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Revenue at Risk for Automotive Dealerships

The Growing Use of Manufacturer Incentive Programs

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Foreword

The use of manufacturer incentives has steadily grown in the Automotive industry over the past decade. These include traditional sales incentives, facility support payments, subsidies for advertising, reimbursement or credits for achieving various targets, and a wide variety of other payments, credits, and cost reductions.

This phenomenon is well-known in the industry. However, until now there has been no systematic effort to catalog these incentive programs, estimate the total amount of revenue involved, or consider how they collectively might undermine some of the hard-earned progress of the industry in the United States since the dreadful year of the bankruptcies of two major manufacturers.

My colleagues at Anderson Economic Group are well positioned to handle this task. They work on a regular basis with dealers, manufacturers, dealer associations, and investors. They understand the importance of a healthy franchise system for manufacturers, dealers, and customers. And lastly, they have extensive knowledge of the often-hidden programs, as well as the data on dealership finances that can be used to reveal the size and scope of these programs.

The Surprising Scale of Incentive Programs

No one in the industry should be surprised to find that the use of these programs is large, and growing. However, many will be surprised to learn just how large, and just how risky, the practice has become.

In particular:

- There is now over a million dollars a year on the table for a typical dealership from incentive programs—an amount that has grown steadily over the past several years.
- Incentive payments are often the difference between operating in the red, and operating profitably. Indeed, the size of incentive payments substantially exceeds the normal operating profit of a typical dealer.
- These programs extend far beyond sales incentives to facilities, customer service scores, advertising, training, and loaner cars.
- The management requirements for "participating" in the programs are significant.

Growing Conflicts with Federal Statutes, State Laws and Franchise Agreements

A long-standing economic principle of franchised industries is the provision by the franchisor of goods to their franchisees on nearly identical terms and prices. This principle began with the Federal Robinson-Patman antitrust statute and is included in various forms in numerous state laws, as well as franchise agreements.

The ubiquity and size of incentive programs today means that the effective price charged to the franchisee in this industry is not a clearly defined concept. To be sure, there have always been variations, sales promotions, advertising supports and other factors in the mix—but our estimates suggest that many dealers now rely on incentive payments in order to operate profitably.

Given the size and complexity of these incentive programs, conflicts between them and the statutory and contractual requirements for franchise agreements are already occurring. Unless industry practices are adjusted, these conflicts are certain to grow in the future and result in increased litigation.

Vulnerability in the Coming Recession

Finally, everyone in the industry must be aware that a recession will come in the future, and with it a sharp drop in auto sales. The pervasiveness of "incentive" programs may place dealers more at risk to recessions now than they were in the past, and complicate manufacturers' efforts to sustain inventory and production during a downturn. We may explore this in a future report.

The work my colleagues at Anderson Economic Group have contributed will be informative to every participant in the industry, and should inform a much-needed debate over the proper use of incentives.

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Patrick L. Anderson
Principal & CEO

Revenue at Risk for Automotive Dealerships

PURPOSE

Manufacturer incentive programs have become increasingly controversial. Because incentive programs are overlapping, complex, and subject to confidentiality provisions, the general public, lawmakers, and even some dealers are uncertain about their full extent.

Over at least the past six years, dealerships' gross margins and operating margins have been on the decline. These declining margins have made manufacturers' incentive program payments all the more important to dealerships try to maintain their profitability.

Anderson Economic Group has prepared this report to focus on these programs' extent, potential effect on dealerships' financials, and on certain problems associated with these programs.

For more about our approach in this report, see "Methodology" on page 10.

FINDINGS

1. Manufacturer incentive programs are now common in the automotive industry, and can involve almost every aspect of a dealership's operations.

Incentive programs are common among manufacturers. Numerous manufacturers offer or impose incentive programs on their dealerships. This includes some of the biggest names in the automotive industry including Ford, Chevrolet, Cadillac, Buick, Chrysler, Dodge, Jeep, Ram, Nissan, BMW, and Audi.

The manufacturers named in this report are only those for which we could confirm their programs' existence in public sources. Anderson Economic Group is aware of numerous other programs, including those offered by other manufacturers, for which there is no publicly available source to confirm the programs' existence or terms.[1]

- See Exhibit A-1, "Confirmed Elements of Manufacturer Incentive Programs, 2015-2018," on page A-2.

Incentive programs have elements that span dealerships' operations. There are many types of incentive programs manufacturers use with their dealerships. The incentive programs involve an assortment of areas for compliance, for example: new and CPO vehicle sales volumes, facility requirements, customer

1. See "Confidential Sources" on page C-1.

satisfaction survey scores, personnel training, the number of vehicles or parts purchased from the manufacturer, and even email capture rates.

- See Exhibit A-2, “Elements of Manufacturer Incentive Programs, 2015-2018,” on page A-3.

Manufacturers change their incentive programs from time to time and often overlap programs. Changes to programs may come as a result of multiple factors, including: changes in the market or macroeconomic conditions; a manufacturer’s intent to improve those programs; management changes at the manufacturer; aggressive pressure from dealerships;[2] and litigation between manufacturers and dealerships.[3] Additionally, many manufacturers run multiple—even dozens—of incentive programs simultaneously.[4]

2. The amount of revenue at risk is highly significant, and can account for the entire profitability of a dealership during a calendar year.

Revenue at risk. Increasing reliance on payouts from manufacturers’ incentive programs raises the overall risk profile of dealerships. We estimate that the revenue at risk due to the presence of incentive programs rose to 1.3 million dollars per typical dealer in 2017. See Figure 1 on page 6 and “Payouts conditional on sales effectiveness” on page 8.

Dealerships’ gross and operating margins have been decreasing. Based on nationwide figures compiled by the National Automobile Dealers Association (NADA) for franchised auto dealers, average gross profit margin declined from 12.5% in 2012 to 11.4% in 2017.[5] Almost all of this decline originated in the new and used vehicle sales departments.

- See Exhibit A-3, “Average New Vehicle Dealer Profile, 2012-2017,” on page A-4.

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2. One recent example is Ford ending a sales incentive program for its dealerships; see Jamie LaReau, “Dealers fear losing control as factory incentives burgeon,” *Automotive News*, April 10, 2017, accessed on March 15, 2018.
3. See Jackie Charniga, “Maserati’s program changes ‘unfair,’ NY judge rules,” *Automotive News*, November 22, 2017, accessed on March 16, 2018.
   For information on how multiple sales incentive programs were determined to discriminate against smaller dealers, see Donna Harris, “Suit challenges Kia’s stair-step spiffs,” *Automotive News*, June 20, 2005, accessed on March 29, 2018.
4. See Jamie LaReau, “Dealers fear losing control as factory incentives burgeon,” *Automotive News*, April 10, 2017, accessed on March 15, 2018 which states that one dealer was managing 57 programs in his dealership.

- See Exhibit A-4, “Breakdown of Revenue and Gross Profit, Average New Vehicle Dealer Profile,” on page A-5.

Incentive program payouts have been increasing. Net other income, which is mainly comprised of incentive program payouts from manufacturers, increased from 1.8% in 2012 to 2.2% in 2017. Based on our estimates, incentive program payments reached 2.2% of revenue in 2017, almost corresponding to the profit before tax margin of 2.3%.

The payouts associated with incentive programs can make the difference as to whether a dealership is earning a profit or losing money. Although participation in these programs is usually considered “voluntary,” dealerships often feel they have effectively no choice whether to participate or not.[6] Not participating can put dealerships at a large disadvantage to competing same-make dealerships with regard to pricing, inventory, and profitability. See Table 1 below.

TABLE 1. Analysis of Average Dealerships' Profit Margin and Incentive Program Payouts

Margins (as % of Total Revenue)	2012	2013	2014	2015	2016	2017
Gross Profit	12.5%	12.0%	11.7%	11.8%	11.6%	11.4%
Operating Profit	1.0%	0.9%	0.8%	0.8%	0.5%	0.2%
Profit Before Tax	2.8%	2.6%	2.6%	2.7%	2.5%	2.3%
Estimated Incentive Program Payouts	1.9%	1.9%	1.9%	2.0%	2.1%	2.2%

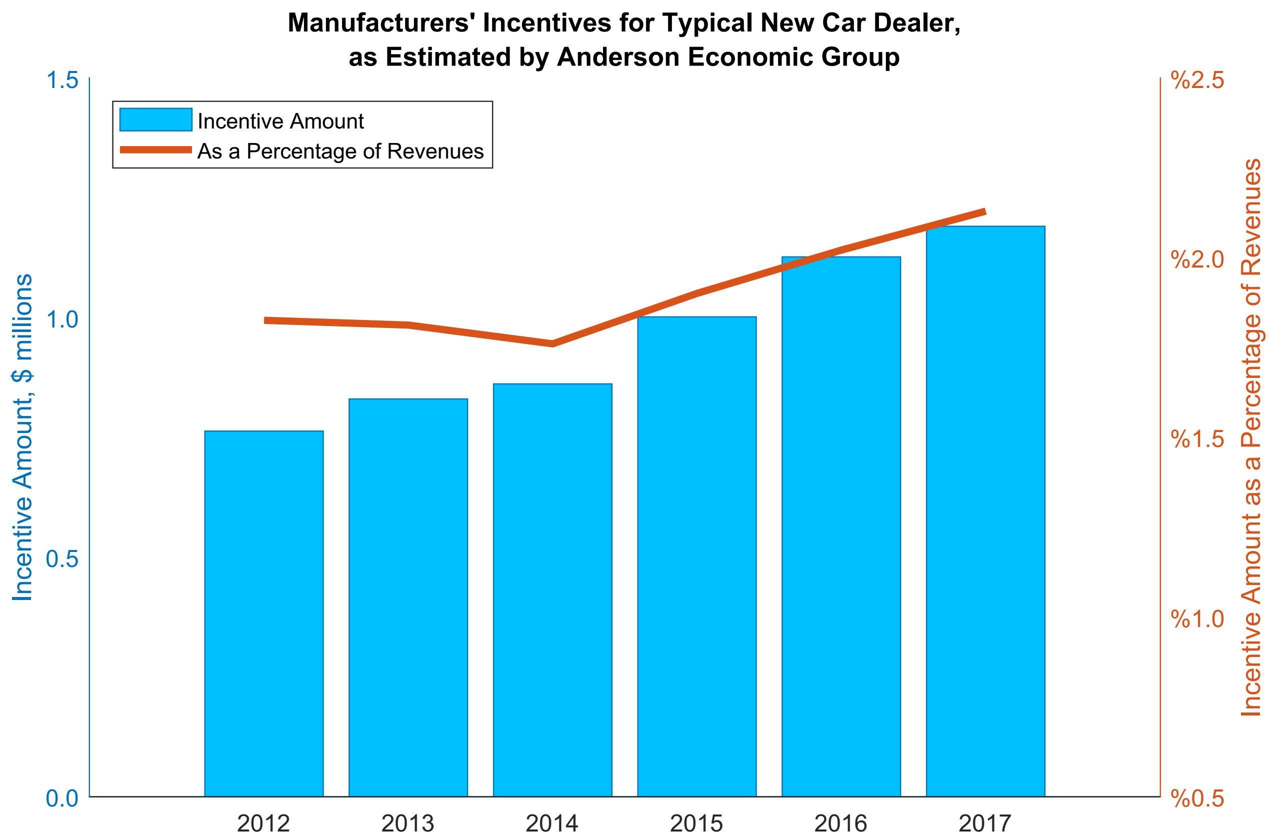
Sources: Anderson Economic Group estimates based on NADA data, NADA Average Dealership Profile data for December year-to-date 2012–2017

Analysis: Anderson Economic Group

- See Exhibit A-5, “Estimated Revenue at Risk Due to Incentives for Typical Franchised Dealer,” on page A-6.

5. NADA's monthly survey of dealership finances involves a sample size of over 2,000, and a weighting of responses by sales to ensure that the sample is reasonably close to the population of dealerships. Sample data represents all major brands in the US market. Anderson Economic Group consultants confirmed the sampling methodology with NADA. See “Methodology” on page 10 and “Limitations” on page 11.
6. Jamie LaReau “Dealers fear losing control as factory incentives burgeon,” *Automotive News*, April 10, 2017, accessed on March 29, 2018.

FIGURE 1. Estimated Revenue at Risk Due to Incentives for Typical Franchised Dealer



Source: Anderson Economic Group estimates based on NADA data, NADA Average Dealership Profile data for December year-to-date 2012–2017
Analysis: Anderson Economic Group

Incentives increase economic risk. The increasing reliance of dealerships on incentive programs also has the unintended effect of subjecting dealerships to greater economic risk. The automobile industry has historically experienced widely fluctuating sales.[7] Indeed, one of the first signs of a recession is a drop in auto sales, as consumers cut back on their major purchases in the face of uncertainty about their earnings.

Because sales incentive programs are typically based on a target that represents an increase over sales in past periods, dealerships are vulnerable to a sudden drop in incentive earnings at exactly the time when overall sales are declining.

7. Automotive News data shows that light vehicle sales were 68.1 percent higher in the record-setting year of 2016 (17,539,052 vehicles) than in lowest year of the great recession in 2009 (10,431,509 vehicles).

This double-whammy could have serious effects in the next economic recession. Anderson Economic Group may examine this phenomenon in more detail in a forthcoming publication.

3. Incentive programs can create a number of problems for dealerships, including:

A. vulnerability to flawed measures of sales effectiveness;
B. increasing demand on dealership personnel to effectively manage the programs; and
C. conflicts between incentive program terms and State laws or dealer agreements.

Vulnerability to flawed measures of sales effectiveness. Many manufacturer sales incentive programs rely directly on sales effectiveness metrics. These metrics are well known to have flaws.[8] While dealership sales effectiveness is a legitimate concern of manufacturers, the flaws that have been observed in their metrics include:

1. Reliance on manufacturer-assigned market territories that are unfairly assigned;[9]
2. Use of unreasonable and overly-broad vehicle segment definitions;
3. Failure to adequately account for local market conditions; and
4. Notoriously requiring all dealerships to have “above average sales performances.”[10]

Other programs use a similarly flawed measure of brand performance (or “brand opportunity”) in a dealership’s manufacturer-assigned market territory to determine sales targets. When manufacturers use flawed metrics to generate

8. For example, a fairly recent case in New York’s highest court determined GM’s sales effectiveness methodology was unfair and illegal. Sales effectiveness metrics like the one in question, or very similar metrics, are used across the automotive industry. See Final Decision, *Beck Chevrolet Co., Inc. v. General Motors, LLC*, United States Court of Appeals for the Second Circuit, December 29, 2016. See also Initial Decision, *Jack Daniels Motors, Inc. v. Audi of America, Inc.*, State of New Jersey, September 26, 2016; Report and Recommendation, *Northgate Chrysler Dodge Jeep, Inc., et al. v. FCA US, LLC*, Motor Vehicle Dealers Board of Ohio, November 30, 2016; and Proposal for Decision, *Bayway Auto Sales Inc., d/b/a Bayway Volvo v. Sonic Houston V LP d/b/a Volvo of Houston and Sonic Momentum JVP LP, d/b/a Momentum Volvo*, State Office of Administrative Hearings, February 17, 2010.

9. Automotive manufacturers generally assign non-exclusive market territories to their dealerships. The process for assigning market territories is similar across manufacturers, despite the assortment of names manufacturers use to refer to their dealerships’ market territories. See Exhibit A-6, “Market Territory Descriptions by Manufacturers, 2017,” on page A-7. Anderson Economic Group independently assesses the fairness of market territory assignments for dealerships and sometimes determines them to be unfairly assigned by the manufacturer.

sales targets for their dealerships, payouts conditional on meeting those targets are similarly flawed and could prevent dealerships from earning payouts.[11]

Payouts conditional on sales effectiveness. The payouts earned by dealerships of different sales effectiveness scores are significant. We estimate that in recent years, mass market brand dealerships with above average sales effectiveness scores earned around $0.6-$0.9M more (on average) than similar dealers with below average sales effectiveness scores. Similarly, we estimate that in recent years, the luxury brand dealerships with above-average sales performance scores earned around $0.3M more than similar dealerships with below average sales effectiveness scores.[12] See Table 2 below and Table 3 on page 9.

TABLE 2. Estimated Sales Incentive Revenue, Mass Market Brand Dealer, by Sales Effectiveness, 2012–2017

	Revenue ($ millions)					
Sales Effectiveness Score	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
"Above Average"	$0.9	$0.9	$1.0	$1.1	$1.3	$1.4
"Average"	$0.6	$0.7	$0.7	$0.8	$0.9	$1.0
"Below Average"	$0.3	$0.4	$0.4	$0.5	$0.5	$0.5

Sources: Anderson Economic Group estimates based on share of dealerships that earned payouts from Automotive News, NADA Average Dealership Profile data for December year-to-date 2012–2017

Analysis: Anderson Economic Group

10. Patrick L. Anderson has referred to this requirement as the "Lake Wobegon fallacy", which is a reference to the stories told by Garrison Keillor about a fictional town. The author introduces this fictional town by saying "Welcome to Lake Wobegon, where all the women are strong, all the men are good-looking, and all the children are above average."
For more information about this particular failing of dealership sales performance metrics, see Scott Watkins and Sara Bowers, "Evaluation of Automobile Sales Effectiveness Metrics," Anderson Economic Group, commissioned by the NYSADA, East Lansing, December 18, 2014.
11. Some State laws require that incentive programs use "fair, reasonable, and equitable" performance standards, or similar such requirements. For example, see also section 4517.59 (24) of the Ohio Revised Code and section 15-207(e)(3) of the Annotated Code of Maryland.
12. Our estimate of sales incentive revenue for luxury brands is lower than for mass market brands as we have seen that luxury brands typically have many incentive programs with new vehicle sale incentives representing a smaller share of total payouts. Sales incentive programs tend to make up a higher share of total incentive program revenue with mass market brands.

TABLE 3. Estimated Sales Incentive Revenue, Luxury Brand Dealer, by Sales Effectiveness, 2012–2017

	Revenue ($ millions)					
Sales Effectiveness Score	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
"Above Average"	$0.4	$0.4	$0.4	$0.5	$0.5	$0.5
"Average"	$0.3	$0.3	$0.3	$0.4	$0.4	$0.4
"Below Average"	$0.1	$0.2	$0.2	$0.2	$0.2	$0.2

Sources: Anderson Economic Group estimates based on share of dealerships that earned payouts from Automotive News, NADA Average Dealership Profile data for December year-to-date 2012–2017
Analysis: Anderson Economic Group

- See Exhibit A-7, "Estimated Distribution of Sales Incentive Payments, Selected Mass Market Brand Dealerships, 2012–2017," on page A-8

- See Exhibit A-8, "Estimated Distribution of Sales Incentive Payments, Selected Luxury Brand Dealerships, 2012–2017," on page A-9.

Increasing demand on dealership personnel to effectively manage incentive programs. With sometimes dozens of incentive programs that need to be actively managed, it is not unusual for dealerships to have partial, or even wholly, dedicated staff to focus on them. To be successful, dealership staff need to be able to:

- Determine if there is a reasonable chance that a program's targets are achievable;
- Monitor program performance throughout the program;
- Determine if operations need to change as a result of observations taken from monitoring programs; and
- Audit the results of programs, as OEM chargebacks are not unusual and can run into the hundreds of thousands of dollars.[13]

The resources required to effectively manage these incentive programs can make them less profitable for dealerships.

Conflicts between incentive program terms and State laws or dealer agreements. Certain State laws require that manufacturers sell new vehicles to dealerships at the same price, and specify that manufacturers cannot use devices such as incentive programs to effectively charge dealerships different prices for the same vehicles.[14] Many across the automotive industry contest that (1) the amount of incentive program payouts, and (2) the fact that not all dealerships

13. See Eric Freedman, "Dealership suit alleges FCA 'money grab'," *Automotive News*, February 26, 2018, accessed on March 27, 2018 for an example of a court case regarding a dispute over such a chargeback.

are able to earn program payouts effectively results in the manufacturer charging dealerships different prices for purchasing the same vehicle.[15] This issue is far from settled.

Most dealership agreements require dealerships to actively and effectively sell and promote new vehicle sales within their manufacturer-assigned market territories. It is not uncommon for some dealerships' sales incentive targets to be much higher than the number of same-brand registrations that occurred within their market territories during the same time period. This effectively requires dealerships to actively sell and promote new vehicle sales outside of their market territories in order to attain their sales objective targets.

There are numerous other ways that incentive programs (or portions of incentive programs) could be considered to be in conflict with Federal anti trust statutes, State laws, or dealer agreements.[16]

METHODOLOGY

In order to conduct our analyses, we took the following steps:

1. Reviewed our prior work with dealerships regarding issues they have had with particular manufacturer incentive programs;
2. Reviewed published AEG reports and an NADA published report that address topics such as manufacturer sales performance metrics and manufacturers' use of facility incentives. See "Appendix C. List of Sources" on page C-1;
3. Reviewed publicly available information—including legal decisions and news articles—on different brands' incentive programs, these programs' role in the industry, and information regarding their effect on dealerships' financial performance. See "Appendix C. List of Sources" on page C-1;

14. For example, see sections 4(e)(2) and 4(e)(3) of the Illinois Motor Vehicle Franchise Act and section 4517.59 (A)(8) of the Ohio Revised Code.

15. This can occur as a result of not just new vehicle sales incentive programs, but even from incentive programs targeted at getting dealerships to upgrade their facilities. See Glenn A. Mercer, "Factory Image Programs, An NADA Research Project," National Automobile Dealers Association, February 4, 2012, pp. 20–22.

16. One example is a legal dispute between Wide World Maserati and Maserati. In this case, part of a proposed incentive program decreased Maserati dealerships' hold back from 4.0 percent to 2.0 percent. This was determined to be an alteration to the Dealer Agreement and illegal. We note that in this case, numerous other proposed incentive programs were also either determined to be unfair or to violate New York law. See Jackie Charniga, "Maserati's program changes 'unfair,' NY judge rules," *Automotive News*, November 22, 2017, accessed on March 16, 2018.

    See also, Order Denying Motion to dismiss, Bedford Nissan et al. v Nissan North America, Inc., USDC, ND Ohio Case No. 1:16 cv 423, October 28, 2016, which addresses a Robinson-Patman anti trust claim regarding sales incentives that were not known and available to all Nissan dealers.

4. Reviewed a number of data sources for dealership finances including both NADA and Risk Management Association (RMA), as well as numerous financial statements of individual dealerships. Among these data sources, we consider the NADA dealer profile data to be the most reliable information on dealership finances for the purposes of this study. NADA's dealership financial data have been assembled using a consistent methodology and manner for over a decade. The data have been regularly published both monthly and annually.
5. Using financial data from NADA, analyzed dealer financial profiles over the 2012-2017 period, including estimating the total amount of incentive monies earned by dealerships.
6. Using publicly available information and our industry experience and expertise, estimated the effect of dealership sales performance metrics on sales incentive payouts.
7. Using our industry expertise, assessed other problems that incentive programs can cause for dealerships.

LIMITATIONS

To complete this report we relied on publicly available aggregate dealership financial profile data, publicly available industry information, and our own experience and expertise in the industry.

Limitations in our analysis include:

- Manufacturers may at any time change fundamental portions of their incentive programs, discontinue programs, and create new programs.
- We did not have complete sales incentive program information for many brands.
- Our financial analyses rely on aggregates of dealership data. Of course, dealerships have meaningful differences from each other, including: (1) volume of new vehicle sales; (2) local market conditions; and (3) accounting practices.[17]
- Accounting practices of some dealers may change over time. Hence, some incentive payouts that were previously recorded above the operating line may be recorded in the other income line (below operating line) at later dates.

17. NADA confirms that dealerships use different accounting practices in their below quote:

> ...we receive financial statements from dealerships of nearly all brands for sale in the US. All of these financial statements are different not just in the format, but in the way they report certain accounts. When we process the financial statement data we take the data and organize it into one format that we can use it to create the average dealership profile series. The discrepancy between operating profit and net profit arises because of the way certain brands report incentive money from an OEM in their financial statements. For some brands, the money is reflected in operating profit, while others report it in their overall dealership net profit. With the average dealership profile statements, you will not be able to use any of the line items to bridge between the two measures of profit.

See National Automobile Dealers Association, "NADA's Dealership Financial Profiles Frequently Asked Questions," found at www.nada.org, accessed on March 8, 2018.

Appendix A. Exhibits

This appendix contains the following exhibits:

Exhibit A-1. Confirmed Elements of Manufacturer Incentive Programs, 2015-2018

Manufacturer	Incentive Program Element(s)
Audi	Service loaner vehicles, signage, dedicated showroom, number of vehicles in showroom, dealership name, new vehicle sales incentives
BMW	Service customer penetration, brand defection rates, staffing product specialist non-sales people
Buick	Payments to dealership sales personnel for performance
Cadillac	Customer satisfaction, new vehicle sales volumes, brand standards, CPO sales targets
Chevrolet	Incentive money paid to dealership sales personnel for performance
Chrysler	New vehicle sales incentives
Dodge	New vehicle sales incentives
Ford	New vehicle sales incentives
GMC	Incentive money paid to dealership sales personnel for performance
Jaguar	New vehicle sales incentives, facility requirements, customer satisfaction
Jeep	New vehicle sales incentives
Land Rover	New vehicle sales incentives, facility requirements, customer satisfaction
Maserati	Purchases of accessories, CPO sales, personnel training, contributions to manufacturer's advertising
Nissan	New vehicle sales incentives, aftersales, customer satisfaction programs
Ram	New vehicle sales incentives

Source: Anderson Economic Group research, and publicly available sources as of March 2018.

Exhibit A-2. Elements of Manufacturer Incentive Programs, 2015-2018

Program Category	Incentive Program Element
Advertising	Contributions to manufacturer's advertising
	Compliance with advertising guidelines
CRM	Customer issue resolution rates
	Customer satisfaction survey scores (multiple departments)
	Mystery shoppers' experience
	Email capture rates
Facility	Dealership brand exclusivity
	Dedicated showroom
	Signage
	Number of vehicles in showroom
	Name of the dealership
	Meeting widely varying brand standards
Purchasing	Targets for purchasing vehicles from manufacturer
	Ordering particular options from the manufacturer in new vehicles
	Parts purchase volumes
Sales	New vehicle sales targets
	CPO sales targets
	Selling particular model vehicles
	Brand defection rates
	Payments to dealership sales personnel for performance
	Writing target number/share of loans from manufacturer's captive finance arm
Service	Minimum number of loaner vehicles
	Minimum number of service vehicles
	Service customer penetration
Training / Personnel	Personnel training certifications (for all departments, and virtually all positions)
	Minimum number of manufacturer-trained personnel for different positions
	Staffing (non-salesperson) product specialists

Note:
Not all manufacturers use the same program elements, and program terms vary and can change frequently.

Source: Anderson Economic Group research, discussions with individual dealers, examinations of program documents and publicly available sources as of March 2018.

Analysis: Anderson Economic Group

Exhibit A-3. Average New Vehicle Dealer Profile, 2012-2017

	2012	2013	2014	2015	2016	2017
<u>Revenues</u>						
Total Dealer Revenues ($ millions)	$ 44.4	$ 49.3	$ 52.9	$ 56.7	$ 59.6	$ 59.7
<u>Profit Margins</u>						
Gross Profit ($ millions)	5.5	5.9	6.2	6.7	6.9	6.8
Gross Profit Margin	*12.5%*	*12.0%*	*11.7%*	*11.8%*	*11.6%*	*11.4%*
Operating Profit ($ millions)	0.4	0.4	0.4	0.5	0.3	0.1
Operating Profit Margin	*1.0%*	*0.9%*	*0.8%*	*0.8%*	*0.5%*	*0.2%*
Profit Before Taxes ($ millions)	1.2	1.3	1.4	1.5	1.5	1.4
Profit Before Taxes Margin	*2.8%*	*2.6%*	*2.6%*	*2.7%*	*2.5%*	*2.3%*
<u>Analysis</u>						
Difference Between Profit Before Taxes and Operating Profit ($ millions)	0.8	0.8	0.9	1.0	1.2	1.3
Difference as a Percentage of Revenues	*1.8%*	*1.7%*	*1.8%*	*1.8%*	*2.0%*	*2.2%*
Memo: New Vehicle Department Gross Profit Margin	6.6%	6.1%	6.0%	6.0%	5.5%	5.3%

Note:
Average new vehicle dealer profile involves dealerships selling Acura, Audi, BMW, FCA, Ford, GM, Honda, Hyundai, Infiniti, Jaguar/Land Rover, Kia, Lexus, Mazda, Mercedes, Mitsubishi, Nissan, Porsche Subaru, Toyota, Volkswagen, and Volvo brands.

Source: NADA Average Dealership Profile data for December year-to-date 2012–2017

Analysis: Anderson Economic Group

Exhibit A-4. Breakdown of Revenue and Gross Profit, Average New Vehicle Dealer Profile

	2012	2013	2014	2015	2016	2017
Revenue Breakdown						
New Vehicle Sales Department	56.6%	57.5%	57.6%	58.2%	57.9%	57.6%
Used Vehicle Sales Department	31.2%	30.8%	30.7%	30.4%	30.4%	30.3%
Service, Parts & Body Shop	12.1%	11.7%	11.7%	11.4%	11.7%	12.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross Profit Breakdown						
New Vehicle	30.1%	29.3%	29.5%	29.5%	27.8%	26.6%
Used Vehicle	25.1%	25.6%	25.3%	25.1%	24.9%	24.4%
Service, Parts & Body Shop	44.8%	45.1%	45.2%	45.4%	47.3%	49.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Memo:						
Gross Profit Margin	12.5%	12.0%	11.7%	11.8%	11.6%	11.4%

Note:
Average new vehicle dealer profile involves dealerships selling Acura, Audi, BMW, FCA, Ford, GM, Honda, Hyundai, Infiniti, Jaguar/Land Rover, Kia, Lexus, Mazda, Mercedes, Mitsubishi, Nissan, Porsche Subaru, Toyota, Volkswagen, and Volvo brands.

Source: NADA Average Dealership Profile data for December year-to-date 2012–2017

Analysis: Anderson Economic Group

Exhibit A-5. Estimated Revenue at Risk Due to Incentives for Typical Franchised Dealer

		2012	2013	2014	2015	2016	2017
Total Dealer Revenues ($ millions)		$ 44.4	$ 49.3	$ 52.9	$ 56.7	$ 59.6	$ 59.7
Difference Between Profit Before Taxes and Operating Profit ($ millions)		0.8	0.8	0.9	1.0	1.2	1.3
Estimated Incentives							
"Above Operating Line"	(a)	0.2	0.2	0.3	0.3	0.3	0.3
"Below Operating Line"	(b)	0.6	0.7	0.8	0.8	1.0	1.0
Total Estimated Incentives ($ millions)		0.9	0.9	1.0	1.1	1.3	1.3
As a Percentage of Revenues		*1.9%*	*1.9%*	*1.9%*	*2.0%*	*2.1%*	*2.2%*

Notes:

(a) Incentives recorded above the operating profit. We assume this amount to be a small fraction of total dealer revenues. We estimated this incentive amount by taking 0.5 percent of total dealer revenues.

(b) Incentives recorded below the operating profit. We estimated that these payouts made up almost 80 percent of the difference between profit before tax and operating profit amount.

Sources: Anderson Economic Group estimates based on data from NADA (NADA Average Dealership Profile for December year-to-date 2012–2017), and industry sources cited in text.

Analysis: Anderson Economic Group

Exhibit A-6. Market Territory Descriptions by Manufacturers, 2017

Manufacturer	Descriptions
General Motors	“Area of Geographic Sales and Service Advantage” (AGSSA) (a)
General Motors	“Area of Primary Responsibility” (APR) (a)
Ford	“Dealer Locality” (DL)
FCA	“Trade Zone” (TZ) (b)
FCA	“Sales Locality” (SL) (b)
Honda	“Area of Statistical Analysis” (ASA)
Hyundai, Nissan, Toyota, BMW	“Primary Market Area” (PMA)
Audi, Volkswagen	“Primary Area of Influence” (PAI)
Mercedes-Benz	“Area of Influence” (AOI) (c)
Mercedes-Benz	“Area of Responsibility” (AOR) (c)
Kia	“Area of Primary Responsibility” (APR)
Mazda	“Statistical Observation Area” (SOA)
Subaru	“Area of Responsibility” (AOR)
Jaguar, Land Rover	"Area of Primary Sales Responsibility" (AOR)

Notes:
(a) In a metropolitan area, the APR may contain multiple AGSSAs.

(b) In a metropolitan area, the SL may contain multiple TZs.

(c) In a metropolitan area, the AOR may contain multiple AOIs.

Source: Anderson Economic Group research

Exhibit A-7. Estimated Distribution of Sales Incentive Payments, Selected Mass Market Brand Dealerships, 2012–2017

		2012	2013	2014	2015	2016	2017
Sales Incentive Program Revenue ($ millions) "Above Average" Sales Performance	(a)	$ 0.9	$ 0.9	$ 1.0	$ 1.1	$ 1.3	$ 1.4
Sales Incentive Program Revenue "Average" Sales Performance	(b)	0.6	0.7	0.7	0.8	0.9	1.0
Sales Incentive Program Revenue "Below Average" Sales Performance	(c)	0.3	0.4	0.4	0.5	0.5	0.5
memo: Total Incentive Program Revenue ($ millions)	(d)	0.8	0.8	0.9	1.0	1.1	1.2

Notes:
(a) We assumed that 50 percent of dealerships had above average sales performance, that 70 percent of dealerships earned payouts, and that approximately 70 percent of dealerships with above average sales performance scores earned payouts.
(b) We assumed sales incentives represent 80 percent of total incentive program revenue for mass market brands.
(c) We assumed that 50 percent of dealerships had above below sales performance, that 70 percent of dealerships earned payouts, and that approximately 30 percent of dealerships with below average sales performance scores earned payouts.
(d) Total incentive program payouts available to mass market brand dealerships. This estimate is separate from our estimate for luxury brands because the distribution of payments for mass market brands are typically different than for luxury brands. See “Payouts conditional on sales effectiveness” on page 8 and note “(b)” above. Note that incentive program revenue for mass market brand dealerships tends to be lower than for luxury brands dealerships.

Sources: Anderson Economic Group estimates based on industry expertise, share of dealerships that earned payouts from Automotive News, and NADA (Average Dealership Profile data for December year-to-date 2012–2017).
Analysis: Anderson Economic Group

Exhibit A-8. Estimated Distribution of Sales Incentive Payments, Selected Luxury Brand Dealerships, 2012–2017

		2012	2013	2014	2015	2016	2017
Sales Incentive Program Revenue ($ millions) "Above Average" Sales Performance	(a)	$ 0.4	$ 0.4	$ 0.4	$ 0.5	$ 0.5	$ 0.5
Sales Incentive Program Revenue "Average" Sales Performance	(b)	0.3	0.3	0.3	0.4	0.4	0.4
Sales Incentive Program Revenue "Below Average" Sales Performance	(c)	0.1	0.2	0.2	0.2	0.2	0.2
memo: Total Incentive Program Revenue ($ millions)	(d)	1.7	1.8	2.1	2.4	2.4	2.4

Notes:
(a) We assumed that 50 percent of dealerships had above average sales performance, that 70 percent of dealerships earned payouts, and that approximately 70 percent of dealerships with above average sales performance scores earned payouts.
(b) We assumed sales incentives represent 15 percent of total incentive program revenue for luxury brands.
(c) We assumed that 50 percent of dealerships had above below sales performance, that 70 percent of dealerships earned payouts, and that approximately 30 percent of dealerships with below average sales performance scores earned payouts.
(d) Total incentive program payouts available to luxury brand dealerships. This estimate is different than our estimate for mass market brands because the distribution of payments for luxury brands are typically different than for mass market brands. See “Payouts conditional on sales effectiveness” on page 8 and note “(b)” above. Note that incentive program revenue for luxury brand dealerships tends to be higher than for mass market brands dealerships.

Sources: Anderson Economic Group estimates based on industry expertise, share of dealerships that earned payouts from Automotive News, and NADA Average Dealership Profile data for December year-to-date 2012–2017
Analysis: Anderson Economic Group

Appendix B: About Anderson Economic Group

Anderson Economic Group, LLC is a boutique consulting firm founded in 1996, with offices in East Lansing, Chicago, New York, and Istanbul. We are one of the premier consulting companies in the automobile industry. We have worked with manufacturers, suppliers, automotive dealerships, and trade organizations across the United States.

Past clients of Anderson Economic Group include:

- *Businesses:* automobile dealers and dealership groups representing most brands in the United States including Audi, BMW, Buick, Cadillac, Chevrolet, Chrysler, Dodge, Ferrari, Fiat, Ford, GMC, Harley-Davidson, Honda, Hyundai, Jeep, Kia, Lexus, Lincoln, Lotus, Mazda, Mercedes-Benz, Mini, Nissan, Porsche, Ram, Smart, Subaru, Suzuki, Toyota, Volkswagen, and Volvo; Ford Motor Company; General Motors Corporation; DaimlerChrysler; Honda North America; Lithia Motors; New Country Automotive Group; Spartan Stores; Nestle; First Merit Bank; and InBev USA.
- *Governments:* the government of Canada; the states of Michigan, North Carolina, and Wisconsin; the cities of Detroit, Cincinnati, and Sandusky; counties such as Oakland County and Collier County; and authorities such as the Detroit-Wayne County Port Authority.
- *Trade associations and nonprofits:* trade associations such as the Maine Auto-dealers Association, New York State Automobile Dealers Association, Virginia Automobile Dealers Association, the Michigan Manufacturers Association, Service Employees International Union, Automation Alley, and the Michigan Chamber of Commerce; higher education institutions including Michigan State University, Wayne State University, University of Michigan, and University of Chicago.

Anderson Economic Group regularly performs the following services for dealership clients:

- Sales incentive program consulting
- Expert testimony
- Lost profit and damage calculations
- Market territory fairness assessments
- Sales performance analyses
- Strategy consulting and investment risk analysis
- Market potential analyses

Please visit www.AndersonEconomicGroup.com for more information.

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Mr. Tsarong-Blomker is a Consultant at Anderson Economic Group, working in the Market and Industry Analysis practice area. His background is in providing quantitative analyses for matters being litigated in the automotive industry.

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While at AEG, Mr. Tsarong-Blomker has conducted numerous analyses for automotive-related matters. These analyses include the degree to which certain vehicles compete within OEM-defined segments, the relationship between consumer demographics and vehicle preferences within OEM-defined segments, and geographic modelling of lost sales.

Mr. Tsarong-Blomker holds a B.S. in Physics from the University of Wisconsin-Madison. He is currently pursuing a Master of Science in Analytics from the Villanova School of Business.

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Mr. Cosguner is a Consultant working in the firm's Strategy & Business Valuation practice area. His work includes financial and industrial data analysis, equity research, and valuation. He specializes in automotive, beverage, food and non-food retail, and franchise businesses. In his work at Anderson Economic Group, he has evaluated the business performance of automotive dealerships, and assessed the value of automotive dealers and commercial damages, if and when their businesses are harmed.

He holds an MBA degree with concentrations in Accounting and Finance from the Eli Broad Graduate School of Management at Michigan State University, and a B.S. degree in industrial engineering from Bilkent University in Ankara, Turkey. He has been a Chartered Financial Analyst (CFA charter-holder) since 2001.

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Appendix C. List of Sources

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State Laws

- Sections 4(e)(2) and 4(e)(3) of the Illinois Motor Vehicle Franchise Act.
- Section 4517.59 (A)(8) of the Ohio Revised Code.
- Section 4517.59 (24) of the Ohio Revised Code.
- Section 15-207(e)(3) of the Annotated Code of Maryland.

Confidential Sources

Because of our work in the automotive industry, we have access to conversations with dealers and manufactures, and to detailed incentive program information. In some cases this information is confidential. In order to preserve confidentiality, we have named manufacturers' specific incentive program if we were able to confirm it with a public source.

