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Dealer Digest

6 tips for conjuring service customer loyalty

In the brave new world of customer behavior, a cynic might advise that, if you're looking for loyalty, you'd be better off getting a dog than expecting unconditional devotion from your customers. Nonsense! Although it might take more know-how and creativity to instill customer loyalty nowadays than it did in days gone by, this golden commodity is still obtainable. Here are six ways to conjure up loyalty among your service department patrons:

1. Put someone in charge. Service customer loyalty should be a defined goal. Managers from the department in question are a natural choice to champion a formal program to address this objective. But don't overlook a marketing or general operations manager, either. Whomever you choose, task this person with tracking and improving customer loyalty.

2. Use phone calls to foster relationships. Phone calls are part of dealerships' daily routines. But don't take them for granted — train your service employees to transform humdrum phone calls into relationship-building opportunities. High-quality calls should be the goal, not rushing people through the pipeline. Ask managers to occasionally monitor phone interactions to ensure employees are following protocol and behaving as professionally as possible.

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3. Remember the "personal touch." When customers are in your shop, take advantage of opportunities to "bond" and make positive impressions. Of course, there's the crucial exchange between the service advisor and customer over the work. But don't forget the extras: For example, have service advisors escort customers to the waiting area and offer them a beverage. Or give the customer a ride home.

4. Spruce up your waiting area. Although customers want to get in and out of your shop as quickly as possible, they may have to wait. Make their stay as pleasant as it can be. Consider offering more food or beverage choices than just caffeinated coffee. Install a Wi-Fi connection. Survey customers on their favorite magazines and then stock up on them.

5. Follow up on customer feedback. Does your dealership respond promptly to all of the comments it receives from service department customers? Negative feedback is never enjoyable, but it can be the start of turning bad situations around. Regularly review your Customer Response System to see how comments are being handled.

6. Say "thank you." Tell customers that you appreciate their business, often. If they make an appointment online, follow up with a personalized "thank you" e-mail to show that you noticed. Expand your thank-you campaign to all communications with your dealership — for example, when customers sign up for your dealership's newsletter or request information over the phone or via your website. ■

Employee fraud

How to prevent the "inside job"

Alarming accounts of employee fraud at auto dealerships are, unfortunately, not unusual. Take this case from just this past January: A 58-year-old Iowa man and former dealership office manager was ordered to pay back more than $1.4 million he had embezzled from his employer over a 14-year period. He was sentenced to 41 months in federal prison. As office manager, the man had been able to manipulate the dealership's accounting system, causing money to be wired or deposited in his personal bank account.

Crimes such as this one don't have to happen at your dealership. Aligning financial transactions with strong internal controls will generally thwart employee fraud. Here are some measures you can put in place to prevent the "inside job."

Avoid one-person duties

For any employee position, be sure to separate the duties of authorization, custody and recordkeeping. Ideally, different people should perform each of these functions. In no case should any one person be responsible for all three.

Restrict access to cash to as few people as possible. In the case of cash register drawers, ask your cashiers to count the money before and after their shifts. Clarify that, during the time in between, this money is their sole responsibility — no one else should have access to it. When it's time to deposit the cash, require that two people perform this task.

Review the procedures in your accounting department for dealing with receivables.

Make sure no one person can approve the sale, post it *and* apply the cash. Being able to do so would provide a thief with the opportunity to create fictitious receivables, apply the payment and pocket the money.

For payables, no single person should be able to set up a vendor, post invoices, and then cut, sign and mail the checks. Again, this situation could let a thief set up fictitious vendors and then post and pay fictitious invoices — ultimately to him- or herself or to a co-conspirator. Also establish a strict approval process for new vendors and allow only a few select employees to see vendor files.

Limit access

In your parts department, limit access to the inventory system — especially in terms of receipts, sales and adjustments. If proper controls are in place, a periodic test count of parts will reveal discrepancies, as will complete physical inventories.

From time to time, you might even consider taking a day to open the checks that arrive in the mail.

In the service department, restrict access to override passwords, which will minimize unauthorized discounts to friends and family. Also, regularly monitor open repair orders (ROs) to ensure all open ones are current. Old ROs may indicate service was performed, but was never billed.

Use other safeguards

There are other ways that you, as dealership owner, can discourage theft or dishonesty at all levels. Some of these safeguards involve personnel management.

For example, enforce mandatory vacations of at least one week per year. Doing so allows another worker to perform the job duties of the absent person, possibly uncovering undesirable activity. And periodically rotate the duties of accounting personnel. This can serve the same purpose as requiring vacations.

Also, intermittently review your dealership's vendor list to see whether mysterious providers have materialized. Have your bank statement delivered, unopened and accompanied by that month's canceled checks, directly to you for examination.

From time to time, you might even consider taking a day to open the checks that arrive in the mail. Total the incoming amounts and then compare that figure to what's later deposited.

Set the tone at the top

In addition to having strong internal controls, you can minimize embezzlement by setting "the tone at the top" — management needs to demonstrate a high level of integrity and communicate their beliefs on embezzlement. Employees also should be trained to recognize embezzlement "red flags."

Keep an eye, as well, on workers whose standard of living suddenly seems to increase or who openly show they feel underpaid or undervalued. The latter group is often able to rationalize stealing as a way to make up for what they feel you owe them.

Call in a professional

Be careful, though, of jumping to conclusions about wrongdoing unless you have proof. A forensic accountant or other outside financial professional can examine your books to see whether something seems awry. ■

The ins and outs of earnouts

They can seal the deal, but be sure to think it through

It's one of your worst nightmares: After years of hard work, you're ready to sell the dealership and enjoy your golden years. Your business has been on the market for months, and you finally find a potential buyer. But when it comes to the selling price, you're miles apart — what you think the dealership is worth vs. what the buyer is willing to spend is at odds, and there's no solution in sight.

Don't lose hope yet. Consider adding an earnout provision to the purchase agreement. One of these can help seal the deal in stalled sales negotiations and get you on your way to your life's next chapter.

What is it?

An earnout provision is contractual language that commits the buyer to make additional payments to the seller if the business achieves agreed-upon financial targets after the sale. Sometimes earnouts are called "payouts" or "contingent payments."

Earnout arrangements can be the answer when the seller and the buyer disagree on the purchase price, and the seller believes, simply stated, that the business will do well. An earnout also can be useful when the buyer can't come up with the full purchase price, and the deal will collapse without seller participation.

How does it work?

In an earnout agreement, the seller typically accepts at closing a payment lower than the asking price and maintains an interest in the

How long is long enough?

Three years is generally the longest term covered by an earnout provision. A longer period can subject the seller to greater risk, because it increases the possibility of adverse business events — for example, a new competitor, a consumer credit crunch or a major economic downturn — that are beyond the seller's control.

If a longer period is sought, the seller could consider financing in the form of preferred stock in the dealership or a loan. Both of these alternatives give the seller recourse in case the business is mismanaged and the buyer can't meet his or her financial obligations.

business. As mentioned, if the agreed-upon financial targets are met during a specified period, the seller will receive additional remuneration. Some earnout provisions give the seller the right to claim company assets if the buyer fails to meet the payment schedule.

Say that the owner of an auto dealership is firm with a $2.5 million asking price for his business based on projected earnings. But the buyer is only able to pay or finance $2 million. The two parties could agree on an earnout provision whereby the seller will be paid $1.75 million at closing and receive payments totaling $250,000 over the next three years. These payments would hinge on the dealership achieving, for instance, $20 million in gross annual sales for each of those years.

What are the targets?

A crucial part of an earnout provision is developing the financial targets or milestones. As noted, these will entitle the seller to be paid the balance of the purchase price. Set targets carefully, making sure that your dealership's new owner will likely achieve them.

The targets might involve gross sales, as in the example above, or some other metric, such as the number of new and used retail units sold or gross profit percentages by department. A different metric: A buyer might agree to pay the seller, for instance, 20% of annual earnings that exceed the previous year's earnings by a certain amount. A CPA can help develop or assess ideal targets in an earnout arrangement.

How can you manage risk?

During the life of the agreement, various factors might affect the buyer's ability to meet financial targets. For example, the length of time in which postclosing payments will be made can be a risk factor. (See "How long is long enough?" on page 5.)

Other examples of risk: The new owner might decide to relocate the dealership or take on the costs of an expensive renovation project. If the buyer decides to write off a portion of the move or the renovation project's expenses, the resulting change could lower earnings, causing the seller to lose out on one or more earnout payments.

To guard against this scenario, both parties need to identify any contingencies — the "what ifs" — that could affect the buyer's ability to meet the financial targets. Moreover, they must build in some protection measures so that the seller is adequately paid. Such measures include:

- ❑ Restrictions on owner salary and compensation,
- ❑ Dividend distributions,
- ❑ Ceilings on the amount of capital expenditures allowed per year, or
- ❑ Restrictions on rent increases.

As you can see, a keen understanding of every risk facing the dealership is essential to crafting the right targets and identifying the contingencies to attach to each.

What's acceptable?

An earnout provision can eliminate uncertainty for buyers and provide sellers with additional postclosing payments they might not otherwise receive. But, whether you are the seller or the buyer in such an arrangement, tread carefully. Make sure that the details of the agreement reflect what you're willing to accept. ■

DEALER DIGEST

Tax break still in play for improvements

It's not too late to take advantage of the American Taxpayer Relief Act (ATRA). One tax break that may particularly interest dealers extends accelerated depreciation for *qualified* leasehold retail-improvement property (including ceilings, doors, floor tiles, nonstructural internal walls and security systems) through 2013. More specifically, the provision allows a shortened recovery period of 15 years — rather than 39 years — for such property.

Talk to your tax advisor before year end if you're considering making such investments. Even if you haven't thought about making some physical improvements to your dealership, you may want to while the getting is good. There could be some real tax advantages to sprucing up your surroundings this year in case accelerated depreciation isn't extended to 2014. ■

Same number of stores, but growth in unit sales by 2025?

In a "Dealership of the Future" presentation, auto industry consultant Glenn Mercer recently forecast that the number of U.S. auto dealerships will remain relatively flat in the next 12 years but stores, as a whole, will sell more cars. "By 2025, we'll see more of an evolution than a revolution," he said, predicting that future "throughputs" (or deliveries) will average "well over 1,000 vehicles" per dealership per year. Current per-store throughputs average about 800 units annually, according to industry estimates.

Mercer made the forecast at a March conference sponsored by J.D. Power and Associates and the National Automobile Dealers Association. The conference was held in tandem with the New York International Auto Show.

The consultant also said that dealership showrooms will remain important places to feature and sell vehicles, though consumers will be doing even more car shopping online than they are now. Also, dealerships will build satellite service centers to try to gain more customers, Mercer predicted. ■

C corporations look rosier

Because their income flows through to the owners' tax returns, entities such as partnerships, limited liability companies (LLCs) and S corporations will be indirectly affected by ATRA's changes to ordinary-income tax rates for individuals. For example, if your dealership is an S corporation (the corporate type for many dealerships), you may face the highest rate (39.6%) as an owner. Traditional income and deduction timing strategies may help you minimize the impact or at least defer taxes to 2014.

You also may want to consider converting your business to a C corporation, because the top corporate rate remains at 35%. But there are many other tax and nontax consequences of a conversion, so discuss the impact with your tax advisor and attorney when contemplating such a change. ■