How OEMs Can Drive More Sales **While Saving Millions**

Maximizing the ROI on
new vehicle incentives

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Introduction

Each year, automotive manufacturers (OEMs) spend billions of dollars on financial incentives such as rebates, special financing, and cashback offers to reduce excess inventory and boost market share. It is one of the largest expense items in their sales and marketing efforts. For example, by the end of 2016, the average incentive amount reached a record of almost $4,000 per vehicle, or about 9 percent of the average transaction price.

However, because of the total amount spent on incentives and their effect on bottom-line profit, they need to be continually scrutinized and refined to maximize their cost effectiveness. If you work for an OEM and are responsible for vehicle sales, you know how critical this is.

Now imagine having a way to optimize the allocation of incentives that is data-driven and automated. Sounds good, doesn't it? Well, it is being done today and the results are impressive. This paper focuses on OEM-to-consumer incentive programs and how with the right data, analytics, and commitment you too can drive more vehicle sales at a lower cost.

Show Me the Money

When it comes to automotive incentives, money talks. Research and our own market experience shows that monetary incentives, including cash back at time of purchase, financing discounts, and post-purchase rebates, are most appealing to consumers over merchandise and other non-automotive benefits. This is not terribly surprising as "money" has general appeal, whereas consumers may, and usually do, view merchandise offers differently. Not everyone wants to wear automotive brand apparel or tote sports gear with an automotive logo on it. Discounts on parts and service also typically fall short on performance vs. pure cash offers.

In fact, we've found that consumers will take a smaller amount in a cash back offer delivered now than a larger amount in a service offer that is consumed over time. A program that offers $400 immediate cash back will do better than an offer of 10 free oil changes with a market value of $450, because the oil changes will be spaced out over several years. Consumers are simply not good with deferred gratification.

Knowing that cash is king, how should OEMs optimize how they use monetary incentives? Well, first they can offer either public incentives or private incentives. Public incentives are, as their name implies, those that are exposed to the general public, typically in general advertising campaigns. Private offers, on the other hand, are discrete offers that arrive in personal communications and are meant only for the recipient. For many years, public incentives were fairly ubiquitous and any normal television viewer or radio listener could quote the prevailing rebate offers and assorted financing bargains that OEMs were pushing. They simply dominated the general airwaves.

The obvious problem with these offers is that they are available to everyone whether they need an incentive or not, and they do not account for differences in consumers or underlying economic conditions in different parts of the country that could make the incentives less effective and more wasteful. Consumer buying preferences and willingness to pay deviate widely depending on a consumer's disposable income, vehicle choice availability, brand loyalty, and other factors. Regionalization of incentives can remedy some of these issues, but it doesn't eliminate them.

Consequently, at least some OEMs have tried to migrate away from public incentives in favor of private incentives, where distinctions among consumers can be factored into the offer. However, while private incentives are intuitively appealing to OEMs, finding the right incentives for the right customers is easier said than done. We have identified some of the most common roadblocks and how to overcome them.

Ask the Tough Questions

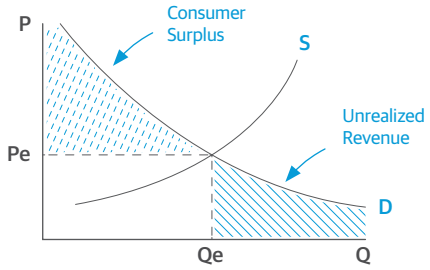
Before creating an incentive strategy, OEMs must first answer the following questions to understand the best next steps to take.

1. Who should get an incentive, and how much should it be?

Economic theory teaches us that demand (D) for a product is the sum of every consumer's willingness and ability to pay for the product at various prices (P). See Figure 1. And clearly some consumers are willing to pay more than others for the same product. Everyone with a willingness to pay above the market clearing product transaction price (Pe), where supply and demand intersect, enjoys a consumer surplus, while everyone with a willingness to pay below the product transaction price represents an unrealized revenue opportunity.

Figure 1.

Supply & demand curves, consumer surplus and unrealized revnue



Giving a monetary incentive to a consumer who doesn't need it because he is already willing to pay more than the transaction price, or giving too large an incentive to someone who would take a smaller amount, obviously wastes money and hurts profit. On the flip side, not giving enough of an incentive to a consumer in need of one may mean a lost sale.

Of course, OEMs can't give every consumer the incentives they need to get them to purchase a vehicle. After all, the OEM still has to make a profit. For this reason, profit margin on the vehicle also needs to be considered.

Thus, for each vehicle model, OEMs need a way to derive the appropriate incentive for each consumer in market to buy, recognizing that many of those consumers shouldn't get an incentive at all.

2. What external factors influence incentives?

In a dynamic market like the automotive industry, determining the "right" incentive for each consumer can be like chasing a constantly moving target. Changing market conditions and competitor actions can quickly affect the level of incentive needed to stimulate a consumer to buy.

Take the example of a consumer who is about to purchase an SUV. He may have been unable to buy the vehicle without a generous cash back offer or low interest financing loan from the OEM, but a dramatic jump in gas prices can alter the cost of ownership and lead him to postpone the purchase or switch to a fuel efficient vehicle. This was seen not long ago when gas prices were in the $5 range and there was a surge in hybrid vehicle sales. By contrast, the relatively low gas prices now have coincided with a surge in large truck and SUV sales.

Similarly, a brand's incentive offer may be suddenly and unexpectedly eclipsed by a competitor's offer. OEMs need to be very nimble in responding to competitor pricing actions to ensure that its incentives remain enticing and effective.

Thus, these external factors also need to be considered when deciding who should get an incentive and what amount that incentive should be.

3. How can incentive insights be used "in the moment" to complete a sale?

On any given day in the dealer showroom a sales agent may see a range of consumers come in and negotiate for a purchase or discuss a possible deal over the phone. Without good intelligence on each consumer, how does the sales agent decide what he is willing to give to each one? Often the dealership will run a standard, publicized promotion, but the sales agent may want to toss additional cash discounts into the deal to coax a hesitant consumer to buy. Today those in-the-moment decisions are often decided on "gut feel."

With an analytic tool to recommend personalized incentive offers, the guesswork can be eliminated and sales performance can be greatly improved. These offers, which can be refreshed as frequently as necessary, can be delivered to each consumer touchpoint consistently and automatically so that a sales agent has the best information when he needs it.

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Data analytics: A solution that works

In the automotive market, demand generally is relatively responsive to price (though less so with high priced luxury brands). This is why monetary incentives typically work. So solving the automotive incentive optimization dilemma requires that we pinpoint the ideal discount for each consumer that's in the market to buy.

Fortunately, consumers are constantly signaling how much they are willing to pay for different vehicles. After all, over a million vehicles are sold in the U.S. each month. Additional experiments can also be introduced to the market to generate more data at different price points if it is needed. Employing this type of experimental testing approach is what enabled the OEM we mentioned earlier to create an optimization solution that vastly improved the performance of its private incentive offers.

With a large enough dataset of sales across vehicle models at different prices, you can estimate the demand curve for each vehicle and determine through statistical modeling what the probability is that each consumer will buy at different prescribed prices. The accuracy and predictability of these models improves dramatically the more data you have on the attributes, behaviors, and attitudes of the consumers you are trying to model.

External data including regional brand preferences, competitor strengths, economic conditions, and gas prices can also be included in the models to account for the differences in these factors. Although this information does not have the same power as consumer information, it can produce different recommendations, which can be explored in scenario simulations.

All of these variables will help to distinguish the likelihood to buy from one consumer to another, which is the core requirement in developing a solution that will truly optimize the allocation of incentive dollars across your target population.

Once you have models to estimate the probability of purchase at the individual consumer and product level, it is a short walk to find the optimal incentives that will generate the most sales or the most profit for different target populations. By embedding the models into an optimization system, you can run numerous solutions virtually instantaneously.

The process starts by setting your objective (e.g., sales volume) and specifying how much incentive budget you have to spend. There may be other constraints you also need to input into the system, such as the profit per vehicle or average incentive size. The optimization program and the computer do the rest. The computer can examine thousands of potential solutions, based on various combinations of consumer / product type / incentive offer, and find the "best" solution that meets your objectives.

That solution will tell you what incentive offer to extend to each consumer on each vehicle. The offers will be distinct to the individual consumer and ensure that you are not giving too large a discount or too small a discount, but one that is predicted to be just right.

This is not a one-and-done endeavor. We recommend that you continually run tests in the market, pitting your solution's assignments against hold out control samples and other pricing strategies to see what incremental gains you can achieve. Additionally, the models should be calibrated on a regular schedule so that they can incorporate and reflect new information coming out of the market. This means a commitment to the approach as the system learns from market experience and becomes more precise. Having a disciplined review methodology will insure this is the case.

This type of solution also works best when marketing to your own customers because of the enormous amount of data that is captured on their attributes, behaviors, and responsiveness to previous marketing offers. We've seen improvements of 50 percent in incremental sales, with a 10 percent reduction in average incentive cost in some cases. Even on moderate-sized campaigns, these results could easily amount to several million dollars in gain.

Another aspect of making this solution work is ensuring that the assigned incentive offer is delivered consistently across channels, whether in email or postal mailings, service to sales contact center interactions, or face-to-face meetings in the showroom. With today's technology all of this is feasible. So, more sales and greater incentive efficiency are possible. All that is needed is the proper data, the right analytic infrastructure, and, most importantly, the commitment to this approach.

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Summary

Automotive manufacturers rely on incentives to help boost vehicle sales, move excess inventory, and increase market share. With the size of the average incentive increasing it is incumbent on OEMs to find ways to ensure that they are getting the best return on this spending and allocating the incentive budget in an optimal way. An automated, analytically based, incentive optimization system can vastly improve this process and significantly increase ROIs.

Talk to us about maximizing your ROI on new vehicle incentives.

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