Dealer Profitability

Despite cars being high ticket purchases, it is ironical that the buyer never gets to communicate or meet any employee(s) of the manufacturer. He doesn’t meet the sales manager, the service manager, pose for pictures with the brand ambassador, or even communicate with anyone responsible for customer satisfaction.

In the ideal scenario he doesn’t need to. In fact, the car buyer meeting the regional management of a vehicle manufacturer often means that he has either catastrophic problems with the product quality / service or has won a raffle.

The former is low probability and the latter a miracle.

The customer-OEM interface is actually handled by the dealer.

From a INR 200,000 Nano to a top-of-the-line Mercedes, no matter what you may buy, the dealer is a critical part of the decision making. In 99% of the cases, it is the dealer – the appointed representative of the vehicle manufacturer – who is responsible for providing the front end of the sales & service process. In many a ways, the dealer is the most important part of the value chain as he dictates the experience of a car buyer. For the buyer who has made up his mind, it is the dealer’s job to ensure that he drives off with his car and not a rival’s. For the fence sitting potential customer, it is the dealer’s job to persuade him to jump in as soon as possible.

Dealer Drives Customer Satisfaction

The dealer is the first line of contact between the vehicle manufacturer and the customer. Often how good, or how well-trained a dealer is, is the deciding factor between a happy customer and a whining pain-in-the-ass. After the experience with the actual car, it is the experience with the dealer that becomes the focal talking point when the car buyer communicates about his automobile. After the engine and the gearbox, it is the experience with the dealer that decides positive or negative word-of-mouth. That is the key factor governing success and failure six months after the model has been launched in the market, the first six months having been run purely on euphoria and adrenaline.

Dealers make or break sales. The way a dealer has been trained is a critical factor in deciding the overall sales performance of a car manufacturer. It is not surprising that the largest selling brands – Maruti-Suzuki & Hyundai – also have some of the happiest customers.

At the same time, it is quite surprising that most multinational car manufacturers still struggle at the dealer front as customers often have horror stories to report about them. Many years of presence has given them the time to hone their dealer training and inculcate systems and discipline. However, in many cases the dealers fall short of the customer’s expectations.

Dealerships are Expensive

Every dealer is an entrepreneur. Unlike the services industry where an idea may take you far, setting up a dealership is a high-cost, capital intensive affair. In most cases, the requirement is of land, showroom space, and of a capital commitment of more than a million dollars. The dealer has to set up a full-fledged workshop, a bodyshop and various other facilities. Most manufacturers spell out the number of workshop bays – depending on the sales volume of a dealership

– required to be set up by the principal. This is expensive by any standard and a dealer needs to see a healthy Return on Investment (ROI).

In such a scenario, a manufacturer often has to behave like the promoter of a start-up – convincing every new dealer on the viability of the new business. Considering the large investments required, dealers evaluate business prospects and future manufacturer volumes

And that brings us to what EMMAAA calls the Dealership Expansion Paradox.

As per the Paradox, the smaller manufacturers continue facing challenges in attracting new dealers. Dealers don’t come to them as they are not convinced of the volume and product pipeline. As a result, the volumes continue to stay small. The vicious circle has the potential to continue for many years

Dealership Profitability is Paramount

Considering the huge investments needed to set up a dealership and allied facilities, it is the carmaker’s business responsibility to ensure that its dealers stay profitable. Carmakers compensate dealers for sales performance, meeting & exceeding sales targets and through revenues from service that the dealer is expected to provide. In most cases, the labour charges that the dealer asks for, the margins on components, the accessories that the dealer may sell and the actual profit on selling the car are all decided by the carmaker and is part of the business plan to ensure that the dealers make a healthy ROI.

However, the business plan is made with the assumption that every dealer would sell a certain number of cars. This minimum number is what forms the basis of the dealer’s investment and the OEM’s promise to deliver a certain ROI for the dealer.

So what happens in the time of a downturn when volumes fall below the assumed numbers?

Average Sales per Dealership

We looked at the 2014 sales numbers of every major brand in the country and put it against the number of primary dealer principals they had. This gave us the Average Sales per Dealer, an important snapshot of the health of the dealer's business. These are the average number of cars that an average dealer representing the brand managed to sell in 2014. Needless to say, the higher the number, the more money a dealer is expected to make. Not only that, the higher the volume of cars exiting an average dealer showroom, the higher would be the number of cars returning to the service centre, making more money for the dealer.

Plotting everything on a graph and using EMMAAA's passenger vehicle forecast as a base, we also get an indication on how the situation would be in 2015.

How do the Brands Fare?

Not surprisingly, Maruti-Suzuki leads the pack. However, what did take us by surprise was the sheer volume of cars exiting an average Maruti dealership every year. The volume was heads-and-shoulders and ribs-and-torso above everyone else.

At 3848 units per year, a Maruti dealer principal was outselling the Hyundai dealer principal 2:1. Incidentally, Hyundai was second best in the pecking order going by 2014 numbers.

The situation tilts even more in favour of Maruti-Suzuki dealers in 2015. Going by forecasted numbers, the average Maruti-Suzuki dealer would be selling 3960 units in the year.

Again, this is more than double the volume output from an average Honda dealership, which is likely to sell 1912 units this year.

The sheer volumes that Maruti-Suzuki dealers is a testimony to the brand's popularity. At the same time, the fact that they do so efficiently with high customer satisfaction is a nod to their training.

The high volume of cars exiting Maruti-Suzuki dealerships every year compounded with the huge vehicle parc the brand represents results in a very high volume of cars entering the average service centre in a year. While we do not have an accurate measurement for the service numbers, they would be comfortably above the closest competing brand with a margin of 150%.

In short, Maruti dealers earn a lot of money.

No wonder, ~~most~~ all of them are happy to abide by the brand's unwritten code of conduct which does not allow any dealer to take up the dealership of any other car brand. Not even through a sister concern which is run independently of the Maruti dealership.

Thanks to the high volumes churned out every year, dealers which have stayed with Maruti-Suzuki for a long time have reaped considerable financial benefits. Some have forayed into alternate non-competing businesses like real estate development.

Next in the pecking order were Honda and Hyundai thanks to the generous volumes the brands sold in 2014 and the comparatively limited number of dealerships they have in their network. While Hyundai led in the 2014 average dealer volume at 1918 units, Honda pulls ahead in 2015 with an expected average dealership volume of 1912 units.

Mahindra, Toyota, Tata and Ford were the middle-of-the-pack while Renault and Nissan were below them in the pecking order. Both Renault and Nissan are expected to gain some average dealership volumes due to expected improvement in their overall volumes. Conversely, both are in the midst of an aggressive dealership expansion which may affect the average volumes adversely. However, the quantum of expected expansion in dealer network is a data vacuum for us at this time.

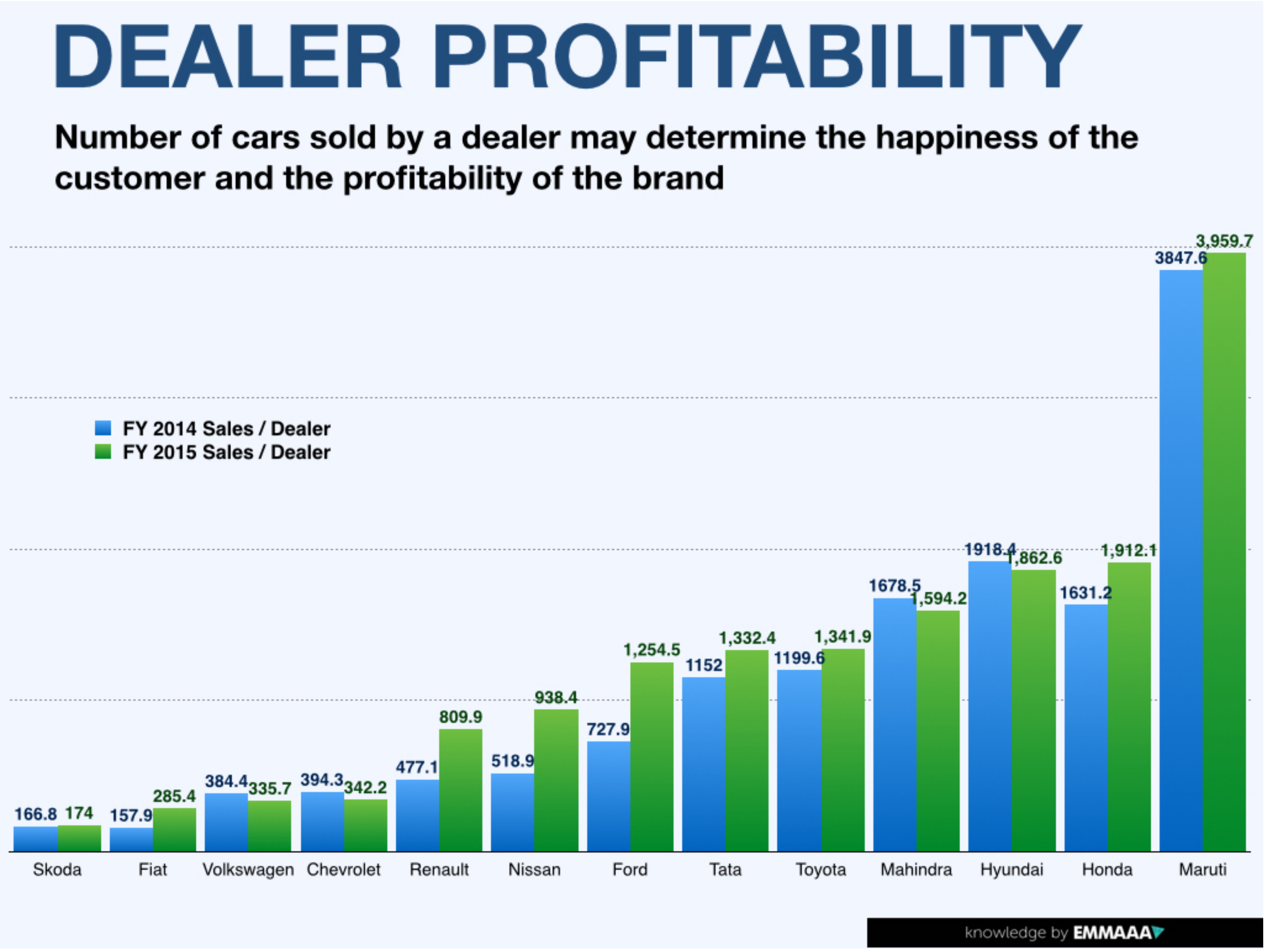
The Backbenchers

The bottom end of the table is made up of Chevrolet, Volkswagen, Fiat and Skoda in that order. All of them have very low average sales per dealer principal numbers and have their own reasons for that.

Chevrolet has been suffering from a drastic fall in volumes as new products have failed to make an impact. The brand counted for 394 units per dealership in 2014, a number which is expected to further decline to 342 units per dealer this year as the brand further loses market share.

Volkswagen dealers averaged 384 units in 2014. The brand is aware of the importance of keeping dealers happy and profitable and has been working on improving the dealer margins on car sales. This is important as Volkswagen volumes are not forecasted to improve in 2015.

Fiat is likely to make significant improvements in average dealership sales in 2015 improving it to 285 units from the 2014 number of 158 units. However, even then Fiat would be amongst the worst placed brands on our measurement criteria.



Skoda occupied the last slot. An average Skoda dealer sold only 167 cars last year. This is a terrible score and Skoda would need to compensate the dealers through high service and component margins. However, the customers face the impact of any such move and they end up dissatisfied.

Skoda realises the problem and the brand is making a focussed effort to reduce the number of dealers it has.

That’s an interesting contrast from any other carmaker as most are focussed on improving their coverage.

Limitations of the study

A dealer’s profitability depends on multiple factors, sales of new cars is just one of them. In limiting the discussion to only average sales per dealer, we exclude several important factors that may have a significant impact on dealer profitability.

The average price of the car is one of them. Car prices dictate the money that the dealer stands to make – a Skoda pays more per car than a Maruti. At the same time, higher car prices do not necessarily mean that the dealer’s ROI will improve. Most OEMs ask dealers to pay upfront for the cars. A higher price of the car may end up in higher inflow for the dealer but the net margins may still stay the same.

The service side of the business is arguably the bigger money spinner for the dealer. Our study does not cover that as getting a good estimate of service margins for dealers is a ~~full-fledged consulting project~~ difficult exercise. However, the average sales per dealership is a good indicator of the volume of cars that are likely to come to the dealership for servicing.

Another grey area is the sales data itself. The data we have used also includes sales of micro trucks and light commercial vehicles. Both Tata and Mahindra have commercial vehicles in their range. In both cases, there are dealers which sell only passenger vehicles, some that sell only commercial vehicles and some which do both. It is not possible to identify the number of dealers under each category. The inclusion of commercial vehicles to the mix is the reason why Tata Motors ranks quite high in our study despite dismal passenger vehicle sales volumes last year.