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DEALER INSIGHTS

Is now the time?
Passing the baton to your children may be a wise move

Keeping tabs on Mr. Wrench
How to measure your technicians' performance

3 qualified retirement plans you may want to consider

Dealer Digest

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Is now the time?

Passing the baton to your children may be a wise move

Reflecting the downturn in the general economy and especially the automotive industry, the value of many auto dealerships nationwide unfortunately is quite low of late. For this reason — and because interest rates also are low — now may be a good time to transfer your dealership to your children. If dealership values rise again, as many analysts expect them to do, there could be an upside to this down economy after all.

Weigh the advantages

One kind of business transfer that has advantages in the current economy is an installment sale, with payments made to you over a period of years. This often makes sense when the children lack the cash or borrowing power to buy the business outright. With interest rates extremely low and credit hard to come by, installment sales eliminate the need for outside funding, a more important point today than in a bullish economy.

One popular type of intragenerational installment sale is the sale to a "defective trust" that's purposefully drafted (so as to be ignored for income tax purposes), but designed to be effective for estate and gift tax purposes. Gain on the sale isn't subject to tax, and the seller still pays the income tax on the business's income, while future appreciation, above and beyond a normal interest rate, is removed from your estate.

By locking in a low long-term interest rate, your children can be ensured of lower payments in the future while you set plans for the continuity of the business and your own retirement. But keep in mind that, if the current 15% long-term capital gains tax rate isn't extended beyond 2010, an installment sale could have somewhat less favorable income tax consequences.

Shrink estate taxes

To minimize estate taxes, it's ideal for a dealership's owner to receive as little as reasonably possible in the installment sale. So, lower interest rates and a lower sales price are preferable. When market interest rates are low, the minimum tax rate set by the IRS also is lower. The lower the interest rate, the easier it is for the total return (net income plus appreciation in value) from the business to "beat" that interest rate and thus create value for the next generation.

But getting as little as reasonably possible makes sense only if you can afford to do so. It doesn't make sense if you're counting on the fair market value your business would have in a strong economy — along with a higher market rate of interest on the loan — to secure your own retirement future.

Selling the dealership to your children also may be desirable if its value is still high enough in today's market that traditional gifting techniques are insufficient to minimize taxes. In other words, your dealership may be worth more than the amount you can transfer as a tax-free gift, even over a period of years. That's because the dealership's value is high enough to exceed the current lifetime gift tax exemption of $1 million, even when combined with annual exclusion gifts of $13,000 per donee.

Keep the voting stock

A common way of structuring a sale of a dealership to a child is to create voting and nonvoting common stock. You transfer the nonvoting stock and retain the voting stock, which can be transferred to the child at a later date.

This approach allows you to retain control until your son or daughter is ready to fully run the business. It also provides a reason to value the nonvoting stock at a discount for either gift tax purposes or in arriving at a sale price. Even an S corporation is allowed to have both voting and nonvoting stock.

Satisfy the factory

There are two general approaches to accommodating factory concerns about the transfer of ownership to a child. One is to name the child as the *successor* owner in the dealership agreement. This approach gives him or her no current rights and imposes no current obligations on the factory.

Alternatively, the child can be given or sold stock, evidencing his or her new role as owner/dealer. To achieve this type of acknowledgment with the factory, the child must generally own 20% to 25% of the dealership's stock.

A rule of thumb is to inform the manufacturer of any transfer of ownership of 10% or more. Although the factory typically imposes some restrictions on transfers of ownership, it generally won't raise any objections if its rules are followed.

Assign real estate rights carefully

Much of your dealership's value may be found in its location. Dealership real estate is often owned by a separate entity. If that's the case with you, be careful to tie real estate rights to the dealership's transfer.

Some owners transfer the dealership to a child working in the business and the real estate to others who don't. If you take this approach, be sure to protect the child who owns the dealership with a long-term lease and perhaps an option to buy.

Take stock of your choices

If you're considering transferring your dealership to a child (or children) at this time, take stock of your choices. Be sure to weigh the risks against the benefits of such a transaction. Professional advice can help you meet your goals in the most financially advantageous way. ■

Keeping tabs on Mr. Wrench

How to measure your technicians' performance

When your service department is slow, it's more important than ever to make sure your technicians are performing up to par. Do you have procedures in place to ensure accountability? Tracking performance is a must.

Calculating contributions

On the simplest level, you know how much you charge your customers and pay your technicians per labor hour. It's easy to subtract the latter from the former to see whether you're making money on your technicians. Just leave in room for your overhead.

You also can divide a technician's total pay for a particular period by the total hours he or she booked to calculate a labor cost-per-booked-hour figure. You'll likely want to add 15% to 25% onto the total pay to account for benefits.

You can use this figure to compare one technician's contribution to the dealership vs. those of the others. It can give you an idea of who's contributing the most and who's costing the most money.

Creating incentives

Technicians frequently are paid a flat rate based on the actual hours of labor produced, not on the hours they're in the shop. If you don't have an incentive-based pay system like this, it's something you should consider in full or modified form.

One version of a flat-rate plan is a tiered system. For example, technicians may earn $25 per hour for each hour they book up to 30 hours. If the technician books 35 hours, he or she earns $28 per hour. At 40 hours, the hourly rate jumps to $31 per hour.

This rewards the high performers and pushes technicians to complete as much work as possible. But remember to put checks and balances in place so the technicians aren't recommending unnecessary work to fatten their total weekly hour totals.

Guaranteeing wages

Most dealerships also have a weekly guarantee — for example, 30 hours a week. This means that, even if a technician books only 15 hours for the week, he or she will earn wages for 30 hours (30 hours x the technician's regular hourly rate). This helps buffer the technicians' earnings when the shop is slow and there isn't enough work to keep everyone busy.

But if you have technicians who are earning only a guaranteed amount week after week after week, be aware that they're *costing* you money. You need to assess whether to try to improve that technician or trim your service department.

Labor hours and profitability

The number of labor hours your service department needs to produce to be profitable is another useful figure to have at your fingertips. Take these three steps to find out that amount.

1. **Start with the department's expenses.** This should include fixed costs, such as tools and equipment.
2. **Divide by your labor gross profit percentage.** The ratio of gross profit to labor expressed as a percentage is the gross profit percentage. For instance, a dealership collects $1,000 in labor, and the technician is paid $300 (cost of sale) for a gross profit of $700. The ratio of $700/$1,000 expressed as a percentage would be 70%.
3. **Divide by your overall effective labor rate.** Labor sales divided by hours of labor equals your effective labor rate. For example, a dealership collects $1,000 in labor, and the technician produces 15 flat rate hours of labor. The effective labor rate would be $1,000 divided by 15 flat rate hours, or $66.67.

Following these steps will give you the number of labor hours you need to sell. For instance, $60,000 in department expenses ÷ 70% labor gross profit ÷ $66.67 per labor hour = 1,286 flat rate hours.

Judging the comeback ratio

Your star performers may book 50+ hours each week. But if they also have a higher-than-average comeback ratio, they could be costing you more in "free" labor hours to fix problems for dissatisfied customers than their 50-hour weekly average would lead you to believe.

On the other hand, if you have a technician who's solidly booking 40+ hours a week and has a low comeback ratio and other pluses, he or she may be a keeper.

Counting experience and team play

It's perhaps unfair to criticize a six-year technician for underperforming if he or she always is assigned intense diagnostic work instead of straightforward preventive maintenance and repairs. It's no secret that it takes an entry-level technician a minimum of three to five years to achieve journeyman skill levels.

Also consider the technician's interaction with the rest of the crew. Does this person take time to assist other technicians when they're stuck on a diagnostic problem? Will this employee answer questions or offer advice to an apprentice technician voluntarily?

If the answer is "yes," this is someone who enhances your work environment. On the other hand, you may have a technician who's only looking out for No. 1.

Assessing your staff

Tight budgets, close margins and a down-turned economy leave no room for under-achievers in your service department. But simple calculations can help you determine which technicians are pulling their own weight and which are not. ■

3 qualified retirement plans you may want to consider

The recession has caused many dealerships to review the benefits they offer their employees. Although making cuts may be tempting, qualified retirement plans still offer sound advantages such as tax breaks for your business and its employees — and morale and productivity boosts from investing in your workers' well-being and future with your dealership. Here are brief descriptions of three of the most popular qualified plans:

1. 401(k) plan. This is a defined contribution plan — the amount available at retirement isn't guaranteed, but depends on the amount contributed and the performance of the plan's investments. In 2009, employees can contribute pretax up to the lesser of $16,500 ($22,000 if age 50 or older) or 100% or their salary — a greater percentage than they can contribute to other plans.

Your dealership can offer a matching contribution to employees who contribute — or a contribution to all employees, even if they don't contribute. The total combined 2009 contributions for employer and employee are limited to the lesser of $49,000 ($54,500 for employees age 50 or older) or 100% of the employee's salary.

2. Simplified Employee Pension (SEP) IRA. The employer makes all the contributions in this defined contribution plan. For 2009, employers can contribute a maximum of 25% of an employee's eligible compensation or $49,000, whichever is less. Keep in mind that catch-up contributions for employees age 50 or older aren't available. This type of plan often calls for less administration than other plans, and annual contributions aren't required.

3. Savings Incentive Match Plan for Employees (SIMPLE). As the name implies, this defined contribution plan is simple to set up and administer. But it's an option only for businesses with less than 100 employees. For 2009, employees can contribute up to $11,500 ($14,000 if age 50 or older) while employers generally must provide a dollar-for-dollar match of contributions up to 3% of the employee's salary or contribute 2% of salary for each eligible employee, regardless of whether the employee contributes. A SIMPLE can be a good choice for qualifying employers that want to allow employees to make contributions.

Online auctions: An oasis in arid times?

American auto dealers are spending more time online buying vehicles at auction. So claims an executive at Manheim Auto Auction, which recently handled its 3 millionth online vehicle sale since 1996. The Internet now accounts for almost 20% of company sales.

Manheim runs several types of Internet auctions, including a simulcast that lets dealers either bid online or in person for the same vehicles going down a brick-and-mortar auction lane. The company also operates OVE.com, a 24/7 wholesale marketplace for autos that aren't run through actual auction lanes and may be brand-specific for brand-specific dealers.

A new venture, Online Event Sales, features program vehicles being sold by a particular group, such as automakers, car-rental firms and banks. For example, a weekly auction, held by Chase Auto Finance, features up to 800 vehicles.

Reasons for the supposed upsurge in popularity include convenience — the dealership representative saves travel time and money bidding from his or her office rather than at a live auction. Also, dealers pressed for profits are finding bargains on forfeited cars and trucks. And they like drawing from a wider selection than would be found at a local auction facility. Plus, buyers who want a particular make, model, color and features have a better chance of finding what they want. ■

Survey shows execs focused on cost cutting

What strategies are the financial executives of small and midsize companies engaging in to stay in business during this economy?

Cost cutting is a favorite weapon among companies that range from $10 million to $2 billion in annual sales, according to a survey by CFO Research Services, an arm of CFO.com. Nearly three-quarters of the 129 respondents said that reducing nonoperating expenses is more important this year than last year.

Asked to rank the importance of liquidity management activities in view of the changes in the financial markets, the execs chose as their top picks improving working capital processes and forecasting cash flow. They also favored "taking costs out," running lean and efficiently, optimizing working capital and keeping closer tabs on financial performance.

Auto dealerships — many running austerity programs over the last year or so — have cut back on a slew of operating costs (and more) to survive. Some of the biggest money savers? Ordering fewer new vehicles and cutting back on other inventory, consolidating jobs and reducing staff, freezing staffing levels as well as salaries, requiring staff to pay a greater share of health care costs, axing business travel, renegotiating vendor contracts and rental agreements, and cutting out nonessentials — from magazine subscriptions to janitorial contracts. ■

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