEHICLES	USED VEHICLES	PARTS	SERVICE
		Do we dispose of stock that has reached a certain age limit?		
		Do we have a disciplined reconditioning process that ensures vehicles are ready for sale within 3 days?		
Are we incentivising our managers and front-line staff to achieve the activity targets we are looking for?				
Do we have strict debtors collection policies and procedures in place?				

WHAT DO WE MEAN BY OPERATING ASSETS?

In the **balance sheet**, we need to distinguish between the **long term assets**, such as property and inter-company loans, from the operating assets. This is particularly important because the general manager has no influence over the growth of these **long term assets**. Looking at the shorter term assets, however, represented by **total current assets (stock / debtors / cash)** as well as other operating assets such as the workshop hoists, any shelving or computers and capitalised vehicles, we end up finally with those assets under the true control of the general manager. In taking these assets into account, the **total current assets** by far makes up the bulk of the operating assets. For the sake of simplicity and ease of understanding, we will confine our attention to **total current assets**, which is the essence of the controlled assets and for which the general manager is accountable. The formula below adopts this particular approach.

Annualised Net Profit / Total Current Assets x 100 = Return on Operating Assets

If the result is less than 15%, then depending on the **cost of funds** (COF) in your country, there is work to be done if you are to establish a return closer to two or even three times this important ratio. On the other hand, if your calculation of this ratio shows a return of greater than 25%, then some tweaking can commence. As the operator, you can concentrate on target setting of your 'flight path' to improve your business result. This return of 25% or greater is likely to position you in the upper quartile (top 25%) of dealers, so congratulations!

Let us see what you can glean from these outstanding dealers because, as we all know, there is always something to learn in auto retail from other good players. We purposely use the term 'players' because business is a game played well by some and poorly by others. The MRA performance model gives the dealer a chance to play the game better through well considered planning and decision making, all aimed at making the dealership more sustainable going forward.

This figure is calculated in various ways based on the dealer or dealer group. Among the more sophisticated dealers, one would see a difference between those that consult and interpret the **balance sheet** and those that do not consider such a step to be necessary. Congratulations to those dealers that do consider assets to be a critical part of their key measures.

For those that regularly assess the state of their assets, some will include inventory plus **receivables** plus cash plus **work in progress** (WIP) plus furnishings, hoists and computers (depreciated). The recommended solution for the less-well informed is to simply look for the **current assets** in the **balance sheet** and use that number only as a means of assessing and calculating the ACTIVITY in the business. This recommendation stems from the fact that the **current assets** will invariably represent 90% or more of the **operating assets** in whatever way this is calculated.

It is important to note that fixed assets such as land and buildings should never be included in this calculation because the operator should never be measured by shifts in property values. We are concerned only with the performance of the operator as such performance relates to the things that the dealer can control in the trading company, which is almost entirely reflected in the **balance sheet** under **current assets**.

So let us return to the numbers under assessment from the previous chapter:

- Total Sales $487,500,000
- Total Gross Profit $70,690,000
- Total Operating Expenses $57,542,000
- Total Net Profit $13,148,000

Now this time we will bring the **total current assets** into play, and the **balance sheet** in this case shows this value to be $78,500,000 (78.5 million dollars) as included in the schedule below:

- Total Sales $487,500,000
- Total Gross Profit $70,690,000
- Total Operating Expenses $57,542,000
- Total Net Profit $13,148,000
- Total Current Assets $78,500,000

To calculate the **asset turns** simply divide the annualised **sales** by the **total current assets** (487.5 mil / 78.5 mil) which equals 6.2 turns and represents the 'A' of the MRA equation. Again though, it begs the question 'hmmm...', is this good or bad? Stay patient because in the guideline above, this level of turns is quite ordinary. This will be given more attention as the MRA model becomes clearer.

Now we have as much as we need to form a calculated judgment about the state of health of this dealership.

We have established that the M = 14.5, the R = 18.6% and the A = 6.2 which when multiplied together equates to:

$14.5 \times 0.186 \times 6.2 = 16.7$

This is the same as the ROOA calculation of (annualised PBT / Total Current Assets), or it is like saying 'Taking into account the $78.5 million (the capital that has been employed in the business), we produced a profit of $13,148,000'. Simply calculate the return in the same way your computer would calculate it as follows:

$13,148,000 / $78,500,000 × 100 = 16.7% (**ROOA**).

It is at this point and *only* now that a qualified decision can be taken regarding the financial health and well-being of this dealership. How do we make this judgment? The answer is simple: 'It depends which country we are in' because the **cof** is the true parameter against which a result can be judged. Therefore this result in Australia where (at the time of writing) funding was available at 6%, this result of 16.7% ROOA represents two and a half times the **cof** rate. If the dealership were in India or in South Africa where the **cof** is much higher (>10%) the result would subside to being very marginal and so on.

The cof rate is fundamental to judging whether performance and returns should be regarded as good or not so good

Now that the MRA equation is becoming clearer, we can reveal that the single most important aspect associated with the model lies in the way *decision making* is enhanced through its use. We can now isolate each of the three key drivers and independently deal with them as required, making calculated decisions in each case that ultimately enhance the returns and the business results in general. It should be stressed in advance that all three of these key drivers, the M, the R and the A, are intrinsically intertwined and interdependent, and the reader will come to understand that any movement or change in one of the factors is likely to have an impact on the other two factors.

ACTIVITY - THE ENERGY IN THE DEALERSHIP

When all is said and done, retail space is costly and therefore precious. The more modern dealers take this fact into account to move stock quickly and eficiently. At the same time, cashflows are critical, so **receivables** in well-run, modern dealerships are given extreme levels of focus. For every cent of own funds used to finance purchases and facilities upgrades, the less will be charged in interest on loans.

Therefore, stock and debtors warrant high levels of attention and best-practice dealers generate enough energy to get their turns up to, or within reach of double-digit numbers. Ten **asset turns** and greater is regularly seen in the MRA results of 'best in class' dealerships. The higher the **turns**, the better the energy levels in the dealership, and the super-star dealers run their assets at extremely lean levels relative to the **sales** created.

THE IMPACT OF REAL ESTATE VALUES ON ACTIVITY

It has been interesting to observe how rising real estate values have driven higher levels of activity over time. Businesses that occupy valuable sites are looking at space and *time* through fresh eyes, which was not the case ten or fifteen years ago. No longer are smart dealers looking only at the value of stock. Suddenly the value of land comes into the equation, resulting in the emergence of the *velocity* models for vehicle stock, which postulates that the more stock-turns can be generated from the space on the floor, the more valuable the site. The measure then becomes *return per square meter* in the store. In other words, how much gross profit can a particular square meter of space generate potentially in a day, in a week, a month or even a year? The measurement of space yield is becoming more and more vital as real estate values climb.

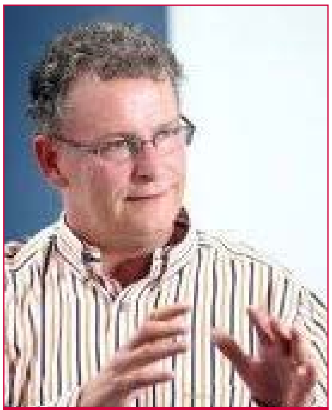
In modern day retailing, there are very few who would refute the importance of creating stock-turn energy on the shop floor. The faster the products move, the greater the return.

Now that all three of the key drivers have been covered, let us see how they come together to impact the business result in a very potent way.

Chapter Five

THE POWER OF THE MULTIPLIER EFFECT

STEVE KEYS



STEVE KEYS

Most dealer groups, particularly the publicly listed entities, will tend to equate their returns to lending rates or the **cof** rate in any given country. Taking this into account, one has to search far and wide to find groups that exceed this rate by four or five times.

Those that do reach these levels of return would invariably be doing lots of things right with their decision making and planning, especially in the case of groups that have fifty or more branches. In the case of Steve Keys, CEO of the Bidvest McCarthy Automotive Group, we are talking about ninety-two trading operations (dealerships) averaging a **ROFE** in the mid-30% range.

Six years ago (2012), when Steve Keys was engaged as CEO of the group, it was flailing in single digit returns and at risk of being dispensed with by its holding company, the acclaimed Bidvest Group, which is highly rated by investors on the Johannesburg Stock Exchange. The group chairman lacked the appetite to tolerate low returns from a subsidiary and Steve was tasked with influencing and aligning the automotive results in accordance with the greater group's stated goals.

Huge credit should be given to Steve Keys and his team for the way in which the group results have turned favourably over the last four years. In particular, he deserves acknowledgment for the way he has linked his own **management gap** philosophy with MRA in a real-world circumstance. So profound has the impact of this recipe been on the Bidvest McCarthy results that the group has once again returned to its rightful position as the one-to-watch amongst the five large auto groups in South Africa.

More striking than anything is the affect he has had on the culture of the organisation. He has unbundled and decentralised operations, invested substantially in technology, invested substantially in management development and empowered his general managers to think rationally in a way that has seen business results make a sharp upward turn in what has become a 'planning' culture.

When one examines the way 'management information' is disseminated, analysed and acted on by every key executive, it raises eyebrows. In a declining South African market, Bidvest McCarthy Automotive has continued its upward trend and, in line with Steve's **management gap** philosophy results, has held strong and outperformed the market admirably. In particular, the group's investments in Toyota and Volkswagen / Audi (jointly comprising over fifty branches) have performed outstandingly and the best of these operations have achieved returns way above the South African lending rate. The highest accolades of the industry, including factory 'Dealer of the Year' and industry 'Business Person of the Year', can be counted amongst their regular acknowledgments. Both internally and externally, everyone can see that things have changed for the better under Steve's leadership.

As part of his masterplan, Steve has put each of his branch managers through a development program in order to empower each of them and firmly embed the concept of MRA and the financial multiplier into the very culture of the company. The grasp by each of these general managers has ultimately ensured that the Steve's **management gap** continues to widen favourably over time, improving both profits and returns.

By instilling MRA as the language that focuses and aligns decision making into a more logical pattern at every level across the group and by developing each general manager to firmly grasp the MRA business model, he has, in so many ways, lifted the general 'business language' and unleashed a healthy atmosphere of inter-branch and intra-franchise competition throughout the company.

Each general manager works to a personally developed and 'signed-off' business improvement plan rather than a budget. It is the personal duty of each general manager to 'raise the performance bar' and raise it yet again period after period. Volkswagen / Audi franchise Director Hendrik Vermaak has seventeen of his twenty-one (80%) dealerships producing returns greater than the 30% **ROFE** levels required within the group. On his heels is Toyota franchise Director Trevor Herbert and his team. They have eighteen of their twenty-three dealerships (78%) performing at these 'eye-watering' greater-than-30% returns. It is not difficult to imagine how these two franchises go head-to-head month by month. The drive to achieve and exceed key targets prevails both internally (intra-franchise) as well as between franchises (inter-franchise) resulting in an overall drive to make their respective franchises and more importantly their group's results 'stand out' in the industry. The spirit of continuous improvement flows deep through the veins of the organisation and those not yet at the desired levels of performance are vigorously working on structured plans to get where they need to be, causing constant upward pressure on business results. Excuses are frowned upon and general managers are quick to pounce on employees or even on one another whenever unreasonable 'cannot be achieved' reasons are tossed around.

Thanks to Steve Keys and his 'highly charged' team, Bidvest McCarthy Automotive is on an upward trend that is likely to last a long time.

Having grasped the three key concepts as encapsulated in MRA, we can now begin to test the interactive dynamics of using any one of these drivers to affect the other. Experience shows that any action relating to any one of these drivers will invariably impact the other two.

Whatever the current level of returns in your dealership, if you want to improve your position, you need to map out a clear plan of where you want to be, and we refer to this plan as your 'flight path'. If your MRA configuration is lower than 3 × **cof**, there is work to be done. This is challenging because more than anything else, such improvements require dedication, hard work and focus, and planning is the key 'point of difference'.

THE 'FLIGHT PATH' TECHNIQUE

For the purpose of illustration, let us consider a market where the **cof** is at 7.5%. The dealer wishes to improve his return from the mid-teens to the mid-twenties. He decides on this solution as the means of moving from a return of 2 × **cof** to a much safer position of 3 × **cof**. At the time of considering this necessary change, the dealer's 'flight path' in MRA terms might conceivably have been 15.8 × 0.14 × 6.8 = 15.0. One solution would be to re-set the 'flight path' by tweaking each of the key drivers to produce a plan along the lines of 16.4 × 0.2 × 7.6 = 25, which would comfortably place the dealership in the mid-twenties. The more balanced the plan, the more likely the execution will succeed. Balance is assured when all three of the key drivers are given equal attention in the way that they are tweaked. Of course, there are a host of 'flight path' options from which to choose and a solution such as 16 × 0.22 × 7.1 = 25 would be just as balanced and would achieve the same result. It is entirely dependent on what the planning dealer *believes* to be possible. This kind of 'flightpath planning' is flexible and powerful and is a matter of personal choice.

The key lies in first understanding where the dealership stands at a moment in time and then plotting a *believable* path. Experience has shown that '*self-belief*' ranks among the most powerful of motivators for both the visionary as well as the supporting members of the dealership team.

It is all about having a plan to tweak and improve each of the key drivers. When they are each independently under the microscope, there are infinite possibilities to grow your returns impressively, especially given the way the drivers interact with one another. As will be seen, when one variable changes, there is an effect on the others.

At this point, the vital aspect of sustainability also needs to be addressed as the means of instilling some form of constancy in order to remain in your chosen zone of financial return. Each of the three drivers will now require specific focus in order to get your business balanced (M) at 16% TGP or thereabouts, your expenses adequately absorbed (R) at the 80:20 split level or thereabouts and to ensure the atmosphere in the dealership is sufficiently energised (A) to keep the 7.2 or 8 × turn momentum 'on track'.

It is equally important to stress that once the 'flight path' has been laid down, those that develop an *obsession* with achieving and maintaining the target seem to do better than those that focus only from time to time. This obsession, in turn, is easier to develop when specific targets are assigned to each department.

As the dealership finds its rhythm at the desired MRA levels, it becomes easier to play one driver off against the other, and when *this* becomes possible, the magnificence of the financial multiplier emerges. But there are rules associated with getting it right, and, as always, rules require discipline.

This is best illustrated via an example of an anonymous dealership where we are comparing a particular year (2016) with the prior year (2015), only taking the key numbers into account. For ease of calculation, numbers have been rounded up to the nearest hundred:

TABLE 5.1

(Annual Picture)

YEAR	2015	2016	
SALES	$32,366,600	$35,247,200	Revenue growth **8.9%**
TOTAL GROSS PROFIT	$4,790,300	$5,408,300	TGP growth **12.9%**
OPERATING EXPENSES	$3,544,800	$3,792,900	Expense growth **7.0%**
NET PROFIT	$1,245,500	$1,615,400	Profit growth **29.6%**
CURRENT ASSETS	$4,753,800	$5,129,300	Asset growth **7.9%**
MIX	14.8%	15.3%	
RETAINED	0.26	0.30	
ACTIVITY	6.8	6.87	
MRA	**26.2%**	**31.5%**	

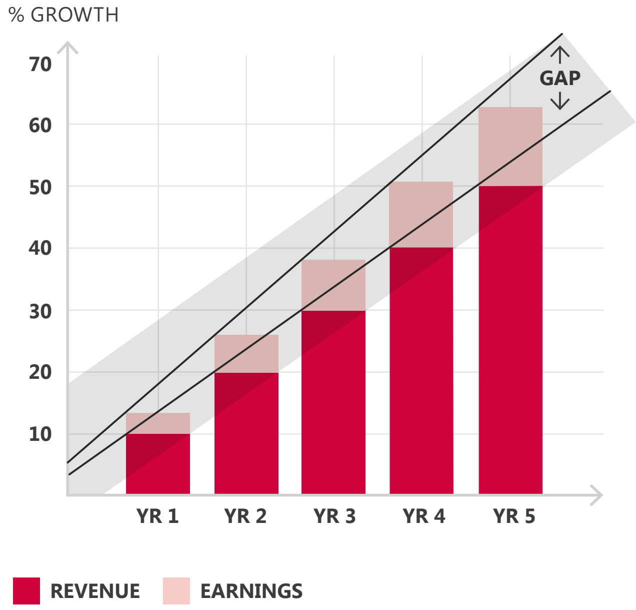
Note that the **return on sales** (**ROS** or **PBT**) ratio has been omitted from the table above. This ratio, so popular among dealers, has been purposely excluded because the PBT is an outcome that can only change if either of the **mix** (M) or the **retained** (R) should change. The variables to drive therefore, are the M and the R. In this case ROS = 4.59% (M × R equates to 15.3 × 0.3 = 4.59). This was an improvement from the prior position of 3.85% ROS (14.8 × 0.26). It is important to note that there is a causal *relationship* between **mix** and **retained** that results in the **ROS** percentage. **ROS** is, therefore, a consequence of any actions that have altered the M and R factors. The **ROS** can never be deliberate, whilst the **mix** and the **retained** should *always* be deliberate areas of focus.

IT ONLY TAKES THE SMALLEST OF 'TWEAKS'

Note also that with the tiniest of tweaks, the MRA or ROGA has improved by 20% because it changed from 26.2% to 31.5%.

It is important to point out that your decision making has been sound when your profits outgrow your *revenue* proportionately. In our case (refer table 5.1) the dealer grew the *revenue* by 8.9% and yet profits grew by 29.6%, which indicates that some seriously good decisions must have been made in the period under review. Steve Keys (Case #5) refers to this gap between revenue change and profit change as the **management gap**. This gap represents precisely what the general manager's job is all about.

THE MANAGEMENT GAP



It is futile to work with the MRA model if the 'multiplier effect' is not pervasive in every decision. Using the key drivers to make decisions is so much more meaningful if the interaction between these key drivers is fully optimised. This results in a widening gap between revenue growth and the growth in profits (earnings). In the graph above, we see the earnings grow at a 4 × greater rate than growth in revenue.

The widening of this gap is easier to understand and apply after gaining an appreciation of the discipline it takes to apply the *rules* involved in bringing this wonderful concept to fruition.

THE RULES OF THE MULTIPLIER

If we use table 5.1 (opposite) as the example, we will see how the changes to the key drivers brought about a positive or a negative multiplier effect on the business results of the dealership.

RULE #1 Make sure you grow gross profit at a faster rate than you grow revenue.

RULE #2 Make sure any growth in expenses is at a lower rate than your growth in gross profit.

RULE #3 Make sure your asset turns are being maintained or even increasing period after period.

The dealer in table 5.1 was disciplined in applying these three rules and the results were extremely impressive. This dealer has achieved a profit growth of 29.6% in a situation where revenue grew at only 8.9%, which has caused a **multiplier effect** on the business result.

Importantly, the easiest way of telling whether there is a positive gain in gross profit percentage is to simply look at the TGP% when comparing period by period. If the TGP% improves from 14.5% to 14.8%, then there has been a positive shift of gross profit relative to sales revenue.

It is worth considering a second example so that we can consider which decisions taken by this much smaller-country dealer were good and which were not good. It should also be noted that, in this case, the financial numbers are expressed as a monthly average rather than the annual picture. This means that in calculating **asset turns** (ACTIVITY) the revenue has to be annualised in order to properly assess the turns so that the ACTIVITY in Table 5.2 below is calculated in the following way: ($2,636,000 × 12) / $4,234,500 = 7.47.

TABLE 5.2

(Monthly Average)

YEAR	2015	2016	
REVENUE	$2,636,000	$2,915,400	Revenue growth **10.6%**
TOTAL GROSS PROFIT	$434,000	$476,500	TGP growth **9.8%**
OPERATING EXPENSES	$415,500	$437,100	Expense growth **5.2%**
NET PROFIT	$18,500	$39,400	Profit growth **112.9%**
CURRENT ASSETS	$4,234,500	$4,611,400	Asset growth **8.9%**
MIX	16.5%	16.3%	
RETAINED	0.043	0.082	
ACTIVITY	7.47	7.59	
MRA	**5.2%**	**10.1%**	

In this case, **gross** has grown at a slower rate than **revenue**, and that is in breach of *Rule #1*. However, there has been such a gain from the lower growth of **expenses** (5.2%) relative to the growth in **gross** (9.8%), and this has had a spectacularly positive **multiplier effect** on the result with profit growth up by 112.9%. This fine example of the effects of the financial multiplier clearly illustrates the interactive dynamic of one factor relative to another. The concentration on gross profit, whether relative to sales or expenses, is of extreme importance.

Remember that an M × R of 14 × 0.25 = 3.5% produces a stronger **ROS** than a combination such as 18 × 0.15 = 2.7%. Always consider the one in relation to the other and aim to improve each of them. By all means, aim to shoot for 18% TGP, but also shoot for the 0.25 (**Split** of 75/25) because 18 × 0.25 would result in 4.5% ROS.

The '**flight path**' technique provides the user with a clear visualisation of the various ways in which a target may or may not be achieved. It enables the ability to scenario plan against a range of possibilities.

In table 5.2, the dealer clearly has much to do in order to achieve 3 × **cof** or more. How about aiming to achieve 16.8 × 0.12 × 7.6 = 15.3% or is this too much of a 'stretch'?

GETTING BACK TO 'IT ONLY TAKES A LITTLE TWEAK'

Let us consider the potential improvements of the picture as depicted in table 5.2 from its present MRA level of 16.34 × 0.082 × 7.59 = 10.1 to an even better level in the year ahead. We could consider a targeted MRA level of 16.8 × 0.12 × 7.6 = 15.3 (3 × **cof**), as proposed in the previous paragraph. To achieve this, it is now merely a question of how to improve TGP from 16.34 to 16.8 whilst also considering how it might be possible to improve the R from 8.2% (0.082) to a level of 12% (0.12) — we can almost afford to leave the A the current value of 7.59.

Because of the interactive dynamic that operates between the key variables, it is worth illustrating how the improvement in the M factor affects the R factor. Had the dealer in question ended the year 2016 at TGP 16.8% rather than 16.3%, the TGP value would have equated to $489,787 — (Revenue × TGP) $ 2,914,500 = 16.8%. When we now deduct the expenses of $437,100, we have a net profit of $52,687 which constitutes a **retained** of 10.8%. This means that the **split** is now 89.2 / 10.8 (0.108) even before we have made any decisions about tweaking the expenses or looking for any more gross profit opportunities.

These small tweaks to M = 16.8 R = 0.12 and A = 7.6 will have the collective effect of improving the MRA result from 10.1% to 15.3% — an improvement in the ROA result by a whopping *fifty percent* (15.3 – 10.1) / 10.1 = 51.5%... Wow!

WHAT WOULD IT TAKE?

From an MRA perspective, the question should be 'can the dealership do better?' By a large measure, the answer to this question resides with the owner or general manager, and what is *believed* to be possible.

If the attitude and mindset are 'we're doing the best we can...', it is often difficult to budge. Our experience has shown that the moment the result is broken down into its constituent parts, these stubborn attitudes are diminished because we now focus on the *key drivers of results* and deal with them independently on a one-by-one basis.

The most effective way of encouraging change is to pose the question 'what would it take?' rather than trying to convince or coerce managers into making these improvements. The open-ended tone of 'what would it take...' is far more likely to evoke a positive response than any attempt at verbal persuasion.

In table 5.1, the MRA equation shows the example dealer to have scored:

15.3 × 0.3 × 6.87 = 31.5

Using a planned '**flight path**' technique for the year ahead, let us assume that a change in management will mean a change in the result. For whatever reason, let us also assume that, by whatever means, the new manager improved the M to 15.8 from its existing level of 15.3. With the improvement in the MIX, try now to estimate the impact this change might have on the R factor.

A quick calculation against the original **revenue (sales)** number of $35,247,200 at a TGP 15.8% = $5,569,057 against *expenses* of $3,792,900 means that the revised profit would be $1,776,157 net profit which equates to a **retained** value of 31.9% (0.319). Assuming there was no further change in assets, the revised MRA would be 15.8 × 0.319 × 6.87 = 34.6% ROA. Again we see that the shift in M has had a significant effect on the **retained** (R) factor and indeed the overall MRA result.

Of course, this example is theoretical, as is any planning initiative, but we should nevertheless see that the control and tweaking of key numbers can bring us to a desired outcome. Let us take this theory in table 5.2 to a planning level for the next year and not be unrealistic with our outlook. We ask 'what would it take?' in planning to grow **revenue** by 7% to tweak gross profit so that it grows by 9% and to keep a tight eye on *expenses* so that they grow no more than 4%. Table 5.3 represents the outcome if we achieved our targets by the end of the 2017 period. We should also keep a tight eye on the assets; let us assume these grow by 4%. The impact on the growth of earnings (*profit*) will of course be impressive. In this case (table 5.2), the application of the rules of the multiplier has caused a growth in sales of 10.6% to convert to a sensational change in *profit* of 112.9%.

TABLE 5.3

(monthly average)

YEAR	2016	2017	
REVENUE	$2,915,400	$3,119,500	Revenue growth **7.0%**
TOTAL GROSS PROFIT	$476,500	$518,385	TGP growth **9.0%**
OPERATING EXPENSES	$437,100	$454,584	Expense growth **4.0%**
NET PROFIT	$39,400	$63,800	Profit growth **61.9%**
CURRENT ASSETS	$4,611,400	$4,611,400	Asset growth **4.0%**
MIX	16.3%	16.6%	
RETAINED	0.082	0.123	
ACTIVITY	7.59	8.12	
MRA	**10.1%**	**16.6%**	

From this, we see a very good example of all rules being applied so that a 7% gain in **revenue** has resulted in a much greater (59.6%) gain in *profit*. The **management gap** is in place and the incredible effects of the multiplier will have been realised.

For those interested, the ROS (PBT) ratio is now M × R = 16.6 × 0.123 = 2.0% (rounded up) — a definite move towards respectability. More importantly though, the key return ROA has improved by greater than 60% from 10.1% to 16.6%, taking it steadily towards the vital 3 × **cof** level.

If you worked through this exercise in your own way and got to the 61.9% improvement in **profit** brought about by whatever changes were necessary, then we say 'well done'!

Most dealers that have experienced **MRA** have been especially surprised at how much small tweaks of the right numbers can impact returns. It is all about putting the focus where it belongs. The multiplier for those that use it in their planning can have potentially 'life-changing' effects for the user.

Ultimately, the objective of the book is to build management skills, particularly relating to *decision-making*. In addition, it serves to create a common business language by exposing readers and others to the successes of fellow dealers that have implemented **MRA** to great effect as a business model or decision-making technique to enhance business results.

WHAT HAPPENS IN A FALLING MARKET?

When markets are changing for the worse, the multiplier can quickly act in reverse, resulting in a devastating effect on business results.

It is every bit as important for the dealer to remain focused and disciplined when things are declining in a market as it is when things are growing. Here is an example (table 5.4) of an undisciplined decline in performance.

TABLE 5.4

When the market is declining and discipline is absent (Annual Picture)

YEAR	2015	2016	
REVENUE	$32,366,600	$30,100,900	Revenue falls by **7.0%**
TOTAL GROSS PROFIT	$4,790,300	$4,359,170	TGP falls by **9.0%**
OPERATING EXPENSES	$3,544,800	$3,403,000	Expenses fall by **4.0%**
NET PROFIT	$1,245,500	$956,170	Profit decline by **23.2%**
CURRENT ASSETS	$4,753,800	$5,129,300	Assets grow by **7.0%**
MIX	14.8%	14.5%	
RETAINED	0.26	0.22	
ACTIVITY	6.8	6.87	
MRA	**26.2%**	**18.6%**	

Here we see that **revenue** has declined by 7.0% while *profits* have declined three times greater by 23.2%. Clearly, something has gone horribly wrong in the decision making, and discipline has clearly not played a role. What we are seeing is the reverse multiplier in operation. This is why decision making for management needs to be so well-considered.

Dealers that express their performance in non-scientific terms, *the artists*, more often derive satisfaction from making a million dollars ($956,170) in any year rather than concerning themselves with ways in which the key percentages are trending. Those that are measuring more scientifically would be distressed at the destruction of value (wealth) in this business. The drop from $1,245,500 to $956,000 is severe. When **revenue** falls by 7% and *profits* fall by almost a quarter, the decisions in the dealership have been appalling. The scientist will undoubtedly express these changes in proportional (percentage) terms, which will far more accurately expose the scale of any change.

Table 5.5 below illustrates what is possible in a declining market when discipline and rules have been astutely applied:

TABLE 5.5

When the market is declining and discipline is applied (annual picture)

YEAR	2015	2016	
REVENUE	$32,366,600	$30,100,938	Revenue falls by **7.0%**
TOTAL GROSS PROFIT	$4,790,300	$4,550,780	TGP falls by **5.0%**
OPERATING EXPENSES	$3,544,800	$3,349,830	Expenses fall by **5.5%**
NET PROFIT	$1,245,500	$1,200.950	Profit decline **3.5%**
CURRENT ASSETS	$4,753,800	$4,991,500	Asset growth **5.0%**
MIX	14.8%	15.1%	
RETAINED	0.26	0.264	
ACTIVITY	6.8	6.03	
MRA	26.2%	24.0%	

Despite a decline of 7% in **sales**, the *profit* has declined a mere 3.5%, clearly showing that good decision making has taken place through this tough period. Remember the tiniest of tweaks to the results could have had a positive effect. Once again, *rules and discipline* make all the difference in a declining market and here are these rules:

RULE #1 When revenue is falling, make sure gross profit falls at a lesser rate.

RULE #2 When gross profit is in decline, make sure expenses decline at a faster rate than the decline in gross profit.

RULE #3 When sales are declining, you need to ensure that your asset turns do not decrease.

THE POWER OF COMPARING PERIOD AGAINST PERIOD

When assessing these key numbers, we need to select an appropriate period such as a month, a quarter, a half-year or full year, and we need also to be consistent in sticking to the period selected so that we are not comparing apples to oranges.

Experience shows that the motivational factors increase when we have something to compare performance against like quarter versus quarter or year versus year. Nothing does this more powerfully than looking at an equivalent prior period.

It is always easier to assess decision making and the application of these rules whilst comparing period against period. Whether it is a monthly, quarterly or annual comparison, you need to compare like-with-like.

Now that we have taken care of the methodology involved, it is time to turn to the style of leadership that brings the most effective results. In this regard, it is the vision of the leader coupled with a strong sense of self-belief that will have the most profound effect.

Chapter Six

INSTITUTIONALISING MRA

In practice, it has been found that those that build MRA into the very fabric of everyday life of the dealership have enjoyed more success in improving their business results over time than those that merely talk about the model.

MANAGEMENT REPORTING

Under the modern day, state-of-the-art conditions, dealer management systems (DMS) have provided for pinpoint daily reporting of all transactions. Those dealers that have embraced MRA have also developed the ability within these systems to ensure that each department has a detailed result including everything that relates to the income and expenditure schedule. Most importantly, though, the report should consolidate all of this into an MRA format for the department manager to have an overview that highlights the impact of changes in the key drivers that have had an effect on the departments' returns.

In the case of groups, most are also ranking their branch operations and benchmarking internally as a means of encouraging each to compare and compete with the best in class within the group.

INCENTIVE PROGRAMMES

There is no finer way of focusing attention than to reward changes in the key drivers wherever they occur. Broadly speaking, people will do what they are paid to do. When the targets for incentives cater for rewards that encourage improvements in the **mix**, enhancements in the **retained** and reductions in asset levels relative to **sales**, they will usually ensure that these key drivers will improve. Whilst there is no doubting the potency of monetary rewards, there are some great examples where travel incentives and study tours have also brought about the desired effect.

MEETING FORMATS

Management meetings and sales meetings should be encouraged to include MRA factors on each agenda. It is critical to monitor these three key drivers to ensure that the entire dealership team is focused on the impact that each of these drivers can potentially have on the business results across the dealership.

TRAINING AND DEVELOPMENT

Wherever the MRA model is incorporated into training and induction programmes, it has been found that the language and implementation of the model are made easier. Many large dealer groups have conducted training sessions for key personnel at all levels throughout their structures as a way of embedding the model into the operational behaviour and language of front line as well as support staff throughout the dealership.

BUSINESS LANGUAGE (DECISION MAKING)

Whenever talking **mix**, well-versed managers are aware that when it thins out, there is a falloff in **quality** and the **balance** of the dealership has been adversely affected. Obviously, the reverse applies when gross profit percentage levels are rising. If this happens, it is often because more time is being spent with precious customers and more products and services are being provided in the sales transactions. Department managers should be encouraged to improve the quality of their products and services. We should be talking more with our personnel about quality and not as much about quantity.

It is far more impactful to discuss the concerns of becoming too skinny with department managers than to simply talk or complain about the TGP% result. This is even more meaningful when one is comparing period with period and thinking deeply about the decisions or actions that have caused these changes. The period-by-period trend should always provoke useful discussions about ways in which more quality can be added into the sales or repair orders.

In the same way, changes in the **retained** percentage, whether positive or negative, have usually been caused by changes in volumes or expense levels. It is extremely important to regularly assess and consider these key measures and to take necessary actions to ensure that they are corrected before they get out of control. Again, it is worth repeating that the higher the levels of **absorption** contribution by the non-new vehicle departments, the more solid the business. Expenses need to be well understood and laid out for scrutiny and comparison against gross profit across all of the key dimensions referred to earlier in this book.

For the most part, **activity** is best measured by controlling stockholding days and sharpening up the collection of receivables (debtors). The lower the level of activity, the more sluggish the dealership is becoming.

Chapter Seven

VISIONARY LEADERSHIP

STEPHAN DELPORT & LES ANDERSON

The auto industry's 2017 'Businessperson of the Year' for large dealers in South Africa is Stephan Delport of Bidvest McCarthy Volkswagen in Arcadia.

Without drilling down into the detail of Stephan's business, we can be assured that his entire team was committed to attaining this spectacular level of achievement by following Stephan's dream in the year just completed.

As the stand-out performer among the Bidvest McCarthy trading operations, Stephan and his team magnificently executed on the *simple yet highly demanding vision of '20/40/10'*. Every key member contributed in the most meaningful way. The contributions from his non-new vehicle departments ensured that his **absorption** exceeded 100%. When adding in the new vehicle contribution, his total gross profit represented 160% of the total operating expenses, and that is why the second part of his vision, the 40% **retained**, was achieved.

Stephan's vision was inspired by his timely grasp of the MRA concept. He is quick to admit that the model enabled him to forge the way to success by harnessing the focus of his key managers on the task ahead.

The *MRA inspired 20/40/10 vision* brought him a return on operating assets in the mid to high seventies, leaving him a fraction short of his dream but with a committed agreement that there is more to come in the year ahead.

Whist others may occasionally obtain this 'eye-watering' level of achievement, the fact that it represented the average level of performance for an entire annual cycle makes the performance of Stephan Delport and his team truly exceptional.

The clarity of his *dream* coupled with an exceptional level of *self-belief* leaves one justified in characterising him as the 'Roger Federer of the automotive retail industry'. Perhaps his training as a used car manager provided him with the balance needed to achieve this wonderful all-round performance

STEPHAN DELPORT

LES ANDERSON

When Les Anderson first learnt about MRA, he immediately pondered the possibility of lifting his very good business result from three times the **cost of funds** rate (18% ROGA) to an even greater return. His business, Anderson's Auto City (Mazda / Holden / Mitsubishi), is situated on the central Queensland coast at the coal-mining port of Gladstone.

In June 2011, Les gathered his management team to get the dealership into pristine condition with a clearly articulated vision spelled out as 'Anderson's Auto City and all who work in the business should look and behave as though we were about to sell the dealership. As such, our people should always be on the front foot and alert, the facility should be sparkling clean at all times, the expense structure and assets should be lean and appropriate.'

Using this 'high energy' vision as the focus point, Les was able to turn the team's attention to his dream of improving returns by tweaking each of the key drivers as reflected in the MRA equation. By March 2012, a mere nine months later, the **mix** at the dealership had improved from 14.3% to 15.6%, the **retained** had enjoyed a positive shift from 19% to 24% and the **activity** had moved from 7.1 to 7.3. Although these might seem like small tweaks, the overall result, $15.6 \times 0.24 \times 7.3 = 27$, had seen the return on assets **ROGA** improve in the short space of nine months from 18% to 27%, representing an exciting improvement of 50%.

Noted author and satirist Jonathan Swift once said 'Vision is the art of seeing things invisible'. The challenge in business it seems, is to ensure that the *purpose* of the leader's vision should become visible to key persons in the company if they are to accept responsibility for turning it all into a well-executed plan. In reality, there are many leaders that do not possess this capability, so frustration takes over with Peter blaming Paul for keeping them in the dark with little or no appreciation of *why* a certain pathway may be more desirable than another.

Those that have *clarity of vision* will know success when it shows up. The rest are just trading on good feelings and relying on external reinforcement to assure them of their greatness. The importance of having a clear vision cannot be over-emphasised. When it is clear, the vision provides direction and reassurance to all involved. Having said this, there are many that have the vision yet lack the ability to execute, and this inability to reach key goals can be very frustrating as many leaders have discovered to their peril. Execution is therefore critical, and a well-scripted vision that is supported by a well thought out plan of execution carries the key to success.

VISION AND MRA

Where MRA is concerned, visionary leadership should be stressed in the most forceful of terms. In this regard, it is always most wise to commence such a vision by spelling out the end goal. Visionary leaders get better results when everyone in the organisation has a clear understanding of the end-goal. This is why so many successful publicly listed companies include teams that understand the need for a particular return and also make it clear to shareholders that investors can expect this level of return (refer Steve Keys page 43). Because of the '**flight path**' planning principle, the MRA model adheres magnificently to this requirement, and having a clear picture of this end-goal is crucial.

Within the outstanding dealers featured in this book, without exception, the vision characteristic was deeply entrenched. Even more impressive was the fact that the vision and goals of these outstanding dealers was mostly in alignment with their life purpose, which naturally creates a high degree of universal harmony in every endeavour. Vision should never be a bunch of framed words hung on a wall with no relationship between business activities and the actual business. The vision should be the bedrock of the business, and the values should be reflective of the persona of the business.

It is obvious that leaders who have defined their purpose are so much more passionate and live more consistent value-based lives.

Employees should not be expected to blindly follow any path, and those that do not challenge strategic change are probably not worthy of a place in the inner circle of the company anyway. Leaders that have clarified their visions with purpose-filled statements have tended to embroil their teams in a more meaningful way, and team commitment in a dealership is critical if plans are to be well executed. The vision needs to be supported by key strategies that in turn are executed through a detailed action plan that clearly shows the responsibilities and timings of each action as outlined in the plan.

In any plan that involves growth or change, it is usually *people* that stand between the decision of a leader and the likely success of its implementation in the real world. It pays, therefore, to stand back and examine the purpose for which the change might be necessary in the first place and to what extent others should be involved in the implementation of any such change. The decision to involve key people is vital, and since auto retail is essentially a people business, there is no good reason to support the alienation of these important people from vital decisions. Each of the cases cited in this book have included concrete examples that support the committed belief that without the involvement of all managers, the exciting levels of growth in each case would not have been possible. The people factor is irrefutable and good leaders bring their key people along for the journey when it comes to making important and often strategic changes.

Whilst the engagement of key people presents less of an argument, what does stand out is the ability of the leader to present a clearly articulated picture of the future. Those who need to participate in any required change need, more than anything, to appreciate the purpose for which the change was conceived in the first place. Here is where one leader may differ markedly from the next. Visionaries seem to count among the minority in all spheres of life, but this rare talent stands out among great business leaders, great sporting coaches, great politicians and sometimes such talent can be discovered at a tender age because it is all about creativity, clarity of thought and a fertile and creative mind that seems to make the principle difference.

However, the successful execution of a vision is by no means confined to the world of business. People young and old have pursued and executed their dreams and goals in the sporting, business and academic arenas because outstanding examples of 'performance based leadership' can even be found at the school level.

Melbourne schoolgirl Tracey Leigh had toiled through her high school years as a member of her school's most perennial 'bottom placed' school house. Year after year, Hensley House seemed to languish behind the rest in almost every event. Tracey had mentioned on several occasions that the house simply lacked spirit.

Without the consultation of any expert, she had visualised that a happier group would perform better, so she lobbied on this basis and was duly elected house captain for her final year at the school. Tracey was not a particularly gifted athlete, but she raised the spirits by participating in everything she possibly could, capitalising on her strengths and making light of her inadequacies. She 'piled in' participating in every event from hockey to the dramatic arts. More importantly though, she re-wrote the lyrics for the house song, encapsulating the key values of 'respect and fun'. In no time, her fellow members of Hensley were loudly singing and even dancing to the groovy rhythm of Aretha Franklin's famed hit. Like never before, Hensley House started winning event after event. Victory became infectious and a mood of self-belief started to prevail.

To the great delight of her fellow house members, at the year-end valedictory service, Hensley was awarded winning house for 2009 — a feat they had not achieved for thirteen years. In the most compelling way, Tracey had shown strong leadership qualities by executing a well-orchestrated and forcefully communicated plan. She had a *vision* that clearly showed that respect, fun and harmonious effort would affect levels of performance with each event, and activity strongly focused on supporting this endeavour.

Tracey had 'unlocked the code' that appears to lie in the ability of the dreamer to engage others in *believing* and converting such dreams into actions that motivate and unify key members of any team and bring measurable improvements.

Yet again, a *dream* supported by a strong sense of *self-belief* had prevailed.

In the same way, the attainment of any 'purpose-filled' goal in business is made infinitely easier when the vision of the leader is clearly understood by those who follow and, more particularly, when each strategy and tactic is calculated to support the vision. At a simplistic level, this means that the leader, having communicated the purpose, should then ensure that every strategy and tactic is thought through and executed in support of that vision.

Whilst mission statements are commonplace in automotive retail, it is seldom that one comes across a clearly articulated *vision* that spells out the reasons for wanting to succeed and grow the business. These *vision* statements are rare, but they do exist and should be encouraged wherever possible. Here are some examples:

The Australian auto market had reached a plateau in the period from 2008 to 2012. Les Anderson (page 56) ascribes his ability to 'grow against the tide' and sustain healthy returns to the fact that he vigorously re-defined his vision in the following way:

> *On a day-by-day basis, Anderson's and all who work in the dealership should look, act and feel as though we were about to be sold. As such, the assets should remain clean and relevant, the personnel should achieve exceptional levels of productivity, customers should rave about our service and the earnings should generate outstanding returns for the capital that is employed in the business.*
>
> *As attractive as AAC may then appear to any potential investor it should equally, produce results for the owners that make it impossible to consider any such offers to sell the business.*

In a lasting way, no message could have been clearer. Les simply wanted his team to perform 'on their toes' and the notion of the potential sale of the business has served to keep the Anderson's Auto City team vital and alert.

SPELLING OUT THE VALUES OF THE DEALERSHIP

When the vision is clear, nothing supports and reinforces the prospect of successful implementation like when the company's values are also made clear. Vision and values are inextricably linked together.

Thought-out values describe the persona of the company. Holistically, if a well-executed plan is to ensue, nothing glues the plan together more than when the vision and values fit together. The more these two aspects align, the greater the chance people will engage and commit to the leader's plans.

Here are some examples of values that have more commonly become essential of dealership operations. These values have been defined to avoid ambiguity:

Integrity

What we think, say and do should be in harmony. All who deal with us should admire our honesty and consistency.

Growth

By encouraging our employees to develop, and by becoming more accountable, they will accept and thrive on the responsibility they have to grow themselves and to grow their business and consequently grow the company's returns.

Transparency

By encouraging open communication at all levels, we will extract the best from our people who should feel eager to contribute their ideas for improving the business.

Ongoing Improvement

By ensuring that we take nothing for granted and constantly challenge our approach, we will be driven by renewed thinking and innovation in all that we do.

Self-belief

The trust we place in our ability to stretch and attain new heights of excellence triggers our level of confidence, our energy and our ability to achieve.

Pride

The attainment of our stated goals enables us to stand tall in all that we say and do.

There are too many examples where these values are spelt out for all to see, but many vision or mission statements are often nothing but mere rhetoric, representing meaningless words. As stated before, values are true when they represent the personality of the business and are lived out every day. Finally, the agreement of realistic goals in the vision are of critical importance and may be represented as follows:

TYPICAL BUSINESS GOALS

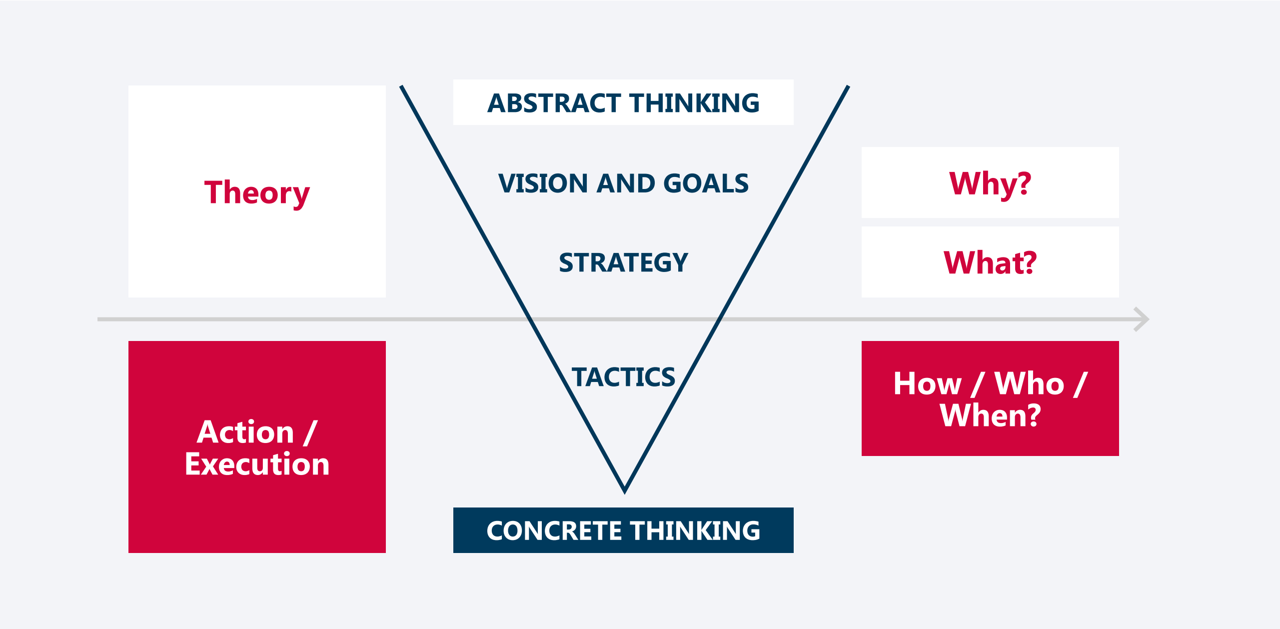
SALES MIX	> 16%
SPLIT	75/25
NET TO SALES (PBT)	> 4%
ASSET ACTIVITY	> 7.5 X TURNS
ROOA (MRA)	30% = 4 X COF
PRODUCTIVITY	> $10,000 GP PER HEAD EMPLOYED

Les Anderson's team (page 56) has further split these goals into departmental objectives, and the performance of the team ever since redefining the vision has been exceptional. It is an inspiring example of what can be done, driven by their value of self-belief. Whilst this works well from task to task, the longer term is more complicated because the vision is more like a dream, and very few leaders share their dreams, mostly because planning is something that many prefer to avoid. It seems that most feel more comfortable 'fighting fires' than developing medium to long-term solutions, which is implied by planning.

There is very little evidence showing that this important principle is followed. Dealers usually operate with the vision buried in some personal chamber that only the dealers themselves can explain. For the rest, the staff come and go with a vague sense of budget goals and other targets that are expected of them.

As such, many dealers seem to operate with a 'blurred' picture of the future, preferring to deal with the immediate aspects of the everyday life in this chaotic industry. This often leads to dealers operating behind the cloak of monthly targets provided by factory principals and choosing to blame others, typically department managers or the factory, for the business' weak performance.

This book shelves any ideas of 'failure to implement' by focusing on successful dealers whose plans have enjoyed sublime execution and whose performance levels have been admirable, generating returns of 30% or more for the capital employed in their dealership.



Let us introduce the 'why / what / how' phenomenon. This relates to the fact that one should never embark on any 'high stakes' endeavour without understanding its purpose. The illustration indicates that vision happens at the higher order of thinking, which is broader, whereas execution happens at a more concrete level of thinking.

This purpose is best clarified by exploring the reasons why it exists. Once this happens, one needs to isolate what the key strategies might be, followed by what tactics to employ. Finally, determine who will carry them out and when. The sequence of a well thought out plan is best indicated by the above illustration.

Prior to being acquired by MSXI, Sewells Group relocated its office from South Africa to Australia in 2006 because of the need to access the key developing markets of China, India and South-East Asia. The auto manufacturers were starting to rely on global suppliers to provide key services and the eastern markets had become crucial. This 'global supplier strategy' posed a grave risk to the longer term of our company if we did not display an ability to support key clients across these global boundaries. Because we had, by that stage, conducted multiple study tours to Europe, America and Australia, we felt very confident that we could 'hold our own' on the global stage. And so it was that our vision of 'going global' in order to thrive and grow served to inspire the key members of the team to make enormous sacrifices in order to '*follow the dream*'.

As a result, and with the encouragement that we would become a global player, we pursued our *vision*, believing in a compelling way that we could grow the business and prosper. In short, the key people on our team saw nothing but opportunity and a brighter future on the horizon.

Once everyone understood the reason why we needed to disrupt our everyday lives, we now needed to know what the key strategies were that needed considering. These included strategies to ensure we found the right people, strategies to ensure we were familiarised with eastern markets and eastern culture, strategies to align our products and services in accordance with the unfamiliar requirements of the Asia Pacific Region and strategies to ensure that family commitments of each key official became paramount. The support (in principle) of key clients, the packaging of our offer, etc. was also important.

Only once these strategies had been discussed and agreed upon did we get down to the tactical level of how each factor would be carried out, followed by who would execute each of them and lastly *when* they would happen. The why / what / how phenomenon was 'set to work' in an astute plan that would stabilise the future of the Sewells Group on a new but solid ground.

The vital importance of aligning strategy with vision cannot be stressed enough. Avoid acting only to keep yourself busy, or you might end up a 'busy fool'. The planning process has to include every vital consideration related to any key project. The dealer cases, as illustrated in this book, have all thrived because their planning has pointed them in this direction. It would be fair to say that the higher the stakes, the more time should be allotted to the execution of the plan. Distractions should be avoided and less relevant activities should be given less attention. Time is, after all, the most precious of all commodities. It is a fact, however, that in so many instances, dealers allow the plan to 'take the back seat'.

Since planning is such a critical part of the business process, the tools as outlined in this book will challenge readers to start dreaming about better results in the future. The capacity for longer-term dreaming is inhibited by the unwillingness to commit to the long-range thinking, mostly because our industry is seen by many as being myopic. The problem is that, unless there is a longer-term vision or dream supported by a deep sense of self-belief and commitment, things are unlikely to improve. People need to know where they are going, and the more employees understand where the company is going, the more strongly they are likely to commit and the more likely they are to perform at their best.

The relationship between well-run dealerships and good *leadership* is profound. The difference between dealers who run at optimum potential levels and those who do not lies in the ability of the *leader* to visualise a goal. Secondary to this is the ability of the *leader* to articulate this vision to the dealership team and engage them in ensuring that the execution is aligned and executed to the letter in alignment with the vision of the leader.

FOCUS

It is important for a dealer to enter this mode of planning and strategizing in a focused way that outweighs natural instincts. Unless the dealership is *obsessed* with the implementation of the plan, it is unlikely that the plan will eventuate. The factory push for market-share is often the determining factor, with many dealers being heavily influenced in their decision making by the weight of opinion of the all-powerful principal...the automaker. Where this is the case, the vision of the dealer is often blurred by other distractions whilst values are often compromised. And yet, this planning ability is a key differentiator in the assessment of exceptional performing dealers versus the rest.

LOCUS OF CONTROL

This intriguing psychological concept examines and describes the extent to which human beings are responsible for their actions in everyday life. In the way that they describe this fascinating phenomenon, one is either driven *internally* and accepts responsibility for one's decisions and actions, whether positive or negative, or *externally*, meaning that everyone else is to blame for what happens in one's life. The externally driven individual seems constantly to be 'dogged' by bad luck whilst the internally driven individual sees mistakes as an opportunity from which to learn and ensure that these mistakes are not repeated.

Discipline too is a matter of whether we are adhering to our 'own rules' or the rules of others. Parenting is no different, and discipline in the household can be either an internal or an external concept. Parents, and for that matter teachers as well, should rather be discussing whether their version of discipline is internally driven or externally driven in their everyday discussions on the subject. In line with the Locus of Control model, the individual will grow when they develop their own good sense of distinguishing right from wrong.

There is a school of thought that claims that true discipline comes with the adherence to self-imposed rules that restrain the individual from losing control over one's emotions. At the very least, ownership seems best achieved when the rules are negotiated between parent and child as well as between manager and subordinate.

In the ideal case, rules should be agreed upon and even negotiated, but once agreed, they should be strictly applied. Here the analogy of a sports referee and his 'yellow or red card' comes to mind. The single biggest differentiator between dealerships lies in the level of discipline from one business to the other.

SELF-BELIEF

Self-belief starts with an attitude of 'I can do better'. It is better than having the attitude, 'I'm doing the best that I can'.

Attitude is overwhelming in its power. Of the many lessons to be learnt in this industry, one of the most powerful is the fact that 'whatever the dealer believes in will happen'. It is a self-fulfilling prophecy. The dealer who believes that service advisors who are female will do better than males will make this happen because he believes it to be the case. The dealer who believes that he will do better by placing the emphasis on retail sales, rather than fleet sales, will show this to be the case. The dealer who believes in Finance and Insurance (F & I) will make this happen.

This willingness to stretch one's own potential relies on the ability of the dealer to influence others to stretch equally. The dealer who never stops believing that there is more to come from the business is the dealer who will never stop improving business results.

As an example, a dealer from Perth had regularly achieved satisfactory results from his F & I department when he decided to elevate his performance and had struck on an idea to motivate his newly married F & I manager. Rather than sit him down to demand an improvement in performance, he invited him to take a ride so that they could have a quiet chat. Naturally the F & I manager was cautious and guarded, but to his surprise, the dealer drove them to the newest developing area in Perth where he posed the question, 'How would you like to own a brand new home in this area?'

By the time they returned to the dealership, they were well into the 'How will we make this possible...?' factors. Suddenly the improvement in penetration and per contract values were easy topics to discuss. One year later, the young man had achieved the bank approval for a 'first time' homeowner's grant and had become the top earning sales person in the dealership. It does not take much when one knows where the 'hot buttons' are located.

Sporting heroes succeed mostly because of their determination to be 'lean and mean', to focus in a very committed way and to constantly raise the performance bar to new heights.

Cadel Evans, winner of the 2011 Tour de France, had lived out his every dream on a bicycle. Seventh in the Sydney Olympics for Mountain Biking, he crystallised his life goals and within the next four years had twice won the world mountain biking title. In 2005, he rode his first Tour de France and in the years 2007 and 2008 finished second to Spaniard Alberto Contador on both occasions. When he suffered a serious fall in the race the following year, most people thought it was over for him, but quitting was not part of his vision. His confidence was lifted in 2010 when he won the world road cycling title. At this point, his mentor, the late Aldo Sassi, had told him that if he could win one of the 'Grande Tours' of Europe, especially the Tour de France, he would be *immortalised* as a cyclist supremo. That was all Evans needed — a compelling dream to follow. In July 2011 he resolved to realise this dream. He signed to ride for a more balanced American team BMC that included veteran George Hincappe and began to put a winning strategy in place. Throughout the race, he was to stay in close touch with the more favoured riders, keeping the ace, the gruelling 'Time Trial', up his sleeve for the final hurdle.

Evans immediately secured his presence by taking second place on the Tour in the second stage and, but for one hiccup at stage 18, maintained a position in the top three throughout the entire Tour. During Stage 18, young Luxembourg superstar Andy Schleck broke from the field and, at the base of the final tortuous climb in the Alps, led by a clear four minutes. Having appealed unsuccessfully to others in a field that included Schleck's brother Franck, none of the riders demonstrated any willingness to take up the chase with Evans. Drawing on his dream of immortality, and with all of the intensity he could muster, he powered ahead, dragging the field up the mountain to reel back two vital minutes from Schleck on the steepest part of the stage. Whilst Andy Schleck went on to win that particular stage, Evans had reclaimed enough time for him to take the leader's yellow jersey at the stage 20 Time Trial, a feat that enabled him to go on and win the Tour and become the supremo he had dreamed about.

In stressing his belief in himself in the winner's enclosure, Evans told reporters at Paris's Arc de Triomphe that it was the step-by-step-plan that had come together with perfection for him and the BMC team. He had changed the attitudes of an entire nation and more Australians would believe in themselves for the future. The dominance of the Europeans had been challenged by Lance Armstrong, considered a freak at the time for his seven consecutive victories, but now there was another non-European. Australians everywhere assembled in crowds at 1:00 am to cheer and celebrate his astounding victory. '...in history's page let every stage advance Australia fair'.

Evans was no overnight sensation. Small in stature, he worked harder than most to become the oldest winner in the post-war era by clearing up and following his dreams to win world titles in three categories.

Without exception, the dealers featured in this book are dreamers who have the long-term as a priority, and their key personnel have been engaged in all future planning. All too often, dealers recruit people and expect them to behave appropriately without ever explaining the meaning of what is and is not appropriate for the business. For many, the idea of sharing financial visions is less easy to articulate, lest the team member should feel that the owner is making too much money. In cases such as this, an obtuseness of purpose among employees might well result in any purposeful dreams in the mind of the dealer being disdainfully regarded. Most of this perception, whether false or real, is dealt with once the employee has a keener appreciation of the need to generate an adequate return for the capital employed in the business.

But most importantly, you need a dream that has a purpose and you need to support this dream with goals and strategies that are exciting and engaging. Unless you reset and visualise your dream to achieve greatness, you run the risk of ending your career in this wonderful industry in the bowels of mediocrity. So why not dream of getting from wherever you may be up to a level of 30% and beyond? Here's the formula:

16.3 × 0.23 × 8.2 = 30 or it might be...

14.8 × 0.26 × 7.8 = 30 or perhaps...

15.3 × 0.26 × 7.5 = 30

or any number of other configuration that achieves the 30% result.

KEEP IT SIMPLE

Try as best you can to simplify your dream target. Here are three different targets to arrive at the same return of greater than 30%. Obviously, you are free to tweak the variables, but you should not compromise the end result... the *dream*.

16 × 0.25 × 8 = >30%

14 × 0.25 × 9 = >30%

12 × 0.3 × 9 = >30%

Or use any other equation that achieves a 30% result. Remember that if you cannot easily enrich your MIX then you need more energy (turns) in the business and so forth.

The most crucial aspect is to decide on the result, in this case 30%. Once this is clear, it is about deciding the '**flight path**' in a way that represents the most sensible way of getting to this result from a **mix**, from a **retained** and from an **activity**.

All the dreamers that we have encountered, especially those that understand and pursue the magic that an MRA culture can bring, reach these goals by a variety of means largely associated with well-devised business plans and strategies. But it needs to be engrained in the psyche of leaders and team members alike. It needs to be *institutionalised* within the organisation.

Remember: if you can dream it, you can do it. Why not start by assessing where you are currently at and taking a decision to move forward. It will only take a few tweaks before the delight of performance improvement sets in.

In July 2017 during his victory speech, when receiving the trophy for his record breaking eighth Wimbledon title, the world's most marketable athlete Roger Federer stressed the importance of *dreaming and believing*... what else is there to say!

MRA is now in your hands. Why not dream about getting to 30% and beyond.
You only have to believe!

Chapter Eight

CONCLUSION

Setting aside the success that so many have enjoyed from implementing the MRA performance model, it is considered important to pause and reflect upon those cases where dealers have been exposed to the model and yet have done nothing to implement it for their own benefit. Sadly, those that have been exposed yet walked away and did nothing to change their ways considerably out-numbers those that have benefited from their decision to implement the MRA model and thereby improve their returns.

In agonising over why this might be, the complexities of habit retention obviously spring to mind. But perhaps also, there are those that find the model complex and difficult to manoeuvre, especially when it comes to the 'slicing and dicing' of key numbers. Seldom is the model's worth repudiated. It seems that, for whatever reasons, the formula causes those that have difficulties with numbers to become embroiled in calculations rather than elevating the thinking above the arithmetic. It is far more important to grasp the principles relating to the impact of the model on planning and decision making than to worry about how a formula is derived.

When the manipulation of financial data is a weakness in the individual and people lack the financial dexterity needed, the barriers tend to flare up. Quite simply, those that thrive under 'what if' type scenario-planning circumstances invariably 'click and go' with a brightness that can be seen in their eyes. On the other hand, those that have difficulty with calculations will tend to succumb to their weakness with a 'what's the use' attitude, whilst the number lovers will eagerly deepen their appreciation of what MRA brings to the planning and decision-making activities in the business.

It has been pleasing to see how this move towards science on the art-versus-science continuum has resulted in the arrival of bright, young individuals in the industry. These new arrivals have suddenly discovered an aspect of automotive retail that provides huge appeal – the using of spreadsheets that bring decision making to life and allowing them to speak with authority whenever poor decision making is indicating worrying trends in the data. Right now, many of the thinking dealers have either hired or are seeking persons with financial and statistical talents that stretch beyond the everyday 'backroom' role that accountants have tended to play until now in the dealership. This should especially be the case when the dealer himself or herself has difficulty with the 'slicing and dicing' of data. In the modern world, investment levels in land, buildings and inventory have become prohibitive to the extent that a finance director, equipped with competent analysts who are proactive and courageous, has become the imperative.

Now the choice is up to you. Do you engage with the key members of your team, agree upon a vision and develop a '**flight path**' to get you to three or four times the **cost of funds (cof)**, or do you simply place this book on the shelf and continue with your life as always?

Given what you now understand, you are encouraged to begin with a crystallised vision that has a quantifiable goal and time-frame. Where are we now versus where do we believe we can get to and how long do we need to get there?

Remember to *dream and believe* in your goal and your plan.

Once you have mapped out your dream and have a clear picture of why the change will be more healthy and sustainable, it is time to embroil the key members of your team. The wording you use in engaging them is key and it is unlikely that devoted members of the team will refute the notion of building 'sustainability' into the business for generations to come, so build the reason on these 'sustainability' grounds. Most will respond well to ensuring that the business is on 'solid ground'. After all, the health and well-being of the business is their job and the notion of the 'management gap' philosophy needs to be firmly instilled in the very psyche of your managers.

It is important to gain the commitment and participation of all departments towards a common goal. Whether the goal be to achieve a comfortable level of **absorption** (90% plus) or to drive the MRA (ROGA) levels to 30% or more, it is critically important to focus in an obsessive way on those actions that will result in the achievement of your dreams and the dreams of your management team. When these are aligned, you will achieve greatness!

Measure the key drivers, set stretch targets to admirably reward exceptional achievers and celebrate achievements at key milestones along the journey. As long as the key drivers are being measured and rewarded, it is far more likely that the performance levels will improve and business results will change for the better.

Great dealers excel because they play the game by hitting the 'sweet spots' of opportunity across each driver. These '*sweet spots*' are represented by a gross profit MIX of 16% or greater, a RETAINED proportion of 25% or more and an overall ACTIVITY of 7 × turns or better, collectively resulting in the deeply sustainable and highly satisfactory *30% or higher* return on operating assets.

Depending on the gap between your own MRA performance and each 'sweet spot', you are encouraged to set a time-frame that can realistically work, given your particular circumstance. Above all, you have to *refrain from making or accepting any excuses* that might rescind the achievement of your goals. Rather ask yourself and the members of your team 'what would it take?'

You now know what to do, so your journey towards the magical '30%' target is in your hands. With the proper focus, MRA should infiltrate your planning, your financial reporting and your reward systems. Hopefully you operate in a world where these important cultural attributes are within the realms of your own control.

If this is indeed so, then the choice to embrace the model is entirely your own!

Finally, in bringing everything together, here are ten important points to remember:

1. **Establish exactly where you are at present before setting fresh MRA goals**
2. **Begin with the end target in sight and build a plan to clarify and support your 'flight path'**
3. **Use the RULES of the financial MULTIPLIER in setting realistic growth targets**
4. **Use the ABSORPTION concept as the means to engaging and committing your managers**
5. **Consider the key decisions to be taken to improve each of the MRA elements independently**
6. **Make the management team accountable for departmental MRA targets**
7. **Build MRA into your monthly reporting**
8. **Implement rewards that encourage improvements in all three of the MRA drivers**
9. **Establish key milestones to analyse and compare your business results whether positive or negative e.g. quarter vs. quarter, half-year vs. half-year, year-end vs. prior year-end**
10. **When changes have occurred period-by-period, consider the causes and plan to correct going forward**

Hopefully now, you have been encouraged to use MRA to guide and direct your decision making in the future. Start dreaming about the twenty to thirty percent returns you have read about because whatever you believe will decisively influence what you ultimately achieve.

You are encouraged to align your 'flight path' with your reality, so whether your target is made up of a 16 x 0.25 x 7.5 vision or a 14 x 0.3 x 8.2 or whatever, is entirely in your own hands.

Become obsessive about your dreams...set the plan and above all... believe!

KEY WORDS AND ACRONYMS

The language used by motor retailers universally takes on a unique form in the sense that key words have evolved to describe relevant key performance indicators. In alphabetical order, the following list covers such words and labels as used throughout the contents of the book.

A

ABSORPTION – *specifically refers to the extent to which the overheads (expenses) in the business are recovered from the contributions of each department. These should ideally be broken down and divided between each department so that everyone has a role to play.*

ABSTRACT – *describes higher level thinking... usually as a thought rather than an idea.*

ACTIVITY – *refers to the sales flowing from the assets employed in the dealership. In particular, this refers to the speed in which cash is converted into stock, which in turn is converted into sales and so on. The higher the activity level in a dealership, the more energy exists in the business. Formula : Annualised Sales divided by Total Current Assets.*

ANCILLARY PRODUCTS – *refers to those products that can be added into the sale after the vehicle has been purchased. These include items such as alarm systems, insurance products etc.*

ASSETS – *these are divided into 'Long Term and Current Assets' in the Balance Sheet of the business. The Total Current Assets (defined below) are particularly relevant because they relate to those assets that have operational relevance in the dealership. Long-term assets such as land and buildings, inter-company loans etc. have nothing to do with the company's effectiveness as a business.*

B

BALANCE – *as described in the book, this relates to the manner in which the dealership is firing on all cylinders, including the pre-owned vehicles, service and parts departments.*

BENCHMARK – *relates to the upper-quartile (top 25%) performance levels in respect to any particular key performance indicator, as compared to others in a particular segment of the market.*

BEST PRACTICE – *relates to procedures or practices that can be regarded as being the best to be found. Sometimes referred to as 'best in class'.*

BULLET PROOFED – *expresses the degree to which the dealership can withstand turbulent changes in the marketplace. It indicates the sustainability of the business. The more reliant a dealership is on new vehicle contributions, the less it is 'bullet-proofed'.*

C

COF – *Cost of Funds relates to the bank lending rate in any market.*

COGS – *Cost of Goods sold describes the acquisition price of the goods or services being sold. In a dealership, this relates to the price paid to acquire cars or parts and in service, the price paid per hour or per day for the technicians.*

COS – *Cost of Sales is yet another way of describing COGS (above). It is one and the same thing.*

CONCRETE – *relates to thinking at the lowest level. One is doing rather than thinking. At this level, people are focused on facts and physical objects.*

Key Definitions

D

DEBTORS – *also referred to as receivables. It relates to monies owed by those customers that have not paid in cash for goods or services provided by the dealership.*

DMS – *is the acronym for Dealer Management Systems, which describes the accounting and computing systems used by dealers to produce financial accounts and other key measurables.*

E

EFFICIENCY – *in the most particular sense in a dealership, this term describes the extent to which a technician converts hours worked to saleable hours. More widely, it also describes the way that personnel across the dealership effectively use time, space and resources available.*

ENERGY – *as used in the book relates to the extent to which operating assets (principally stock) is converted to sales.*

F

FLIGHT PATH – *relates to the manner in which a dealer's plan is mapped out in MRA terms over a period.*

G

GP – *Gross Profit relates to the amount remaining after deducting Cost of Goods from the Sales line in the Profit and Loss (P&L) statement. Gross Profit can also be referred to as the dealer's income.*

I

INSTITUTIONALISING MRA – *relates to the way that reporting systems and remuneration programmes are used to embed MRA within the culture of the business.*

INCREMENTAL SALES – *In a sense, this is the same as the ancillary sales described above. It relates to anything else sold once having concluded the sale of the vehicle. Tow bar and non-factory fitted sun-roofs are typical examples.*

K

KAIZEN – *is a Japanese business philosophy of continuous improvement of working practices and personal levels of efficiency.*

L

LOCUS OF CONTROL – *describes to the extent to which individuals assume responsibility for their actions. One is either internally reliant on one's behaviour or externally reliant, in which case usually others are to blame for one's actions.*

LONG TERM ASSETS – *relate to those assets usually not under the responsibility of the general manager, such as land, buildings, and inter-company loans.*

Key Definitions

M

MANAGEMENT GAP – *relates to the degree to which a manager influences profit growth in relation to revenue growth. If sales grow by ten percent period-by-period and profit grows by fifteen percent, there are some seriously good decisions being made in the business.*

MIX – *relates to the way in which a dealership manager engages contributions from all business units including new vehicles, pre-owned vehicles, service and parts. Collectively these departments make up the business mix. The stronger the contributions from service and parts, the higher the TGP% is likely to be.*

MUDA – *the Japanese term for wasteful or uselessness. It is a key concept in lean process thinking.*

MULTIPLIER EFFECT – *comes about when the growth in profits exceeds the growth in sales. Whenever the rules of the multiplier effect are diligently applied, profit will improve at a greater rate than revenue. The management gap above is reliant on the multiplier effect when executed per the 'rules'.*

N

NPBT – *represents Net Profit Before Taxation and is calculated by deducting the operating expenses from the total gross profit in the business. Otherwise referred to as PBT (Profit Before Taxation) or ROS (Return on Sales) referred to below.*

P

PBT – *Profit Before Taxation – described under NPBT above.*

PRODUCTIVITY – *has a specific meaning in the service workshop and relates to the extent to which hours available are converted to hours worked. More widely though, it relates to the number of units or revenue, or in some cases gross profit generated, relative to the number of staff employed.*

Q

QUALITY – *as used in this book relates specifically to the amount of value added into each transaction. It is decisively indicated in the level of Gross Profit expressed as a percentage (TGP%). The higher the TGP% the more quality in the dealership.*

R

RECEIVABLES – *is the same as Debtors described before. It relates to monies owed by those customers that have not paid in cash for goods or services provided by the dealership.*

REVENUE – *this relates to the sales generated and charged for by the dealership. The sales are reflected on the very top line of the Profit and Loss (P&L) statement. It is otherwise described as Sales or Turnover (refer ahead).*

RETAINED – *relates to that portion of the gross profit remaining after deducting the operating expenses. Ultimately, the amount retained becomes the net profit of the company. It is expressed as a proportion of the TGP in considering the SPLIT of gross profit and indicated as 80:20 or as 75:25*

ROA – *Return on Assets – in the classical accounting sense, this ratio is reflective of all assets in the company's balance sheet. As such, the ROOA (below) is more accurately reflective of MRA, which excludes the long-term assets.*

ROFE – *Return on the Funds Employed is a fairly common way of measuring the effectiveness of the company's return to investors. Simplified, it represents the return on investor funds employed as expressed by dividing annual profits by the operating assets, after deducting externally funded assets.*

ROI – *Return on Investment as used in the book relates more to the attitude of looking for a return on funds invested rather than simply assessing profits made by the dealership.*

ROOA – *Return on Operating Assets – for the purposes of MRA, this ratio refers to the return generated from the operating assets, reflected by the* ***total current assets*** *as indicated in the balance sheet of the company.*

ROS – *Return on Sales is described under PBT earlier. It is calculated by deducting the total operating expenses from the total gross profit in the business in order to get the profit and then dividing this net profit figure by total sales. (PBT / Sales).*

S

SALES – *as relates to revenue above, this represents the sales generated and charged for by the dealership. Sales is shown on the very top line of the Profit and Loss (P&L) statement in the accounts.*

SPLIT – *refers to the division of expense relative to what is retained from the gross profit for net profit. Formula: TGP minus expenses equals net profit. In this book, SPLIT is represented as 75:25 / 80:20 and so on.*

SWEAT THE ASSETS – *this is the term used in accounting parlance to describe the need to reduce operating assets in order to improve returns. People easily relate to the term because it describes the need to shed unnecessary bulk (waste) from the business.*

T

TOTAL CURRENT ASSETS – *relates to the operating assets in the business. These include inventory, receivables and cash in the business with work in process (WIP) also included.*

TURNOVER – *means the same as sales and revenue described above. It relates to those goods and services sold by and charged for, once goods and services have been provided to the customer. Turnover appears on the top line of the dealership Profit and Loss (P&L) statement.*

W

WORK IN PROCESS (WIP) – *refers to the amount of uncompleted jobs in the workshop. For the most part, this relates to those jobs awaiting parts that were either not in stock or may be on back order. High levels of WIP represent inefficient processes in the business and are, therefore, considered undesirable. Referred to by some also as 'work in progress'.*

ABOUT THE AUTHOR

The effect **Paddy O'Brien** has had on automotive retail groups and dealers around the world has been profound. The MRA performance model emerged and grew in his very fertile mind after years and years of consulting to dealers in various parts of the world. These consultations included debates and discussions around what constituted the key drivers of success in an automotive retail operation. Once he had isolated and tested these drivers, it was a matter of putting them all together in what ultimately emerged as the simple yet highly effective equation known as MRA.

Since taking over Sewells Group in South Africa in the eighties, Paddy transformed and grew the company to eventually become an authority source in the area of auto retail financial and performance data and benchmarking across nine countries. His initial establishment of industry benchmarks and dealer comparison groups in South Africa had such a profound impact that he was ultimately acknowledged as Industry Person of the Year in 1999. One year later, he relocated the company to Australia as the means of supporting auto makers to access and establish dealers in the fast-growing Asia Pacific markets. The MRA business performance model was eagerly 'snapped up' and implemented by auto makers and auto retailers alike throughout Australia, New Zealand, China, India, South East Asia, the Middle East and Japan.

More than anything, Paddy's career can be characterised by his extraordinary love for teaching and coaching dealers to think creatively in a 'plan for sustainability' manner, which is why the effects of MRA as his consulting 'tool' became so vital as time went by. Letters of gratitude and celebration have never stopped flowing from his appreciative clients, students and other recipients of his teachings. He has thrived on the measurability of his life's work, and the growth of both his company as well as the business improvement results of his clients speak for themselves.

His factual illustrations and lucid explanation of the workings of MRA, backed by the evidence of real-life business cases that have indicated the impact of the model on business results, has found him presenting at industry conferences across six continents.

In his thirty-five years in the industry, Paddy has influenced or guided thousands of auto industry leaders and managers, particularly in the way that planning and decision making is considered and executed.

Paddy and his wife, Felicity, live in Melbourne, Australia.

"Paddy's laser-like focus, coupled with his charisma and drive to uncover untapped potential is masterful. He has earned the respect of auto dealers around the world simply because he gets it…!"

– ALAN BATEY
EXECUTIVE VICE PRESIDENT & PRESIDENT NORTH AMERICA
GENERAL MOTORS CO

"Paddy is an international authority on the benchmarking of motor vehicle dealerships for financial performance and operational processes. The impact of his work on dealerships around the world has been a significant factor in their profitable performance."

– LEWIS BOOTH
FORMER EXECUTIVE VICE PRESIDENT AND CFO
FORD MOTOR COMPANY

"Paddy O'Brien's MRA model has been instrumental in enhancing the business results of some of our most outstanding Toyota dealers."

– DR JOHAN VAN ZYL
PRESIDENT AND CEO TOYOTA EUROPE, CEO EUROPE REGION
TOYOTA MOTOR CORPORATION

"I spent a day with Paddy O'Brien going through his MRA business model with a select group of our Mercedes Benz business owners. It deeply influenced the way both I and they now view their financial numbers at the retail level."

– NICHOLAS SPEEKS
PRESIDENT & CEO BEIJING
MERCEDES-BENZ SALES, SERVICE COMPANY LIMITED

"For many years Paddy has created great business value for both the Nissan dealers and ourselves as the manufacturer. His approach of using science and data to benchmark, analyze and then improve dealer performance is more relevant now than ever."

– ROEL DE VRIES
CORPORATE VICE PRESIDENT, GLOBAL HEAD OF MARKETING AND BRAND
NISSAN MOTOR CORPORATION