

Show Me The Money!

By Tom Herald
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There is plenty of discussion about money, or the “lack” of money as I should say, today throughout the automotive special finance industry. Dealers, lenders, customers and even industry vendors are all scrambling for hard to find cash. Well, I’m going to help you find some by focusing on the three revenue centers of a special finance deal. These three centers for cash are what I call the *Trinity of Profit*. They are your only true sources of cash and profit in a special finance deal.



The Trinity of Profit:

- **The Lender** – No two lenders were created equally and each has what they consider is the best model for making a profit by loaning money and collecting it. The key to success with any lender is to build a real relationship with your buyers and understand their program like it is your own. You must structure deals that best fit their parameters and what they want in a borrower. And since there is no one-stop lending solution in full-spectrum financing, you need 5 – 7 quality lenders that cover the full spectrum of finance in your market.
- **The Customer** – This is the most overlooked source of cash. Too many sales teams lose the negotiation battle for cash with their customer because it’s easier to fold than it is to ask the customer face-to-face for something the salesperson *believes* the buyer does not have. I’ve sold too many vehicles to people with bad credit thinking I’ve gotten every last dime possible only to see the customer “pimp” out their new ride within the next couple of weeks with new wheels and LCD televisions. Apple doesn’t negotiate on the price of the iPhone nor does Louis Vuitton on their handbags or sunglasses. But we see special finance customers all the time wearing designer clothes or using expensive cell phones. Why? Because they want to. And, if you don’t ask for it, you’re surely not going to get it. The key is to get your customer to really “want” the vehicle you are selling more than anything else that is available.
- **The Vehicle** – Every vehicle has three different values: the “book” value, the “market” value, and the ACV...how much the dealer actually has in the vehicle. If the ACV is too high, you lose. It’s that simple. You can sell vehicles all day long that make money at the auction but if there’s not enough spread between your actual cost and the preferred valuation guide in your market, you are

wasting your time selling the wrong vehicle to a special finance customer. You need enough spread behind the book to cover the discount fee plus any acquisition fees from the lender. Otherwise, you're making up the difference with down payment, or even worse, with lost profit. And there is a huge difference between the "market" value and "book" value of specific vehicles. The key is to know which vehicles have the largest spread between these two values and at the same time, is something that customers want to buy.

Now I don't mean to trivialize the business model but I see too many dealers, managers and salespeople making the special finance sales process much more difficult than it has to be. Or, they cut corners and take shortcuts with pre-conceived ideas about the industry, the economy, or the customer. There are processes that have a proven track record for success and if the dealership team follows these procedures every time, without fail, and with no exceptions, they will sell more cars and earn more money.

I realize fully that our industry is changing every day and there are experienced dealerships who are really struggling to put special finance deals together. But, don't discard the fundamentals. The only way to overcome the many obstacles we face is to master the fundamentals that maximize the cash from each of the three sources and look for solutions instead of problems. Let's take a look at the lender side of the equation.

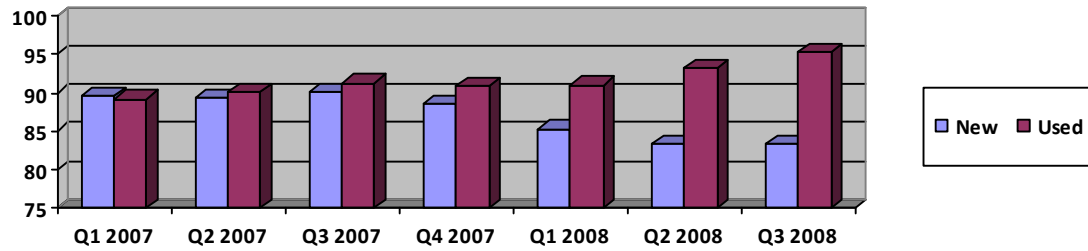
HSBC is out. Wells Fargo and Wachovia have joined forces to evolve the old WFS program and find their new niche. AmeriCredit is reeling from rising delinquencies in near-prime loans and struggling to find new sources of capital. And several other lenders have tightened their belts significantly which has squeezed profits and sales from dealers. So, what do we do? Heed the words of Albert Einstein and the US Marines: "Insanity is doing the same thing over and over, expecting a different result." Don't be insane! Improvise, Adapt and Overcome. Find alternative sources and with every lender you use, adhere to three unwritten laws:

1. Dealers must know the top lenders in their market and fully understand their programs.
2. Dealers must develop strong working relationships or "partnerships" rather, with the buyers at a select few lenders and send them plenty of deals that fit their program. It's a matter of "quid pro quo."
3. Dealers must be proactive with originating and helping to manage profitable loan portfolios with their lending partners. Auto loan originations are not a one-sided business affair with the lenders having the sole responsibility for portfolio performance. The crooks and criminals are quickly being weeded out.

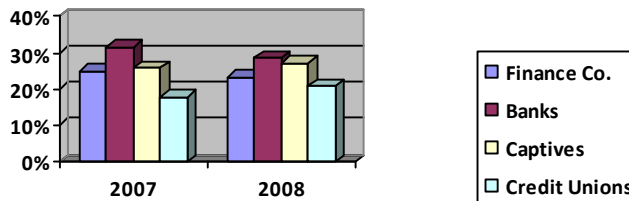
Credit Unions can and will be a powerful lending partner for a dealer that takes the time to develop a strong working relationship with one. So can the smaller, local banks. They operate by different guidelines and restrictions than most other lending entities and tend to take an "old school," common sense approach to loan originations. If the deal makes sense and is submitted by a dealership they trust, the odds are that it will be bought and quickly funded.

Several dealers have realized this opportunity and although vehicle sales nationally have continued to slide, the credit union share of the market has increased according to the recent CUDL 2008 market report. Credit union market share reached 20.8 percent in September 2008 which was a 3 percent increase over September 2007. The report also shows that there has been a significant increase in loans for used cars. Take a look at the following graphs that highlight these two key trends.

Outstanding Auto Loan Balances (\$Billion)



Auto Lending Market Share



Source: CUDL and AutoCount

Credit unions are increasing their share of the auto lending market by being a consistent “local” alternative source for consumer financing and, by partnering with dealerships that understand and pre-empt the changes in the market. Together, they take a proactive approach to finance that mitigates the risk of non-prime automobile loans by focusing on a sound structure for each and every deal. It is an old fashioned business model that has stood the test of time and economics and one that makes sense for the customer, the dealer, and the lender.

Deal structure determines profit. Deal structure dictates loan risk. Deal structure will make or break the deal. And, the Cardinal Law of deal structure is affordability. Can the customer afford the payment? Can the lender afford the risk? Can the dealer afford the profit margin? You can make every deal affordable by focusing on the three profit centers and understand the critical role each plays in determining the profitability and collectability of a loan.

Mr. Tom Herald is a Professional Consultant and National Trainer and with Benjamin Herald Associates. He has over twenty years of experience in the automobile business and ten years as a dealer principal. He is a former Air Force Commander with extensive training as a leader and instructor. He is one of the top experts on Special Finance and can be reached at tom@heraldassociates.com or by phone 859.816.7990