Driven

NADA MANAGEMENT SERIES SP2

A DEALER GUIDE TO

Improving Parts Inventory Efficiency

NADA
NATIONAL AUTOMOBILE DEALERS ASSOCIATION

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SP2

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EXECUTIVE SUMMARY

A Dealer Guide to Improving Parts Inventory Efficiency discusses the use of internal controls to improve your inventory efficiency and your parts department's profitability. The guide details how to calculate and improve your months' supply level and turn rates. Also covered are the elements of parts turn: stock order inventory, customers' special orders, and emergency purchases. A method is offered for identifying which parts are eroding your profits. The guide also suggests how to analyze staff efficiency, and lists numerous types of inventory discrepancies.

INTRODUCTION

The parts department is often overlooked as a source for increasing profits—even though this department is typically the most profitable one in the dealership. But good can become great. By implementing the basic internal controls discussed in this guide, you can improve your inventory efficiency and your parts department's profitability.

Many variables influence the inventory control equation. Traditional formulas for measuring your efficiency in the parts department include these two variables: months' supply and parts turn. But there are other important variables. To optimize inventory control you should strive to:

- Increase your customer efficiency rate
- Minimize your lost sales, emergency purchases, outside purchases, and non-selling parts
- Build your inventory with the parts that turn most often and the parts for the most common vehicles on the road
- Make sure your employees are spending their time efficiently
- Watch for inventory discrepancies caused by poor data-entry habits, bookkeeping errors, etc.

MONTHS' SUPPLY

NADA recommends that you keep your parts and accessory inventories at or below a 1.5 months' supply. You shouldn't have any problem maintaining this level. If you are stocking below this level, you may not have an effective first-time fill rate. If you stock above this level, you may have too many non-selling parts on your shelf, an expensive situation.

Calculate your months' supply below:

$ _____
Average YTD inventory investment (purchases)

÷ $ _____
Average YTD cost of sales

= _____
Months' supply of parts

PARTS TURN

Keep in mind that most dealers have three different types of inventory, and these will turn at different rates:

- Stock order inventory
- Customers' special orders
- Emergency purchases

Your overall objective should be to stock the parts that are most in demand as stock order purchases and to buy them as favorably as possible. By buying as much of your parts inventory as possible from your manufacturer, you can take advantage of stock order allowances and discounts. Following is more detail about each of the three inventory types.

Stock Order Inventory

To calculate your dollar value invested in stock order purchases for a given year and the number of times per year your stock order inventory turns, complete the following two formulas:

$_____ x 12 = $_____
Stock order purchases (per average month) | 12 months' stock order purchases

$_____ ÷ $_____ = _____
12 months' stock order purchases | Parts inventory | Parts turn (Guide is 6–8 times/yr.)

Customers' Special Orders

Special orders can cost you money. Too many times, customers will special-order a part, then decide they want to get it elsewhere. The special-order part ends up as a costly non-selling part in your inventory.

To avoid these lost sales, you must establish firm internal controls on special orders. Implement a policy requiring that all special orders be paid for in advance. Or, in the case of a warranty part, require the service manager's or service advisor's approval before the part can be ordered.

Emergency Purchases

Emergency purchases are an unavoidable part of a dealership's effort to provide high levels of customer service. Excessive levels of emergency purchases, however, can drastically reduce the profitability of a parts department and the dealership.

The markup factor of emergency purchases represents just a fraction of the cost associated with an emergency purchase. Others are:

- Administrative costs of issuing and reconciling purchase orders
- The time associated with contacting another dealer and placing the order
- Costs related to delivery or picking up a part, including driver, vehicle, and fuel
- Lost shop and parts staff productivity

In fact, between markup and the costs listed above, the overall acquisition cost associated with an emergency purchase multiplies exponentially—often to several hundred percent above the cost of sourcing a part through the normal supply chain.

Industry numbers suggest that emergency purchases should be maintained at a level between two and three percent of total purchases, as measured by the DMS.

To avoid exceeding that level, you should put internal accountability controls in place that prevent emergency purchasing from jobbers, other dealers, and other outside sources.

Such purchases are justified only when the price is lower than the manufacturer's, or in the case of a bona fide emergency purchase. The service manager's signature should be required, in advance, to authorize these purchases—along with the reason for the purchase.

To calculate the dollar amount of your inventory that is invested in outside purchases and the percentage of inventory that you buy from these sources, complete the two formulas below.

$_____ x 12 = $_____
Purchases from jobbers, etc. (per average month) | 12 months' purchases from jobbers, etc.

$_____ ÷ $_____ = _____%
12 months' order purchases | Parts inventory | Percentage of inventory from jobbers, etc.

CUSTOMER EFFICIENCY

You should be able to fill customers' requests for parts most of the time. Try to have at least nine parts for every 10 requests. This includes all customers, including your body shop or service department, wholesale customers, and retail customers. In view of the efficiency of manufacturer distribution systems,

you shouldn't have any problem maintaining the 90 percent level. Calculate your customer efficiency rate below:

_____
YTD number of requests filled from stock

÷ _____
Total requests YTD

= _____%
Percentage of orders filled from stock (guide is 90%)

NON-SELLING PARTS

A non-selling part is simply a part that has not sold; exactly when a part should be classified as non-selling depends on several conditions. A general rule is that if it hasn't sold after nine months on the shelf, it's non-selling. There's one exception to the rule: seasonal items. Although these parts may have been on your shelf for nine months, they have no history and therefore should not be categorized as non-selling. But speculative buys, such as those for brand-new models, will inflate the inventory and contribute to obsolescence in the future.

Check your DMS periodically to look at the aging status of parts, and see how many parts have been in stock for a year or more. Those are the parts that erode your profits.

INVENTORY DISCREPANCIES TO WATCH FOR

Are you depending on your computer to do all the work for you? Regardless of how sophisticated your computer system is, it cannot reveal actual inventory values unless all purchases are entered daily: inventory adjustments, lost sales, outside purchases, and emergency purchases.

Only a physical count can reveal forgotten entries or discrepancies. Most of the types of inventory discrepancies in the following checklist can be corrected with a little effort:

- ☐ Flawed receiving process
- ☐ Posting errors
- ☐ Inaccurate bin counts
- ☐ Parts for work-in-process orders
- ☐ Failure to log in parts that are on loan, out for repair, or consignment parts
- ☐ Parts accumulated for return to manufacturer
- ☐ Parts at the manufacturer, not yet credited
- ☐ Miscounted parts (e.g., a box of six parts is counted as one part)
- ☐ Percentage costing
- ☐ Refunds
- ☐ Service department costing of parts
- ☐ Purchases or returns of accessories from the new-car department
- ☐ Poor parts ordering procedures (should be done only by authorized parts personnel)
- ☐ Manufacturer literature, promotional items, tools, etc., expensed or capitalized and not booked to inventory
- ☐ Failure to check parts receipts against delivery receipts
- ☐ Poor purchase order system
- ☐ Parts loaned to other departments for display but not noted on inventory
- ☐ Crossing out parts on repair orders for "goodwill"
- ☐ Poor warranty claim submission and record-keeping procedures
- ☐ Lost repair orders or counter tickets
- ☐ Poor back-up document review when signing payables
- ☐ Failure to account for discounts
- ☐ Credits not received for returns
- ☐ Lack of security, including unauthorized access to inventory storage area
- ☐ Failure to book price changes from the manufacturer
- ☐ Posting expense items to the inventory account (e.g., freight charges, sales tax, and handling charges should not be booked in inventory)
- ☐ Failure to conduct an annual physical inventory

Problems in one or more of these areas can create extreme shortages, unnecessary expenses, and other undesirable situations in your parts department.

CONCLUSION

All of the ideas in this guide can help you increase efficiency in your parts department, but you must establish and monitor the recommended procedures. Neither your computer system nor your parts manager—regardless of their effectiveness—can replace your control of your dollars.

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