Be Careful What You Ask For - Pay Plans Can Encourage Prohibited Practices

A pay plan is a job description.

I have not yet spoken with a dealer who refutes this basic premise. Simply put, an F&I Manager is going to manage her pay plan through the products she sells. For example, if her pay plan is heavily dependent on product penetration, you can bet she will sell a number of products on most of the deals she closes.

Likewise, if the F&I Manager's pay plan rewards profit per retail over product penetration, her average profit per product will likely be higher and she will sell less products.

It is a simple fact that there is only so much elasticity in a customer's budget when purchasing a car. How the back end monies are distributed is driven in large part by the F&I Manager's pay plan.

Now, I don't profess to be the world's leading expert on developing pay plans. In fact, when dealers ask me, I refer them to their F&I product provider.

I do, however, like to see the pay plans when I enter into a compliance consulting agreement. The reason? Very simply, it tells me what prohibited practices to look for in my reviews! I focus on 3 key items:

1. Product penetration
2. Profit per retail
3. Balance between rate and products

Product Penetration

Some pay plans set a baseline for product penetration, paying a bonus percentage if the product penetration exceeds a higher level. For example, the F&I Manager must achieve an average of one product per retail deal as the base and is paid a bonus when she averages 1.4 products per retail deal.

This is a logical pay plan aimed at increasing the number of products a manager sells. It can lead to these prohibited practices:

- Bundling of products
- Product stuffing
- Trading rate for product

Bundling occurs when two or more products are sold as one product (typically service contract and maintenance), and are disclosed as one product on the buyer's order, on the Retail Installment Sales Contract and on the product enrollment form. When the deal is recapped on an internal form the customer does not see, the products are separated by reducing the price of the product that was disclosed and allocating a sum of money to a second or more products.

Stuffing is different from bundling in that the allocation to pay for the undisclosed product comes from gross, not from a second product.

Trading rate for product is self-descriptive. Once an F&I Manager settles on the customer's APR, lowering the rate to facilitate the sale of products is a deceptive act in most Attorneys General's eyes.

Profit Per Retail
Most pay plans are based on this simple concept; the more profit the manager generates per deal, the higher the percentage of the profit. This stair step approach tends to generate more profitability for the dealership, which is a good thing.

This approach can also encourage an F&I Manger to:
- Engage in price gouging
- Pursue excessive reserve

I think we all know what price gouging is. Selling a $19 etch product for $2,000 or a Maintenance product for 5 times cost.

Today's definition of excess reserve is different than last year's definition and certainly different from 5 years ago. Today, any amount of reserve over 250 basis points raises eyebrows. The shrewd F&I Manager will find a lending source that is still dealing with the practices from the 20th century and try to hold 4 or 5 points in reserve.

Balance Between Rate and Products
Many pay plans pay a manager for both rate and product. The ratio between the two can lead to the deceptive practice of trading rate for product. For example, if the Finance Manager is paid 5% of the reserve he generates versus 10% on the product profitability, guess what is going to happen to rate. It is likely going to be traded for product.

There is no magical pay plan available to dealerships; if there were such a device, everyone would be using the same plan. There are necessary risks associated with any pay plan you put into place. Just recognize that there may be unintended consequences to any plan you have in place. As a result, you must take action to set controls that help eliminate prohibited practices.

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