



# THE PATH TO PROFITABILITY:

## A Call to Action for All Dealers

Recently, I received a note from a successful dealer stating in part that they've experienced difficulty with appraisals of late. Part of it is that they are stretching so far to make new car deals, they're often putting too much into a trade. His desk managers are really finding a larger disconnect between auction values and what other similar cars with respect to miles and trim are selling for on the Internet.

There is no question that the pain being experienced with respect to appraising vehicles for acquisition and the amount that's necessary to be paid at auction isn't justified when you consider the retail market. I've been speaking incessantly over the past year about the rapid increase in wholesale values without a corresponding retail price increase. The effect is a highly compressed margin environment. There are identifiable reasons for this compression; however, that's another discussion, and it will not likely change in the future. In other words, this is the reality of the current and future retail automotive environment.

Although the industry is struggling to accept this margin compression, it's clear that it is the reality of all efficient markets. Specifically, this reality begins with the recognition that profit margins will be much smaller than they were in the previously inefficient market. This new reality sets up two important questions. First, will there be a race to the bottom, where no one makes any money? Second, if not, who are the winners and losers in such an environment?

With respect to the first question, the answer is no, there will not be a race to the bottom where no one makes any money; in fact, some will make plenty. The support for this position can be found by examining some of the most efficient markets in the world. Such markets include mercantile and commodity exchanges — markets where everyone has access to relevant information with lightening speed. In these markets, there are certainly winners and losers; but to be sure, the profit margins are razor thin.

So who are the winners in these most highly efficient razor-thin margin markets? They are the companies that possess two essential characteristics. The first characteristic is the company's ability to perceive the price at which their products will sell at any given moment and their willingness to offer the products at that price point without delay. The price at which the product will transact at the given moment is called "the equilibrium price."

The second essential characteristic of efficient-market winners is a highly cost-efficient operation. Since the profit margin at the equilibrium price is razor thin, less-efficient operations cannot survive for long at that pricing level. If, and when, too many sellers meet the equilibrium price, the equilibrium price will drop and thereby systematically weed out those sellers with marginally less operational efficiency. Under such circumstances, these sellers will exit the market in favor of more profitable opportunities, which could mean soy beans instead of corn, compacts rather than SUVs, or storage facilities instead of dealerships.

The good news is that, as the less-efficient operations exit in favor of better opportunities, the equilibrium price will then begin to rise. The profits of the most highly efficient operations will soar as a result of their extraordinary efficiency. Once the profits for the most efficient operations climb to a high enough level, the other less-efficient competitors will again return to this sector searching for a share of the profits. At this point, the cycle repeats itself over and over.

The bottom line is that the reality of the ever-more efficient retail automotive market is lower margins. There will, however, certainly be winners and losers. The winners will possess the two essential characteristics of being able to move immediately to the equilibrium price and hang in there until the less efficient are flushed out by the inefficiencies of their operations. This new paradigm for the retail automotive industry

poses challenges at multiple levels.

First and foremost is the industry's culture of pursuing fat margins in favor of moving directly to the equilibrium price. This cultural resistance is presently allowing dealers to significantly improve their market share. Another significant challenge, however, is the restructuring of their businesses to create more efficient operations. Only some of this restructuring can be achieved through conventional cost cutting and expense control. Fixed expenses such as land and facility costs are prime examples of those that can not be easily or quickly reduced.

Because the greatest cost efficiencies, and to be sure the hardest ones to achieve, lie in the dealership's organizational structure and processes, it is now time to take inventory of all the necessary tasks and to eliminate all non-essential ones. This effort requires hard choices to be made between the "nice-to-have" and the "must-have." Moreover, the remaining tasks must be reengineered to achieve effectiveness with lower cost. This, too, will require tough choices involving employees and relationships with outside entities.

The present moment in the industry is one between from where we came and where we are headed. Although there is a growing trend of dealers characterized by this movement who are learning and executing the principles, there are many others who have simply adopted the practice of equilibrium pricing. The consequence for such dealers who are willing to price at or near equilibrium without attaining greater operational efficiency has not yet been realized. Without question, over time this group of dealers will experience results that will cause them to retreat from the market by either reverting to non-equilibrium pricing or pursuing other more attractive investment opportunities.

*Dale Pollak is the founder of vAuto and an author. He can be contacted at 866.867.9620, or by e-mail at [dpollak@autosuccessionline.com](mailto:dpollak@autosuccessionline.com).*

### LEARN THE RULES IN CLASS - NOT IN COURT

Legal Compliance & Harassment Prevention Training Programs that are Convenient & Affordable. Train & Certify Your Entire Staff Online for a Fraction of the Cost of Traditional Programs.

One low price. No monthly fees or maintenance charges.

Your staff can train according to their own schedules & at their own pace, 24/7 anywhere there is computer access.

Prevent Potential Harassment, Discrimination, F&I, Advertising or Other Legal Claims.

Eliminate Exposure to Lawsuits, Regulatory Actions & Negative Publicity. Protect Your Valuable Reputation.

**DEALER COMPLIANCE**  
CONSULTANTS, INC.

[www.DealerComply.com](http://www.DealerComply.com)  
866.627.0915