Factoring in Finance Companies

By Andrea McCullion

Selecting the right finance company for your dealership

Every dealership has an opinion on what is most important in a finance company. Some care only about the interest rate the customer will pay; others worry more about how they will be treated or how quickly their loans will be funded.

By focusing on only one specific aspect of a program, a dealer may be missing out on some great financing opportunities. There is no one-size-fits-all answer to what makes the best finance company. Here is a look at just some of the criteria to consider.

Annual Percentage Rate

The annual percentage rate (APR or interest rate) on a finance contract is the amount of finance charges a customer must pay over the life of the loan. APR can be an important factor when choosing a finance company, but its level of significance can be based on several elements.

Most finance companies offer promotional programs, such as 12 months same as cash. Under one of these promotions, customers make minimum monthly payments, but if the loan is paid in full within 12 months, all accrued interest is waived, meaning they get 12 months "interest-free." Dealers pay a fee for the use of these promotions; generally speaking, the longer the same-as-cash period, the higher the fee.

Most customers pay off these contracts during the same-as-cash period, so effectively it does not matter what the APR is. It could be 12% or 30%, but if a customer pays the loan off during the promotion, it becomes zero. Customers are used to seeing these types of promotions at big-box retailers, and those programs generally have interest rates of more than 20%. People continue to sign up, however, because they know they will pay the loan in full and avoid any finance charges.

For dealerships using same-as-cash promotions, the interest rate charged to a customer may not be important.

Discounts

Some finance companies buy contracts for customers with good credit and not-so-good credit. For riskier customers, a discount is charged to the dealer. For example, on a $1,000 contract with a 10% risk discount, the dealership would be funded $900. The dealer is "sharing the risk" with the finance company by paying the risk fee, which cannot be passed on to the customer. This allows dealers to sell to a wider range of customers, assuming they have the margins to do so.

If finance company A offers a loan with a 10% discount and finance company B offers the same loan with an 8% discount, company B seems like the obvious choice. However, the answer is not so simple.

There are a variety of factors potentially influencing a dealer's decision: Is the promotion cost the same? What are the terms for the customer? How fast will the loan be funded? For some dealers, getting paid more quickly by finance company A might outweigh a small difference in bids. And how do the two companies compare on customer service? The overall value of the relationship might play a big role.

Ease of Paperwork

One aspect of financing concerning many salespeople and dealers is the amount of paperwork required for a customer to get a loan. Many of the forms and disclosures are required by state or federal law, but the paperwork can vary from company to company based on a variety of factors.

If finance company A requires two forms and finance company B requires four forms, company A should be the obvious choice. Once again, this may not be the case. The terms offered to the customer, the pricing offered to the dealership, the customer service offered by each company and the speed of payment are just some of the other factors that may play a larger role in a dealer's decision.

Completing paperwork correctly is mostly a matter of training. Most paperwork can be completed in less than five minutes with a little practice. If completing two more forms means getting a few hundred more dollars, most dealers would probably do it. The ease of paperwork is just one factor to consider when selecting a finance company.

Customer Service

Most dealers are not selling products strictly on price. It is difficult to remain the low-cost leader or to stay profitable using that strategy. Instead, most dealers focus on the features differentiating them from the competition, the value those features add and the service they provide.

When considering finance companies, however, some dealers think that the "bottom line" price on each individual deal is the most important factor. For some dealers, this may be true. For others, paying a few additional points here and there for unique promotions or challenging loans might be worth it. If a finance company offers outstanding service, helps out on "iffy" deals, pays quickly or makes the process simple, a dealer may choose to pay a little more for the value added in the relationship.

By building a strong relationship with one or two finance companies, dealers may gain additional benefits that they will not get by shopping every individual deal to multiple companies.

Summary

When it comes to choosing a finance company, there are a variety of factors to consider. The overall value brought by each company should be weighed against the costs involved. Much like a customer choosing a water treatment system, cost is usually not the only factor to consider.

Each dealer must decide which factors are most important to the business and work toward building strong, long-term relationships with the finance companies that best fit their needs. Developing strong relationships with finance companies can help dealers close more sales, increase profits and succeed even in tough times. *wqp*

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