NTDA Dealer Financial Performance Highlights Critical Differences Between Typical and High-Profit Firms

Profit Planning Group conducted a Dealer Financial Performance Survey on behalf of the NTDA in 2018 based on 2017 data. NTDA Member survey participants will soon receive the aggregate survey data report that examines “typical” versus “high-profit,” return on investment, labor costs, asset productivity, and other performance metrics. Below, are some highlights of the report.

The Typical NTDA Dealer

Survey data revealed that the typical NTDA Dealer member participants had 2017 sales of $20,699,904. The typical participant had 37.5 full-time employees in 2017.

High-Profit Versus Typical Profit Dealers

One of the important questions answered by the survey are “What is the typical profitability in the industry” and “How are most firms performing?” These questions are both addressed by Exhibit 1 below.

Exhibit 1
Comparing the Critical Profit Variables

	Typical	High Profit
Performance Results		
Profit Margin (pre-tax)	2.9%	3.9%
Return on Assets	10.7%	14.4%
The Critical Profit Variables		
Sales Change	-3.1%	6.9%
Gross Margin	16.8%	15.7%
Payroll Expense	7.6%	6.9%
Non-Payroll Expenses	5.9%	4.8%

Which of the Critical Profit Variables (CPVs) appear to drive profitability? The above figures present two different measures of profit for the typical NTDA Dealer member and the most profitable Dealer members.

Profit Before Taxes (PBT) % measures pre-tax profit as a percent of revenue. For the typical NTDA Dealer member this figure was 2.9%, while the high-profit firms enjoyed a 3.9% PBT.

Return on Assets (ROA) calculates the same pre-tax profit figure as a percent of the total asset investment in the business. Again, there was a striking difference with the typical firm at 10.7% versus 14.4% for the high-profit firms.

Critical Profit Drivers

The key to moving from typical to high-profit levels of performance is understanding the nature of the CPVs. Namely, which ones are most important and how did they impact performance for the typical and high-profit firms

Sales Growth

There is a common misperception that sales will solve all problems. Sales certainly do help with most problems. However, the ideal level of sales growth is in a fairly narrow range. Excessively slow growth certainly creates profit problems. Interestingly, excessively rapid growth does also.

Slow sales growth means expenses, which tend to be tied closely to inflation, out-pace the rate of growth so expenses as a percent of sales increase. While very few firms believe so, rapid sales growth is also a problem. Financing rapid growth is always a challenge, and operating systems tend to get taxed when growth is too rapid.

The rate of sales growth that allows firms to operate without serious financial challenges depends upon the rate of inflation. The "ideal" rate of growth is the inflation rate plus three to six percentage points. So, if the inflation rate is 2%, then ideal sales growth would be in the 5% to 8% range. This should be viewed as a minimum. Firms may grow faster, but without basic growth, profit improvement is very difficult.

Gross Margin

Price pressures never go away, even if sales are growing. It would seem as sales growth takes hold, firms would enjoy a pricing advantage. The reality is just the opposite. The excitement associated with increasing sales tends to cause firms to become lax regarding pricing control.

In almost every industry an adequate gross margin is a major determinant of profitability. The real driver behind improved, or at least maintained, gross margin performance is continual monitoring. There is not a firm in any industry that could not make a modest improvement in gross margin, even including the high-profit ones.

Gross margin, in turn, is largely a pricing issue. Margin enhancement through pricing changes must involve stretching the price matrix. In simplest terms, distributors tend to be price aggressive on fast-selling items, which they should be. However, they tend to underprice slower selling items. It is a substantial opportunity to raise gross margin. Of even greater consequence, it is payroll-expense free.

Payroll Expenses

Payroll is <u>always</u> the largest expense factor in a dealership or distribution business. As a result, controlling payroll is essential to controlling expenses. Payroll is another area where a specific improvement goal can be established. Ideally, payroll costs should increase by about 2% less than sales. For example, if sales increase by 5%, then payroll should only be allowed to increase by 3%.

At first glance, controlling payroll growth would appear to be a relatively simple and probably easy to achieve target. The reality is a different story. Controlling payroll becomes even more difficult in a growth market. Firms often hire in expectation of even more sales growth. Additionally, the same "eye off of the ball" problem associated with gross margin also takes place regarding payroll.

Non-Payroll Expenses

The non-payroll expenses are the "least difficult" of expenses to control. Most of these expenses can be brought into line provided sales really are rising faster than inflation. The vast majority of these expenses are directly related to the rate of inflation. If sales growth is maintained above the inflation rate, there is the potential to lower the non-payroll expense percentage.

Moving Toward High-Profit Results

High-profit dealerships produce great results virtually every year. They also reflect that there are no industry barriers to success. The key to improved performance is to develop a specific plan for each of the CPVs and combine them in a positive way. The goal is not perfection. The goal is to do a little better across the board. It is an opportunity that is open to every firm.