

The Special Finance Customer

By Tom Herald

Several years ago when I first started out as a dealer one of my biggest frustrations with Special Finance was paying a salesperson 25% of the gross profit for basically, just going on a test drive. It didn't take much talent or effort to sell a vehicle to these credit-challenged consumers who otherwise were relegated to driving their "hoopties" or taking public transportation. From my perspective, it was like selling water to man dying of thirst. The real challenge of the sell was getting a lender to pony up some money for a loan that in all likelihood may not be repaid.

Well, it's not much different today with one major exception – competition. As recently as five years ago any dealer who focused on the Special Finance customer could easily run a successful business as long as they had a few good sub-prime lenders and could find affordable cars to sell that would outrun the term of the loans. For many of us, this business was easy and simple. It was like shooting fish in a barrel.

We had the business. We had the "know how." And we had plenty of captive customers, desperate for a reliable automobile but with very few places to buy one. To be successful, we didn't even have to be nice to the customer. We only had to be nicer than the local franchise dealer who aggressively shooed them off their lots like they had a contagious disease. And if you had any business sense at all, it was not too difficult to corner the market for these "unwanted" customers because the demand for services was high while the supply of effective "know how" and desire to sell to them was low.

But the industry changed and the evolution of special finance really started to gain momentum. By 2003, several dealerships across the country were offering some sort of "guaranteed financing" to customers with bad credit. Numerous bright, opportunistic dealers, both franchise and independents alike, started delving into the special finance segment for its huge profits. The secret was out about these unwanted customers and many dealers were starting to prefer them over the price-conscious negotiators with good credit, fresh on the lot and armed with a wealth of internet information.

The oversimplified secret of success in special finance was a much more desirable business model, or at least something worth trying. Many dealers signed up every non-prime lender possible, appointed a talented "paper hanger" as a special finance manager, and employed a couple of inexperienced salespeople as assistants. They then started buying leads from a third-party provider and instantly were in the "Spy Fi" business, much to the chagrin of the more experienced dealers.

As more and more car dealers entered this segment of the market, the landscape of automotive financing quickly began to change. Competition and capitalism were major driving forces and the sub-prime customer suddenly had more choices for buying a vehicle, both good and bad, than ever before. As long as they had a decent paying job with some stability at their residence, they were driving, regardless of down payment. Special finance sales quickly became a major profit center for many

dealers and the “value” proposition for the customer began to focus more on “how much car they could get with little or no money down,” than on prudent deals that actually fit their budget.

The captive finance companies even jumped into the ring in full force. And soon it became common to see customers with credit scores below a 520 drive away in a new car...with little or no money down and no redeeming credit qualities. It seemed nobody had a concern for common sense and logic with loan originations. The focus instead was on profit without regard for equity or concerns for loan-to-value.

Thirty-six month terms on sub-prime loans quickly grew to forty-eight months, then to sixty, then to seventy-two and even eight-four month terms for non-prime auto loans. Deal by deal as the market continued to grow, we struggled to maintain profit margins while at the same time cover up negative equity that in many cases exceeded the actual value of the collateral being traded. We were inadvertently creating our own version of an economic “bubble” by putting too many people into vehicles they simply could not afford.

Can you imagine where we would be today if the automobile was an appreciating asset like homes used to be? We would have a bigger mess than our cousins in the mortgage industry once the laws of business and economics finally collided. It would be another fiscal train wreck, and perhaps much worse than it already is.

So, where do we go from here? The special finance industry will continue to evolve naturally under the brutal forces of capitalism while dealers, lenders and the manufacturers continue to react to their economic environment. It’s back to the basics where the laws of supply and demand and the fundamentals of finance will dictate the future. And for us, it all starts and ends with the customer – The special finance customer.

This buyer still needs reliable transportation and the associated financing that goes along with buying a big-ticket item. And, just like the rest of us, they also want the best value they can afford to buy. But the real art to putting together a special finance deal focuses less on what these high-risk customers want and more toward finding a lender that will finance them and still advance enough money so that a dealer can make a profit. Every deal must be aggressively negotiated for sound, profitable and collectable structure because the list of lenders lining up to loan money at unrealistic terms is dwindling as the market settles back down to reality.

The special finance segment now comprises over 60% of the market and continues to grow while at the same time, we have collectively lost 40% of our ability to finance non-prime customers. The demand for vehicles is still strong and growing, at least in this segment. But the supply of financing has stalled. More and more people are now suddenly unqualified to buy late-model and new vehicles at least at terms that cover up huge equity deficits and still provide a dealer a modest profit margin.

As a result, the special finance customer is again becoming an unwanted entity in the marketplace and only those dealers who have the “know how,” ability (lending strength), and desire will be able to offer viable choices that actually satisfy their needs. Special finance dealers will soon have a more captive customer once again. However, this time around, these astute dealers have learned to master the

fundamentals of finance and the art of customer service. They fully understand what every good buy-here-pay-here dealer has known for years: You can build a very lucrative business around the Special Finance customer with a good lending source and a lot of common sense

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