

## **MATCHING THE RIGHT CUSTOMERS WITH THE RIGHT VEHICLES!**

### **BY KENNETH B. SHILSON, CPA**

In a recent article, I mentioned that Buy Here, Pay Here sales nationally were lower during the first six months of 2006 when compared to last year (2005). A client survey I recently conducted suggests that the decline averaged approximately 10% overall. My previous article cited the following reasons:

- 1) Higher gasoline prices hovered around \$3.00 during the first half of this year thereby reducing customer disposable cash flow. Although gasoline prices have recently declined, many believe that lower prices may only be temporary.
- 2) Energy prices for heating oil and electricity have also skyrocketed. Although heating bills were much higher, many consumers were mercifully spared by the relatively mild winter nationally. However, it has been an extremely hot summer throughout the nation and higher air conditioning bills have really hurt consumer cash flow and restricted their ability to make major purchases.
- 3) Immigration reform continues to create both unrest and uncertainty amongst many foreign Americans. These immigrants have been reluctant to make larger purchases for vehicles until the immigration laws are resolved.
- 4) Inflation has generally increased the overall cost of living quicker than most incomes have risen. Although our government continues to regulate inflation with monetary controls (like interest rate increases) there is much uncertainty about inflation ahead.

Fortunately for the Buy Here, Pay Here industry, credit impaired Americans need vehicles for their jobs and due to their past credit problems have very limited financing options. Therefore, the industry need not worry about selling vehicles. Instead, dealers must make sure their customers can pay for them given the aforementioned tight economic circumstances. In other words, collections again move to the forefront!

It is a certainty that Buy Here, Pay Here customers will have very limited financial flexibility to withstand the impact of the aforementioned items individually, let alone collectively! Therefore, prudent operators can help by performing more analysis of the customer's financial condition when underwriting a sale.

It is my belief that a more thorough understanding of each customer's recurring income and expenses and the preparation of a budget are good first steps. For instance, if a customer's income includes having overtime or is dependent on other factors (seasonal), a careful analysis must be made to ascertain how much of their income will likely recur. Expense items must be separated between discretionary and non-discretionary items. Both are important! Non-discretionary expenses like food, rent, gasoline, and utility bills will recur along with their car payments. On the other hand, discretionary expenses for entertainment and miscellaneous items really represent the only source of their financial flexibility. In other words, these will be the first items to be cut when gasoline or utility costs increase.

Maybe all of the above just seems like good common sense. However, many of the dealer's I see nationally don't attempt to help their customers determine which vehicles they financially can afford versus those vehicles they may "want". In these circumstances, if the customer is sold a vehicle with too high of a payment, he or she is destined to fail! Unfortunately, so is the buy here, pay here dealer who sold it.

Other factors, like time on job, time in residence and other items used to measure a customer's stability, are also important. However, the stability factors only indicate that that customer may try and pay for the vehicle and not that they will actually be able to afford it.

The car payment when compared with a customer's disposable cash flow seems to provide the best indicator of whether a customer can really afford the vehicle being purchased. Unfortunately, most dealers differ on what ratio really works. In practice, I see dealer's limit debt / disposable cash flow ratio's to a maximum 10 – 40%. Alternatively, many merely use a ratio of debt / gross income without deducting customer living expenses. The variances in these practices are too significant for all of them to be right!

Unfortunately, unless dealers can gather the aforementioned data electronically through their software systems, it is difficult to assemble, correlate, and analyze it. This makes a great case for using online credit applications instead of the antiquated manual application techniques which are prevalent in the industry today.

A few software vendors have already realized that online applications will allow dealers to develop profiles of their customers – good or bad. Verification of income and expenses coupled with budgetary analysis will allow dealers to find the optimum debt / disposable cash flow level that really works. In the months ahead, Buy Here, Pay Here dealers must fight for every customer's cash flow dollar. That battle will be more easily won if the dealer has good information and uses it prudently at the time of sale. If dealers expect customer repayment, each deal must begin with the right customers in the proper vehicle. Good Luck!

Kenneth B. Shilson, CPA, is a Principal in Shilson, Goldberg, Cheung & Associates, LLP, and is President of Subprime Analytics, which performs electronic portfolio analysis. Mr. Shilson is also the founder of the National Alliance of Buy Here Pay Here Dealers (NABD) which will host a BHPH Collection Academy near Atlanta, Georgia, at the Manheim DRIVE Center, January 9 – 11, 2007. Collection and underwriting practices will be discussed in detail at the Collection Academy. For further information, visit the NABD website at [www.bhphinfo.com](http://www.bhphinfo.com) or call 713-290-8171.