Building Competitive Advantage in Machinery Dealerships

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Introduction

Competitive advantage in machinery dealerships cannot be developed and sustained through functional excellence in any single department. The purpose of this brief is to stimulate consideration of a renewed focus on building aftersales overhead absorption rate as a key tool in establishing sustainable competitive advantage.

Given that manufacturer and dealership success are two sides of the same coin, it is essential that both parties in the relationship share a common focus on the same set of principles driving their collective success. The central principle at the core of this brief is that the aftersales functions are not simply the most profitable functions in the dealership model, but are the key to achieving sustainable competitive advantage in new machine sales.

An efficient aftersales operation, extracting the maximum profit potential from an established machine parc, through a combination of exceptional customer service, active sales and planned marketing programmes can and should cover the significant majority of the total dealership overheads. The achievement of this objective delivers a direct competitive advantage to the machinery sales teams by reducing the pressure they face to achieve unrealistically high margins.

The knock-on effect of a sales team focused on maximising margin is that they will shy away from aggressively seeking conquest business opportunities, where they know they will come under price pressure, and focus instead on established relationships where they feel they can negotiate more effectively.

This is not an argument for selling on price by allowing sales people to sacrifice margin. It is for dealership management to decide how they wish to use their competitive advantage. In fair weather they will enjoy higher overall profitability, with contribution from all departments. In foul weather they will be able to compete more aggressively on price, without exposing their business to undue risk.

There are other benefits delivered by this approach to building competitive advantage, including improved customer relationships, more predictable revenue streams, improved cashflow and reduced exposure to the sales impact of sudden economic downturn.

Finally and perhaps most importantly, this approach to Key Performance Indicator (KPI) management is one of the very few that drive increased competitive advantage at the same time as focusing the management team on reducing risk. Since absorption rate is a measure of how well dealership overheads are covered by the aftersales operation, it serves to ensure that operational efficiency remains a focus of management thinking.

The Two Measures

By establishing a robust target for aftersales overhead absorption rate and linking departmental managers incentives to the achievement of this single, shared goal, all departments experience individual benefit and the dealership develops improved competitive advantage. The basic formula for calculating absorption rate is simple and the accountant for each dealership will probably already calculate it:

$$\frac{\text{Parts Gross Margin £} + \text{Service Gross Margin £}}{\text{Total Dealership Overheads}}$$

Often overlooked, is the importance of calculating the "under absorption" present in the dealership in order to place a value on the extra contribution needed from sales:

$$\text{Dealership Overheads £} - \text{Parts \& Service Gross Margin £}$$

The first formula is a simple KPI that immediately shows what percentage of dealership overheads are covered by the profit generated from aftersales.

The second formula tells you how much cash profit needs to be generated from the sales function to make up the shortfall. This helps sales teams understand exactly how important aftersales success is to the wholegoods sales operation.

The use of both means that all departments can see the benefit and importance of a highly effective aftersales operation and the direct impact this has on the competitive advantage provided to the sales team.

At an absorption rate of 100%, competitive advantage is high and risk is low.

At an absorption rate of 50%, competitive advantage is significantly reduced and risk is high, because the dealership is depending on its sales team to generate profit just to cover half of its overheads before a penny of "real" profit is made.

In order to increase absorption rate the dealership must provide more and/or more efficient services to their customers. So the financial benefit to the dealership is based on a benefit to the customer of increased service from the dealer.

For the service and parts departments to generate increased absorption rate they must generate increased gross profit contribution, which means they must become more efficient in managing their labour or their parts operations as cash generators. This again means that you cannot achieve an improvement in absorption rate without getting better at your business.

"Dealers of the Year registered an average absorption rate of 78% (industry average: 60.89%) and a nearly 8% return on assets (industry average: 4.70%)."

Source: (US) Farm Eqpt April 2008

Not only are the best dealers covering a greater proportion of their overheads from the aftersales operation, but also they are achieving a higher return on assets; meaning that they are measurably more efficient operations. Dealers that focus on building aftersales absorption rate as one of their chief KPIs will be less likely to lose control of overhead or allow resources to be under-utilised. Dealers that maximise their parts and service business profitability stand to win:

- Increased customer loyalty and retention
- Increased brand loyalty
- Significant aftersales revenue growth
- Increased overall profitability
- Machinery repurchase loyalty
- Tactical Competitive Advantage

To convert all of these benefits into sustainable, or strategic, competitive advantage, they must be accompanied by the deployment of an active field sales team, finding and securing conquest business and increasing market share. In good times the sales team will be adding to the profitability of the business by selling at strong margins and in tough times or in the face of direct competitive action the sales team can take aggressive steps to secure new sales, safe in the knowledge that the vast majority of dealership overheads are already covered.

So, there are 5 key recommendations from this brief:

1. Identify the existing absorption rate and under absorption value
2. Establish a realistic target for absorption rate
3. Engage all departmental managers in building aftersales profitability
4. Identify & share best practice in machine sales territory management
5. Make active use of CRM systems for sales and aftersales development

Methods for increasing Absorption Rate

There are very few things that need to be considered in order to improve overhead absorption rate:

- Reduce dealership overheads and keep them low
- Increase labour rates
- Increase labour recovery and productivity
- Sell more parts at existing margins
- Sell parts more profitably
- Recruit more technicians where existing productivity levels are high

Conclusion

There are very few opportunities in the modern business world to minimise risk whilst pursuing growth. The use of both the absorption rate target and the under absorption figure achieve just that. They ensure that dealership overheads are covered by the profit achieved from high levels of customer service and sound management of the machine parc, freeing the sales team to compete aggressively in their territory for the new machine business that will provide the aftersales profit over the following years. Risk management and growth; you can have your cake and eat it.