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DEALERSHIP OF THE FUTURE

A Look At What's Coming Down The Road For Independent Dealers

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FEATURES

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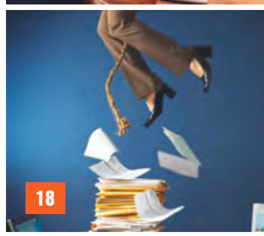

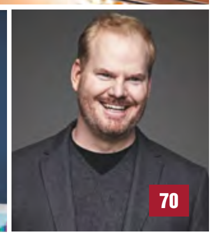

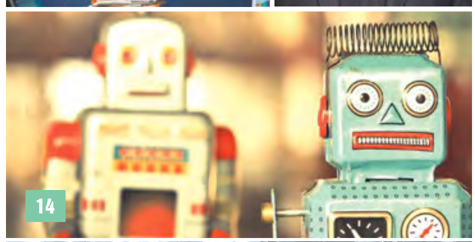

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$ERVICE PAY$

What Does Customer Service Have to Do With CASH FLOW?

Everything, When It Comes to BHPH Operations

By Mike Rizkal

High default rates have inspired some Buy Here-Pay Here dealers to manage cash flow through repossession.

They sell cars and, if necessary, repossess them and sell them again. A customer who fails to pay is seen as an opportunity rather than a liability.

But dealers interested in stronger financial management are choosing a better alternative.

It's called customer service.

Before we go down the road of discussing transient, hard-to-reach clientele, abandoned cars and months of missed payments, let me say that customer service in the Buy Here-Pay Here world means something different than in your average retail scenario.

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The ultimate goal is to secure a longer stream of monthly payments per customer, while realizing some contracts might not get paid in full.

Change Your Service Mindset

It takes time for a dealership operating on the repossession model to develop a focus on customer service.

First of all, the sales process must shift from a focus on getting the car sold to a focus on learning about the customer. Each customer has unique expectations, needs and approaches to problem-solving and communication.

That information will be important if the dealer's mindset is now to keep the customer in a car and to collect payments.

For example, a dealer might explain up front that the customer has a full or limited warranty on any mechanical repairs for a set period of time. That option is designed to keep the dealership in contact with the customer and make small repairs to avoid bigger ones later.

Frequently, a broken-down car equals stopped payments.

Instead, the dealer offers to make repairs, eliminating that common excuse for non-payment and staying in contact with more customers.

Other examples of establishing regular communication and service include offering regular spot checks on the vehicle and letting customers upgrade to a nicer model while keeping payments the same. Dealers can also offer to pick up a vehicle free of charge if it breaks down.

While all the work and expense seem to come from the dealer, the benefit of that extra service is sustaining thousands in payments each month while reducing the need to sell as many cars per month.

Plus, the customer may feel more loyal because of the help provided and could refer friends and family.

Get Your Team on Board

For the customer-centric approach to work, the dealer must get buy-in from the entire team, including reception, the collections staff and the service team.

If, for example, the collections staff is now focused on keeping a customer in a vehicle rather than expecting to repossess it, the communication style has to change. The staff must communicate with customers as soon as a payment is missed, rather than waiting 60 to 90 days to meet the legal requirements for repossession.

Collections staff must be trained to ask more questions when calling about missed payments and to show sympathy by offering solutions. They can ask the customer to come in and make a payment. They can offer a discount if the payment is made within the week. If the car is broken down, they can discuss repair options.

Sometimes it is helpful to review the payment history and the customer's income arrangements to discuss paying ahead when cash flow is healthy, then having a couple weeks or months of no payments when cash flow is thin.

Service technicians must provide a cordial environment to support the customer relationship. Their goal has changed from getting a job done to keeping a customer happy.

Follow a Consistent Strategy

A dealership cannot focus on repossession and also provide good customer service.

A consistent, customer-centric approach looks more like this:

- Review all customers on a weekly basis and identify which are currently behind on payments.
- Contact customers and invite them to the dealership to talk about getting current on payments.
- Offer a list of options that can support up-to-date payments.
- When customers visit the dealership, provide a welcoming experience that demonstrates your interest in keeping the relationship.
- Outline a plan to continue the payment stream.
- Get the vehicle in and inspect it or make repairs.
- Provide a discount.
- Add missed payments or big repairs to

the end of the existing contract.

- Get customers into another vehicle through refinancing.
- Adjust the payment schedule to support changes in circumstances.
- Follow up and stay in contact through in-person visits as much as possible.
- Monitor payment habits and communicate as soon as there is a change.

Once the customer-centric approach is in place and working consistently, dealers can calculate how many customers making regular monthly payments are needed to support a consistent budget and profit margin. That can help dealers plan ahead by creating a fund that can cover customer repairs, service area upgrades or advertising.

That consistent approach can also reduce the required quota of sales per month, which reduces investment in new inventory.

Invest in Better Tools

All dealerships need an effective way of tracking the number of customers they have and the current level of collections. If customers are behind on payments, dealers need to know the level of delinquency to prioritize which accounts need attention first.

Again, the longer a delinquency is left unchecked, the more likely you are to lose that

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customer and default to repossession.

There are several software packages that support dealership efficiency, including but not limited to DealerSocket's AutoStar and FEX, Frazer and Dealer-Mate. The software must be used properly and regularly for a customer-centric approach to succeed.

In a repossession approach, dealers simply wait for delinquency. In a customer-centric approach, dealers must look at reports weekly. They look for signs of changes in payment streams, then communicate with the collections staff, which must reach out to those flagged customers.

Once collections improve, the reports can tell dealers how to improve budgeting, track inventory and monitor related finance company reimbursements (if applicable). The software can be tailored to provide the reports that are most meaningful.

Dealers should be sure to pay attention to a number of the reports and elements of reports.

Inventory listing: This keeps track of cars available for sale. It should include the purchase price at the cost to dealer plus make-ready costs.

Many dealers apply a standard cost to vehicles for making them ready for sale, based on historical trends. Some try to assign exact costs, but the recordkeeping can be cumbersome.

A compromise would be to use the standard cost for most vehicles and add large, specific make-ready expenses if applicable.

The inventory list is also used to reconcile against the lender's floorplan records. While the dealership's profits are primarily earned through interest, maintaining appropriate inventory costs by not overpaying for inventory is still a critical piece for a healthy dealership.

Accounts/notes receivable (dealership's portfolio): Keep track of all open accounts and note those that are past due. This report can also separate the components of the account between the principal balance, current balance, accrued interest, sales tax and discounts – original and current.

Charge-offs: After reviewing the A/R reports, dealers can refer to this report for a list of every account that will no longer be collected. That's useful for year-end reporting, as the IRS may require a Form 1099-C (cancellation of debt) to be issued to those customers.

The penalties for noncompliance are steep, so it's worth it for the dealer to keep accurate records.

Some dealers only move a small portion of their contracts to the full charge-off stage – issuing a 1099-C can drive away a potentially good future customer. If you don't expect (or want) the customer to return, consider a full charge-off.

Cash flow report: This is different from the cash flow statements included in GAAP financial statements.

This is a report from the dealership's sales software that shows the amount received from customers. It separates payments into down payments, interest, principal, sales tax and unearned discount.

Some dealers keep track of their cash flow by the number of open, current accounts.

For example, if they have 100 current accounts paying $400 per month, they know they should be receiving $40,000 per month. That can even be broken down into bi-weekly or weekly, depending on the dealer's needs.

This report also helps track the payments to the actual bank statement and can be reconciled with the monthly expected cash flow receipts from the account/notes receivable report.

Sales tax report: This important compliance-based report keeps track of sales tax due.

In certain states, sales tax is due in full when the car is sold. In others, the sales tax is due as payments are collected. In those states, the sales tax report works in conjunction with the A/R and cash flow report to make sure the dealer is paying sales tax only as monthly payments are received, improving the monthly cash flow.

While all of those reports are very helpful in running a BHPH dealership, it's also important to maintain the company's balance sheet, income statement and statement of cash flows as part of financial statement audits and potential IRS examinations.

Software investment and tracking can pay dividends.

Build in Safeguards for Bad Breaks

Not every customer will respond positively to improved customer service at a BHPH dealership. There will be times when customers take advantage and eventually stop paying and communicating.

Be prepared for a level of default and repossession. Build that expected percentage of defaults into your budget while focusing the majority of your efforts on well-intentioned customers who need the option your dealership offers.

Don't assume it's a customer issue until you explore the situation. If collections start to dip, check in with your collections staff to make sure they are reaching out to customers regularly, assessing the situation and discussing payment options.

At times, you may find collections outreach is inconsistent. That is an internal operations issue, not a customer issue. Check the call logs to determine where and when the communication process is breaking down.

It might also be a matter of how the collections staff is communicating with customers. In that case, you'll need more training around appropriate or scripted conversations that support a positive customer response and cooperation. Collections conversations about repossession are very different than conversations that encourage a customer to get current on payments.

If your staff is unable or unwilling to work in the new model, it might be easier to replace the staff and promote "new management" to encourage more customer interest and communication. That includes anyone who interacts with customers.

The longer you wait to re-educate your staff and get customers talking, the more likely you will lose the payment stream and deal with more repossessions.

Slower collections might also come from a dealer who is not pulling and reading reports every week – or at least biweekly. If the dealer doesn't have the time to pull and review reports regularly, assign a back office team member to pull reports and summarize the findings.

One important factor for achieving regular payment streams is how the payments are set up in the first place.

Customers in BHPH arrangements typically make weekly or biweekly payments, sometimes in person. Payments should be set up according to how the customer gets paid, which is usually weekly or every other week. For some customers, income can change during the year.

It's much easier to handle a collections issue later if you are aware of how the customer gets paid, what could hinder the customer from paying and how you will resolve a cash flow issue on the customer side if and when it happens.

Meet with your accountant every month or quarter to gain insight on reporting and budgeting improvements as well as cash flow projections for the dealership.

Your CPA will not make customer service calls for you or force you to design and read more accurate reports. But he can make sure the software is set up properly to provide up-to-date and helpful reports.

CPAs familiar with BHPH can also identify the information dealers should pay attention to in a customer-centric environment.

Dealers will still have to repossess vehicles at times, even with good customer service. So why make the switch?

The simple answer is that valuation of the dealership is tied to strong collections, a well-performing portfolio and healthy margins. Lenders and investors consider those areas of the operation carefully when deciding to extend credit. At least one investment group we know of required a dealer to switch to the customer-centric approach as a way to improve cash flow.

Mike Rizkal, CPA, *is the audit and assurance partner for Cornwell Jackson's assurance practice and auto dealership segment. Mike uses his real world practical experience to provide consulting and accounting services to Buy Here-Pay Here dealers and managers across North Texas.*