

Benchmarking the Best: How Top Dealers Compare Their Performance

A common misperception among dealers is that revenue and/or gross profit are the key to profitability. Many believe that their main focus should be on increased sales and deriving higher gross margins from those sales. We respectfully disagree.

Over the years in many dealerships, we've seen the results of dealers who have benchmarked themselves against the best of their peers. The profitability improvements of the best dealers demonstrate that expense control is the main driver of improved profitability.

This is not to say that revenue and gross profit are not important — only that expense control is the most important.

In this issue of the "Planning for Profits" series, we'll discuss why and how to benchmark your dealership's performance against the best, and why a defined cost structure and strong financial discipline leads to higher profitability.

Why & How to Benchmark

Are you creating value in your business? How do you know for sure? By comparing your business against the best, you can be assured that your dealership is creating value — and if isn't, how you can do so.

One very successful entrepreneur and owner of many private small businesses, Rob Slee of MidasNation, says that only 5% of private business owners actually create value. His experience, like ours, says that the other 95% can learn how to improve their business like the 5% that can show that they are creating value.

Benchmarking is both a measurement of the numeric gap against the best ("How Much") and a tool for improving performance ("How").

Benchmarking can also show what areas you need to focus on and how to improve them.

This knowledge means that you can communicate with and direct your people to the most significant added-value activities. It also means that you can and should track those specific activities that create the most value.

The most direct way to benchmark is to compare your financial performance to other high-performing ag equipment dealerships. Some full-line manufacturers publish summaries of the financial ratios of their dealerships annually.

The best of these analyses include comparisons to averages, as well as to the top-performing dealers by region. Another source of comparison is the North American Equipment Dealers' Assn.'s (NAEDA) *Cost of Doing Business Survey*, which is prepared by the Southwest Assn.

The best way to effectively benchmark is to participate in a best practices dealer peer group, such as NAEDA's Dealer 20 Groups.

There are also consulting firms that specialize in facilitating farm and construction equipment dealer groups. Some even mix in dealers from different industries. In most cases, the vendor provides a comparison of financial performance to averages or composites of the other dealers in the group. Some facilitators also compare against the best-performing dealers in the industry in

order to "stretch" the performance gaps and achieve higher results.

Improving Expense Control

Benchmarking the "best" demonstrates that expense control is the most important factor in improving overall profitability.

We say this because of our experience with dealers across several different industries, and with dealer best-practices groups in the farm and construction equipment industries. Time and time again, we find that the best-performing dealers have at least two things in common:

1. A well-defined cost structure for their business.
2. A disciplined process of managing and comparing costs against budget.

The most profitable dealers regularly compare — or benchmark — their actual performance against a target that is established by the performance of the best dealers in the industry or in a similar industry.

In addition to sales mix, the targets are ratios that are independent of size of the businesses. For setting targets that are actionable, each department should have a benchmark target for gross margin, cost structure (further broken down into personnel, operating and occupancy expenses) and operating or department profit.

We find the factors that are most important for success by analyzing individual targets vs. actual results for the whole dealership and for each department.

Our "Benchmarking the Best" analysis compares key summary numbers to support our conclusions

about the importance of expense control: 1. gross margin, 2. expenses and 3. overall performance (based on net profit before tax as a percent of revenue).

The top 10% of dealers in terms of financial performance have on average an operating profit slightly higher than the target. For these "best" dealers, gross margin vs. the target is almost 1.5% less than expected, but total expenses were 1.7% less than the set target.

With this in mind, it's apparent that controlling expenses, not higher revenue or margins, contributes most to the higher profitability.

Analyzing two other groups of dealers, as well as our experience in many best practices groups over the years reinforces this conclusion.

The top 25% dealers show a similar performance trend as the top 10%. The top 25% group is actually closer to the target gross margin

than the top 10% group, missing it by 1.1% vs. 1.4% for the top 10 group. But the best-performing 25% overspent by about 0.5% compared to the target and ended up missing their operating profit target by 1.5%. Keep in mind that the top 10% actually underspent vs. their target.

The poorest-performing dealers missed their gross margin by nearly 2%, but more importantly, exceeded expense targets by more than 6%. The end result is a big loss on the operating profit line.

An important point here is that, even without any margin improvement, the worst-performing dealers could at least be profitable if they were to keep within the target expense range.

'Benchmark the Best' Now

The value of benchmarking and of expense control should be obvious. Early in the year is a good time to

set targets for your business. As with any change of behavior and practice, it will take time to implement. We encourage dealers to set benchmark targets and compare them to monthly goals. Many of the best dealers take it even further by establishing weekly or even daily activity goals.

Finally, we encourage dealers to learn by watching and interacting with successful dealers. A good way to do this is to join a best-practices group if you aren't already doing so. There are many good choices to consider. Make this one of your goals for this year. **FE**

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