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Blessing in disguise

Longer factory warranties don't faze independent service contract sellers as other 'wrap products' proliferate

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Those new extended powertrain warranties General Motors and Ford have resorted to this year aren't hurting independent service contract providers. In fact, the independents say they are helping.

The providers concede that the extended factory warranties are depriving them of some revenue from full-coverage plans they sell. But they say that as automakers and dealers promote longer powertrain warranties, more customers are willing to pay for extended coverage of nonpowertrain parts.

That shift bumps up service contract volume and spreads the warranty risk for less-costly parts, providers say.

David Cole, CEO of Aon Warranty Group Inc., says his company sees the extended factory warranties "more as a positive." Aon, of Glenview, Ill., is the nation's largest provider of service contracts.

The factory powertrain warranties create "an opportunity for us to sell what we call a wrap product, which wraps around the powertrain," Cole told Automotive News. "We probably see a higher percentage of customers buy the upgrade."

It costs less to extend coverage of parts such as brakes and steering components than to extend full coverage that includes the powertrain, Cole says. The more-limited coverage is easier to administer and to sell to consumers, he adds.

"If 30 percent of consumers were buying full warranty (coverage) under the old practice, when the manufacturer goes to an extended powertrain warranty, 40 to 45 percent of people will buy the upgrade or wraparound," Cole says.

When an automaker extends its powertrain warranty, Cole estimates that dealerships' cost for more-limited extended warranty products drops by 40 to 60 percent, depending on the vehicle model and manufacturer.

"For whoever is providing the warranty, powertrain components have the highest claim dollar amount for repair," Cole says. "If you have to repair an engine or transmission, those are more expensive to fix than air conditioning or the brakes. Powertrain failure requires more technical expertise and more phone calls."

Powertrain warranty claims often do not emerge until 30 to 36 months after coverage begins. Ultimately, he says, longer factory powertrain warranties could benefit independent providers of service plans.

"Down the road, we won't need as many engine people or powertrain technicians," Cole says. "Long term, our technical costs may not be as much because we won't need as many senior people to handle high-dollar items.

"The manufacturer benefits by selling more cars," he says. "We spread our risk and sell to more consumers. And consumers have more coverage on the vehicle. It's win-win all the way around."

GM, Ford changes

In September, GM announced a 5-year/100,000-mile powertrain warranty for its 2007 models.

In July, Ford Motor Co. extended its powertrain warranty coverage. For 2007 models, the warranty is 5 years or 60,000 miles for Ford and Mercury powertrains. For powertrains on Lincoln vehicles, coverage is for 6 years or 70,000 miles.

Hyundai and Kia also have marketed long-term warranties successfully. (For a chart of 2007 warranty coverage, go to autonews.com/moreonline.)

Service contract sales, as a percentage of new vehicles retailed, fell in 2005, the National Automobile Dealers Association says. Data for 2006 are not available.

The service contract penetration rate fell to 31.2 last year from 34.1 percent in 2004, NADA says.

Ford Motor anticipated a "slight decrease" in its extended service plan business after the warranty changes, says spokeswoman Kristen Kinley. The company increased advertising and point-of-sale marketing of service contracts, along with dealership training, she says.

Those changes have been effective, Kinley says. She would not provide specifics.

At GM, the cost to dealers of buying extended service contracts through General Motors Acceptance Corp. dropped an average 25 percent after the extended-warranty upgrade, says GMAC spokeswoman Sarah Comstock.

The cheaper contracts will lead to increased sales volume for more-limited warranties, Comstock predicts. That should offset any revenue drop from costlier service contracts for GMAC and GM dealerships, she says.

By the first half of 2007, the Chrysler group plans to revise wraparound products for its dealerships that sell used GM and Ford vehicles, says Ann Tomlanovich, the company's director of service contracts.

"We have to look very closely, comparing what is covered and what

isn't," Tomlanovich says. "You don't do that quickly. We have to make sure that the components our wraparound plans have are the ones that should be there."

"A big piece is removed from the revenue stream" when a factory extends powertrain coverage, she says.

"You have to come up with new products and new ways of penetrating into the business," Tomlanovich says. For example, she says, the Chrysler group used "aggressive maintenance contracts" to replace

revenues when it moved to a 7-year/70,000-mile powertrain warranty on 2003 models.

"We tripled our maintenance contract business," Tomlanovich says.

Powertrain warranties on 2007 Chrysler, Dodge and Jeep vehicles are 3 years/36,000 miles.

Creating awareness

Because of GM's and Ford's shrinking market shares, the companies' warranty changes are having less impact than they might have had a decade ago, says Bill Stoothoff, vice president of finance and insurance with Universal Underwriters Group in Overland Park, Kan.

GM and Ford can afford to extend their powertrain warranties because the quality of their vehicles has improved, he says.

"If Ford and GM cars weren't better, they wouldn't have extended it," he says. "Their quality is ahead of the perception."

Stoothoff says his company's service contract business is up this year over 2005. He would not give specific data.

The extended factory powertrain warranties "create awareness for the consumer," Stoothoff says.

"The customer gets more years of coverage on the powertrain," he says. "But the items most likely to break are air conditioning or electronic (parts), which they don't have coverage for. When you present that to them, they are very open to purchasing additional coverage."

Stoothoff says limited service contracts yield "quite a few claims, but they are usually not very large."

Cheaper offerings

Even if revenues drop for independent service contract providers, their net income may not, says Gil Van Over, president of gvo3 & Associates, a finance and insurance consulting firm in Chicago.

"Their revenues drop because they are not as able to sell as much high-end product as they normally would," Van Over says.

"It doesn't mean their income drops, because the cost of the product they are selling is cheaper. At a lower price, consumers are buying more."

When manufacturers started extending powertrain warranties about 15 years ago, Van Over says, "Everybody fretted about what it would do to the service contract business."

But independent providers, he says, "are good salespeople. They figured out what is available for them to sell and for dealers to sell to consumers. When you are talking about monthly payments, it is easier to talk about a wrap."

JM&A Group, of Deerfield Beach, Fla., is one of the nation's largest independent providers of service contracts. Jim McDavid, the company's vice president of North American sales, says JM&A's contract volume with GM and Ford dealerships have remained steady despite the warranty changes.

"At the end of the day, there isn't a lot of effect on income," he says.

Dealers still can sell powertrain coverage beyond the factory warranties, he notes. For Ford dealers, he

says, "the opportunity lies in selling the warranty past the 5- year/60,000-mile drivetrain."

"The proof that it can be done is that our penetration (among import-brand dealers) is as good as with domestics," McDavid says.

Factory-extended warranties offer "pluses and minuses" to dealerships, says Paul Taylor, NADA's chief economist.

Although dealerships sell fewer expensive service contracts, Taylor says, they get more warranty work. They also have an opportunity to boost parts and service sales to warranty customers, he says.

Adds Taylor: "And it assures the dealership will be hanging onto the customer because the warranty work is done at the dealership."

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Chrysler group's Ann Tomlanovich: Maintenance contract business has tripled.

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