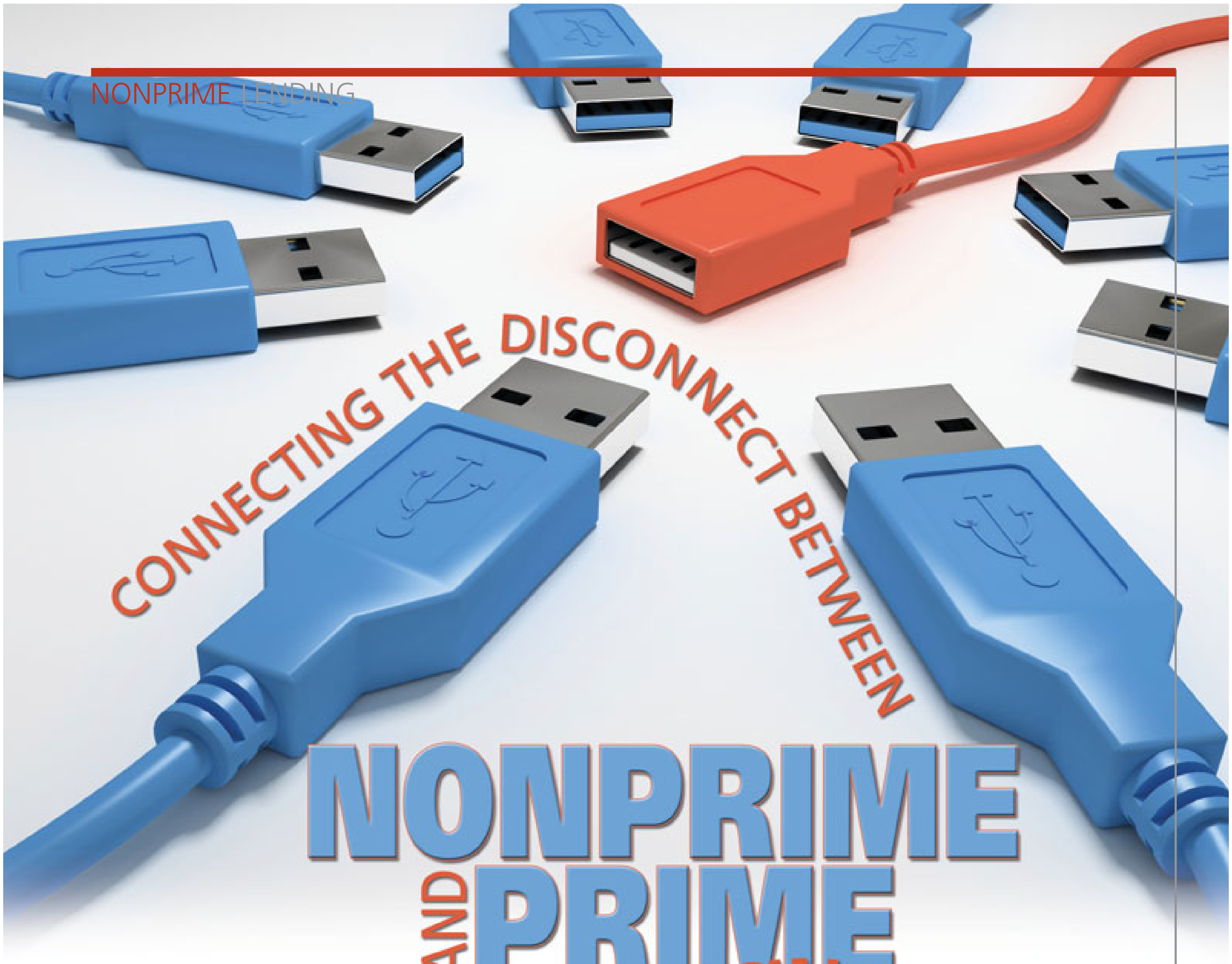


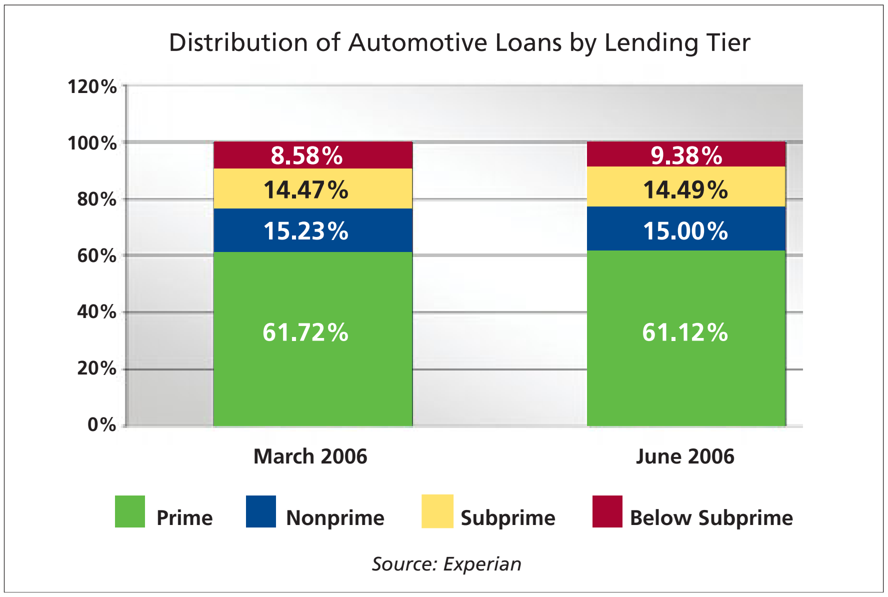
Connecting the Disconnect Between Nonprime and Prime Financing

The financial process can be the difference between average sales numbers and great sales numbers. **Is your dealership prepared to capitalize on both the prime and nonprime markets?**

By Ron Martin

In 2005, CNW Marketing Research conducted a study that broke out the percentages of prime vs. nonprime. Of the $175 billion in financed vehicles, 40 percent were considered "A" paper and 23 percent were considered "B" paper. These categories would, by most accounts, represent prime finance customers. Experian represented a similar result in June 2006. It broke the numbers out like this: 61.12-percent prime, 15-percent nonprime, 14.49-percent subprime, and 9.38-percent below subprime. No matter how you divide it up, one thing is for certain: To be successful, the F&I department needs to be well versed in both prime and subprime.

Lending has evolved significantly in many respects. Our F&I departments are controlling most of the automobiles financed today. Credit scoring and tiered interest rates have allowed lenders to better manage their risks. The ability to charge higher interest rates for customers with marginal credit enables them to give their preferred customers better rates. The old system of everyone getting the same rate actually worked against both sides of the spectrum.



Between Q1 and Q2 2006, distribution of consumer loans across the prime to subprime lending tiers shifted with an increased growth rate in the higher-risk categories, translating into a 3.6-percent increase in consumer credit degradation during the period.

The tier system has allowed lenders to get much more aggressive in what we refer to today as special finance, subprime or nonprime financing. As a result, the new system has enabled customers with marginal credit to drive a vehicle financed by a bank instead of making a buy-here-pay-here purchase.

Are there differences between prime and nonprime customers during the buying process? Of course there are. The real question is how to handle this challenge. Not only is the buying process different, but the lending approval process also varies greatly. Since the lender's guidelines are much more stringent with the nonprime customer, the dealership needs to be able to recognize these customers early on in the buying process. This difference in process leads to several different challenges. *(See sidebar on page 34 for tips).*

Selling: Prime vs. Subprime

With prime customers, you're selling the vehicle, payment and interest rate. With subprime customers, you're selling the financing. When a customer is purchasing a vehicle and has excellent credit, he or she is in complete control of the financing process. It's likely that he or she could go directly to a bank and get similar terms and interest rates. In this scenario, the process will focus on the selection of the automobile, options, accessories and getting the customer competitive financing and leasing options.

When it comes to your subprime customers, the transaction becomes less focused on what they want and more on what they are actually qualified to purchase. Why? Allowing subprime customers to pick out the vehicle they want can lead to frustration — both for the customer and, ultimately, the dealer. This is especially true if the customer finds out later that he or she doesn't qualify to purchase his or her preferred vehicle unless a significant down payment is made. A successful dealer is the one who is able to identify this customer early on in the selling process, which is before expectations must be changed.

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When Pay Plans Get in the Way

Many salespeople do not want to handle subprime customers because typical dealership pay plans pay salespeople more commission if the deal is approved by a prime lender rather than a subprime lender. This is attributed to two factors:

1. The lender reduces the advance on the automobile for the subprime customer.
2. The pay plan changes when the deal goes subprime.

The latter of the two creates a process problem for the dealership. With most pay plans for subprime, the salesperson has to share the gross profit with the special finance manager. With that in mind, salespeople want the regular F&I manager to try anything possible to get the deal approved via a conventional route to preserve their commission. Since the special finance department and prime F&I department are usually separate, the customer's application can sit in finance for a couple of days while the F&I person tries to get the deal approved. When he or she finally gives up and turns it over to the special finance manager, oftentimes the customer has already purchased elsewhere. The dealership that has a process designed to handle this dilemma will have a much higher penetration of automobiles delivered.

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5 STEPS TO CONNECTING THE DISCONNECT

Recognizing that there is a problem is clearly the first step. The key is to build a process that is customer-friendly for both scenarios. Here are five steps to help you get started.

STEP 1 EARLY CUSTOMER QUALIFICATION

Asking questions will help determine whether your customer is a prime or subprime candidate. Here are a couple of questions to get you started:

1. Did you intend to finance or pay cash for your purchase? *If they intend to pay cash, they are most likely prime. If not, proceed to question 2.*

2. Where did you finance the vehicle you are trading in?

3. Do you intend to have us take care of your financing on this purchase?

4. Where would you categorize your credit rating: A, B, C or D?

Answers to questions 2, 3 and 4 will provide you with the information necessary to categorize them as subprime or prime. If they are financing currently with a subprime bank or rate their credit as B, C, or D, they are most likely candidates for subprime financing.

STEP 2 REQUESTING A CREDIT APPLICATION

It's probably best at this point to obtain the customer's credit application to ensure that you meet his or her needs. This will also tell the sales manager whether he or she needs to consult with the F&I manager or with special finance to complete the deal. Clearly, an open line of communication throughout the dealership's management team is critical in making this process work. Without it, the salesperson has a slim chance of showing the customer the right vehicle.

A good software program that helps book out your dealership's inventory will significantly enhance this process. The salesperson could say at this point, "Mr. Doyle, let me go ahead and get your credit information now so that we can get you pre-qualified for a loan."

STEP 3 PROCEED TO THE SELLING PROCESS

It's safe to proceed with the sales process if the customer has financed his or her vehicle with a prime lender and rates his or her credit as "A." Once he or she selects a vehicle, I like to provide a list of pricing and payment options to help the customer make a decision. You won't know what rate he or she qualifies for if you don't have a credit application. So giving the customer an A-tier rate might be misleading.

Quoting an average interest rate until the customer commits to buying the automobile is the safest and best choice. The salesperson can present it like this: "Mr. Doyle, we use an average interest rate when initially quoting payments. Once you have concluded that this is the vehicle you want, our business manager will get your credit information and will be able to quote you the exact payment and interest rate."

If the customer reviews his or her choices and asks for an A-tier payment immediately, then it's time to get his or her credit information to ensure he or she qualifies for it. This is actually a perfect place for a trial closing question: "Mr. Doyle, could I get your credit information now so you can speak to our finance department? They'll be able to make sure you get the best financial arrangements."

STEP 4 GETTING LENDER APPROVAL

Which department does the application go to: regular or special? If the two are one in the same at the dealership, the answer is simple. But if the dealership separates the two, it's not so clear. It's in the best interest of everyone involved if the deal is approved by a prime lender. The customer gets better terms and the dealership has more flexibility to earn additional revenue. The salesperson likes this because he or she gets full commission. On the other hand, it's not in anyone's best interest for the deal to be bogged down in the F&I department when the special finance manager is more likely to get it approved.

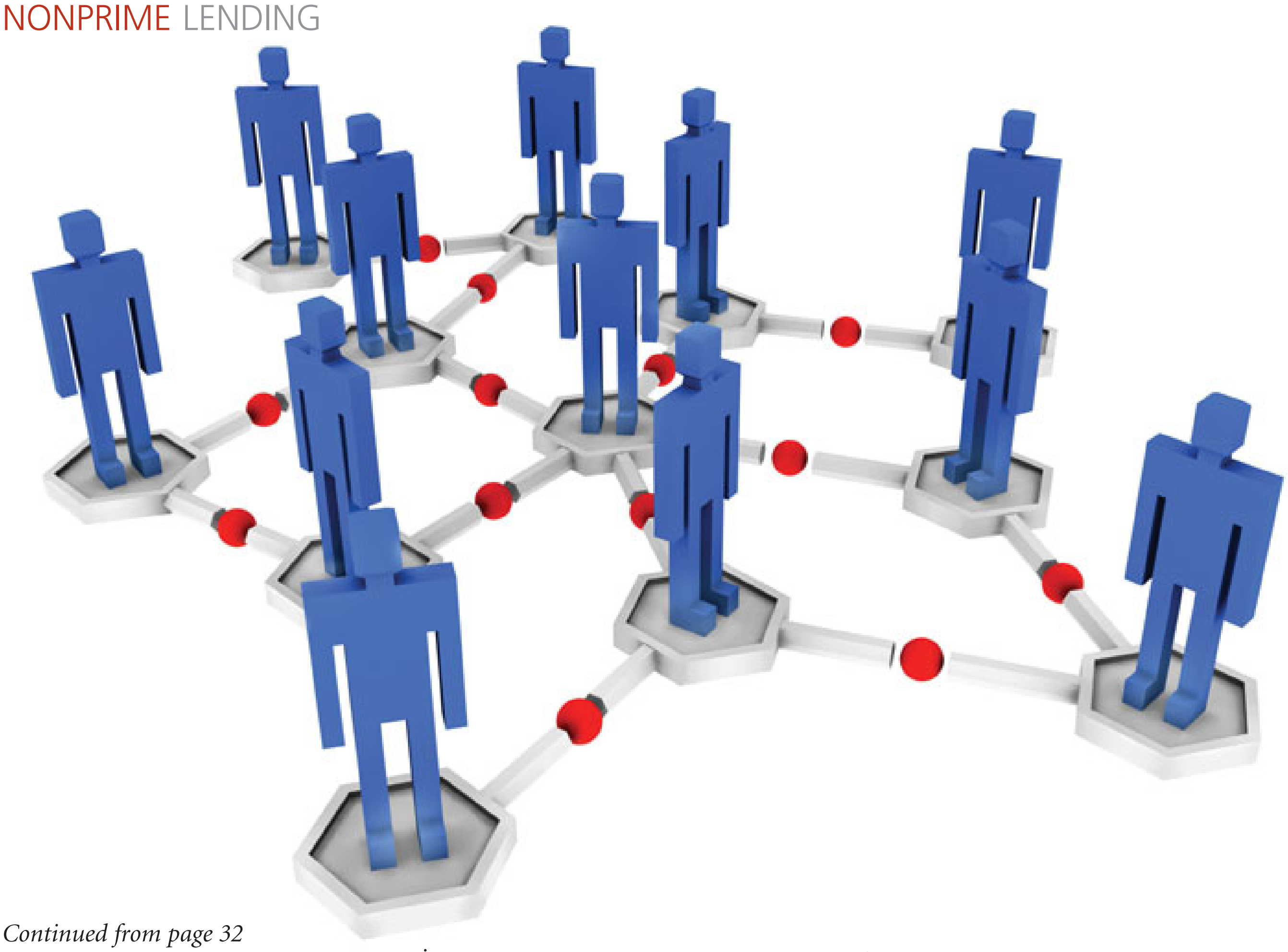
The process works best if the dealership establishes a black, white and gray area. The easiest way to differentiate is by credit score. For example, if the score is 650 or higher, it goes initially to regular F&I. If it's 580 or lower, it goes to special finance. If it's in the gray area of 580-650, then it's submitted to both departments. Regardless of where you set the limits, they need to be set jointly by the management team.

If the F&I department gets the deal approved, then it gets the deal and delivers the vehicle. If special finance gets it approved first, then it needs to apply the necessary encouragement to get the F&I department to get it approved or pass it along so the customer can realize his or her purchase.

STEP 5 SELLING THE F&I PRODUCTS

When you're selling F&I products to prime customers, your regular menu process works great. With special finance, you're typically limited on the amount of back-end products you can sell. You can still offer all of them, but the customer can only finance up to what the lender approves. The rest has to be paid in cash. In this case, you have two choices: step-sell the items that the lender has given room for, or offer all products showing additional cash down.

I prefer to sell all the products that I would normally offer to a prime customer. The only difference is you'll need to show on your menu the cash down payment required to purchase that package. The last choice on the menu could be the products that are available to them based on the lender's approval. Of course, when using the menu, you still need to have a base payment displayed with no products included. Clearly, this process is time-consuming; consequently, using an electronic menu that is capable of showing the max payment with varying amounts due is essential.



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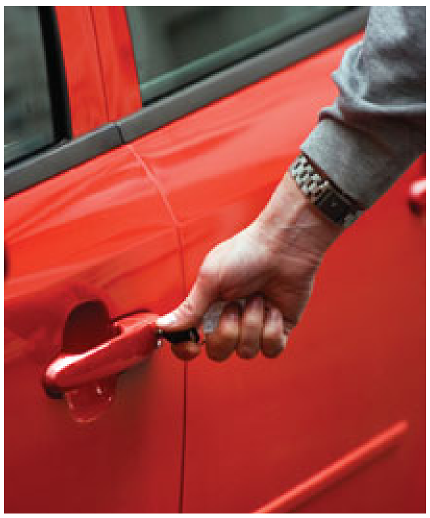
PRICE QUOTING: PRIME VS. NONPRIME

The process of quoting prices, payments, interest rates and terms is different for prime vs. subprime. Since interest rates can vary widely from an A- to a D-tier, the payments can quickly reach above the customer's budget. That's why it is imperative that the customer lands on the right vehicle from the start of the process. If the customer has taken mental ownership of a new $20k vehicle before learning they only qualify for a pre-owned $12k vehicle, there is a significant chance that no delivery will occur.



When D-tier customers are quoted an A-tier rate — even if they take delivery — you can be sure they won't be completely satisfied with their purchase.

How a dealership manages both pricing and payment options (i.e., desking processes) will greatly affect sales penetration and customer satisfaction. When D-tier customers are quoted an A-tier rate — even if they take delivery — you can be sure they won't be completely satisfied with their purchase. On the flip side, an A-rated customer may feel insulted if he or she is asked for a credit application before picking out an automobile. If you're the dealer who doesn't care whether the customer comes back, this probably won't matter much. However, if your goal is to sell the customer and his or her family and friends more vehicles, you probably want to pay attention to the process.

SELLING F&I PRODUCTS

When an A- or B-tier deal is approved, there are usually few or no limitations on what can be added in regards to aftermarket F&I products. That's not the case with credit-challenged customers. The typical subprime lender will limit aftermarket additions that the customer can add as part of the loan approval or qualification. In this case, the F&I manager is typically capped or limited to one or two products. This completely changes the F&I selling process, as it can make it much easier to step-sell. It can also change the way a menu is presented. This arrangement is also highly susceptible to "the bank approved it this way" explanations, which sets up a dealership for liability under payment packing. ■

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