

# Toyota Case Study

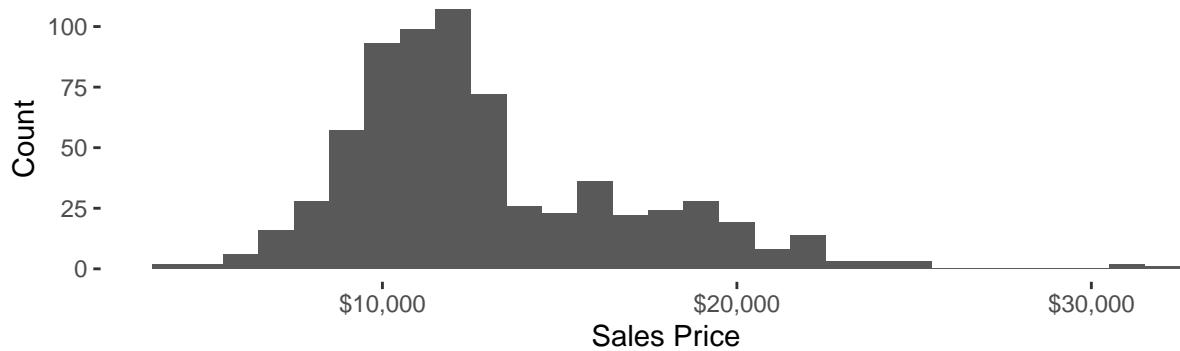
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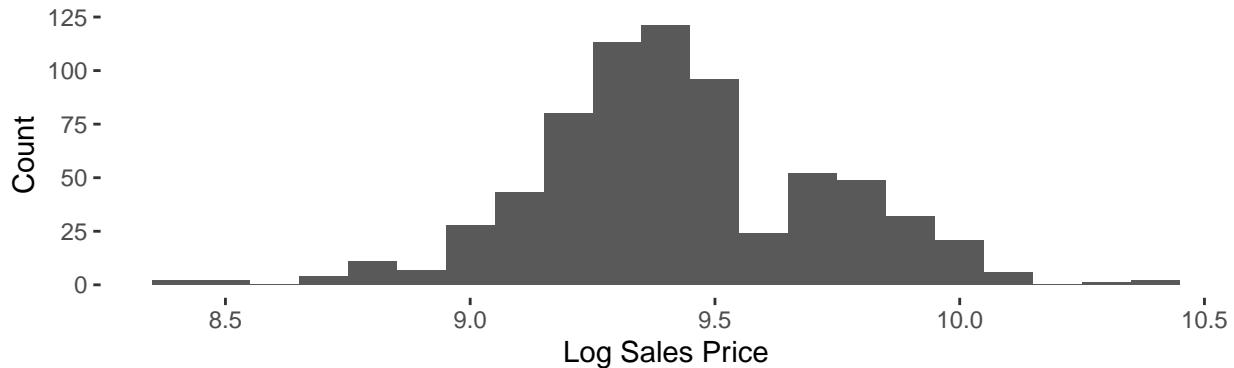
## Introduction

Consumers shopping for new cars often have the option to trade in their current car for money towards their new one. Dealerships, in turn, sell the used cars at a slightly higher price. To do this effectively, the dealership must be able to accurately estimate the expected price that it can sell each used car for based only on characteristics of the car. Specifically, a Toyota dealership was interested in fitting a regression model to estimate Price using 16 different predictor variables and a data set of 694 used Toyota Corolla sales. Figure 1 shows the prices of those Corollas and to eliminate the skewness in Price, figure 2 shows the log(price) of those same Corollas.

Used Toyota Corolla Sales Prices (Figure 1)



Used Toyota Corolla Log Sales Prices (Figure 2)



Numeric predictors included Age, KM (odometer reading), HP (horsepower), CC (cylinder volume), QuartTax (quarterly road tax), Weight and Period (guarantee period). Categorical variables included Mfg\_Month (manufacturing month), Mfg\_Year (manufacturing year from 1999-2004), Fuel\_type (CNG, Diesel, or

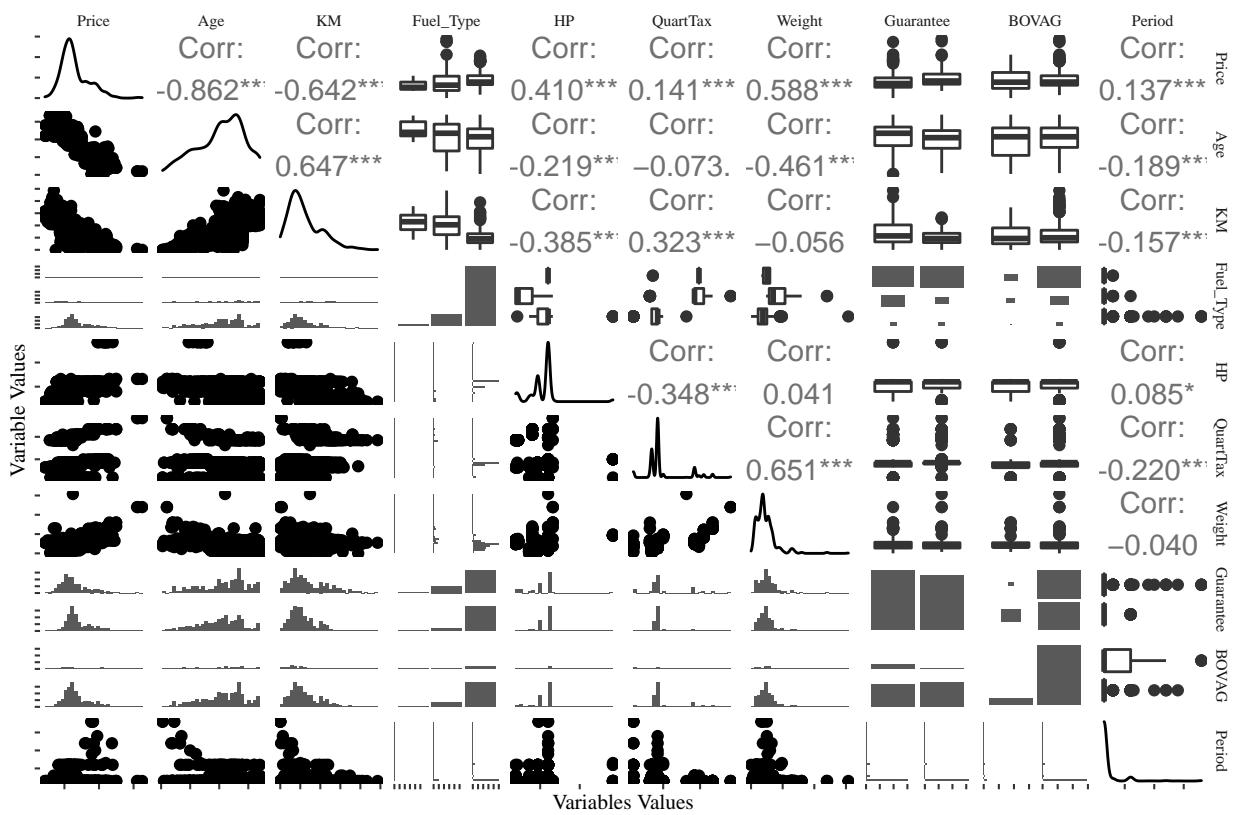
Table 1: Summary Statistics

Variable	Mean	Std. Deviation	Minimum	Maximum
Age	41.31	15.77	1	68
BOVAG	1.90	0.30	1	2
Fuel_Type	2.80	0.44	1	3
Guarantee	1.48	0.50	1	2
HP	102.49	16.95	69	192
KM	60614.31	41309.23	1	243000
Period	4.03	3.81	3	36
Price	12928.45	4012.51	4350	32500
QuartTax	96.47	48.92	19	283
Weight	1090.51	62.13	1000	1615

Petrol), Metallic, Automatic, Doors (3, 4, or 5), Gears (5 or 6), Guarantee (manufacturer's guarantee), and BOVAG (BOVAG guarantee). The Cylinders predictor was removed from the original data set because all recorded cars had 4 cylinders, and all categorical predictors were made into factors in R. No other cleaning was performed on the data.

A set of practical predictors of interest were chosen based on contextual knowledge and exploratory data visualizations to use for model fitting separately of any formal variable selection techniques. Intuitively, older cars (indicated by Age and KM) should be worth less and larger and more powerful cars (indicated by Weight and HP, respectively) should be worth more. It was assumed that cars that take different fuel types (Fuel\_Type) are likely different kinds of cars and would likely vary in price in some way. Finally, Guarantee, BOVAG, and Period are financial-based incentives that should also intuitively lead to a higher car price. Summary statistics (Table 1) and plots (Figure 2) for these predictors of interest are shown below.

Paired Plots and Correlations (Figure 3)



## Analysis

The relationships between many of the predictors and the response variable of interest, car price, was largely unknown. Aside from a selection of predictors deemed to likely be important based on contextual knowledge, it was not known which predictors should be included in a regression model. Therefore, an array of models were fit using various transformations, variable selection methods, and prior assumptions. All models were fit with the `stan_glm` function in the `rstanarm` package using a Bayesian framework that incorporates prior belief into traditional regression by use of prior distributions. After fitting, all models were assessed for explanatory power, overfitting, and violations of model assumptions by comparing  $R^2$  and  $R^2_{LOO}$  and by generating QQ-Normal plots for residuals and residual vs fitted values plots.

To begin, a full model (1) was fit using the default `stan_glm` priors ( $N(0, 6.25)$ ) to serve as a comparative baseline for future models. The regression intercept was estimated to be  $\beta_0 = -4,173.88$  and can be interpreted as the expected price (in dollars) of 3-door, manual, non-metallic, CNG-fueled car that was manufactured in January of 1999 with no manufacturer or BOVAG guarantee and a value of 0 for all numeric predictors included in the model. The regression coefficients,  $\beta_j$ , could be interpreted as the expected difference in expected car price associated with a one unit difference in the predictor (or associated with whether or not an observation assumes that specific level of a categorical predictor), with all other predictors remaining constant. These interpretations are unreasonable in a practical context and it makes no sense that the price of a car could be estimated to be a negative value. Therefore, another full model (2) was fit, also using the default `stan_glm` priors, but now with scaled numeric predictors and a log-transformation of car price. This was done to make the interpretation of coefficients more practical and comparable, and to restrict predictions of price to positive values. There may also be potential for modeling benefits from scaling. Then, regression coefficients for numeric predictors could be interpreted as the expected percent difference in expected car price associated with a one standard deviation increase in the value of the predictors, with all other predictors remaining constant.

The full models fitted utilized 32 predictors (16, not including dummy variables) for modeling. Using a large number of predictors can be damaging to a model due to redundancies in predictor information (multicollinearity) and the potential for overfitting. Several different variable selection methods were applied to the car prices data set to determine which predictors were most closely related with car price. First, a Bayesian variable selection method called a horseshoe prior was used to systematically exclude unimportant predictors from the model. A horseshoe prior places a large amount of prior mass near 0, forcing predictors to be highly related with the response to be included in the model. This model (3) determined 14 predictors (12, not including dummy variables) to be significant in predicting car price: `Age`, `Mfg_Month`, `Mfg_Year`, `KM`, `Fuel_Type`, `HP`, `Metallic`, `QuartTax`, `Weight`, `Guarantee`, `BOVAG`, and `Period`. A follow-up model (4) was fit using only these selected predictors, with only an inconsequential loss in  $R^2$ . Next, a model (5) was fit using a variable selection method called LASSO that penalizes a model for producing large coefficient estimates, forcing it to be selective with how it chooses estimates (equivalent to using a Laplace prior). This model determined 15 predictors (12, not including dummy variables) to be significant in predicting car price. These were the same predictors chosen by the horseshoe prior model previously fit. A follow-up model (6) was fit using only these selected predictors, again with only an inconsequential loss in  $R^2$  (DO WE NEED THIS MODEL?? ISNT IT THE SAME AS 4??).

Thirdly, a more contextual approach was taken to variable selection and the predictors selected previously based on practical knowledge and data visualizations were used for modeling. These predictors were selected independently of the results of the horseshoe and LASSO selections, but aligned closely with these selections nonetheless. First, a model (7) was fit using these predictors and the `stan_glm` default priors. A follow-up model (8) was then fit using weakly informative priors (Table 2) informed by prior knowledge and exploratory data visualizations. This model showed slightly less evidence of overfitting than the previous model but was otherwise similar. Finally, two models (9) & (10) were fit to explore potential interactions of interest. The first of these models included an interaction between `Age` and `KM`, and the second included an interaction between `Weight` and `HP`.

Table 2: Prior Parameters

Variable	Prior Mean	Prior Std. Deviation
Age	-100	625
BOVAG Guarantee	0	100
Fuel (Diesel)	1000	62500
Fuel (Petrol)	-1000	62500
Guarantee Period	1000	62500
HP	50	100
KM	-0.0625	0.125
Manufacturer Guarantee	1000	62500
Quarterly Tax	100	625
Weight	10	0.125

Table 3: Model Fitting Results

Model	Predictors	R <sup>2</sup>	LOO R <sup>2</sup>	LOO ELPD
1	32	0.902	0.891	557.32
2	32	0.882	0.869	568.70
3	32	0.880	0.870	572.20
4	27	0.881	0.870	573.42
5	32	0.881	0.870	573.03
6	27	0.881	0.871	573.45
7	10	0.867	0.857	538.72
8	10	0.865	0.863	488.79
9	11	0.867	0.857	538.25
10	12	0.867	0.857	538.27

## Results

For our final model, we decided to use model 4 (Table 4). This model was constructed using horse-shoe selected predictors with scaled data and default priors. The horseshoe selected predictors include `Age`, `Mfg_Month`, `Mfg_Year`, `KM`, `Fuel_Type`, `HP`, `Metallic`, `QuartTax`, `Weight`, `Guarantee`, `BOVAG`, and `Period`. Using the scaled numeric predictors and a log-transformation of car price to restrict prediction prices to positive values only, this model was able to better predict selling price compared to other models. Because the goal of this study was price prediction, our final model needed to have great observed predictive powers.

The intercept coefficient can be interpreted as the expected log(price) of a non-metallic, CNG-fueled car that was manufactured in January of 1999 with no manufacturer or BOVAG guarantee and a value of 0 for all numeric predictors included in the model. The coefficients estimates for the numeric predictors can be interpreted as the expected percent difference in predicted car price associated with a one standard deviation increase in the value of the predictor, with all other predictors remaining constant. This model also produced a residual standard deviation of . Overall, this model had an in-sample Bayesian  $R^2$  value of 0.881 and a leave one out adjusted  $R^2$  value of 0.87. This confirms our model wasn't overfitting while also showing a relatively high  $R^2$  value. Using leave one out cross validation and also k-fold cross validation, we tested each potential model's predictive powers. The tables below show model 4 was the third best model using leave one out cross validation and the best using k-fold cross validation and based on model and data inputs, we chose model 4 as our final model.

Next, the final fitted model should look like our data. By drawing from the predictive distribution and comparing it to the distribution of the response variable (Figure 4), we can determine if our model is fitting appropriately. In the plot below, we see our predictive distribution tracked the response distribution well increasing our confidence in the model.

Table 4: Coefficient Estimates

	Estimate	Std. Error
(Intercept)	9.127	0.652
Age	-0.093	0.384
Mfg_Month2	0.024	0.029
Mfg_Month3	0.036	0.052
Mfg_Month4	0.017	0.075
Mfg_Month5	0.040	0.098
Mfg_Month6	0.024	0.124
Mfg_Month7	0.006	0.147
Mfg_Month8	0.025	0.173
Mfg_Month9	-0.027	0.198
Mfg_Month10	-0.013	0.220
Mfg_Month11	-0.014	0.244
Mfg_Month12	0.014	0.270
Mfg_Year2000	0.017	0.294
Mfg_Year2001	0.026	0.583
Mfg_Year2002	0.159	0.877
Mfg_Year2003	0.206	1.170
Mfg_Year2004	0.198	1.466
KM	-0.078	0.007
Fuel_TypeDiesel	0.030	0.035
Fuel_TypePetrol	0.170	0.036
HP	0.050	0.006
Metallic1	0.022	0.009
QuartTax	0.076	0.009
Weight	0.040	0.008
Guarantee1	0.029	0.009
BOVAG1	0.050	0.015
Period	0.015	0.005

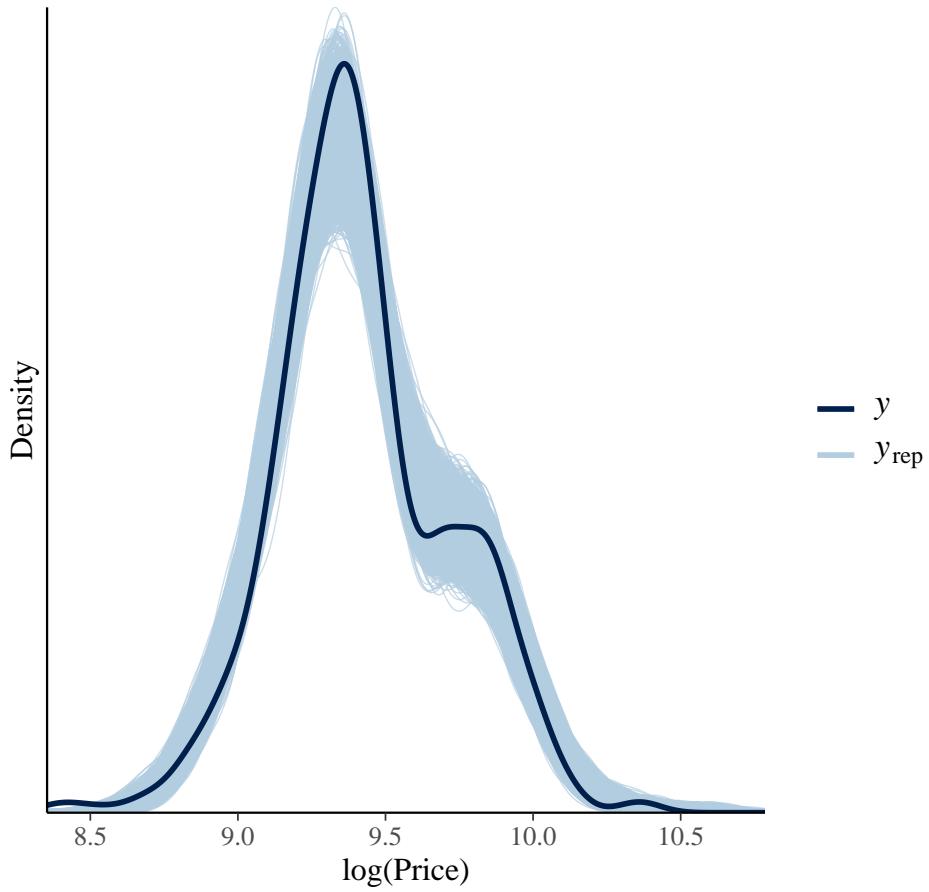
Table 5: LOO CV Results

Model	elpd_diff	se_diff
6	0.00	0.00
5	-0.46	5.43
4	-1.26	0.46
3	-2.80	3.75
2	-4.71	5.81
10	-35.19	13.26
7	-36.08	15.86
9	-36.83	15.32
1	-16.87	28.10
8	-85.33	23.22

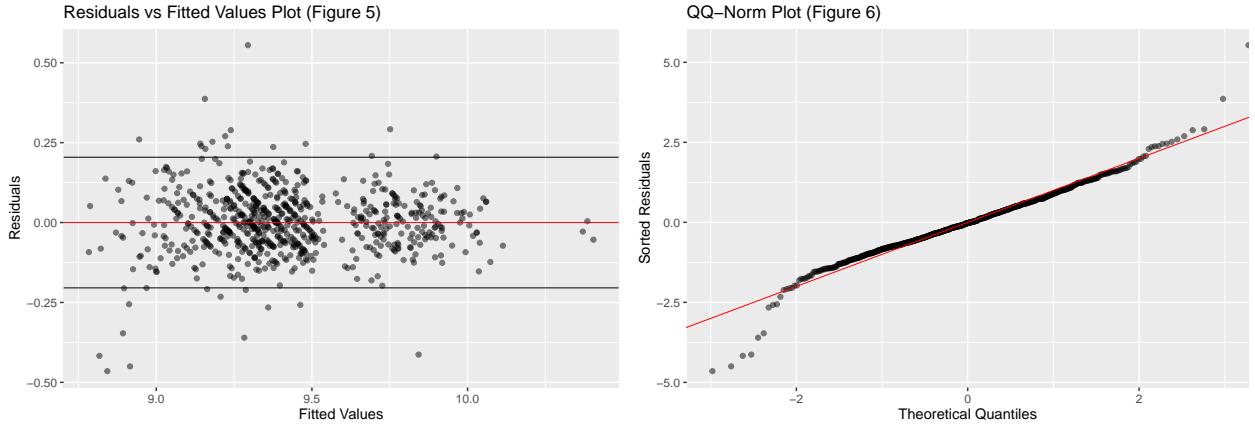
Table 6: K-Fold CV Results

Model	elpd_diff	se_diff
4	0.00	0.00
6	-0.26	0.48
3	-1.15	4.77
5	-2.09	4.07

### Posterior Predictive Distribution (Figure 4)



Checking the assumptions of our final model, we find the model included all the relevant predictors as these were chosen using the horseshoe prior thus forcing predictors to be highly related with the response. The outcome measure accurately reflected our prediction interest and is generalized to all Toyota Corollas. Looking at the residual vs fitted values plot (Figure 5), we see there are no patterns or trends within the residuals vs fitted values plot. Most values are within 2 standard residuals of 0 and the values are spread across the 0 line. There might be some clumping but nothing big enough to question the model. There aren't any heavy tails in the QQ-norm plot (Figure 6) and the values closely align with the red line. These positive assumptions increased the validity of the model.



In all, the purpose of this study was to predict the selling price of used Toyota Corollas and ensure a small profit based on their new purchase and trade-in promotion. Based on several variables, we were able to fit this model to help the dealership closely estimate the final selling price for their used cars. With this model, the dealership can now ensure a reasonable profit by plugging in the characteristics of each individual car and output a predicted selling price. This will result in more accurate selling prices and higher profits for the dealer.