eBook: ADS

Alternative Deal Structures (ADS)

Leveraging Advanced Pricing Analytics to Maximize Automotive Lenders' Competitive Advantage and Best Practices

earnix

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Executive Summary

In the "good old days" of buying or leasing an automobile, once the price negotiation was complete with the dealer's sales representative (the "let me run that by my manager and see if it'll fly…" phase), the financing discussion would ensue.

For many buyers, this phase of the transaction causes anxiety and makes the experience much less pleasant than it should be.

In today's hyper-competitive automotive lending market, consumers have a wide variety of vehicle choices, shopping venues, and financing options. And they now have many ways to avoid back-and-forth haggling, meaning that lenders must accommodate many different modes of financing.

Alternative deal structures (ADS) allow lenders to offer up several financing options in response to a single credit request. ADS are a must-have way for lenders to keep potential borrowers from walking away, whether those consumers are buying in person or online, and whether you're a captive lender or independent of the brand and dealership. ADS also has the effect of retaining and enhancing dealers' and other retailers' loyalty, as it makes their selling and closing job easier.

This eBook recaps some of the market forces driving the need for all automotive lenders to adopt alternative deal structures, the potential payoffs from this mode of financing, and the technology path that will help lenders maximize the effectiveness of ADS today and into the future.

Let's look at a hypothetical conversation between a dealer and a buyer where ADS is not being leveraged:

OK, looks like you negotiated a great price here and got a lot for your trade-in. Congratulations! And your credit score is excellent, so we should be able to get you into a nice loan package. How much are you planning on putting down?

Dealer financing manager

I'm not sure, I'd like to keep the payments manageable, but don't have a ton of cash.

Auto buyer

Let's start with 20% down, how long would you like the loan to go?

Dealer financing manager

Well, my last loan was 4 years. How would that look?

Auto buyer

Let's see. Running the numbers, that would be $348.90 a month over 48 months.

Dealer financing manager

Wow, that's more than I'd like to pay every month.

Auto buyer

Well, we could go to 60 months, that lowers the payment by about $50 a month.

Dealer financing manager

Well, that's better, but I'm not sure I want a loan that lasts that long.

Auto buyer

If you could come up with more cash up front, maybe a 54-month loan would work… If you can't come up with more cash, we could go to 72 months, since people are keeping their cars a lot longer now, and they last 200,000 miles or more.

Dealer financing manager

Wait, wait. Can you run through all those numbers again?

Auto buyer

ADS Is Driven by Changing Market Dynamics

While some buyers still prefer to walk into a dealership with little advance research, and to “kick the tires” and go through the entire purchase and finance process in person, those buyers are becoming more and more rare. Much more of the typical process is now completed mostly, or perhaps entirely, online.



Almost Everyone Uses the Internet for Research

As with all consumer experiences, car buying has been transformed by the Internet. With the wealth of information available online, whether on the auto brand’s site, publication-sponsored review sites, or posted customer reviews, online research can take most shoppers well into the process.

From the very beginning of the search, the overwhelming majority of buyers do their research online, according to Think with Google: **92%** of buyers conduct research online.

When the research is done, and the “consideration set” established, the buying process moves into full swing, and this is where for some, dread begins to set in.

The Rapid Evolution of the Buying Process

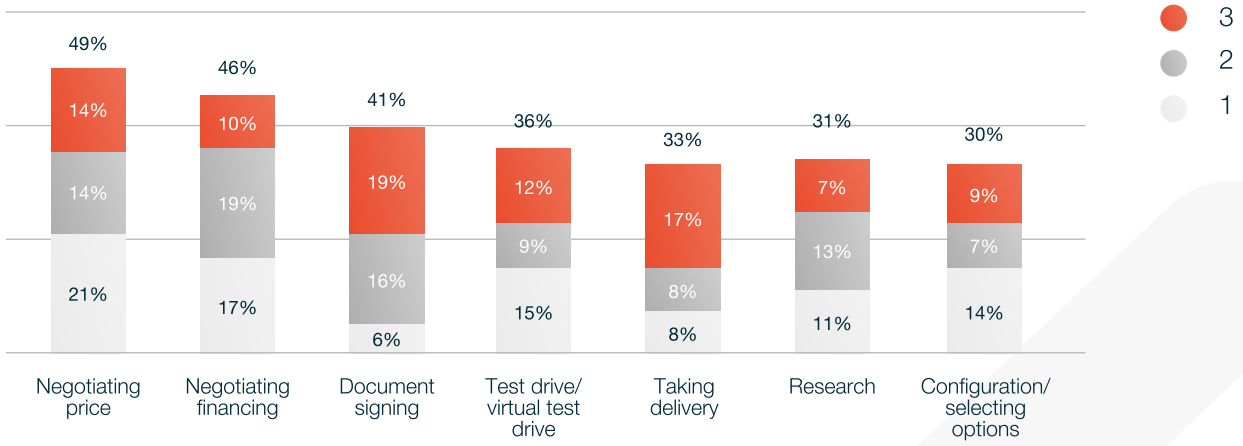
As recounted in a recent PwC survey of consumers and car dealers, the dealer experience is far from dead. 80% of buyers still find the experience valuable for viewing and comparing vehicles, taking test drives, interacting with dealer staff, bringing along friends and family for their opinions, and the like.

But, as PwC puts it bluntly, “Pricing and financing are the two areas that aggravate customers the most and are shifting strongest to online.”

In PwC’s survey of dealers, 46% placed Negotiating Financing among the top three dissatisfiers for customers, second only to Negotiating Price (49%).

Dealership Survey

Which part of the purchasing process do you think creates the most dissatisfaction for customers?

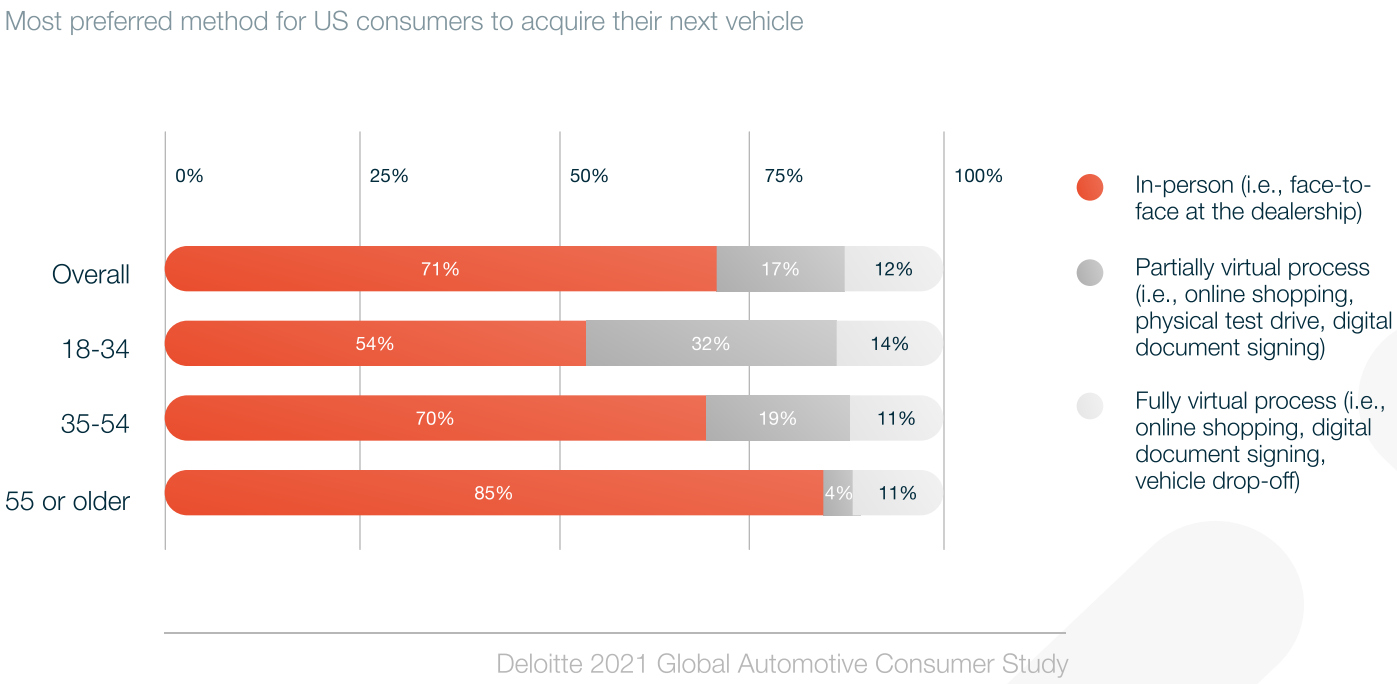


PwC’s 2022 Car Consumer and Dealer Survey carried out in April, 2022. Includes 1,275 US car-owning consumers and 111 owners/general managers of new car dealerships.

The bottom line: Very few people enjoy the haggling involved in auto lending, and everyone else is looking for less stressful alternatives.

Perhaps due to their being raised in an “always connected”/”instant gratification” culture, younger buyers in particular express a willingness to complete all or part of the purchase process online, as seen in this breakdown of consumer preferences by Deloitte:

Most preferred method for US consumers to acquire their next vehicle

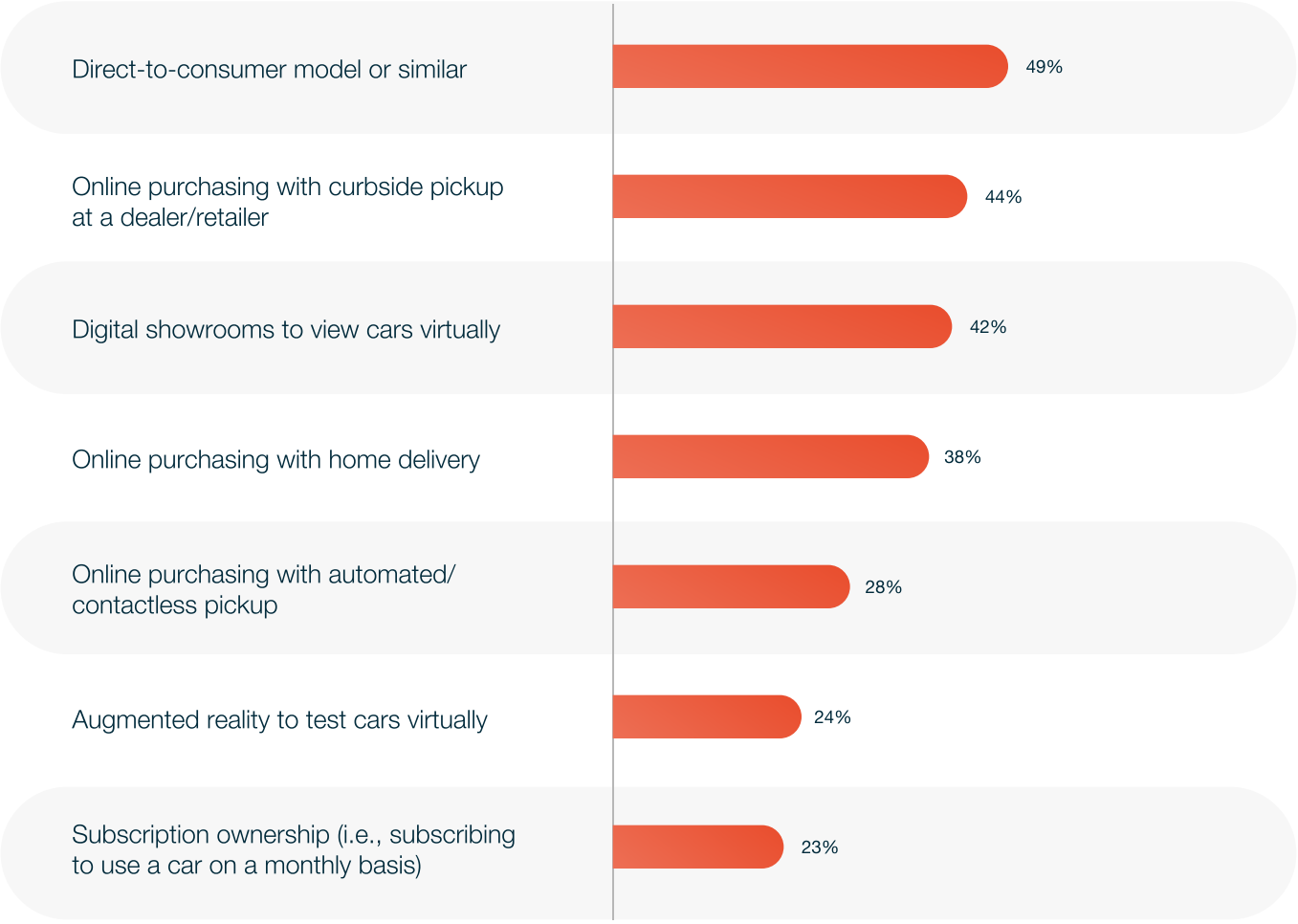


Deloitte 2021 Global Automotive Consumer Study

Across all buyer demographics, a CarMax survey from early 2022 indicates that direct-to-consumer (DTC, or through a dealer) is no longer the preferred purchase method among the majority of those contemplating their next vehicle. Based on their survey, the various “flavors” of digital/online buying are rapidly approaching the popularity of DTC.

Methods of Buying a Car

Which emerging car-buying methods would you be comfortable using for your next vehicle purchase?



CarMax survey of 1000 car owners conducted Feb 9-10, 2022.



And Now Financing Follows the Same Path

Along with the accelerating trend of buying online, and due to the hassle they feel is inherent in the financing process, more consumers today are researching their financing options and even arranging their financing online. They look to complete the financing process before or while online shopping for a car, saving them additional time in the process, whether the final delivery is at a dealer, or to their home or office.

A Cox Automotive survey reveals that **87%** of car buyers researched their financing options before visiting a dealership, and nearly a third (29%) applied for and arranged financing online for their most recent vehicle purchase.

Further, according to the Cox study, buyers who applied for financing online saved 30 minutes at the dealership if they chose that delivery route, and those who also signed paperwork online saved 38 minutes.

The pre-financing trend is expected to accelerate. According to the Cox Automotive study, **96%** of those responding said they would prefer to go that route in the future.

Lenders ignore all these directional signals at their peril.

Enter Alternative Deal Structures

The concept behind alternative deal structures is simple – they provide a way for dealers to quickly access a variety of financing choices to present to their customer. By streamlining the negotiation and rehashing process, ADS improves both conversion rates and dealer satisfaction.

Rather than enduring a frustrating back-and-forth with their financing manager, dealers know up front the various combinations of interest rates, loan periods, and down payments they can present to their customer.

Along with dealer-facing options, ADS can also be presented directly to consumers, allowing them to consider those options in the peace and quiet of their own homes, away from the pressure of a busy dealership.

They can weigh and discuss the tradeoffs with family and friends. They can come away having saved valuable time, and having improved their satisfaction with the process.

If the purchase and financing process is completed entirely online, they may find their new car in the driveway the next day, and the only human they deal with is the one collecting their signature on the delivery paperwork.





Significant Advantages for Lenders and Dealers

Buyers are not the only ones who benefit from alternative deal structures. ADS work to the benefit of lenders and dealers as well.

ADS has two intangible benefits: one, swaying dealer preferences towards lenders who are the easiest to work with; and, alternative deal structures promote a feeling of transparency on the part of the lender, as one is “laying all the cards on the table,” and enabling the dealer to choose from a variety of personalized financing possibilities.

Of the more tangible benefits, here are some that lenders have reported from their implementations of ADS:

01 Faster Loan Closings

In the PwC survey, 66% of dealers report that customers now expect financing information to be available digitally, and 44% expect payment calculators to be available online.

Both help move the process along, but simply posting loan rates and payment calculators online goes just so far. ADS represents a better way – it gives buyers concrete financing options and lets them choose their loan specifics in real time, making the financing decision faster.

02 Higher Win Rates

ADS raises the probability of closing a loan, as the borrower knows they are being presented with pre-approved options and merely needs to select one.

This is far superior to the practice of examining and then potentially declining a loan and hoping that the borrower will continue to pursue financing with that same lender. It's far more likely the borrower will look to another lender at that point, making for a competitive loss in what is a very aggressive market.

03 "Stickier" Borrowers

The higher satisfaction that borrowers feel with loans presented and closed through ADS can pay dividends throughout the customer lifecycle.

The next time these borrowers are in the market for a car, their satisfaction can cause them to lean toward using their favorite lender again. As interest rates and market conditions change, the lender can also present refinancing offers along the way.

Borrowers are also prime targets for other loan products such as mortgages, and other banking products such asdeposit accounts. Once these borrowers are "in the fold," the cross-sell and upsell possibilities grow, and the lifetime value for the customer increases.

04 Higher Customer Satisfaction and a Better Customer Experience (CX)

Getting customers into their new vehicle and on their way faster and more easily is of enormous benefit to the seller and the lender, and drives a more satisfying customer experience, especially if financing can be completed online.

It's not just a matter of time – time translates to customer satisfaction. In the Cox Automotive survey cited earlier, their cohort of "mostly-digital" buyers said that when they arranged financing online, the time they did spend at the dealership yielded a more satisfying experience.

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05 Alignment with Lenders' Overall Financial and Portfolio Goals

Because alternative deal structures provide loan pricing in advance, underwriting can review applications more quickly, or even before presentation to the borrower, see the effects that various permutations will have on the profitability of that loan, and that loan's effect on the lender's overall portfolio.

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06 Higher Dealer Satisfaction and Loyalty

Anything that can help dealers close sales and complete financing swiftly can help make you a "lender of choice," propelling you ahead of your competition for more business.

According to the PwC 2022 Car Consumer and Dealer Survey referenced earlier, dealers are anticipating the proportion of sales they make online will continue to grow for the foreseeable future, and that this trend will positively impact their profitability.

As a result, they are beefing up their digital processes, especially in areas such as financing. ADS can help you be a key part of their digital transformation initiatives.

Implementing Alternative Deal Structures (ADS)

With all these compelling reasons to do so, why are lenders lagging in implementing ADS?

For some, dealing with legacy systems severely hampers the digital transition needed to implement alternative deal structures.

Legacy systems pose problems in several areas:

- ✓ Legacy systems rely on rules-based algorithms that lack analytical sophistication and are difficult to update
- ✓ General lack of flexibility that hampers new initiatives and turnaround
- ✓ Integrations with other applications and systems that range from difficult to nearly impossible, including those at dealerships and online retailers
- ✓ Dwindling pool of experienced resources and staff for maintenance and upgrading
- ✓ Manual updating that slows time to market
- ✓ Inability to add computing capacity without a lengthy procurement process

While legacy systems have some components that still work well and are worth saving, what is required for lenders to take full advantage of alternative deal structures is a rethinking of their lending solutions, and an upgrade of infrastructure and applications.



Technology Requirements for Next-Generation Lending Solutions

01 Advanced Analytics to Drive Price Optimization

One of the most critical tasks for a modern lending system is to use advanced analytics to determine the right product and right price to put in front of each customer at just the right moment.

Earnix Price-It™ adds powerful advanced analytics to lenders' arsenal of competitive weapons.

Employing advanced analytics in the form of machine learning (ML) and artificial intelligence (AI), Price-It makes it possible to deliver personalized products (and alternatives) and optimized pricing to each borrower in real time. It also allows pricing managers to forecast demand and profitability at the customer/loan level, and quickly assess the impact of an ADS strategy.

02 Dynamic Pricing and Decisioning

Earnix technology will allow you to reach a new level of agility and flexibility in adjusting pricing and simulating customer behavior in real time, meeting the demands of both customers and dealers. Earnix's no-code interface allows strategists to assemble and deploy pricing and ADS strategies in real time, without any dependencies on IT or third parties.

Earnix can also deliver conversion forecasts and commission calculations to dealers for each offer, empowering them in discussions with potential borrowers.

03 Shared Technology across Multiple Systems and Applications

No piece of technology is an island, and few lenders have the luxury of assembling a new infrastructure and set of software applications with a "clean sheet of paper." To meet the need for leveraging usable technology along with new solutions, Earnix leads the industry with technology that is composable.

Alternative deal structures that are presented to the borrower must be stored and displayed in the loan origination system (LOS), and must also be available for viewing and action in dealer and consumer portals.

The decision engine and pricing engine must work in concert with these systems, as well as with contract validation systems. Previously-developed models, with algorithms written in Python, R, DataRobot and other paradigms represent thought and hard work worth maintaining.

Integration with complementary technologies is achieved through support for application programming interfaces, or APIs. Any modern lending solution must allow for the use of APIs to reach out to components such as the above that are still functional and valuable, to avoid having to replace them as part of the implementation.

APIs reduce the time to value for the modified lending platform, and save the cost of replacing components that are still functional and familiar to consumers, dealers, and lenders' staff.

04 Governance to Support Business Objectives

Earnix technology allows for the establishment and monitoring of risk thresholds and other portfolio-wide key performance indicators (KPIs), and deployment is more easily managed, monitored, and reported on for regulatory purposes.

Lenders can establish and implement rigorous testing and approval processes for the deployment of new pricing. An audit trail is automatically generated for each decision rule, and every quote is logged for compliance and later analysis.

05 Cloud-Based Deployment for Speed to Market

Earnix technology is implemented in a cloud-based/Software-as-a-Service (SaaS) mode, shortening initial deployment cycles and allowing for unlimited, cost-effective growth and expansion to meet the needs of the market and the business.

Earnix – Driving Success in Auto Lending

Earnix technology delivers on all the requirements above, and many forward-looking automotive lenders have captured those benefits.

Here is the story of the evolution of just one of Earnix's lending customers, who are now implementing ADS as the most recent step in their progression.

Tier-1 Retail US Bank

Earnix has worked closely with this Tier 1 indirect auto lender in the US for several years. At the outset of our engagement, this Top-10 bank was updating prices quarterly, using internal expert judgment in lieu of demand and competition-based analytics. As a result, they often lagged the market and approximately **30%** of their bookings showed negative profitability.

Over the course of their relationship with Earnix, they have moved from expert judgment forecasts to an ML-based framework of customer, dealer and competitor behavior models, with bespoke optimization algorithms powering individual-level price optimization.

By leveraging Earnix's API-enabled price and offering engine, they are now able to deploy individually-optimized Alternative Deal Structures for every approval, with integrated lending policies ensuring that all of these alternatives are within policy.

Earnix's price optimization and ADS platform allowed this lender to react rapidly to the recent interest rate volatility, with price updates deployed in real time 2-3 times per week.

With Earnix, this lender has shown a

65%

reduction in unprofitable loans and a 10-15bp lift in profitability, generating an eight-figure impact on Net Present Value (NPV).

Summary

Now is the time to move forward with modernizing and upgrading the lending technology stack to take full advantage of alternative deal structures.

29 million auto loan originations were initially predicted for 2022 in the US alone, and now new sale and refinancing opportunities are expected to continue to grow in 2023 and beyond, meaning that it is the time to beat the competition and to claim more than your fair share of that business.

Earnix's proven technology is ready to make automotive lending more efficient and effective, enhance the auto buying customer experience (CX), bring lenders closer to their dealer bases, and tie systems such as loan origination, portals, the pricing engine, and any existing external analytical models into a cohesive whole that will win more business and deliver additional profitability.



Maximize the Effectiveness of Alternative Deal Structures today.

Explore ADS →

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Earnix is the premier provider of composable intelligent solutions designed to transform how global insurers and banks are run. Earnix solutions unlock value across all facets of the business, connecting with customers, and breaking away from the status quo imposed by legacy, single systems. Earnix's solutions offer systemized, enterprise-wide value with ultra-fast ROI. It has been innovating for Insurers and Banks since 2001 with offices in the Americas, Europe, Asia Pacific, and Israel. For more information visit: earnix.com.