



# Service Contracts for BHPH are a Must!

by Ben Donnarumma

**S**ervice contracts for a buy-here, pay-here deal are a must. A vehicle is a mechanical item that can and will break down. It is also your collateral for the money that you lend and the odds are that a customer will stop paying whenever the car stops running. A good service contract will protect your investment and your customer's credit. It is also a major source for profit on a deal.

The majority of mechanical claims for a used vehicle service contract occur within the first six months after the purchase. So I recommend selling contracts that cover a term of at least 12, 18, or preferably 24 months. There is a rule of thumb that the service contract should cover the length of term for the customer's loan, but what I have determined is that a good two-year warranty is sufficient for most deals. What's more important is that the selling dealership takes an active role in processing the claims. The best way is to own and utilize your own service facility. You want your mechanics working on your cars. Otherwise, you are leaving post-sale customer service up to the discretion of another business that has no financial motivation to promote your dealership as a partner and could care less about collections and the automobile loan.

It is important that anytime your customer has a problem with their vehicle, you know about it. Being involved in the claims process is a great way to keep up on the condition of the vehicle, the currency of the loan, and the situation of the customer. The more often you see your customers the better the loans will perform. And, anytime they have a problem, whether it's mechanical, financial, or just some other issue that would prevent them from paying, you are aware and can help. You have to know what's going on after the sale, especially in BHPH and keep your customers focused on the goal of improving their credit rating and paying for their car. Vehicle servicing and warranty claims are just another reason for you to see your customer and continue the relationship.

I guarantee if you do not take control of the service claims by your customers, they will go to a mechanic that is usually a referral from a family member or friend, or even

worse, to another dealership that may even be a competitor. Either way, once your vehicle is pulled into the service bay, any problem or flaw will be highlighted as your fault and the customer will become a victim to another bad used car dealer, meaning you. Perception is reality particularly in sales. And you have to always be selling - before, during, and well after the actual sale. So, don't leave something as simple as a service claim to chance. Stay involved in the process and keep in contact with your customer.

A service contract is an insurance policy for which the premium is typically collected up front or financed and remitted by the selling dealer in one lump sum. But, what about a BHPH customer who does not pay for their loan? A service contract can be a great collection tool also. There are several service contracts you can offer for which the premium is paid monthly, over time. If customers stop paying for their cars, the dealership stops paying for their service contracts and the coverage lapses. You retain the control and can reinstate the policy as soon as they become current with their payments.

Dealers should sell their own service contracts too. Besides helping you keep control of the claims process, it is a great source of profit. Three irrefutable reasons that dealers should sell their own warranties:

1. Profit – This reason alone is enough to justify owning and selling service contracts. Do the math.
  - a. If you have an offshore company for your service contracts, the deferred income tax rate is 15 percent. Investigate this with your accountant to determine the best options for you.
  - b. You sell the service contracts for \$1,495. They cost \$1,050 and the dealership earns \$445 at the time of the sale. The warranty company pays \$150 per contract to service and insure the account and earns \$900 in gross profit. Over time and after claims this number decreases to about \$600 per contract sold. The combined profit is \$1,045 for every service

contract sold (\$445 for the dealership plus \$600 for the warranty company).

2. Collections – You are notified for every claim and the first thing you determine is whether or not the customer is current on their payments. It is a great negotiation tool because you hold all the cards.
3. Customer satisfaction – Since you own the warranty company, there is no need to wait for a claims adjuster to show up before starting the work on the vehicle. This saves time and your customer is without their vehicle for less time. Additionally, you have say on all “gray area” claims. Most contracts are written very black and white and have specific expiration dates. However, as we all know, Murphy’s Law kicks in and many claims occur outside the scope of the written contract or coverage period. If a claim occurs and it makes sense to cover it, you decide what is best for your business and your customer. The decisions are yours to make.

BHPH is about constant contact, negotiation and communication with your customers. Selling a service contract on every deal helps you do all three and is a must to protect your investment, improve collections, enhance customer satisfaction, and earn more money. If you’re not selling your own contracts you are giving away too much control after the sale and forgoing a wealth of profit.

*Ben Donnarumma is a successful car dealer who owns and operates one of the top independent car dealerships in New England. He is also the president of a regional finance company that purchases non-prime automotive consumer loans. With over 15 years as a dealer principal he has consulted and advised some of the top lenders in the country, and is recognized as an industry expert on BHPH sales and portfolio management.*

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