Disruptive Auto Finance Technology
Sink or Swim?
Introduction

The automotive finance industry is facing its biggest era of change since the advent of the internet, as customers’ retail behaviours, expectations and preferences relentlessly evolve.

Gone are the days when potential buyers made multiple visits to a franchise showroom before making a purchase, and looked to the dealer to sort out the finance for the car they liked. Now customers are much more likely to devote their time to searching online for the car they want, only going into the dealership to arrange a test drive to confirm their choice.

In a world where a vast amount of information about a car’s performance is available instantly via websites, mobile apps and social media, the whole process of buying a vehicle is changing beyond recognition.

Manufacturers and dealers have started to respond to this change, introducing concepts such as the virtual showroom, where potential buyers can assess and compare details of cars online and customise their choices. Independent website reviews and interactions on Twitter and in other social media now have as much – or even more - influence on a purchaser as the manufacturer’s advertising and the dealer’s recommendations.

Technology has played a major role in disrupting the traditional approach to car buying, and it also has the potential to revolutionise the way in which auto finance is assessed and delivered. What the consumer is increasingly seeking is a blended approach, whereby they are able to choose finance as flexibly and as easily as they can now decide on a particular choice of car.

But lenders, manufacturers and dealers need to be quick off the mark to ensure they harness the power of online systems and applications to create a powerful experience that will help them build close customer relationships.

US President John F. Kennedy said: “Change is the law of life. And those who look only to the past or present are certain to miss the future.”
Getting into the fast lane

After the dramatic slowdown that characterised the recession years, car sales are now well out of the doldrums. Figures for new car registration for August from the Society of Motor Manufacturers and Traders showed a 9.6% increase to 79,060 units compared with August 2014.

David Raistrick, UK manufacturing leader at consultancy Deloitte said: “In a traditionally quiet month, the growth achieved in August is ahead of expectations. Indeed, August registrations have now exceeded the levels achieved in 2007 (77,000). This level has not been reached in the intervening years, even with the assistance of the government scrappage scheme in 2009.”

“At the current rate of growth being achieved, full year sales look on track to reach between 2.55 and 2.6 million. That’s even if there is a quieter last quarter to the year,” he predicted.

More car sales lead to more demand for car finance. Figures released by the Finance and Leasing Association (FLA) show the number of new cars bought by consumers on finance provided through dealerships increased by 13% in July, compared with the same month the previous year.

The percentage of private new car sales financed by FLA members through dealerships in the twelve months to July 2015 reached 78.7%, up from 78.1% in the twelve months to June.

The point-of-sale consumer used car finance market also showed continued growth, with new business volumes up by 9% compared with July 2014.

Commenting on the figures, Geraldine Kilkelly, head of research and chief economist at the FLA, said: “The point-of-sale consumer car finance market has continued to grow in line with expectations. With the latest new car registrations for August suggesting robust growth in demand, we expect new car finance volumes to continue to grow over the coming months.”

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*Credit: Finance and Leasing Association*
Nor is the trend for greater demand for auto finance confined to just the UK market. Latest data from research company Experian’s State of the Automotive Finance Market report covering US trends shows that during the second quarter of 2015, consumers continued to select leasing as a popular option, as 31.4% of all new vehicles financed were leases, up from 30.2% the prior year.

Over the same period, used vehicle financing hit at an all-time high of 55.5%, compared with 53.8% the previous year. The total percentage of new vehicles financed in the second quarter of 2015 reached a record high of 85.8%, compared with 85% a year earlier. As Melinda Zabritski, Experian’s senior director of automotive finance, explains: “The automotive finance market continues to progress in response to consumer demand. The availability of different financing options allows consumers to stretch their dollar and more easily find a vehicle that meets their budgetary needs. Lenders and automotive dealers also can benefit greatly from these trends by gaining insight that will enable them to take advantage of similar market opportunities in the future.”

Technology savvy consumers

One trend that is becoming very apparent is that consumers are going about car buying in a completely different way from before. The established route was linear: several trips into a dealership to look at different models and discuss options, followed by a purchasing decision at the same outlet and then a sale, with or without finance. Deviation from the set approach was rare and difficult, because information was so limited – where else could the would-be buyer find out about the cars and finance available?

Technology is the disruptive factor which is forcing change to the traditional buying model. Graham Wheeler, CEO of captive Volkswagen Financial Services, speaking at this year’s International Auto Finance Network meeting in London outlined how this is happening, as consumers start to use all kinds of online resources long before they get anywhere near visiting a dealership.

Wheeler emphasised that this does not mean that technology will supersede everything the auto finance industry has built up over the decades. While consumers are increasingly researching car buying information online, they still want the physical experience of sitting in a vehicle before making a final choice.

“The idea that the dealership is dead is a myth, as 85% of consumers still use them as a main touch point, although a quarter say they are not satisfied with the process. They are looking for a personalised approach, where dealers use data gleaned from
online interactions to configure the car to meet their specific needs,” Wheeler said.

“Volkswagen’s blended retailing approach allows customers to access information they need consistently online and through the dealerships,” Wheeler explained. The manufacturer’s “Brick, Clicks and People” programme has seen retail sales increase by 50%, while reducing showroom visits by 50%.

Manufacturer-designed technology is available to the customer to allow them to prepare the vehicle acquisition prior to visiting the showroom, so that they are presented with a car customised to their preferences. Suppliers are also altering the look of the showroom, to be able to replicate the home-buying atmosphere there, with premises re-designed to include couches and large TVs.

Wheeler stresses that the sales process itself is changing in line with these developments. Instead of the traditional model of customers being sold the car in the showroom and then working out if they can afford it, the new model is of the customer selecting a rental they can afford and then tailoring the vehicle model to suit that rental.

“The challenge for financial services and fleet suppliers is to integrate and interlock all the sales and funding processes that go on between manufacturers and retailers so that buyers browse, buy and bond,” he added.

Customer service

Unfortunately, the evidence to date suggests lenders, manufacturers and dealers are finding hard to address consumers’ new approach to car buying and financing. For example, according to the second annual customer experience survey from the service design consultancy Engine, just 12.2% of consumers cited the automotive sector as offering the best service and customer experience.

Automotive came immediately behind utilities (12.4%) and public transport and trains (13.5%) – the two sectors most publicly harangued for poor customer service – and was only narrowly ahead of insurance companies (11.4%) among the 14 sectors covered in the study.

“It’s certainly a cause for concern that automotive ranks behind even public transport/trains and utilities in terms of quality of customer service,” said Oliver King, co-founder of Engine.

“Although figures suggest the experience isn’t a strong influence on customer choice, this is because in sales, by the time people reach a dealer, they’ve pretty much decided exactly what they want to buy, so the interaction is much more about ratifying and confirming the product meets their needs.”
“However, it’s naive for manufacturers and dealerships to be lazy about customer experience because of the impact it has on the more profitable and ongoing areas of servicing and repairs.”

Customer service also has a very obvious impact on the other key element of any car sale, namely the financing. The traditional motor finance customer journey is similar to that offered by many auto retailers, and shares many of the same features, namely:

- Limited access (little publicly available information about different types of lending options and ways to comparing them)
- Limited control (the dealer typically handled finance searches, with the customer having little input)
- Limited transparency (the consumer did not have much information about scoring criteria or different lending conditions)
- Limited choice (only a specific suite of finance product on offer at each dealership)

“Dealerships and manufacturers can’t afford to think about what’s important to their ‘average customer’ – that person doesn’t exist,” says King. “Instead, they need to think of the different customer profiles and tailor the experience accordingly for each one.
Millennials on the march

The customer service challenge is being given an additional boost by the so-called Millennial generation, those born in the period 1982 - 2000, who have grown up into adulthood with smartphones giving them readily available online access in their pocket at all times. For this group, the preferred method of making a purchase is to look online first and, crucially, to start to make payments and funds transfer via their mobile as well.

More than half (51%) of new-vehicle internet shoppers use a mobile device—tablet or smartphone—to digitally conduct automotive research on the internet to help them find the right vehicle, at the right dealer for the right price, according to the J.D. Power 2015 New Autoshopper Study.

The study analyzed how new-vehicle buyers use digital devices—tablets, smartphones and computers—to gather information prior to purchase, as well as which websites and apps they use during the shopping process. It found that online research was increasingly being used to check out not just the vehicle on offer, but the finance options as well, and that speed of response, access to wide sources of information and a seamless customer experience were all critical elements.

Recent research from Deloitte found that more than 32 million smartphones will be shipped in the UK in 2015, with 76% of adult owning one. The study reveals that Britain’s mobile phone owners look at their devices nearly 1.1 billion times a day, the equivalent of 400 billion times a year.

Deloitte’s fifth annual Mobile Consumer report confirms that younger age groups (18 to 24 year-olds) make particular intense usage of their phone, with 80% of young people using their devices on public transport and 43% while eating at a restaurant.

Ed Marsden, lead telecoms partner at Deloitte, comments: “Consumers are planning their lives around their smartphones, which are quickly becoming the remote control for their lives.”

According to Deloitte’s research, there has been a significant increase in the number of UK adults who have made mobile payments in the year to May 2015, rising from 3% to 13% of respondents. However, just 1% use their phones to make payments via their mobile phone on a daily basis.

Barriers to entry still exist for the majority of smartphone owners. The most common reason that UK adults gave for not using their phone to make a payment was one of security – cited by 42% of respondents. This was followed by “I don’t see the benefits from using this” (35%), and users lacking the necessary feature or app on their phone (22%).
Lee added: “As technology companies continue to launch and market their mobile-payment systems, smartphone users will increasingly accept it as a method of payment. Within the next year, we would expect around 10% of smartphone owners to regularly make mobile payments.”

**Getting smarter**

The adoption of smartphone and smart watch payments is expected to take-off faster in the UK than it has done in the US, because there are more smartphone devices in circulation than ever before, coupled with an established mobile payments culture.

Deloitte’s study found that over a third of young people (34% of 18-34 year-olds) are interested in using mobile payments, along with a fifth (20%) of 55-75 year-olds. It says the accessibility of sales terminals that have contactless readers, combined with smartphone users’ general awareness over contactless technology, will further drive the acceptance of mobile payments in the UK.

Marsden comments: “People currently leave home with their purse or wallet and their smartphone; ideally we would like to carry just one. Smartphones access social networks, take photos, deliver email, navigate routes, provide news and plenty more. For many, a purse or wallet’s only role is to store credit cards. Subsuming these cards into a phone is a logical next step.

“Security has always been the biggest barrier to the adoption of mobile payments. Yet, making contactless payments can be very secure, thanks to the combination of fingerprint readers and tokenisation technology which means that the phone does not need to transfer credit card details when the payment is made.

“Having overcome these key barriers, we will see a stronger adoption of mobile payments in the coming months. There is little additional effort required by UK consumers to be able to use mobile payments; it is simply a case of activation.”

Millennials are likely to be the first to move towards using mobile devices for payment. As this generation of would-be car buyers starts to shop around for a vehicle and for financing, so they are likely to produce a sea change in the market.
On the road

Analysts have highlighted Millennials’ enthusiasm for the “sharing economy”, as evidenced by the meteoric rise of online options. They challenge the status quo such as the Uber taxi app and Airbnb online accommodation, where facilities are hired on an “as needed” basis. From this trend, some have deduced that younger adults are more likely to look to car sharing and mobility services offerings, rather than outright vehicle ownership.

But recent research from the US underlines that the younger generation will continue to want to purchase a car of their own. Indeed, Millennial car buyers are opting to lease their vehicles at a higher rate than the overall car buying population, according to a new analysis from car-buying platform Edmunds.com. The finding suggests that Millennials are more willing than older adults to sacrifice the long-term financial benefits of car ownership to get into bigger or more luxurious vehicles that are typically more affordable through leasing.

According to Edmunds’ analysis of car registration data, leasing accounted for 28.9% of all new car purchases by Millennials (age 18-34) in 2015. The percentage exceeds the industry-wide lease penetration rate of 26.7%, and reflects a 46% increase in leasing by Millennials over the last five years. By comparison, the share of leasing among all car shoppers has increased 41.7% during that period.

“Most Millennials understand and accept that they’re on a tight budget and that they need to stick to it,” said Edmunds.com director of industry analysis Jessica Caldwell. “But it doesn’t mean that their financial constraints limit them only to the most basic vehicles to get from Point A to Point B. If they see a chance to get into a nicer car while staying within their budget, they’re likely to explore that opportunity. In most cases, leasing opens the door to the bells and whistles that they couldn’t otherwise afford.”

There is a dramatic difference between what Millennial shoppers can afford when they choose to lease compared to when they choose to buy. According to a survey of Millennials conducted in June by Edmunds and Morpace Inc., a global market research firm with a large practice in the automotive sector, a majority of respondents (57%) said that they are willing to put no more than $2,999 down on a new car purchase, and a similar majority (54.9%) said that they are willing to pay no more than $299 per month.

As a result, shoppers who choose to finance their purchase are generally limited to vehicles priced at under $20,000. On the other hand, shoppers who are willing to lease can apply the same upfront and monthly budget toward a vehicle priced as high as $35,000.
There is further data to support the view that fears that younger people have lost their appetite for buying cars are unfounded, in research from TransUnion, which suggests the Millennial generation is the fastest-growing segment of auto loan consumers.

The credit reporting agency’s latest auto market report shows that Millennials represented 27% of total auto loan originations in 2014, up from 16% of total originations in 2009.

Millennials’ total outstanding auto balances have increased 23% in the past year, the highest of any age group. Average opening loan balances for this generation grew 4.1% year over year, up from $17,942 in 2013 to $18,678 in 2014.

According to Experian, Millennials are taking out more auto loans than the generation before them did. It says auto loans made up 14% of all newly opened accounts for Millennials in the last half of 2014, compared with 1% of newly opened accounts for members of Generation X in the last half of 1998, when they were at a comparable age.

“The growth in Millennials’ auto loan originations dispels the common myth that Millennials are not buying cars,” said Jason Laky, senior vice president and automotive business leader for TransUnion. “The growing average loan balances for Millennials, combined with stable delinquency rates, indicate that we are still in the midst of a strong auto lending environment.”

Browse, buy and bond

Technology is changing the global automotive landscape at a phenomenal pace, from driverless cars to unmanned digital dealerships. In particular, technology is enabling customers to have more control of the buying situation than ever before.

Consumers now want to have access to information which they can browse at their leisure. They are then seeking a personalised buying experience, where the supplier is able to use all the data gleaned from earlier online interactions to tailor the sale. Done well, this process encourages the buyer to bond with dealer, lender and manufacturer, who can all use technology to push attractive new offers and resolve any queries quickly.

Technology has not only transformed the way lenders mitigate risk and how payments are managed, but has also aided consumers in both the decision making and application process. With a single click on an online platform, customers can obtain price quotes, lease quotes, trade-in values, loan payoff information and financing options.
Increasingly, online finance platforms are linking to credit checking agencies such as Equifax, facilitating a method of obtaining finance pre-approval which ensures that would-be buyers avoid applying with lenders who are unlikely to approve their application and therefore safeguard their credit ratings.

With this process, credit agencies perform a “soft search” of the potential buyer’s credit. This gives shoppers an idea of what they qualify for, all the better to narrow their search and help them find a vehicle. Enabling consumers to check their potential suitability for a particular finance product before a full credit check is carried out, the soft search is now heavily used by brokers and finance comparison websites in both the US and UK markets.

It works by retrieving information from several sources such as the electoral roll and then matches this against a broker’s panel of lenders and the criteria that applies to each of these. By doing this, the soft search enables brokers to determine the most suitable lender and the likelihood of an acceptance. Crucially, it is not visible to other lenders who carry out a soft search or full credit check, and will show as a quotation search, so will not impact on any credit scoring process.

For dealers, this has important implications. The ability of customers to now qualify for ballpark credit in advance – in particular buyers who fall into marginal categories and may have challenging credit to work with – means drastic cuts in time spent trying to qualify them. This translates into less time for the customer spent waiting in a dealership while due diligence is performed. It is also reflected in dramatically shortened time frames dealers spend trying to get customers into vehicles they may wind up not qualifying for.

Technology is important for lenders, too. Via the online platform, customers can take greater control of the buying experience by keying in monthly payment budgets and receiving electronic offers. Telematics and “black boxes” installed into vehicles can provide data on how the car is used which, combined with the driver’s payment history, allows lenders to better assess risk and thus fine tune loans.

As a result, transparency is the new sales methodology. Online platforms allow buyers and dealerships to communicate messages and provide insights as never before. No longer is a dealership website purely informational—providing prices and options and images for customers to pore over—they should also be transactional, where dealerships can engage customers early in the game.

Of course, dealers have traditionally had the advantage over lenders in that they have the customer in front of them in the showroom when discussing finance, which has allowed them to pick up on issues and develop a deeper relationship with the buyer.
To remain relevant in what is a highly competitive market, funders need to elevate the consumer buying experience beyond expectations so that they, too, have a strong bond with the consumer.

Even though majority of consumers today take several months to go from need realization to actually buying a car they have higher expectations in terms of response times, communication methods, and service levels, especially the younger generation, because of the availability of technology.

For funders this means developing apps, an online presence and a series of tools which make it easy for individuals to seek finance information initially, and make payments or inquiries later on.

This sounds a simple proposition in principle, but is proving much harder to put into practice for many lenders, who frequently face challenges such as legacy systems which may not support online or mobile applications, and a workforce which has grown used to a particular approach.

However, recent business history is littered with examples of companies which tried to ignore the inevitable changes technology was making in their core market. Consumer entertainment supplier Blockbuster is a case in point, illustrating what can happen when the obvious need to change is ignored.

**Hero to zero**

With some 60,000 employees, Blockbuster dominated the market for supplying rental films and computer games for many years. The company adjusted comfortably to several waves of new technology, moving from video rental to DVDs and introducing supplies for games consoles.

What Blockbuster completely failed to notice, however, was the fundamental way in which technology was changing its business. The new kid on the block in 1997 was Netflix, which had abandoned the old model of a physical storefront in favour of an entirely online, downloadable presence.

Netflix started as a DVD-rental-by-mail firm, and spent the first five years struggling to get to a sustainable model that was cash flow positive. But it had a vision of using a new technology – streaming films and TV – to customers who valued an “on demand” approach that cut out the need to go out to the shop to find something to watch.

In 2000, Netflix was offered to Blockbuster with a price tag of $50m. Blockbuster turned down the option to take over the upstart company – and a decade later collapsed. By 2011, the competition from online entertainment services was simply too great for a company which still retained a high street shopfront.

Netflix, meanwhile, has gone on to record a $5.5bn turnover with just 2,300 employees and a lot of use of new technologies. Its $98 share price now eclipses Blockbuster’s 2004 peak of $81. It has over 57 million members in over 50 countries who can access some two billion hours of TV shows and movies per month, for one low monthly price. Netflix members can watch as much as they want, anytime, anywhere, on nearly any internet-connected screen.

As the company states on its website: “We intend to be global by 2017, twenty years after starting Netflix. Over the following decades, internet TV will replace linear, and we hope to keep leading by offering an amazing entertainment experience.”
Get into the driving seat

For auto finance professionals, the challenge is clear: a wave of technology change is coming, and in order to avoid being dragged under, they need to take action to get on top of the opportunities. Lenders, dealers and manufacturers need to think hard – and fast – about how they plan to integrate their systems, so they can link together all elements in the customer sales and financing process seamlessly.

That means bringing together all the information held internally about prospects, sales, quotes and finance offers, and combining this with “big data” available from other sources, including social media, on customers’ preferences and buying trends. Then this needs to be distilled to develop easy to use, intuitive apps and online facilities which create a compelling customer experience.
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