# Leasing:  An Under-Utilized Option

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Leasing, and all its benefits, is often neglected by salespeople and customers as a financing option.  In cash and finance deals, the negotiation is often a zero-sum game of "a higher price for the dealer means a higher cost for the customer.  Leasing can easily be "win-win" where one of its advantages is a lower payment to the customer, moving the focus on price to the background.   As Art Spinella of CNW Research has said,  "Nothing gets people off of looking at the size of the discount more than by giving them a very low monthly payment."  As we will see, leasing has more going for it than cash flow.

The biggest hurdle with leasing is that it has more "moving parts" as a financing alternative. Salespeople may not fully understand leasing or are otherwise ineffective in presenting it.  But this is really an opportunity for the dealer. In this day and age of the Internet, competition for customers is higher than ever.  And those dealers who have the religion on employee training and retention are more apt to win that zero-sum game with other dealers.

The car business has been described before as the Wild West, and in another time, ranchers went after "free-grazers," a term for enterprising cattle owners who allowed their livestock to graze off another's land.    One might argue that dealers who write few lease deals are allowing other dealers to "graze" on what could be their customers.  Leasing is a way to put an invisible, painless fence around your customers. It's no accident that dealers with solid leasing penetration are generally more profitable.

The higher profitability of leasing isn't obvious or easy to measure.  But that doesn't excuse factory statements that do a woeful job of quantifying leasing's inherent profit advantage.  At best, dealer statements may report average gross per unit for leasing separate from retail (i.e. cash & finance). However, domestic franchises don't report this detail at all, a mistake easily overlooked given the anemic penetration of leasing among the industry's "Big Three."

Let's review the leasing performance of all franchises, compiled from both captive and non-captive sources:

| Franchise | Leasing % | Franchise | Leasing % |
|---|---|---|---|
| Cadillac | 61% | Jeep | 26% |
| BMW | 59% | Chevrolet | 24% |
| Mercedes Benz | 59% | Hyundai | 23% |
| Lexus | 59% | Buick | 21% |
| Land Rover | 56% | Ford | 19% |
| Hummer | 54% | Nissan | 18% |
| Porsche | 54% | Pontiac | 16% |
| Audi | 54% | Saturn | 16% |
| Saab | 53% | Subaru | 15% |
| Jaguar | 51% | Mazda | 15% |
| Volvo | 46% | Chrysler | 13% |
| Infiniti | 43% | KIA | 11% |
| Acura | 40% | Scion | 11% |
| GMC Truck | 40% | Dodge | 11% |
| VW | 40% | Mitsubishi | 10% |
| Toyota | 33% | Suzuki | 3% |
| Honda | 28% | Isuzu | 3% |

For various reasons, I've noted lower lease penetration in the Pacific Northwest relative to the national figures reported here.  At a NADA workshop two years ago, a Chrysler dealer was featured in a leasing presentation by Buzz Doering.  The dealer's commitment to employee training produced 60% leasing penetration, making the point that leasing is an opportunity for all franchises and in all markets.

Dealers can sell more cars from leasing for two reasons: it has both higher customer retention and turnover, both key metrics to profitability.  Jim Ziegler has said that dealers writing 72 month contracts are performing marriages instead of selling cars, making it even more difficult for your customers to re-enter your showroom.  The customer who is "upside down" with negative equity is typically a finance customer, not a lease customer.  The below table illustrates why the revolving door to your showroom spins faster with leasing:

| | Lease | Finance |
|---|---|---|
| Customer Retention | 68% | 25% |
| Customer Turnover | 36 Months | 64 Months |

There are other advantages to dealers, but the key challenge of doing more leasing is making your customers aware of their advantages.  Some of these advantages are obvious but some are less so:

- **Lower monthly payment**
  (Lease customers have greater cash flow, freeing them to invest the difference)
- **Lower down payment**
  (Customers have more financial flexibility that can lift your customer's credit score)
- **Vehicle under warranty**
  (Returning lease customers typically stay under a factory warranty)
- **Customer has more choices**
  (Generally, your lease customer is able to choose a more desirable vehicle, making it easier to sell a customer on a vehicle he or she really wants!)
- **Depreciation is fixed**
  (Cash & finance customers assume 100% of resale risk; Lease customers don't)

The last advantage is largely unappreciated by customers. The true cost of any vehicle depends, in large measure, on the difference between what one pays for it and the amount it's sold for later. How much (and fast) the vehicle declines in value, called depreciation, depends on many variables. However, the uncertain pace of technology and price at the pump can significantly impact the resale value of certain vehicles. Cash and finance buyers assume 100% of this exposure to loss in value.

Lease customers assume less depreciation risk.  In Las Vegas terms, leasing can be a form of "heads I win," tails we tie." For example, if the vehicle is worth more than the residual at end of the term, the customer wins by purchasing the vehicle to capture the equity.  On the other hand, if the leased vehicle is worth less than the residual, the customer can simply turn in the vehicle, avoiding the financial hit of excess depreciation. Leasing, in effect, offers the customer a free insurance policy against excessive depreciation (a key factor in determining the actual cost of any vehicle).

Let’s illustrate this point by fast forwarding to year 2015: A breakthrough product is launched, creating a sensation in the auto industry, as the Beatles changed music over forty years ago. The car is 100% electric, gets over 200 miles on one charge, accelerates zero to sixty in less than four seconds and costs less than $35,000. In technological terms, it would be the equivalent of going from analog to digital. It doesn’t take much imagination to realize the impact such a vehicle would have on resale values to cars lacking these features (making large assumptions about price and availability).

As we have learned from experience, the future always takes longer than the futurists predict. However, even without such a technological break-through, gas prices alone have the power to significantly accelerate the loss in vehicle values. Leasing offers the customer a unique way to protect themselves against this risk. As J. Paul Getty was once quoted: “You should buy appreciating assets, but you should lease depreciating assets.”