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# DEALER INSIGHTS



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Dealer Digest

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# Revisiting what made CarMax big

Its strategies can work for you, too

When CarMax entered the arena two decades ago, traditional auto dealers cringed at its no-haggle sales approach and “big-box” retail strategy. Now that the megaretailer has survived the recession and passed the 100-store mark, let’s re-examine what vaulted the company from start-up to retail giant — and which of its strategies might benefit your dealership.

## Listening to customers

Original parent company Circuit City Stores funded CarMax in 1991 when its founders hatched the concept of selling “like new” used cars en masse. The two began fleshing out a business plan after surveying car buyers about their shopping experience and finding they had more “dislikes” than “likes.” The often drawn-out haggling process over vehicle price was at the top of the customers’ “dislike” list.

CarMax’s first used car lot opened in 1993 and offered customers vehicles at a fixed price. From then on, growth was steady. A portion of CarMax went public in 1997, it recorded its first annual profit in 1999 and it spun off from Circuit City in 2002. That year the company began operating “superstores” stocking about 500 used cars no more than six model years old. And CarMax reported 2011 fiscal-year net earnings of \$381 million, an increase of 35% over its record results in 2010.

## Pricing without haggling

Numerous studies have shown that many car buyers, especially women, prefer no-haggle pricing. The concept has paid off for CarMax, and other retail giants have followed suit.



For example, AutoNation, the nation’s largest auto dealer, recently expanded its no-haggle Value Vehicle Outlets that specialize in low-price (older) cars. The outlets are part of existing locations but have their own section on the lot and separate signage.

Some auto retailers also argue that it’s easier to find good salespeople when you eliminate the qualification that they be ace negotiators. And sales managers reportedly benefit from a negotiation-free sales environment because it frees them from “desking deals” and allows more time for coaching sales consultants and managing other aspects of the sales process, such as inventory, pricing and lead follow-up.

But no-haggle pricing hasn’t been right for everyone. The CEO of the Lithia chain said during a 2010 interview that no-haggle failed as an overall marketing strategy for his company. Nevertheless, fewer than one-half of Lithia’s customers negotiate their purchases because “the [no-haggle] principle is still in force,” he said. The company trains sales managers to discourage negotiations, particularly during used car sales.

If you want to consider adopting a partial or full no-haggle pricing system at your dealership, be sure to consider the following:

- ❑ Your customer base and demographics — how will current and potential customers respond to the switch?
- ❑ Pay plans for your sales staff — how will the plans need to change?
- ❑ Local competition — is anyone else offering this pricing structure?
- ❑ Level of gross profit you'll accept — it's likely to be less per vehicle and more dependent on volume, and
- ❑ Purchasing and trade-in practices — will you use higher used-vehicle trade-in values as a method to sell more new vehicles?

These are complex questions with no easy answers. You'll want to analyze each of these areas closely before making a decision.

## Aiming to please

CarMax began its journey by giving customers what they said they wanted — not only no-haggle pricing but also an upbeat shopping environment and good selection and prices — and it has held tight to its goal.

In 2005, for example, the company learned that 78% of car purchasers suffered from buyer's remorse and wished they could return a vehicle shortly after buying it. CarMax implemented a money-back guarantee for the first five days after a purchase.

Your dealership can apply customer-centric strategies, too. Survey your customers regularly on how you're doing in all areas of your business. Then implement action plans to clear up any false perceptions and to make changes to your operations in response to any negative perceptions that are true.

## Forging ahead online

One key CarMax initiative for fiscal 2012 is to give customers more online abilities before going into a store. That will include setting up an appointment with a sales consultant, starting paperwork and putting a car on hold — all from the comfort of home.

You, too, can make sure that your dealership's website is shopper-friendly, online inventories are updated and Internet inquiries are responded to within 24 hours or less.

## Not for everyone

One-price selling isn't the preferred pricing structure for all dealerships that sell new or used cars. But making the shopping process easier and generally better for the customer — "what car buying should be" — both on-site and online is likely to kick up any store's sales. ■

## Pleasing employees, too

One part of CarMax's success connects to the satisfaction level of its estimated 13,000 employees. In 2011, FORTUNE magazine cited CarMax as one of the "100 best companies to work for" for the seventh consecutive year.

The company's top executives cited a positive and rewarding workplace as the reason behind the distinction. Corporate benefits are competitive and wide-ranging and include, for example, a tuition-assistance program, an adoption benefit and health insurance for domestic partners.

It may be impossible for a local or regional dealership to offer a benefit plan like the one that CarMax offers its employees, mainly because of the dollars involved. But there are many other ways to boost employee loyalty and satisfaction, including recognition, praise, respect and listening to employees' needs.

# Are your firewalls “up to code”?

You likely view your Dealer Management System (DMS) as a primary tool in the every-day operation of your dealership. But could it also give data thieves access to your customers’ personal information?

There are, of course, laws on the books to protect customer information from the unscrupulous, and your dealership likely does its best to follow them. But those efforts may be of only minimal benefit if you haven’t recently evaluated your DMS firewalls — the bundled software designed to prevent Internet intruders from accessing your nonpublic information.

## Why is evaluation crucial?

Your DMS is your dealership’s main vehicle for communicating confidential information on your business and its customers. If you’re like most dealerships, your DMS holds a wealth of information from the administrative, accounting, F&I, parts and service, and sales areas of your business.

Via your DMS you also communicate daily with your manufacturer about inventory, payments, rebates, warranty submissions, parts orders and other matters. Your DMS might even calculate employee commissions and automate your federal and state payroll tax returns.

In short, your DMS holds information you don’t want getting into the wrong hands.

## Which regulations apply?

The Federal Trade Commission’s (FTC’s) 2003 “Safeguards Rule,” which implemented a section of the Gramm Leach Bliley Act, is designed to protect customer information in your DMS and on any other Local Area Network (LAN) you might operate. Penalties for noncompliance can run as high as \$11,000 per location per day.

## If you haven’t evaluated the effectiveness of your DMS firewalls in a few years, do so now.

The rule requires your dealership to have a written security plan that describes how it protects nonpublic information on current and former customers. You also need to designate one or more employees to champion this effort and be responsible for the identification of risks, the design and implementation of controls, and ongoing monitoring and testing.

## What should firewalls do?

Your DMS firewalls should be designed to prevent unauthorized access to (or from) your private network. Firewall techniques include packet filter, application gateway, circuit-level-gateway and proxy server.

The firewall capabilities of DMS software have become more sophisticated over the last decade. Most programs, for example, now offer layered security, which combines multiple security controls to protect data and resources.



Unfortunately, cyberthieves also have become more skillful at pilfering private information. For instance, last year approximately \$37 billion in identity fraud alone was reported in the United States, according to Javelin Strategy & Research, which conducts an annual survey on the topic. And a prolonged down economy has given some people first-time motivation to commit fraud.

### Time to inspect?

If you haven't evaluated the effectiveness of your DMS firewalls in a few years, do so now. An IT specialist can perform a vulnerability

check to see if your controls are "up to code." These checks remotely scan your dealership's firewalls based on IP range, determine all open ports and services running, and identify vulnerabilities of ports and other IT issues related to your firewalls.

Don't delay. If your DMS firewalls are weak, your customer information is at risk, and your dealership may be in danger of an FTC violation. Just as important, you're leaving your dealership open to general business risk — besides customer lists, a wide assortment of private information on your business could be stolen, tampered with or otherwise abused. ■

## A strong offense can ward off an IRS audit

No one likes to be audited by the IRS. It costs time and, thus, money — even if no additional tax, interest or penalties are assessed — and it's stressful. So, what can your dealership do to avoid an IRS audit in the first place? It's simple: Don't attract unfavorable IRS attention. Reviewers can't audit every return, so they rely on key indicators to narrow the scope.

### Plan "A" — careful preparation

To reduce your chances of being audited, you need to examine your business practices and your dealership's return while thinking like an IRS agent. Be accurate and consistent with the information you provide, and pay special attention to:

**Compensation.** Because most dealerships are family-run businesses, the IRS keeps an eye out for unreasonable compensation. Align your salaries with industry benchmarks.



Accurately record hours worked, unique contributions from high-salaried employees, and any other factors that influence pay spikes to executives or officers.

**Cash transactions.** The IRS is much more likely to audit businesses with frequent cash transactions. Most of these occur in your parts department. Report these transactions properly by making sure the transaction is recorded in your accounting records with a proper paper or electronic trail.

**The size of business loss deductions.** Large business loss deductions are red flags to an IRS reviewer. Document each loss and keep receipts. Be able to prove your intent to make a profit, even if you're temporarily losing money.

## You can avoid waving the red flags that might trigger an IRS audit.

**Travel deductions.** Keep detailed auto expense logs and be able to justify the business-use percentage. Alternatively, you can employ the standard deduction rate of 51 cents per mile driven Jan. 1 through June 30, 2011, and 55.5 cents per mile driven July 1 through Dec. 31, 2011.

**Nondeductible contributions.** Contributions to political action funds aren't deductible for income tax purposes, including the portion of your NADA and state auto dealer association dues that fund political action committees (PACs). Provide your CPA with the annual statements provided by your associations indicating the portion of dues that fund PACs so that the matter can be handled properly on your tax return.

**Business credits.** If you think that one of your dealership's credits might come into question, attach an explanation to the documentation. Show the IRS reviewer that you understand the rules.

**Meals and entertainment.** Keep receipts for any expense totaling \$75 or more. Include the name and location of the meeting facility. To avoid penalties if you are audited, keep detailed descriptions of events, who attended, business relationships and business discussed.

**LIFO.** Keep accurate records of your previous years' LIFO invoices. Despite the three-year

statute of limitations for auditing tax returns, your current year's LIFO reserve can be affected by several years of built-in layers. Thus, LIFO workpapers and calculations should be kept permanently.

**Related-party receivables.** Keep documentation of related-party loans. There should be a signed loan agreement between the parties with a stated interest rate. Typically loans greater than \$10,000 need to have interest paid between the parties. The minimum interest rate should be the applicable federal rate in effect at the time the loan is made.

**Variations.** Do a high-level review of your tax return. If items are grouped differently from the previous year, it could draw IRS attention. An example: You classified your rental vehicles as part of your property and equipment in Year 1. Now, in Year 2, you classify them as "other assets."

## Plan "B" — professional assistance

No one wants an IRS audit. If you're conscientious about the records you keep and wise about the tax decisions you make, you can avoid waving the red flags that might trigger one.

But if, despite your best efforts, the IRS requests an audit, enlist the help of your CPA promptly and cooperate with the agency fully. Your CPA can perform a pre-audit, which includes reviewing the more complex areas of your tax return as well as any areas singled out by the IRS. ■



# DEALER DIGEST

## Selling to the “concierge”

A new type of third-party car-selling is entering the marketplace. If you haven't yet worked with a “concierge” car-buying service, it might be only a matter of time.

These enterprises are wrapped around the simple — but winning — concept of working to find the car a customer wants at the best price. Unlike auto brokers, a concierge service accepts no fee or commission from the dealership. It works on the customer's behalf, saving the customer time, money and the stress of direct negotiations.



In Chesterfield, Mo., Concierge Automotive Services (CAS), which started up in April, says it “evens the playing field” for the customer by knowing the ins and outs of auto costs and pricing. CAS finds the desired vehicles through its national network of auto dealers and auction houses and then handles the negotiation process. Customers also may elect to have CAS take care of vehicle registration, license plates, warranty registration, and so on.

Southern California's Authority Auto (AA) has been offering two kinds of concierge services

to customers since 2006. If a customer wants AA to locate a specific vehicle and negotiate a deal, AA charges a flat fee upfront. Or, if the customer has already found a vehicle and negotiated a price with a dealership, AA will take over and base its fee on a percentage of what it saves the customer over the price he or she initially negotiated.

Some dealerships say they enjoy working with concierge services because these professional car buyers understand the business and are likely to return to dealerships that show flexibility. ■

## M&A activity blooms

Merger and acquisition activity among auto dealerships rose dramatically during the first seven months of this year. Public retailers completed \$411 million in acquisitions through the end of July, a 92% increase over commitments made in all of 2010, according to the *Automotive Retail M&A Update* for mid-year 2011. Financial services firm Presidio Merchant Partners prepared the report.

A number of factors are believed to be responsible for the sharp M&A rise: a pent-up interest by dealers awaiting more favorable conditions to exit their businesses, strong unit sales, fewer marginal dealerships and record dealership profitability. Lower operating costs, low interest rates and stabilized real estate values were cited as other contributing factors that have boosted both public and private sales.

If you've been thinking about selling your dealership, now might be the right time to start getting it sales-ready. Valuations of dealerships remain low, but that trend might change within the next few years. ■

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