The Ruggles Report™

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The Ruggles' Report is an ongoing, independently published report with insights, reflections and opinions from noted vehicle expert David Ruggles.

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Dealers Held Hostage By Pay Plans

Dealers have always been challenged with balancing employee compensation plans with what is in the long-term best interest of the dealership. That balance has been particularly difficult to achieve in Sales and F&I as comp plans typically incentivize longer finance terms.

For example, when a lower payment is needed to reach customer requirements, lengthening the term is often the first option for desk managers and is seldom an issue in the F&I office. In fact, most finance managers are all to eager to increase the term because rate participation yields additional back-end gross.

Shouldn't a longer term be the last option rather than the first?

But during these trying financial times, it has been difficult enough to "break black" for the month without putting additional pressure on managers to control (or even reduce) average term.

Dealers understand the ramifications of lengthier finance contracts but few are doing anything about it. Longer terms make it more difficult to re-engage loyal owners even when both parties are ready to do business again. Lenders are much stricter these days when it comes to financing negative equity.

And the cycle repeats.

Dealers desperately need owners to do business more often. They need the volume and to produce trade-ins – especially in today's market where there is an acute pre-owned vehicle shortage.

Yet September's Federal Reserve monthly report shows that today's average finance term is in excess of 63 months up from less than 60 months just a few years ago.

Of course, leasing and balloon financing are excellent tools to shorten term. In a report last month, Art Spinella of CNW Research states, “The average lease term is now 41 months and dropping, while payments are virtually the same as longer term finance contracts.”

But if manager compensation does not incentivize the shortened terms, how can you get there? Frankly you won’t unless you update your comp plan. Otherwise managers will continue to take the path of least resistance and vote their pocket books.

And forsaking rate profit is not the only perceived detriment to implementing a shorter-term strategy. The ability to sell credit insurance and service contracts is thought to be problematic as well. Of course, this will be more than made up if the consumer is purchasing more vehicles more often, but this “big picture” view in dealerships is a rarity these days.

Ex Dealer Mark Ragsdale, author of *Car Wreck: How You Got Rear-Ended, Run Over, & Crushed by the U. S. Auto Industry* comments:

“Since battling with buyers to elect more consumer-friendly financing options can cost both the dealership and the employee money, employees don’t bother with the hassle of it all. While there are long-term dealership benefits to shorter-term financing such as leasing and balloon notes, employees don’t often see themselves as even being employed by that same dealership in order to reap future sales. Employees can and often do find themselves accepting their next dealership job before they have even left the last one. Consequently, dealers are reluctant to train employees to confront financing battles such as increased down payments and logical leasing or balloon contract discussions. After all, if there is an additional buck to be made at a dealership down the street by going with the customer long-term financing flow, why should an employee stick around for painful classroom training?”

And the cycle continues.

Ragsdale goes on to say, “Longer-term finance contracts place consumers in a position of slower loan principal repayment, leaving them upside down in car loans longer. Sometimes the sheer economics of stuffing all present negative equity into a new loan necessitates longer-term financing.

In all cases though, the dealership employee charged with convincing customers to take a shorter term at a higher payment (or cajoling customers into making a larger loan down payment) has little or no incentive to do so. Namely, the consumer resents

higher payments and higher down payments and the dealership actually makes less money by talking a buyer into accepting either of these alternatives to long-term financing."

Becky Chernek, Owner of CCI Learning Center, a nationwide F&I consulting company says, "The course of least resistance leads to managers marking up rate and extending the term to achieve a larger commission check for any given month, absent a compensation plan that takes finance contract term into account." She recommends what she calls a "matrix pay plan" that balances income and term.

Brian Benstock, Vice President and General Manager of Paragon Honda and Acura in New York City, a very successful and high volume dealer, incentivizes his management staff to always look to shorten finance contract term. It is reflected in the dealership's advertising, which features shorter term payments on inventory. Paragon's management staff works daily to apply "Half a Car" principles, which focus on shortened initial finance contract term and renewal procedures to engage owners more frequently. As such, Paragon is winning by focusing on shorter term.

Benstock says, "This will never happen if a dealer's compensation plans works against what is good for the dealership AND the consumer overall. Our dealerships generate a constant supply of excellent pre-owned inventory, all with a local pedigree."

Benstock and majority owner Edith Singer agree that the campaign has resulted in Paragon hitting record profits, despite the bad economy. And it is no accident that Paragon is also the largest selling Certified Pre-owned vehicle operation in the country.

Experts agree, long-term finance contracts aren't good for dealers OR consumers in the big picture and it all begins with pay plans.

The question is, are you prepared to update your comp plan and break the cycle?

About Dave Ruggles

Dave Ruggles is a widely known, auto industry veteran with more than three decades' worth of experience. His self-titled Ruggles Report *is a highly acclaimed industry insider brief detailing the latest hot-button topics in automotive sales, training, recruiting, finance and service.*

Ruggles has sold cars, managed, owned and trained dealerships literally across the world. For the last seventeen years, he has spent a month each summer consulting with the world's largest privately owned Toyota dealership group in Nagano, Japan.

He lives in Las Vegas, Nevada.

Follow his blog "Autos and Economics" at http://autosandeconomics.blogspot.com/

About CyberCalc.com

Founded in 1999 and based in Dallas, Texas, CyberCalc provides a myriad of software services for the automotive finance industry. The company's namesake product is an internet-based lease comparison system used by franchised dealers, credit unions and independent leasing companies. Additional products include private-label derivatives and custom designed commercial leasing, workflow and merchant services applications.