White Paper

Building Synergies: Redefining the Auto Lender's Role in a Market That Still Depends on the Dealership

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Traditional dealerships continue to dominate the end of the consumer auto-buying decision journey, but the front end of that journey is transforming. Consumers empowered by easier access to information and higher expectations require dealers and lenders to provide better integration between online entry points and in-person closing. This new, horizontally-distributed customer journey requires lenders to address three key entry points: aggregation channels, indirect dealer channels and direct lender channels. Lenders need a strategy to pursue profitable customers across these entry points along with a robust technological offering that integrates seamlessly with the dealership.

The Consumer Auto-Buying Decision Journey is Evolving

A decade ago, dealerships controlled most of the critical moments across the car-buying journey (see Figure 1: Traditional Auto-Buying Decision Journey). Dealer-centric ads triggered purchases by prompting customers to start their search at a specific place. Dealer inventories dictated customer options. Dealer incentives influenced financing at the point of purchase, just as dealer satisfaction predicted a customer's probability of default.

In this dealer-dominated world, auto lenders acted as sub-suppliers and the relationship often proved symbiotic. Rather than compete in a crowded consumer marketing space, lenders could target a few dealers to acquire customers for them. These dealers could become lucrative business customers by financing their real estate loans, commercial loans, and floorplan accounts through the partner bank. The consumer also seemed to benefit by being saved from finding auto finance at an offsite branch.

Figure 1: Traditional Auto-Buying Decision Journey

	Dealer	Brand	Bank	Consumer
Trigger	In Control	Main Influencer		
Initial Consideration Set	In Control	Main Influencer		
Active Evaluation Info	In Control			Main Influencer
Moment of Purchase	Main Influencer			In Control
Post-Purchase Experience	In Control		Main Influencer	

Main Influencer · In Control

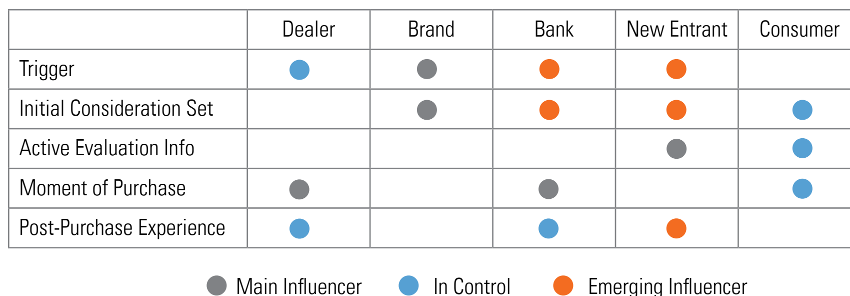
This dealer-dominated model is disappearing. In a world that provides consumers with access to information 24/7, the power balance is now distributed horizontally in favor of the consumer (see Figure 2: Evolving Consumer Auto-Buying Decision Journey). Since the traditional dealer model evolved in a world where dealers could control most information across the car buying process, better-informed customers signal this model's decline. Today, many consumers come to a dealership knowing more about the car they want to buy than the sales person who sells it. These customers know dealer cost and incentives; they know what other customers paid; they know the vehicle's quality score and the dealership's inventory limitations–all before setting foot at the physical dealership. These trends are starting to affect financing too. Rather than suffer through traditional negotiations from a position of weakness at the dealership, consumers now demand the same level of transparency and anonymity that online shopping gives them elsewhere. As lenders attend to this upheaval, we recommend a three-step approach.

A Three-Step Approach for Lenders to Bridge the Digital Demand Gap

Step 1: Understand trends affecting dealer/lender supply and consumer demand

No one needs to be told that car buying can be difficult, but statistics drive home the point. Research from IHS suggests that 44 percent of customers are dissatisfied with the amount of time they spend buying a car, a process that takes 14 hours and 44 minutes on average. Those consumers spend roughly 60 percent of their time researching online, versus 35 percent at the dealership. This data offers a cautionary tale to complacent dealers and to enthusiasts who think that traditional dealerships are poised for complete disruption: 44 percent dissatisfaction is concerning, but surmountable. The reality, and central thesis of this paper, is that dealerships and traditional auto lenders will continue to play an important role in the consumer journey, especially at the point of purchase and beyond. Rather than transform their businesses, dealers and lenders need to work together to ensure seamless integration between online acquisition channels and in-person closing.

Figure 2: Evolving Consumer Auto-Buying Decision Journey



To be sure, the car industry has changed significantly over the last ten years. It no longer makes sense for consumers to select from location-constrained inventory or contend with an enervating, negotiation-encumbered sales process. Even dealers acknowledge the frustration these tactics can cause: "The traditional business model of how cars are sold in the U.S. is flawed," Lexus® dealership owner Peter Cooper told Lexus Enthusiast in September 2016. "It used to be that the dealer had all the information, and the consumer was at a disadvantage. Today, the consumer can find out anything they want about any car."

Indeed, consumers have adapted to this dissatisfaction by reducing dealership traffic. As recently as 2005, J.D. Power reported that the average consumer made 4.5 dealer trips per purchase in the attempt to expand product and financing options. Today, that same consumer makes only 1.4 trips per purchase, with a full 46 percent of buyers visiting just one dealership. The balance of time that consumers spend at the dealership has tipped irreversibly away from the dealer. New car buyers spend 55 percent of their purchase time researching online versus 41 percent of their time in the dealership. Used buyers spend 60 percent online compared to 35 percent at dealerships.

While consumers have always clamored for better service, lower prices, and faster results, they can reasonably expect an improved car buying experience from the multi-player universe today. Startups like AutoGravity are shifting the search and purchase points online, eliminating the inefficiencies of distant dealerships and pre-haggle prices. TrueCar®, another startup, shares real price information with its customers, further eroding the dealer's asymmetric information advantage (even if it still depends on dealership inventory). As a result, dealerships continue to cede control across the consideration and evaluation phases.

Step 2: Adapt to new trends by building a multi-channel strategy native to the demand-centric world

The Dealer is Still King

The best way for lenders to cater to consumers is to devote significant attention to the dealer. Dealerships will not disappear tomorrow, both for legal and operational reasons. Legally, many states still prohibit car sales outside of dealerships. While Tesla has seen more success in changing the dealer-dominated car distribution landscape than any other non-traditional car manufacturer, they continue to face fierce opposition in large markets like Texas, which has the second-largest base of new car buyers.

> While Tesla accounts for less than 0.5% of the total car units sold in 2017, it represents the progress of all non-dealers moving into direct consumer sales.

Where You Can and Can't Buy Cars From Auto Brands Directly

Though Tesla and other dealership alternatives are slowly changing these laws, we expect dealer-dominated distribution to continue for at least the next three years, or as far out as any expert can reasonably forecast. Operationally, dealerships still perform vital functions with acceptable efficiency. Until cars can drive themselves, it makes sense to keep inventories and service facilities close to population centers. Dealerships cross-sell aftermarket insurance products (gap or service contracts), complete necessary paperwork (title applications), and facilitate the trade-in process for customers who want to use equity in an existing vehicle toward the purchase of a newer vehicle. Dealerships do all these functions at an efficiency threshold that would be difficult to disrupt. Despite its reputation for tedium, the dealership is still a one-stop shop.

In keeping with these trends, Fiserv research estimates that less than 2 percent of car purchases were completed without any trips to the dealership in 2016, and that just 5 percent of these purchases will occur by 2020.

The dealer's approach to auto finance is still relatively efficient as well. Dealers who maintain several lender relationships can often match or beat rates offered by a direct lender. An internet-savvy customer who negotiated a low sales price and arranged a direct loan before entering the dealership could still "flip" toward a dealer-suggested payment or rate.

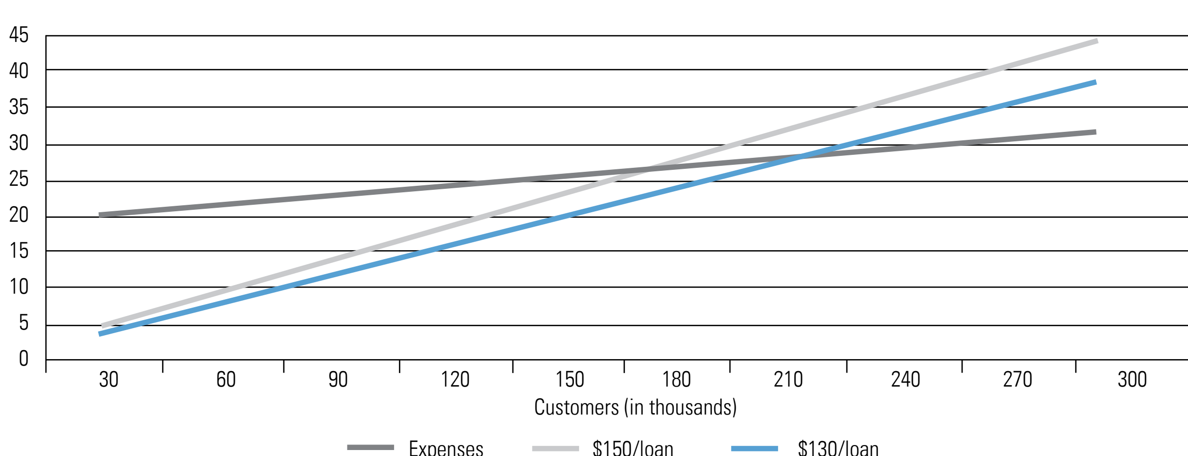
Yet many parts of the traditional dealer are broken as evidenced by dealership financials.

In the average dealer profile published by NADA in 2016, operating profits dropped 32 percent from 2015 to 2016, and net profits before tax fell 4.1 percent in spite of a record setting year for auto sales. Price compression caused by cost and incentive transparency will continue to pressure the net profit per vehicle: last year that number fell by 28.5 percent.

Lenders tied to the dealer need to help the dealer adapt. Those who want to expand into a direct acquisition must recognize their continued dependence on the dealer, even as they look for ways to deliver an improved experience that caters to more powerful consumers. It would be a mistake for most lenders to seek new licensing arrangements that pit them against dealership financing all the time. Simultaneously, lenders seeking online and dealership presences should be careful of "beating their own rate," a pyrrhic victory that occurs when the lender lets the dealer best any offer, including one issued by the same bank on a different channel. Most importantly, lenders must move past the status quo. Those looking to adapt need to renegotiate their dealer relationships as part of a plan that caters to a consumer-centric acquisition model that includes both direct and indirect channels.

Figure 3: Aggregator Customer Acquisition Cost Analysis

Analysis assumes 5 employees per 30,000 net new customers plus industry-standard sales and marketing expenses proportional with customer growth.



Source: Fiserv (analysis)

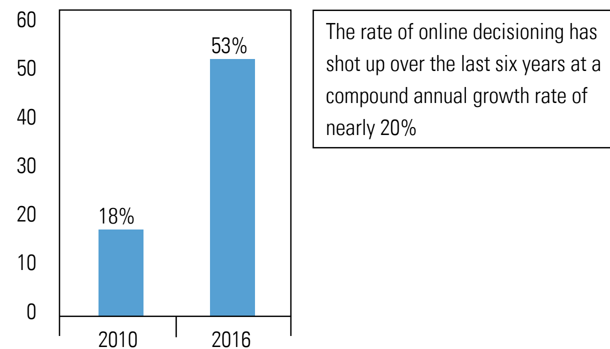
Bolster the Dealership Experience with New Channel Considerations

Lenders can reinforce or replace the dealer in at least three ways:

1) **Indirect: Aggregator** In line with the trends of increasingly abundant information, comparison sites will continue to gain control over the customer journey. Expedia, Moneysupermarket.com, and other aggregators illustrate the success of comparison platforms, which make money by acquiring customers on behalf of partner organizations. These platforms rely on robust decision engines to filter products specifically to a customer's need, and they look promising because they create value for all counterparties: the consumer benefits from comparison-induced price compression, but suppliers can also capitalize on lower customer acquisition costs. For instance, Fiserv analysis suggests that auto finance comparison site AutoGravity has a structural cost advantage over traditional dealers because of its superior ability to scale (see Figure 3: Aggregator Customer Acquisition Cost Analysis).

   Aggregators may also compete with lenders. Platforms that offer their own financing options may present traditional lenders with so few conversion opportunities that a manager may reasonably ask if such a partnership is worth the effort. We believe that lenders need to develop a customer acquisition strategy before joining an aggregation site. The most successful lenders build their pricing strategies around specific customer segments that they can attract with competitive pricing and retain at high margins. Lenders who rush onto comparison platforms without understanding their customer acquisition strategy may fall prey to indiscriminate price compression as real-time conversion data encourages them to chase unprofitable leads.

Figure 4: Automated Decision Rates at American Car Dealerships



Source: Fiserv

   While lenders should first seek out platforms attractive to their target customers, they should then consider casting a wide net. Even when a customer journey does not end in an online sale, the comparison process can provide free advertising: besides facilitating brand recognition, the aggregator can funnel customers directly to the lender. Just as Expedia users may find a deal on Expedia before booking the flight directly from an airline, so car buyers can use aggregators to deal directly with a bank. Against this disintermediation, aggregators sometimes employ call center staff to close inquiries initiated online. Lenders looking to increase the payoff of the aggregator channel should consider ways to collaborate with these contact centers. Some lenders may benefit from offering the aggregator call center staff rewards consistent with dealership incentives. Others may prefer to use their own inside sales force and simply purchase customer information from the aggregator.

2) **Indirect: Dealer/Brand** Lenders need to continue partnering with dealerships and brands (i.e. captives) through traditional, incentive-based relationships.

   If accepted industry wisdom holds, and dealer satisfaction influences a customer's willingness to repay a loan, the best lenders will facilitate hassle-free

financing at the dealership. Fiserv analysis suggests that lenders are embracing this trend. Over the last decade, auto-decision rates at the dealership have improved from less than 20 percent on average in 2010 to over 50 percent in 2016 (see Figure 4: Automated Decision Rates at American Car Dealerships.). Technological intervention can dramatically improve decision making, speeding time to purchase and cutting FTE (full-time employee) costs simultaneously.

In one case, a small bank processing around 12,500 loans per month increased automated decisions at all its dealerships from 14 to 50 percent. Besides cutting time from an unpleasant customer experience, this transformation boosted productivity by 384 percent compared to similar lenders. It also allowed the company to repurpose more than 60 percent of its credit staff.

3) **Direct: Dealer Referral** As new entrants take functions formerly controlled by the dealer, lenders should look for ways to also assume ownership. Direct lending, long dismissed as a distant idea, happens today at the most advanced banks. Chase Auto Direct recently launched an online platform that refers Chase customers to 14,000 Chase-certified dealers. Lenders that leverage their own data can capitalize on the shift toward convenience and transparency. As one example application, a bank could scrape deposit accounts to generate push notifications about lower car payments. Just as Capital One® scrapes its customer base to cross sell American Express cardholders, so banks and credit unions could offer to refinance loans currently held by other auto lenders.

Step 3: Adopt technology to facilitate change

Buyers expect an information-rich transition between digital acquisition and physical sales environments. "Most consumers start their journey online and expect continuity across channels–and for dealers to have access to the information that the customer shared anywhere on that journey," says Patrick Pélata, chief automotive officer and executive vice president of Salesforce.com. To achieve this continuity, lenders need a strategy to integrate the online and in-person experiences. Building a mix of acquisition channels is only the first step; next, lenders need to offer seamless integration across the customer journey.

Online applications and decisions

At a minimum, lenders need to accept credit applications online and electronically return a response to both the customer and the dealer partner. Additional capabilities like virtual finance and insurance (F&I), online trade-in appraisals, and e-signatures can differentiate a lender's online customer experience.

Each of these features requires complex configurations. Take credit decisions, the most basic requirement of an online lending strategy. Dealers expect quick credit decisions most of the time, but they know that some complex deals require manual intervention that can last hours, if not days. Customers do not have that same expectation. In instances where software cannot generate an automatic decision, lenders need to direct the customer to someone who can help. During declines or conditions, for instance, the lender may refer the customer to the dealer who can restructure the deal or fund it through alternative sources.

Vehicle protection

Lenders who attempt to take the transaction completely online need to offer vehicle protection. Gap insurance and service contracts form an increasingly large part of the dealer's gross revenue, so lenders need to work with the dealer to establish options and pricing for these aftermarket products. According to NADA Data, the percentage of aftermarket income to new and used vehicle department gross profit has risen every year since

2009 to over 40 percent in 2015. In 2016, F&I penetration continued to inch upwards, from 89.7 percent in 2015 to 91.2 percent. Lenders looking to facilitate the sale of these products can do so by building a solution in the online application portal, or by working with third parties such as dealer portals or dealer menu solutions.

Online trade-in

Online trade-in quotes constitute another critical part of comprehensive digital strategy. These quotes are available today, but with limited use from only a few providers. Given the low penetration rates, online trade-in quotes can truly differentiate the customer experience of banks who successfully integrate the product into their digital offerings. Customers who can negotiate their trade-in online before entering the dealership are more likely to leave feeling satisfied. As decision making moves online, the technology providers present at the point of decision will increasingly capture brand-building business once won as an afterthought at the dealership desk.

eContracting

Although electronic signatures and e-contracts have been legally recognized for a decade, they have suffered from slow adoption. Thankfully, this trend has started to reverse. If a lender can solve for the aftermarket and trade-in portions of a financial transaction, the final step requires the lender to close transactions online. Here again, lenders should consider plugging into the dealer portal. By letting customers sign digitally at the dealership, the lender can create continuity by allowing consumers to finish their journey at the most natural time: the moment before they take the keys.

Dealers and lenders need technology that eases the transition from research to decision making. Customers who flow from their online starting point through carefully curated channels will likely leave more satisfied, an outcome that benefits all parties.

A Seamless Car-Buying Experience

Before racing to implement the next digital trend, lenders should consider the macroeconomic contours of their current circumstances. Traditional dealerships will continue to dominate the end of the decision journey, but the front end of that journey is transforming. Consumers empowered by better information and higher expectations require dealers and lenders to smooth the integration between online entry points and in-person closing. In the new customer journey, lenders need to address at least three entry points: aggregation channels, indirect dealer channels and direct lender channels. Lenders need a strategy to pursue profitable customers across these entry points. In all cases, they also need a robust technological offering that integrates seamlessly with the dealership. Dealers and lenders should work closely together: not only does aftermarket financing form a growing percent of a dealer’s margin, but dealer satisfaction also influences a customer’s willingness to repay.

About the Authors

Scott Hendriks has over 20 years of experience in the consumer finance industry from both the lender and service provider sides of the business. He spent 10 years in the mortgage lending, consumer lending and indirect automotive lending segments of the market originating receivables both for prime and non-prime portfolios. During this time, he worked very closely in many aspects of auto finance including credit operations, risk management and compliance. Since joining Fiserv in 2002, Scott has been very involved in the development of the Auto LOS product and now serves as the Director of Product Management for Auto Originations.

Vincent Weir has spent his career helping financial institutions adapt to the industry's digital crossroads. As a member of McKinsey & Company's payments group, he advised clients and published research on digital strategy and liquidity regulations. Before joining Fiserv in 2016, he worked in Berlin as an executive advisor in the person-to-person (P2P) lending space.

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