INTERNAL PRICING – THE ETERNAL DEBATE
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Recently I was asked for my input and opinion on an industry forum topic that came up (again) questioning the viability and/or rationale in having all Fixed Operations expenses, those being internal repair orders and parts counter orders, specifically those charged to new and used vehicles departments, performed at dead cost.

When it comes to the topic of providing all Fixed Parts and Services to the showroom at a reduced price, this is not a topic where any statistical or industry perspective should have ANY merit in consideration whatsoever! Dealerships, as much as they may think they do, do not engage in anything even remotely close to "consistent" accounting and operational practices, so any attempt to follow "ideas" based on anyone else's' accounting, or sales, or service practices is like trying to answer the question, "How much is meat?" There are simply too many "other" questions and/or factors to consider.

Now, when I was first asked to provide my input, my initial thought was, "Tell the Used Car Manager to stop whining about reconditioning costs", but I decided to delve a little deeper into some specifics and do my best to be as objective as possible, looking at the issue from all perspectives. All perspectives, that is, as much as a true Fixed Operations guy can....

So, first and foremost - Do not let "discussions" or "supposed" trends within the industry influence your decisions - This is purely and 100% and decision made by any dealership based on their specific situations and beliefs.

Make no mistake, this is a "topic" that comes up constantly, whether on a grand scale (it shows up in a major Industry publication) or on a small scale (everyday "whining" by the Used Car Manager) and there will never be a definitive "right or wrong" way of allocating "Internal pricing", although, like anyone else, I certainly do have my opinion and I will gladly share it.

Let me initially address why this topic constantly comes up:

The reality is that the Service & Parts Departments do have a slight advantage within the industry, as we are able to “change” our prices at a moment’s notice to ensure that we maintain gross profit levels. For example, if we give all of the technicians a $1.00 raise in their hourly rate, we can also change our posted rate to cover that. We have variable labor rate models (grids/matrix) to effectively generate more gross profit on the same sales in both Service & Parts. In Service specifically, we have the ability to reduce the Flat rate hours we pay the technicians without having to reduce the labor sales amounts, effectively giving us an increase in gross profit as well. In Fixed Operations, we have the advantage of charging whatever we want for the services and products we provide, the only limitation is our market.

The other fact to consider is that in Fixed Operations over the years, we have dramatically changed our cost structures, personnel structures, operational conditions, etc to become more efficient and to reduce the expenses making Fixed more profitable today than ever before – This is a FACT, not an Opinion!

Example1: From an industry perspective 20+ years ago, most dealerships had a non-working Shop Foreman (in other words, pure expense), TODAY however, the ‘trend’ is almost a complete 180 – hardly any service departments have any non-working technical staff. If a Shop Foreman was making $70K per year before, NOW, there is a savings of $70K by not having one – SIMPLE Math.

Fixed Operations Managers found a “way” to operate as effectively or even more effectively WITHOUT a Shop Foreman.

Example2: 20+ years ago, we did not charge a separate “Shop Supplies” to cover those expenses, today we do!

Example3: With dealership groups (more common now than 20+ years ago), there are positions like Service Director and Parts Director, who ultimately are responsible for more than one Service and/or Parts Department. This means that the various individual dealerships within the group have effectively “lower-cost” managers in each location than would a stand-alone dealership.

Example4: 30+ years ago, it was "common" for Technicians pay rate to be 50% of the posted rate. Today, no dealership would even consider having a 50% Gross profit on labor – now, 70% is deemed an absolute minimum, and thus, technician rates are more "fixed" than they were 30+ years ago.

Each of these examples represent some of those "changes" in operations within the Fixed Operations that dealers have implemented in an effort to improve efficiencies and lower costs in Service & Parts.

HOWEVER, Showrooms have not really changed their cost structures, personnel structures or operational conditions at all!! Those that have made changes, actually made changes that increased costs, not reduced them.

Example1: 20+ years ago every dealership had a New Car Manager, Used Car Manager & F&I Manager, and, let's assume; averaged 4K front and 2K back. Today, we average half of that amount, yet they still have a New Car Manager, Used Car Manager & F&I Manager. Many dealers have even added the positions of "General Sales Manager" or "Closing Managers, Desk Managers, Floor Managers, and larger Groups typically add Regional or Brand Managers and/or Used Vehicle buyers " to their operation, yet their profit per vehicle, as mentioned, is ½ of what it used to be. Additional management expenses combined with lower grosses – hmmmmm.

Example2: 20+ years ago, sales staff commissions were roughly 25% of the Gross profit. Today those commissions are still at 25% and, to add insult to injury, now the commission has been augmented by the addition of a "spiff", which seems apply to anything and everything – sell an accessory = spiff, sell an extended service contract = spiff, anything sold in the F&I office = spiff. All of these "spiffs" combined with the exact same percentage commission, combined with lower gross profit per vehicle means LESS gross profit in total!

Now, everyone knows that gross profit per unit (front end) has been declining, and has been for 20+ years, but realistically, the showrooms have done absolutely nothing except "whine" about it. They have not made any changes to deal with it. Do they believe that 4K grosses are coming back?

Realize too that in Service, One Manager is responsible for 20+ Administrative, Sales (the Advisors) and Technical staff (a ratio of 1:20). In the Showroom, the ratio of Management to non-management is rarely, if ever, more than 1:5 – That's an awful lot of Management for fewer and fewer sales, at less and less gross profit!

All of this information and these various examples are unfortunately, WHY the topic of "Internal Pricing" constantly comes up. With that being said though, the reality is that this "topic" must be dealt with by Dealers/GMs, so the question then remains of HOW TO deal with them.

Many DP/GM's and of course, New & Used vehicle Managers (collectively "the Showroom") seems to hold the belief that "if" the pricing of Fixed Operations charged to New & Used Vehicles was "lower" than they would actually "make" additional profit in the Showroom.

So let's put that theory through its paces:

Example: Assume a Spoiler installed on an inventory vehicle by Fixed retails (from Fixed) for $400. The "dead cost" of that same installation is $220. The contention on the part of the Showroom will still "sell" that same spoiler to a retail customer at the same $400, thereby allowing the showroom to generate an additional $180 in gross profit per vehicle.

The OPTIMISTIC Response: Making the BIG assumption that the showroom will in fact "make" the additional $180 – the difference here is whether or not that $180 should remain as Fixed Gross or be transferred to Variable Gross – either way; it's ALL Dealership Gross right?

FACT – before ANY Gross is realized by any department, understand that the technician, parts advisor and service advisors have already been paid in that "220 dead cost", so the question becomes how the $180 gross profit would be allocated thereafter if it remains in Service or if it is transferred to the Showroom.

So if that gross remains in Fixed, everyone has already been paid for this except for any Management commission on Total Gross or Total Net. Let's say that Fixed Operations Manager receives no more than 15% of the departmental "net" or "gross", and let's assume the high end and that this spoiler is 100% "commissionable", that would mean that the Fixed Ops Manager will be paid 15% on this $180 – which means he will get: $27 and the remaining $153 goes into the category of: **Overall Dealership NET profit.**

If the gross is transferred to the Showroom, then NOT everyone has been paid – there is a Sales person to get his percentage – as mentioned, typically 25% of the gross, or $45. (We will assume, although unlikely, that there is no "spiff" for this spoiler). Secondly, the Sales Manager gets his "commission" which, like the Fixed Ops Manager is likely no more than 15%, but let's be conservative and say he gets 10%, (Let's also assume, although unlikely, that the there are no other Managers (ie. GSM's who will be getting a "commission" on this amount) and finally, let's go so far to say that this 1 Sales Managers, gets his 10% only on the remaining gross which is $180-45 or $135, so he gets $13.50 in Commissions and the remaining $121.50 goes into the category of: **Overall Dealership NET profit.**

So, with this OPTIMISTIC perspective; the difference to the **OVERALL NET PROFIT** of the Dealership, by simply "shifting" the Gross Profit is that the dealership will actually make $31.50 LESS NET PROFIT.

NOT-SO-OPTIMISTIC Response: In the Showroom, the reality is, unless a customer pays "full retail" or "Sticker Price" for a vehicle, the Showroom "negotiates". Honestly, most negotiation occurs from COST up, NOT Retail Down, therefore, by adding $220 to the cost of the vehicle INSTEAD of $400 (regardless of which department realizes the gross) effectively means that the showroom will not collect that additional $180. If they are not going to collect the additional $180, first, why do they want the discounted internal pricing, and secondly, and more importantly, what is the rationale for this decision?

Now, in all of these examples, we utilized an Accessory as the example, but realistically, this principal is exactly the same whether we utilize used vehicle reconditioning expenses, detailing expenses, etc.

The TRUE question that has to be asked is whether or not the Showroom, if provided with a lower price, will still sell that service or part for the same price that fixed operations does!

1. If they DO NOT Sell at the same RETAIL – then the Dealership is giving up gross profit as a whole.

2. If they DO sell at the same RETAIL – Commission structures need to be reduced in the showroom so that the Dealership still realizes the same gross profit as whole.

3. Also, recognize that as a Dealership, you are taking the commission that was once paid to the Fixed Operations Manager and "transferring" that amount and then some to a Salesperson and a Sales Manager.

Thought: If the showroom did in fact sell the fixed `products` for the same prices as the Fixed Departments do – Why is the "transfer" of gross profit on necessary?

IMPORTANT NOTE: When this topic of "dead-cost" comes up, the Showroom believes that "dead-cost", is really just the technician cost (excluding benefits) and part cost (excluding personnel and inventory expenses), which, as it should be obvious - is not the "true-dead-cost".

Certainly **true dead-cost** has to include facility expenses, as well as the Fixed Operations ever-increasing percentage of office personnel, total dealership maintenance expenses, etc. If these "expenses" are not included in the "dead-cost", then really, aren't you just "making-up" a number out of the blue to charge?

To take this entire theory one step further:

If Fixed Operations is NOT achieving 100% absorption for the dealership, any "reduction" in pricing of anything is simply giving money you don't have away.

If the Fixed Operations is achieving 100%+ absorption – again, why would you give any of it away?

To make a long argument longer, rather than whining about used vehicle reconditioning, which is really what this entire argument is about, Showrooms need to look at ways to improve efficiency and reduce operational expenses in the Showroom, just as we've done (and continually do) in Fixed Operations.

So to spark heated discussion that will actually result in generating more income, rather than shifting it, I've listed a few "Key" points that should be addressed before robbing Peter to pay Paul.

1st – Why do we have so many Sales Managers? If a Service Manager can "manage" 20+ people, certainly a Sales Manager should be able to!

(The Sales Manager will eventually become the GM anyway; shouldn't they gain experience managing more than 5 people?)

2nd – If we make ½ as much per vehicle as we did 20+ years ago, why are we still paying Sales People the same way (and percentage)

3rd – The operational structure of the Sales Department has NEVER changed – maybe it should.

4th – Stop whining about Used Vehicle Reconditioning expenses – If reconditioning charges are constantly higher than you anticipate – shouldn't the individual who made the reconditioning amount assumption be held responsible for his/her mistake? Stop blaming service because a hood wasn't popped by the used car manager during the appraisal.

And for the Used Car Managers - don't try to hang your hat on "we needed to pay that amount to get the deal" either – if a vehicle is worth $5000, and you paid $8000 to "get the deal", who really was the professional automotive salesperson in this kind of situation? YEP – The customer was! (Maybe we should hire the customer to be our Sales person; they obviously know how to get gross!)

5th – Increasing Showroom Gross at the expense of Fixed Gross doesn't generate any ADDITIONAL Gross, stop arguing about which pile it should go in, and go generate MORE gross!

The bottom line, and it is true in both the Fixed Operations departments as well as the Showroom, is that business changes and is changing, and unless we change the way we do business in an effort to GROW the business AS A WHOLE, we accomplish nothing.