Gearing up for servitization in auto finance

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Change is underway

Like it or not, the auto industry is transforming. Car sales are declining. The ‘one car, one driver’ approach to vehicle manufacturing and sales is losing relevance in the market. Customers are demanding access to cars in a different, more flexible, and more convenient way. And increased climate consciousness and the threat of significant fines are putting pressure on original equipment manufacturers (OEMs) to switch from diesel and gas to newer alternatives like electric cars. If the industry fails to adapt to these changes, it risks losing out to other players, who will provide more convenient access to cars, and to increased reliance on public transport.

To gain insight into how best to address these developments, Genpact worked with the International Asset Finance Network to conduct in-depth interviews with global CEOs, national CEOs, chief digital officers, and chief innovation officers from Europe’s largest captives, bank-owned fleet finance, and mobility companies. Our research shows that captives – wholly owned subsidiaries that finance cars on behalf of their parent companies – have an advantage over other finance providers because they are more tightly integrated with the manufacturer than any other competitor in the marketplace, but they need to act now.

Despite this, transformation in the vehicle finance industry remains slow. This is partly due to the high level of investment required to develop new solutions. It is also because the industry is culturally tied to the old ‘one car, one driver’ model. And the operational, manufacturing, and finance processes that feed this model can be difficult to change. Many of the industry executives we interviewed are skeptical about the speed of change in customer behavior and believe that the old model will be around for some time to come.
In addition, they point to a lack of expertise in areas key to the future of mobility, including the use of data and tools like artificial intelligence (AI). To overcome the challenges of investment, scale, and expertise, OEMs and captives need to forge partnerships. Only by partnering will they be able to deliver the flexible solutions customers need, avoiding the large investment required to deliver them themselves, and establish a cost structure to accommodate the variable income that comes from add-on services like roadside assistance, valeting, parking, and more.

Change in auto finance and services is a strategic imperative for OEMs. Demographic changes will certainly help drive adoption of mobility services – but this shift alone is not enough. OEMs and their captives need to take risks now with their business model, data strategy, and partnerships to find a winning mobility strategy.

The future of auto finance relies on the use of data to improve the customer journey. Respondents to our research believe that captives can derive greater value from customer data than competitors because of their close working relationship with OEMs. But customers are already aware of how valuable their personal data is and how vulnerable they can become if it is used improperly. OEMs and auto finance companies will have to work closely with regulators to ensure that there is no overreach and change their models to get consent from customers to use their data.

The industry is moving toward a more flexible, transparent, and simple future – one where cars are a service, OEMs will no longer simply be vehicle suppliers, and customers will have access to a wider range of more convenient mobility options.

Transformation inevitably comes with risks – financial, operational, and legal – including increased oversight from regulators. OEMs and captives are already aware that they cannot afford any missteps.
Direction of travel

Customers want more options than owning and renting

Most analysts believe that car drivers will continue to want exclusive use of a car but will also expect their car provider to offer them a comprehensive range of other mobility options to more fully meet their needs.

This means that, in addition to exclusivity, customers also want flexibility. So in addition to an exclusive-use car, they also want access to daily rental cars, car-sharing options, and cars by subscription. For example, a driver who owns an electric vehicle may want access to a gas car for long journeys, and a soccer mom who drives a minivan may want access to a truck when she is moving to a new house. Meanwhile, as with Airbnb for homes, such drivers can share their exclusive-use car when they are not using it to generate income. And drivers who want to change their cars frequently have the flexibility to do so with models like cars by subscription.

Customers will increasingly pay for ‘outcomes’ – meaning access to any car, anytime, anywhere, and the services that come with it (such as smart parking and vehicle-charging services).
Customer experience, not brand, will be central

In the past, OEMs and finance captives focused on obtaining brand loyalty from customers – to the point that loyalty drove cliché: architects drove Saabs, young men drove BMWs, safety-conscious families drove Volvos. But as customers shift focus toward simplicity, flexibility, transparency, and shorter-term commitments, convenience becomes more important. The future of cars will be less about the brand image of what you drive, and more about where you were able to pick the car up, how quickly you could find parking or charging, and whether your insurance reflected the precise driving conditions for the journey. Variable term and price offerings will reflect customer lifestyles. These changes will put the customer and not the product at the center of finance and servitization.

Finance providers need to get shifting

Finance providers and OEMs already know that customers will transition from ownership to use, from finance to services, and from paying for products to paying for outcomes. But they are not currently moving quickly enough, and there is a risk that others outside the industry will step in to provide solutions – meaning that laggards will have their wings clipped or, worse, be rendered redundant.

At this point, it seems that the most likely opportunities for finance providers to capitalize on these transitions include long-term rental packages with term-flexible offers, such as cars by subscription, and consumption-based pricing such as pay-per-mile and pay-to-use. For finance providers, initially, the best service revenues will likely come from insurance and maintenance. These have the potential to become highly customized too, with predictive maintenance and pay-per-mile insurance likely developments. Charging, parking, cleaning, software upgrades, and in-car apps, which are mostly managed by third parties today, are also likely sources of revenue for finance providers in the future. There are plenty of opportunities for growth under the new model, but OEMs and finance providers must plan for these immediately.

“The development of advanced auto finance and mobility services is not a nice-to-have, but a strategic imperative.”

Giacomo Carelli, chief executive officer, FCA Bank
Low-speed transformation

Why is the pace of change so slow?

The transition to services and outcomes is a fundamental shift in approach for the car industry, which has focused up until now on the simple job of selling more cars. To achieve the required changes, companies will have to rip up their business models, while at the same time meeting the needs of their current customers.

The transition also involves considerable risk. Those captives and OEMs that want to lead will have to invest heavily in ideas that might not pay off soon, or even at all. A CEO of a global manufacturer captive says that, “The business case for more difficult, new, and untested developments where the payback is difficult or impossible to estimate is... problematic.” As a result, many OEMs and finance providers currently plan a gradual transition from simple auto finance models like personal contract purchase and leasing to next-generation finance models more closely focused on outcome – like mobility services, subscriptions, and pay-per-mile solutions.

Most problematically, there is no clear winning strategy for finance captives and OEMs as they try out new outcome-based finance products. Committing to one strategy or another could mean getting left behind if the market decides to move in another direction. At this point, “It is important to remain open-minded and flexible,” says Alice Altemaire, chief executive officer of RCI Bank. But sitting on the fence won’t work for too much longer.

Finance captives are also dragging their feet because they believe that the old model of one car, one driver “has legs for a while yet,” according to Cyrille Foillard, chief innovation officer at RCI Bank. For those who are not yet convinced by subscriptions, a shift from personal contract purchase to private leasing seems to be their preference.

Overcoming cultural barriers and updating infrastructure requires “not only financial investment but also a forward-looking mindset,” says Adrian Samareanu, chief digital officer at Volvo Financial Services. One senior fleet leasing respondent in our research describes the gulf between the knowledge that action is needed and the stasis of the industry: “Leasing companies spend 80% of their meeting time talking about new mobility but still get 95% of their revenue from traditional leasing products.”

Nonetheless, the challenges to the industry have now reached such a critical point that finance captives and OEMs urgently need to make decisions about the direction of their businesses if they want to take advantage of the opportunities at hand.

“Captives are often too big and have very standardized business processes, and do not yet have the infrastructure to manage the flexible terms and conditions that customers are nowadays demanding.”

Vinzenz Pflanz, president of corporate sales, SIXT
Pressures and challenges abound

In addition to servitization, the industry is battling other changes. There is increasing pressure to move away from gas and diesel to electric cars, which involves considerable investment in battery technology research and development, and logistical challenges in charging point provision. Self-driving, or ‘autonomous,’ cars present another challenge. One Volkswagen senior executive likens the investment needed to develop autonomy to the level of investment required to send a man to the moon. And connectivity is a further challenge: collection, analysis, and use of data provided by the car and its driver is a huge potential source of revenue – but tough regulations like the European Union’s General Data Protection Regulation could place considerable restrictions on just how valuable it is. No finance provider wants to be the test case for data privacy.
Disruption from familiar faces

‘Just add fuel’

The number of challenges to the industry and pain points in the existing buying process are drawing the attention of some familiar faces – Google, Amazon, Facebook, and Apple (GAFA). These companies are no stranger to innovation, or to driving into new markets. The giant, potentially lucrative mobility market looks increasingly like a good kill. If the market continues to transform slowly, one or more of GAFA is likely to arrive with the kind of customizable, connected, and convenient solutions they’re known for elsewhere.

In fact, Amazon has already entered the auto industry in Spain. In June 2019, in partnership with ALD Automotive, the fleet finance subsidiary of Société Générale, it launched “Motors,” a new store for convenient online car leasing, built on a simple usage-not-ownership model. Because all the leasing packages on offer include maintenance, insurance, tire changes, breakdown assistance, vehicle registration, and excess mileage buffer, Amazon tells prospective customers they only need to add fuel.

Our research highlights the risk of the ‘just add fuel’ approach to traditional market players.

“As Amazon has effectively set the bar on the level of service that customers now expect,” says one captive. Further, Amazon’s enhanced ability to invest heavily in development presents a challenge to the market given that “investment in IT [among traditional finance providers] is running at a level that is difficult to sustain.”

As one fleet lessor says, “Companies that try to be simple vehicle suppliers will become commoditized.” The trick for the industry will be to find the strategy that does not eat vast amounts of investment – of both time and money – and that ends in solutions with acceptable cost/income ratios. And that looks like a tall order.

So, what do OEMs and finance captives need to do? Our research shows that there are three key industry imperatives: evolve, partner, and analyze.
Industry imperative 1: evolve

Change the business model

Auto finance providers need to change their business model if they want to successfully make the transition to next-generation auto finance. The current business model is designed to generate maximum revenue from the sale of the car – but the oversupply of cars has made this a low-margin activity. The model needs to change to one where the car facilitates the sale of additional services, which in most cases would be significantly higher-margin activities – such as insurance, in-car services like route finders and entertainment, and even the use of the car as a payment device.

The winning strategy for outcome-based finance may lie in longer-term rental products with add-on services. Both Amazon and Lynk & Co (the auto brand launched by Geely, the biggest privately owned automaker in China, which has acquired Volvo, The London Taxi Company, and Lotus) offer a car rental for a few weeks as part of the offer for a long-term lease. This allows customers the flexibility to test the product short-term before making a long-term commitment. As for the most promising source of service revenue, in-car payments (such as payments for fueling or parking) followed by advanced pay-per-mile insurance, preventative maintenance, and mobility services look like healthy income streams.

So far, customer uptake of cars by subscription has been low because they have been priced as premium products. For subscriptions to take off, finance providers will have to review the pricing strategy – which, without changing the fundamental model, may well mean facing a choice between accepting lower margins or driving down costs – neither of which is sustainable in the long run.

Focus on utilization, not depreciation

At the center of the old business model is depreciation: new cars immediately losing value, resale prices, keeping loan volumes high and cars coming off the assembly line. But with car sales at their peak, that thinking should be replaced by an attempt to extract value from the car over a much longer period of time – ideally its whole lifetime as an asset.

Auto finance companies will need new systems to help them achieve this. At each stage, these systems will need to identify the next-best use for each vehicle. Cars by subscription, which are currently expensive due to the high depreciation and wear and tear from new and nearly new vehicles, may be less expensive if low-mileage, older cars are offered by subscription instead.
Incentivize co-ownership

Auto finance companies will also need to change their focus on penalty payments for wear and tear to more transparent methods of paying for usage that reduces the length of each car’s economic life.

They will need to encourage the concept of co-ownership among car users, rewarding customers who take care of their vehicles and extend their economic life, and charging more for those who are tough on their cars.

“Customers will become increasingly used to the concept of co-ownership – a sort of partnership between OEM, captive, and customer, working together to maximize the economic life of each vehicle.”

Adrian Samareanu, chief digital officer, Volvo Financial Services
Industry imperative 2: partner

Build an ecosystem of partners

OEMs and captives are facing a perfect storm of innovation in product, change in consumer behavior, and a requirement to update their business models and infrastructure. The demand for investment is high. OEMs and captives need to find a way to distribute the risk and maximize the chances of return.

Currently, the most effective way for auto finance companies to manage the transition to a different future is to form partnerships. They should connect with:

- Service providers to build a single, comprehensive, variable-cost mobility solution
- Other service orchestrators to gain scale and share development costs
- Specialist technology providers to realize value from emerging technologies
- Outsourcing companies to outsource non-core activities and to bridge larger capability gaps in areas like AI and machine learning

Partnership makes sense – it reduces the amount of infrastructure a single entity needs to develop to deliver services. OEMs are already turning to their captives to manage the delivery of services to their customers in a process called ‘orchestration.’

Band together to reduce the cost of delivering services

Orchestration describes the role of sourcing and managing a range of service providers and bundling their services into a single comprehensive mobility service, which they deliver to the customer. Orchestration places captives at the center of an ecosystem – they are the glue between the customer, the OEM, and any other partners that may be required to run the business.

As Foillard says, “Bundled one-stop solutions are seen as becoming increasingly of interest to customers,” and provide the advantage for OEMs and captives, which then do not need to invest to develop these services in-house. Through the use of external providers, costs remain direct – which is an advantage in the early stages when demand is low and fluctuating.

OEMs and captives can further reduce costs by forming partnerships with other providers. For example, BMW Group and Daimler AG have pooled their mobility services. The companies say that this creates “a new global player providing sustainable urban mobility for customers.” The two companies are investing more than one billion euros in total to develop and more closely intermesh their offerings for car-sharing, ride-hailing, parking, charging, and multimodal transport.

Through these sorts of partnerships, OEMs and captives can build scale and reap the benefits of economies of scale to reduce costs.

As Pflanz says, “Costs and scale have a strong interaction.”
Identify outsourcing opportunities

All respondents to our research recognize the value of outsourcing as an enabler of advanced auto finance and services. They rate outsourcing as ‘fairly to very important’ for developing a cost-effective operating structure and would consider using it to manage non-core activities or wider processes where their in-house capabilities are low.

“Captives will buy [services] ‘wholesale’ and sell at retail with a markup. This will have the effect of moving costs from fixed to variable. As long as this markup can be maintained, then this move should enable captives to more easily manage their margin structures.”

David Betteley, former global head of financial services, Jaguar Land Rover
Industry imperative 3: analyze

Capture, analyze, and use data

The connected car generates data, and data about the customer offers a unique opportunity to deliver new products and services. But there are serious obstacles in the way of captives who seek to capture and use such data.

Respondents to our research suggest that the most common operational challenges around using data are legacy systems, the lack of a model for data sharing, and the lack of capability to interpret data to deliver insight. And they identify even more barriers to the use of AI (which will be essential to using data to automate processes). They say that the quality of data is not always sufficient to implement artificial intelligence solutions, that there are a lack of suitable systems, a lack of skills, a lack of funding, and serious roadblocks raised by corporate culture.

Auto finance organizations urgently need to develop their management of data – how they capture it, analyze it, and use it. To do this they must:

- Establish a data strategy to identify what data is relevant and what they can do with it
- Use AI solutions, focusing on areas of the business where they add the most value
- Extend their capabilities as they build expertise in areas which will be key to manage and develop advanced auto finance services

Captives have the jump on everyone else – they already have access to data from the OEM. They must move quickly to use this data to develop advanced finance and services before other market entrants.

Use data from the whole lifecycle

OEMs and captives can make better decisions if they effectively capture, analyze, and use data from the whole lifecycle of the vehicle and combine it with data from the contract and the customer.

“Captives should seek to become the data hub for their auto finance ecosystems.”

Adrian Samareanu, chief digital officer, Volvo Financial Services

Best uses of data include:

- Understanding the questions a customer has asked when researching which car to buy
- Using data to make better credit decisions and detect fraud; checking the fit between a customer’s contracted use of a vehicle and actual use
- Checking the actual usage of the car and its secondhand value to more accurately predict the price-equity point (when it makes most sense to make an offer to the customer to renew the contract with a replacement car and finance agreement)
- Thorough analysis of the customer’s actual use of a vehicle to make an appropriate renewal offer and not just a replacement of the car with the equivalent current model
And there are other areas for developing the use of data. Predictive maintenance will be an important revenue stream – using connected car data and AI, the OEM can predict when maintenance will be required. Preventative maintenance plans, which are already in widespread use for commercial vehicles and aviation, offer a potentially lucrative opportunity for finance providers.

Connected cars can also tell customers where they can park and how much it will cost or, in an electric vehicle, where the charging points are and what the rate is. Connected cars are also likely to become a place of purchase, almost literally becoming a credit card, and all of this information will flow through the customer to the captive and then the OEM.

Customers hiring cars can benefit from dynamic pricing – as can captives. As Pflanz says, “Mobility providers need to be ready to charge more when a car is nearby, and it is raining.” And fleet management teams can use data from connected cars to manage yield in ways such as predicting where a vehicle will be needed to increase availability. Lastly, this kind of information will be useful for captives because electric vehicles in particular will have a longer commercially economic lifespan and therefore the secondhand market is likely to be more robust. Data on local conditions for selling secondhand cars will be key to developing an important future revenue stream.

“At the root of transition from a transaction to an ‘as a service’ business model are data and insights. Companies will need to rethink their data platform and analytics/AI to manage a stream of customer behavior data versus episodic ‘moments of truth.’”

Amaresh Tripathy, chief analytics officer, Genpact
For captives, the time to act is now

“Captives have a competitive advantage because of their dominant role in the existing new car ecosystem, access to connected car data, and their special relationship with OEMs and dealers, but they will lose pole position to big tech companies like Amazon who are already testing servitized models to see what works, unless they move fast.”

_Rohan de Souza, global client partner, auto finance at Genpact_

With unparalleled access to customer data through the OEM and a unique understanding of the assets being financed, captives have a competitive advantage over other finance providers to win the race to develop customer-focused finance and services. It is important that other challenges do not distract them.

First movers already see the opportunities from advanced auto finance and services as a strategic imperative for survival and are redefining their role accordingly. But the many followers, who are waiting for a winning strategy to emerge, risk ceding their advantage to disrupters.

The winning captives’ new role will be as orchestrators of services, managing the customer on behalf of the OEM and acting as a data hub for the auto finance ecosystem. Their job will be to partner and connect a range of services that ultimately deliver more personalized, convenient, and cost-effective finance products and bundled services to the customer.

But in order to achieve this, all captives need to focus on their competitive advantage – access to data from the OEM. The core capabilities they develop will be derived from extracting value from that data. Not only will they need to develop the capacity to collect, analyze, and use a wide range of customer and vehicle data, but they will also need to become skilled at optimizing the lifetime value of the car – and try to hold on to the lifetime value (that is, the loyalty) of the customer. OEMs and captives will also need to be attentive to the much broader shifts possible in personal mobility. Our research shows that the development of advanced auto finance and services might lead to transport becoming a commodity rather than a lifestyle choice, and that brand loyalty may shift away from car brands and car manufacturers to service brands and service providers.

In order to take advantage of all these developments, captives need to enhance their understanding and use of artificial intelligence and machine learning with a strong initial focus on applying both to the areas where they currently deliver most value. As their capability builds, they will be better able to seize the opportunities arising from connectivity, autonomy, shared services/mobility, and electrification.
About this study

Genpact worked with the International Asset Finance Network to conduct a study between August and October 2019, via 12 in-depth telephone interviews with the global CEOs, national CEOs, chief digital officers, and chief innovation officers of Europe’s largest automotive captives, bank-owned fleet finance, and mobility companies.

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