Driven

NADA MANAGEMENT SERIES SL41

A DEALER GUIDE TO

Appraisal-to-Trade Ratios

NADA
NATIONAL AUTOMOBILE DEALERS ASSOCIATION

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EXECUTIVE SUMMARY

Establishing clear appraisal metrics and rational processes is key to long-term success and profitability. One critical indicator of a dealership's health is the appraisal-to-trade ratio. *A Dealer Guide to Appraisal-to-Trade Ratios* discusses this important ratio and its implications for your business.

This guide considers whether there's an ideal appraisal-to-trade ratio for dealerships. Also addressed is why the appraisal-to-trade ratios of the used-car manager, new-car manager, and salespeople should all look like that of the dealership as a whole. You can deduce some interesting things about your used-car and new-car managers if this metric varies significantly from that of your business overall. This guide suggests what to do if there's an appreciable gap between your dealership's appraisal-to-trade ratio and that of your new-car manager, used-car manager, or any of your salespeople.

INTRODUCTION

A critical indicator of your business's health is the appraisal-to-trade ratio. This guide will explore this important metric and its import for your business.

Does your dealership track how many vehicles appraised at your dealership were actually traded in for other vehicles? It should.

As a dealer, you should be crystal-clear with your staff on the following crucial questions: Is it acceptable to over-appraise a vehicle to close a new-car deal? Or should the new-car department stand on its own and be responsible for separate inventory control without burdening the used-car department with over-appraised trades? How about under-appraising? Some might say that's a good way to maximize profits on the used cars you sell.

PROBLEMS WITH OVER-APPRAISING AND UNDER-APPRAISING TRADES

Before you develop your appraisal policy, let's look at some numbers for a typical dealership:

	Trades looked at	Trades taken in	%
Dealership	320	144	45%
Used-Car Manager	200	85	42%
New-Car Manager	65	38	58%
Asst. Used-Car Manager	55	19	35%

As you can see, this dealer trades for 45 percent of all the vehicles appraised. The used-car manager's number falls just below the overall dealership average at 42 percent, while the new-car manager comes in at 16 percentage points higher than the dealership average.

Why such a difference?

Two possible explanations come to mind. The more obvious one is that the new-car manager has been over-aggressive with appraisals, frequently over-appraising vehicles in order to close as many deals as possible. Not a great situation, because now the used-car department will have to struggle to make a profit on those vehicles, which just might become aged inventory. If more than 50 percent of your inventory is 30 days old or older, it's time to put an end to stretching on new-car trades. The used-car department cannot support the practice, and the new-car department needs to stand on its own.

A second possible reason for the big difference between the two car managers' trade ratios is that the used-car manager is trying to acquire trade-ins for the lowest possible amount, and thus maximize his profit ratio, by under-appraising vehicles consistently. If it's true that the used-car manager is acquiring under-appraised vehicles at a fast clip, he's put the new-car manager in a very awkward and uncompetitive position. Often the new-car manager's only recourse is to "shop" the vehicle to get a fair value and improve his chances of putting deals together. In this scenario, it is the new-car manager's trade ratio that is more likely to be healthy. The used-car manager needs to get more aggressive to pull his individual ratio higher.

Another explanation as to why a used-car manager might deliberately under-appraise trades is to have wholesale profit available to offset the losses that are looming in the current overvalued / over-aged current inventory. This manager is looking for every way possible to avoid glaring wholesale losses. But deliberate under-appraising is an easy shortcut with dire consequences: many lost deals and frustrated staff.

Then there's the assistant used-car manager whose appraisal ratio is even further below the dealership's average. The most obvious reason is his hesitancy to make an over-appraisal mistake. But to avoid the aforementioned lost deals and frustrated staff, you'll have to fix this poor appraisal ratio, and fast.

How to Detect Appraisal Problems

To help you formulate your policy on appraisals, consider the amount of aged used-car inventory your dealership currently has. If over 50 percent of the inventory is 30 days or older, it's time to put an end to stretching on new car trades: the used car department is not healthy enough to support this habit any longer. The new vehicle department needs to be responsible for its own inventory control.

Begin your investigation into the appraisal health of your dealership by examining your used-vehicle wholesale account. One indicator of poor processes is high wholesale profits on trades. If the used-car manager is under-appraising trades, those trades will be very profitable when wholesaled. So, pull a wholesale schedule and study it. Do you see new-car trades that were in inventory for just a few days and then wholesaled for significant profits? If so, this indicates deliberate under-appraising.

Now you might think that wholesaling new-car trades at a handsome profit is good. Why not show a wholesale profit? But you should understand that the only trades that are actually being traded for are the ones where the customer accepts the below-market offer; all the other prospects are leaving your dealership without purchasing. When salespeople follow up with these walkaways, they might regularly hear, "We purchased elsewhere, but you were so nice. Thanks for the four hours you spent with us. We'll send our friends to you!"

That's not what anyone wants to hear.

SALESPERSON APPRAISAL RATIOS

Let's switch over to salesperson appraisal ratios. Consider the sample chart below for the same dealership:

	Trades looked at	Trades taken in	%
Dealership	320	144	45%
Salesperson 1	30	14	46%
Salesperson 2	20	14	70%
Salesperson 3	12	5	40%

Salesperson 1 is very close to the dealership average and thus is not a cause for concern.

Salesperson 2 is considerably higher than the dealership average. What does this reveal? Most likely, talent. But it could also mean that Salesperson 2 is adept at "working" the used-car manager for a high appraisal. The high appraisal ratio might even reflect outright favoritism on the part of the appraiser!

Salesperson 3 is below the dealership average. This situation typically reveals a salesperson who has lost confidence in the dealership's appraisal process. He's had customer after customer tell him that the appraisal is too low or that another dealership has a better offer. The salesperson is now probably telling his prospects to keep their trades, or, even worse, suggesting that they bring them to a national retailer for an offer. In any case, this salesperson is in need of counseling and retraining.

THE IDEAL APPRAISAL-TO-TRADE RATIO

What is the NADA guide for the appraisal-to-trade ratio? Turns out we don't have one, with good reason. Your dealership's percentage will vary depending on when in the sales process you appraise the trade. Some dealers will appraise every trade very early in the sales process, while others will wait for a formal, written commitment before any trades are appraised. The first scenario will understandably lead to a lower overall trade percentage than the second one, since not all prospects become buyers.

So, how should you get to your ideal appraisal ratio? To begin, establish a baseline for your dealership. Adjust your process to ensure collection of accurate data for all appraisers and salespeople. Most used vehicle inventory / appraisal software has this feature built in. Once you are confident you have solid data, begin to look for trends. When you're certain your processes are healthy, start to demand a higher overall ratio. Your goal is to aggressively acquire as many trades as possible — just so long as you are not building up aged inventory.

Establishing clear appraisal guidelines and processes is a key ingredient for long term-success and profitability. Good selling!

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