Three Bottom Lines Are Better Than One

By: Keith Ely

Where performance is measured, performance improves. Where performance is measured and reported, the rate of improvement accelerates.

- **Thomas S. Monson**

Used correctly, performance measurement is a valuable tool that directly links activities with outcomes. It enables dealership owners to make better, more informed decisions. As a dealer, general manager, or departmental manager, it is a safe bet that you are currently engaging in some form of Performance Measurement, paying attention to monthly financial statements or the DOC. But how do you know that you are being presented with the whole picture?

John Madden, during his commentary at a football game, mentioned that the football statistics have changed dramatically over the years. In the early days, he said, coaches only kept track of their offensive statistics. It wasn't until coaches began looking at the defensive statistics that the whole nature of coaching changed. Many dealers are running their businesses this way – just based on half of the information, which creates a lop-sided view of what's really going on.

So how do you get the whole view of the business? By properly interpreting your company's financial statements? A well-run dealership has a bottom line for each of the three financial statements; Income Statement, Cash-Flow Statement, and Balance Sheet. Each bottom line has its own advantages and disadvantages. Only by looking at all three collectively with a tool like a **PROFIT** Scorecard, can you obtain a complete view of your dealership's performance.

Bottom Line #1

Net profit, derived from the income statement, shows whether your dealership's sales exceed its costs in any given time span. As a performance measurement, net profit is an excellent bottom line. The business would understand it and it shows whether you are "making money", But net profit also has many drawbacks. If you track only net profit, you may be able to keep expenses from exceeding sales, but you won't know how much cash is actually going into your bank account. Net profit also is susceptible to various accounting distortions, depending on your accounting methodology. It is only one measure of a business's financial performance and should not be considered by itself.

Bottom Line #2

Operating cash flow (OCF) is the second bottom line that should be considered. IT shows how much net cash is flowing into your dealership, independent of what you may receive from lenders/investors and independent of what you spend on fixed assets or other investments. Unlike net profit, OCF is based on real events and not on accounting theory. If your OCF is consistently positive, you know you are generating enough cash from operations to meet your regular obligations. However, OCF is also subject to external manipulation (for example, you can decide to pay your vendors late, temporarily increasing OCF) and also should not be considered alone as an indicator of overall business performance.

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Bottom Line #3

Dealership **PROFIT** (DP) comes closer than any other performance benchmark to capturing the true performance of a dealership. It also directly measures the creation of dealership value over time. DP gives dealership management excellent information and motivation to make choices that will increase the value of any dealership.

In its simplest form, DP is excess income. For an investor to earn an adequate rate of return, the return must exceed the risk. Accounting measures profit while only taking into account the interest cost of debt. The accounting measure of net income DOES NOT take into account a required return on the net worth (owners equity) of a dealership. Is net worth really a “free ride” to the dealership and its management team, or does the dealer demand a return on the investment, just as the debt holder does? The answer is a common sense “yes.”

DP is net operating profit (after taxes) minus an appropriate charge for the opportunity cost of all capital invested in the dealership. DP is an estimate of true profit, or the amount by which earnings exceed or fall short of the required minimum rate of return that dealership owners and its financing sources could get by investing in other investments of comparable risk. The equation for calculating DP is:

DP=Dealership Net Operating Profit (after taxes) – (capital x cost of capital)

Since it encompasses net profit, it helps you evaluate what’s really happening when your profit moves in one direction or the other.

The truth is that you need all three of these bottom lines; net profit, OCF and DP. Without them, you can’t see the big picture. Your dealership can look good in terms of dollar profits, but poor when you consider DP. Your store can have a satisfactory DP, but flat or declining sales. Only with all three bottom lines can you get an accurate assessment of the status of your company.

Whatever the variations, every dealership needs to make a profit, generate cash and produce sufficient return on investment to be competitive. These three bottom lines give you a powerful tool for evaluating your business’s performance. Together, they provide an executive summary and will highlight cause-and-effect relationships. You can now focus on your dealership’s “offense” as well as its “defense,” thereby avoiding the lop-sided management to which so many companies fall prey.

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