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J.D. Power Insights

Understanding the Emergence of Preferred Dealer Arrangement

Competition is fierce in the auto finance community. In the prime retail credit area, satisfaction scores for 11 finance providers have significantly increased, and many of those providers perform above industry average. Consequently, dealers have a number of attractive options when it comes to selecting a finance provider, making it important for providers to differentiate themselves from their competitors.

Many providers are avoiding a competition to gain dealer business based on price alone by instituting preferred relationships with dealers. Preferred relationships can be defined in several ways. In many instances, captive relationships are, by nature, preferred relationships, given their ties to the OEM and access to subvented deals. However, many non-captives are introducing preferred relationships to the dealers they want to work with most (e.g. high-volume dealerships, etc.) to help garner a larger share of their business.

In general, these preferred relationships consist of volume-based rate discounts on retail or floor plan deals; fast-tracking for approvals and funding; dedicated buyer relationships; and more flexibility in buying policies. In the case of offering discounted rates, a certain threshold of units or a percentage of the dealer's total business (or even a particular tier of business) needs to be sent to the provider in order to qualify for discounted programs. Among captive providers, an established threshold of non-subvented business needs to be sent to the captive in order qualify for special programs. In both cases, the dealer needs to take the initiative in order to qualify for preferred programs.

Finance providers that have already introduced preferred relationships differentiate dealers by using various labels, such as silver, gold, and platinum or Tier 1, Tier 2, and Tier 3. However, they all essentially represent the same focus: preferred dealers have access to special programs but also need to keep up certain standards or risk being dropped from a program.

Preferred programs are not new to the market, but are certainly a growing trend. This is not unexpected, given the hyper-competitive nature of the market. More finance providers are considering preferred relationship programs to help limit transactional discussions and to develop deeper relationships with their dealers that lead to smoother ongoing transactions, deeper penetration, and longer-term partnerships.

Preferred relationships have an impact, as they are designed to do, on the percentage of dealer business captured by finance providers. The chart below shows the impact preferred relationships have on provider share (prime retail data). Dealers in a preferred relationship with a finance provider are much more likely to send a

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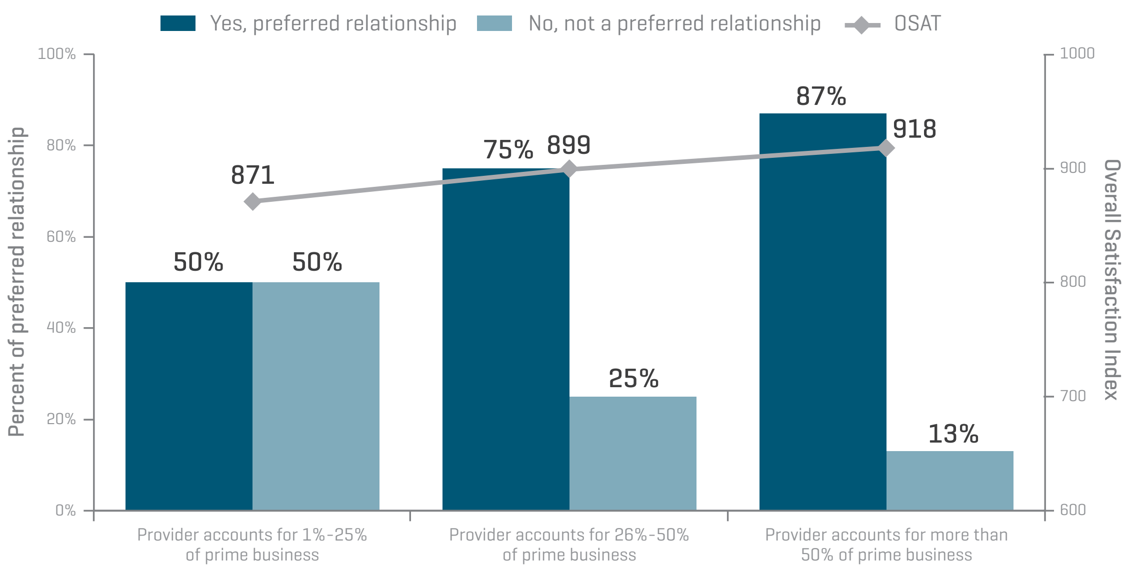
larger percentage of business to that finance provider, compared with dealers that aren't in a preferred relationship. A majority (87%) of dealers indicating they send more than 50% of their prime business to a lender report being in a preferred relationship. Comparatively, far fewer (13%) dealers that aren't in a preferred relationship indicate sending more than half their prime business to a lender. Notably, satisfaction also increases as the percentage of business the provider receives increases, suggesting that both the dealer and lender benefit from a deeper relationship that enables the dealer to sell, approve, and fund vehicles faster and, ultimately, provide customers with a more satisfying financing experience.

PREFERRED RELATIONSHIP WITH FINANCE PROVIDER BASED ON % OF BUSINESS



Total N=8,863
Survey Question: PRC Q20_Prime: Does your dealership have a preferred relationship with [finance provider]? and PRC Q3: What percentage of all your dealership's total funded Prime Retail Credit business goes to each?

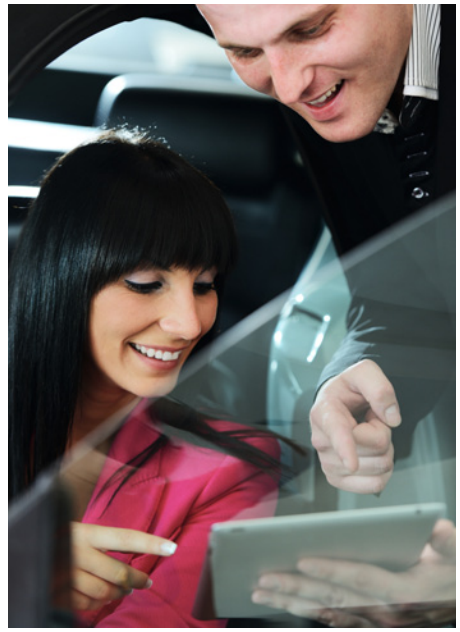
Source: J.D. Power and Associates 2012 US Dealer Financing Satisfaction Study[SM]

In a preferred relationship, the finance provider receives more of a dealer's business, which ideally can be maintained due to a more satisfying experience for the dealer. Dealers provide considerably higher ratings for all attributes when a preferred relationship is in place. The areas with the biggest differences are highlighted below.

1. Flexibility of the buying policy: Dealers in a preferred relationship indicate experiencing a considerable increase in the flexibility they receive from their provider as the single biggest difference between a preferred and traditional relationship. While dealers often communicate the desire for greater flexibility in a provider's buying policy, it isn't easy to build into any business model. However, with the selective nature of preferred relationships, exceptions can be more easily made, as the overall relationship trumps any one given deal.

2. Helpfulness of the credit staff when restructuring deals (application process): Linked to the concept that there is more flexibility with a provider when there is a preferred relationship, dealers also are more satisfied with the helpfulness of the credit staff. Dealer satisfaction with the credit personnel is higher, as staff are more empowered to be flexible with preferred dealers. This is a powerful component of overall satisfaction, as helping to complete the deal is of paramount importance. Another fundamental aspect of the dealer-provider relationship is speed of funding and speed of approval. Both of these attributes are positively impacted when there is a preferred relationship. In addition to the satisfaction attributes, the KPIs help support the contention that preferred dealers perceive faster funding and more automatic approvals with a 12%-17% lift in dealer-reported turn times for both funding and approvals.

3. Usefulness of visits and responsiveness of sales representatives: Dealers most often say they want a valuable visit from their sales representative. Time spent away from selling vehicles is precious and needs to be time well spent. Given the depth of understanding the lender has when there is a preferred relationship, dealers provide much higher satisfaction ratings for Usefulness of dealership visits. Dealers also feel a sense of urgency being placed on their questions and requests when there is a preferred relationship. Whether or not actual turn time between preferred and traditional relationships is perceptual or is reality is irrelevant, as dealers perceive they are being treated special and, as a result, are more highly satisfied.



IMPACT OF PREFERRED RELATIONSHIPS ON DEALER SATISFACTION

Preferred relationship comparison	Preferred relationship	Not a preferred relationship	Importance weight	Difference between scores
Prime Retail Credit Index	**919**	**845**		**74**
Finance Provider Offering	**896**	**816**	**38.03%**	**80**
Competitiveness of rates and terms on new vehicles	9.15	8.50	17.16%	0.65
Competitiveness of rates and terms on used vehicles	8.77	8.15	11.45%	0.62
Appropriateness of financing reserves	9.11	8.38	14.89%	0.73
Flexibility of buying policy	9.11	7.88	26.33%	1.23
Reasonableness of advance on additional items	9.17	8.36	18.33%	0.81
Competitiveness of flat fee	8.64	7.80	11.84%	0.83
Application/Approval Process	**932**	**870**	**36.40%**	**62**
Ease of processing applications	9.52	8.98	13.37%	0.54
Timeliness of approval	9.34	8.61	19.76%	0.73
Helpfulness of credit staff when restructuring deals	9.40	8.51	16.60%	0.89
Professionalism of credit staff	9.59	9.04	13.78%	0.55
Credit staff's responsiveness to questions	9.46	8.72	9.34%	0.74
Reasonableness of documentation required for credit approval	9.37	8.80	12.93%	0.57
Speed of funding the deal	9.30	8.43	14.23%	0.87
Sales Representative Relationship	**936**	**853**	**25.57%**	**82**
Usefulness of dealership visits	9.32	8.14	27.99%	1.18
Professionalism of sales representative	9.60	8.89	31.94%	0.72
Sales representative's responsiveness to questions	9.50	8.59	20.43%	0.91
Timeliness of updates on programs	9.53	8.86	19.64%	0.67

Source: J.D. Power and Associates 2012 US Dealer Financing Satisfaction Study℠

There is a considerably higher incidence of preferred dealers who say their finance provider meets the KPIs. The biggest differences in scores between preferred and traditional relationships are for process-related KPIs. However, the biggest difference between these two groups in the KPI being met is for sales rep visits on-site 12 or more times per year. Finance providers are demonstrating their commitment to and interest in managing those dealer relationships more heavily in order to better monitor program guidelines to ensure they are being met by the dealer, as well as to ensure the dealer is serviced well in an effort to encourage them to continue working with that provider.

IMPACT OF PREFERRED RELATIONSHIPS ON PRIME RETAIL CREDIT

Prime retail credit comparison of preferred vs. traditional relationship	Preferred relationship: percent KPI is met	Traditional relationship: percent KPI is met	Average satisfaction score with preferred relationship	Satisfaction gain with preferred relationship
Automatic approval from application submission to contract approval	53%	41%	933	60
Time to fund is 24 hours or less	63%	46%	935	58
Sales rep currently provides most important function to you	82%	66%	929	57
Sales rep visits on-site 12 or more times per year	58%	33%	942	52
Work with the same credit buyer 80% of the time or more	58%	45%	935	50
3 or more methods used to be updated on program offering/rate sheet changes	51%	38%	932	48
Sales rep contacts by phone 12 or more times per year	66%	42%	935	38

Source: J.D. Power and Associates 2012 US Dealer Financing Satisfaction Study[SM]

In summary, preferred dealer relationships may lead to more business for a finance provider, as well as better service and experience for the dealer—but it isn't necessarily the right fit for all relationships. Depending on dealer status, relationship tenure, and performance history, providers and dealers must make individual decisions on the best relationship in each instance. Dealers may decide not to participate in certain programs offered by the provider if they feel the constraints are too restrictive, exclusive, or damaging to other valued relationships, or are too difficult to meet. However, by and large, preferred relationships are mutually beneficial and most likely are a growing trend. At the same time, traditional dealer relationships will always have a place in the market and need to be nurtured in order to ensure healthy competition for both dealers and finance providers.

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