



Wednesday, July 15, 2007



Why Gross is no Longer King in Used Vehicles Sales

by: Dale Pollak

It never seems to fail; the dealerships that have the most troubled used vehicle departments are also the ones that dealers, GMs and used vehicle managers have what borders on an obsession with making high gross profits on every deal.

It's a completely understandable operating mentality. After all, those of you who grew up in the car business did so believing that if you managed to achieve a high average gross profit on your used vehicles, all the other problems: water in inventory, aged vehicles, wholesale losses, etc., would take care of themselves.

It's also fair to say that there was a reason why this "gross is king" mentality worked well for dealers: They had a somewhat steady supply of buyers who were willing to pay pretty much whatever price was put on the vehicles. If a dealer overpaid to acquire a unit, it wasn't a problem. He'd add the \$2,000 or \$3,000 he overpaid into the asking price and, in time, along came a buyer who'd pay the price for the unit. In some ways, it really didn't even matter what was paid to acquire the unit. Dealers could rest assured that someday the "right" buyer would come along.

So why is it that stores that still apply this "gross is king" mentality to their used vehicle operations are struggling to keep their used vehicle departments afloat today? Why is "water" in used vehicle inventories such a chronic problem across the country?

Both questions can be answered with a simple, but profound statement; gross profit is no longer king in today's used vehicle business. Even though this may seem sacrilegious to some of you, please read on.

For starters, look at how today's buyers are different than those who would willingly step up and pay whatever asking price is put on the vehicle. In those days, buyers didn't have the Internet and its ready-made guide to vehicle selection and pricing. They had to visit a bunch of stores to find the vehicles they wanted and, when they did, chances are they really didn't know how much a vehicle was truly worth. Furthermore, when it came time to do a deal, these buyers often did so with a sense of relief. They could finally put an end to spending their workday evenings and weekends driving to different stores to find a suitable unit. In that scenario, pricing was less important than just bringing the whole shopping process to a close.

Contrast yesterday's buyer with today's Internet-enabled buyer. These days, a buyer can find a wide selection of vehicles and pricing without leaving the comfort of their home. They have ready access to pricing guides telling them how much a vehicle is worth. And, even for those buyers who aren't astute enough to dial into Kelley Blue Book or Edmunds.com to find a price, it takes only a few mouse clicks to compare what one store is asking on a unit versus another.

So what happens when these buyers come across inventory options at a store where the "gross is king" mentality still rules? Here's what happens; they don't even bother giving the inventory a second look because these units are priced too high. Today's buyers are much smarter about used vehicle pricing. If a store is constantly aiming for homerun gross profits on every deal, these buyers can smell it from a mile away. To them, it makes no sense why one unit is priced \$3,000 to \$4,000 when there's another with similar mileage, condition and options readily available.

If you doubt the truth of this theory, take a look at retailers like CarMax. Dealers who compete directly with CarMax are constantly scratching their heads. How is that CarMax can sell a unit, and make a profit, for the same money it takes me to acquire the same car?

When dealers and used vehicle managers ask that question, it's because "gross isn't king" at CarMax stores. In fact, a sales manager at CarMax who did a deal that generated \$3,000 to \$4,000 in gross profits wouldn't get many high-fives

around the sales desk. That deal would probably trigger an inquiry from top-level management. These managers would be asking how the deal happened and what went wrong.

You see, CarMax and other smart used vehicle operators have ditched the “gross is king” mentality because they’ve found a better formula for success in today’s price-transparent and highly competitive used vehicle marketplace. They recognize that they can make more money, and do it more often, if they put their focus on turning units with gross profit averages between \$1,000 and \$2,000.

Who is better off? The dealer who prices a vehicle to yield a \$4,000 gross profit and waits 45 days to (maybe) find a buyer, or the dealer who prices units to yield a \$1,500 gross profit and, as a result, can sell three or four units in the same 45-day window?

In some ways, CarMax and other stores that have given up on the “gross is king” mentality are taking a page from giant retailers like Wal-Mart. If you’ve read anything about founder Sam Walton, you’ll know that he’d likely find our business’ “gross is king” mentality to be close to silly. He’d instantly recognize it for what it is. It is an inefficient, non-market-based pricing strategy that’s really designed to make up for the mistakes we make when we purchase vehicles for the wrong money or fail to pay attention to time-troubled units that end up creating wholesale losses.

Walton would no doubt love the opportunity to compete with most dealers who sell used vehicles and, with the exception of CarMax and other stores that have given up on the “gross is king” mentality, he’d likely eat their lunches, just as his company has done with hundreds of Main Street businesses that cannot compete with his thin-margin inventory purchasing and pricing strategies.

It’s not easy to give up the “gross is king” mentality. However, it’s a necessity in today’s used vehicle marketplace. And, for those of you who think this may be a valid point, I’d encourage you to read my upcoming columns that will show how to ditch this outmoded way of thinking and apply more market- and turn-based approach to all aspects of your used vehicle operation—from acquisition to disposition.

Until then, try a little experiment. Pick out a test group of vehicles you know to be decent sellers in your market. Price and market these units with more reasonable gross profit expectations, say \$1,500 max. Next, pay attention to how these units fare in terms of buyer interest and sales rates compared to similar units with your traditional, “gross is king” markups.

More than likely you’ll find that these test units will generate more leads and sales (assuming you suspend your “gross is king” mentality in negotiations, too). Let me know how you fare.

Dale Pollak is an authority on maximizing dealership profits from pre-owned vehicle operations. Pollak is the founder and chairman of the board of vAuto, Inc. a pre-owned inventory management solutions company.

Source: Dealer Communications, Dealer Pre-Owned E-News, July 2007