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Digital by design

Developing a future value proposition for digital captive finance companies

Contents

Automotive captive finance companies have seen their future, and it is digital. As they look to expand beyond traditional revenue sources of individual vehicle loans and leases, dealer and commercial lending, and white-label insurance products, many captives are eyeing opportunities to use innovative digital platforms and tools to serve customers' broader financial needs.

Automotive captive finance companies are a potent force in the auto lending business. In both 2017 and 2018, original equipment manufacturer (OEM) captives had around 43 percent market share, second only to banks.[1] Yet increasing competition and cost pressures are prompting captives to strategize how they can strengthen their digital capabilities to engage customers at the time and place of need, provide personalized experiences and products, and build longer-term relationships.

How can captive finance companies use digital technologies and data analytics to become more customer-centric? Which types of products and services should they offer? How can they expand upon their existing capabilities to execute on their future vision? Answering these and other foundational questions will help digital captives develop compelling future value propositions that differentiate them in the mobility management and consumer financial services marketplaces.

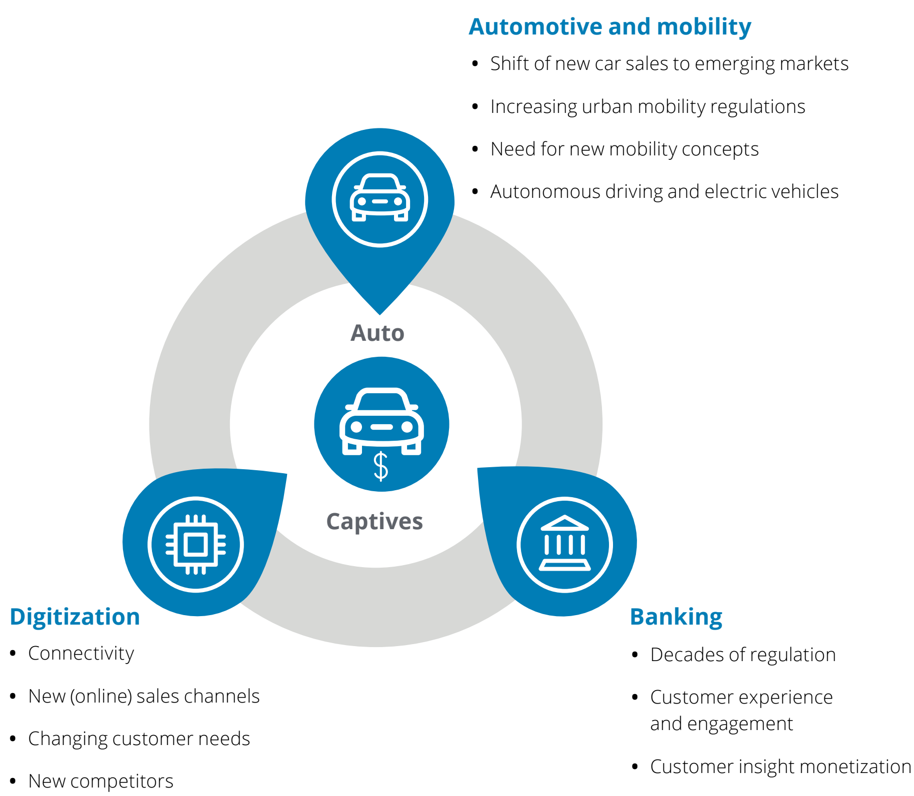
Why now is the moment for digital OEM captives

For decades, the automotive OEM captive finance business has been quite stable and lucrative. Today, however, the status quo is being challenged by the future of mobility (FOM), regulatory changes, financing digitalization, and other disruptions (figure 1).

Value in the FOM ecosystem will be derived from consumer-centric data, systems, and services-oriented business models. Revenues, market share, brand value—everything OEM captives have built over decades—is at risk or at least is going to change.[2] It's likely that captives will face more industry disruption in the next 10 years than they have in the previous 30.[3]

Deloitte's Future of Captives study[4] sees FOM propelling OEM captives more deeply into the services segment as they derive less and less of their profits from traditional loan and lease financing. This comes with a fundamental mindset shift in the customer relationship from focusing on one monthly customer transaction to many transactions per month—likely several per day in the not too distant future (for example, highway tolls and in-car entertainment purchases). If captives can create innovative, flexible services that add value and provide a seamless customer experience in this dynamic environment, consumers and the market will likely reward that leadership.[5]

Figure 1. Disruptive forces in the captive finance market



Source: Deloitte "Future of captives: What will be the core businesses of automotive captives in 2030?", 2018

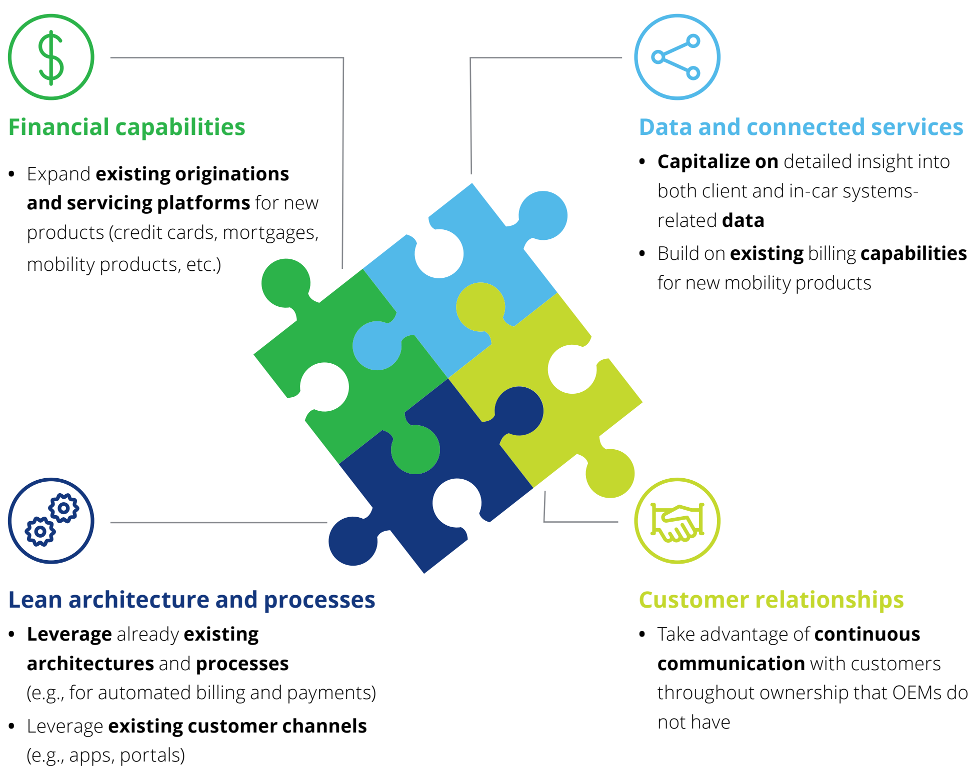
Developing a future value proposition

Captive finance companies seeking to protect market share and grow revenue should take steps now to strengthen their future value propositions against disruptive entrants that have already launched mobility-related services into the marketplace.

Examples include fintechs like AutoGravity and Blinker, bank lenders like LightStream and PNC Total Auto, and mobility tech giants. Many of the entrants encroaching on captives' turf are highly experienced at using digital platforms and tools to acquire and retain consumers. To defend their revenue stream, captives will likely need to become more digitally proficient and extend offerings beyond traditional vehicle financing and leasing into adjacent and new markets with innovative products and services.

Fortunately, captives have existing assets that can help to deliver tomorrow's financing solutions (figure 2), as well as a life trigger and a stronger brand identity than many other financial services players. Consumers' multiproduct requirements at the moment they purchase a car (loan or lease, insurance or savings account) create a natural cross-sales opportunity. Additionally, auto OEMs have new

Figure 2. OEM captives have existing assets to deliver tomorrow's financing solutions

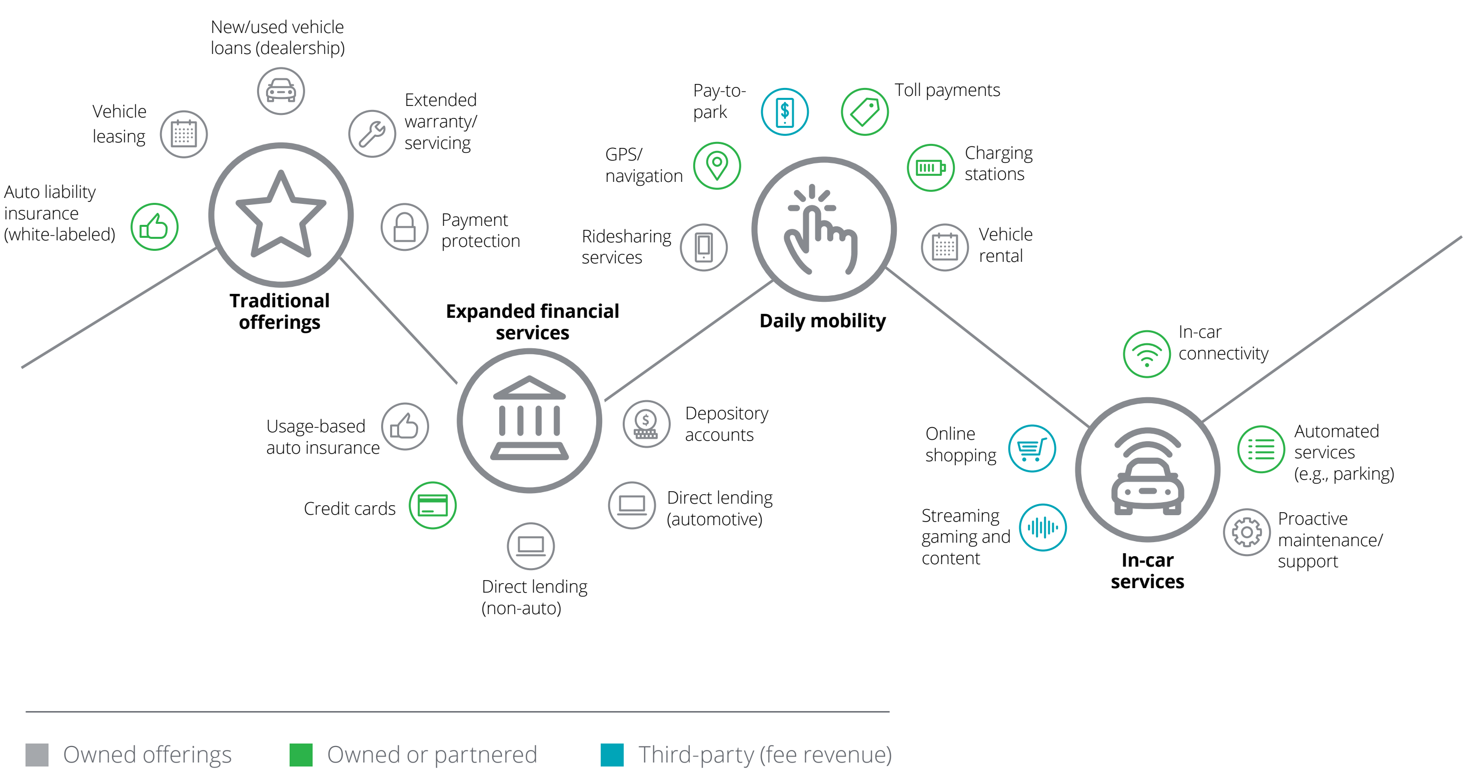


monetization opportunities stemming from the skyrocketing volume of in-car transactions as connected cars become a vehicle for consuming services (for example, data connectivity, e-commerce, and streaming content).

Finally, advances in technology and data analytics provide an opportunity for digital captives to improve the end-to-end user experience for traditional vehicle purchasing or leasing by enabling a seamless, omni-digital process that extends from initial research through delivery.

In addition to enhancing traditional offerings, automotive captives have opportunities to own or support a broader set of financial services, daily mobility needs, and in-car services (figure 3).

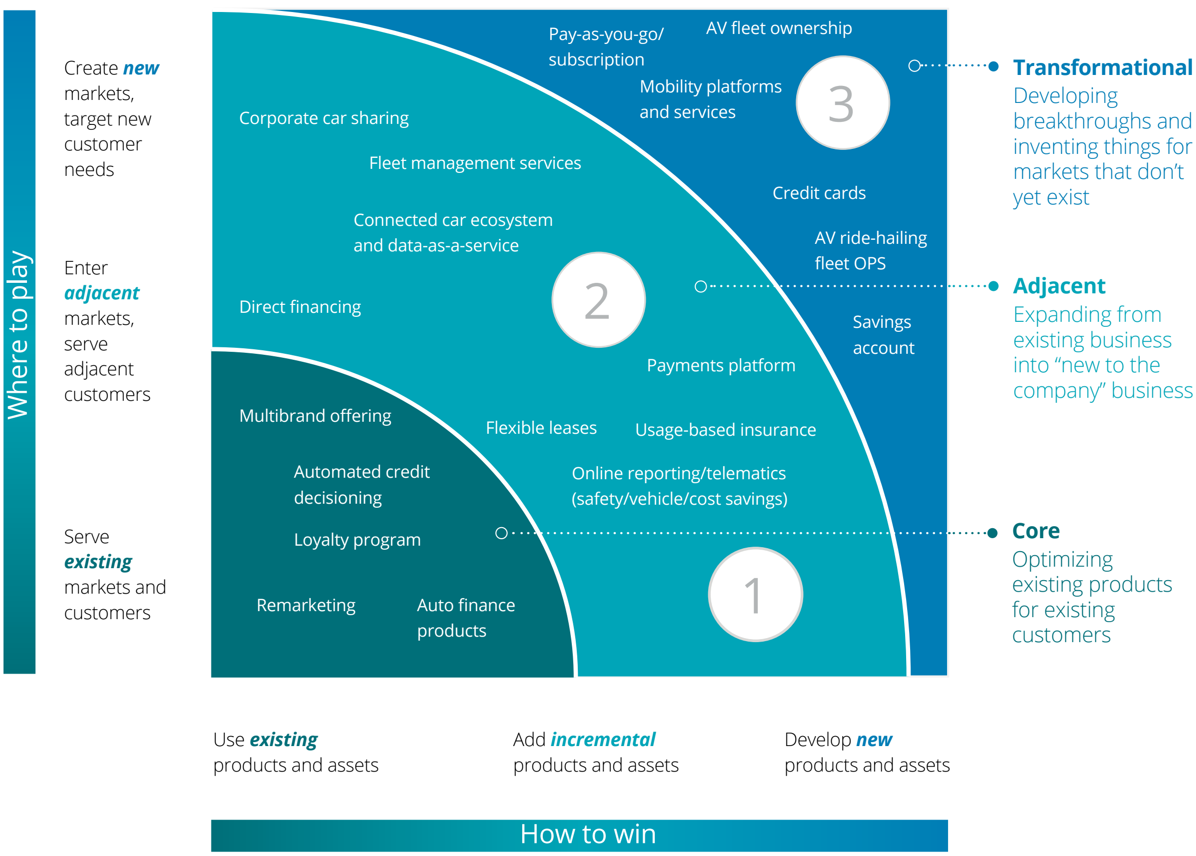
Figure 3. Potential auto captive offerings in the future of mobility



Captives will likely need to determine their level of ambition in order to chart their strategic growth path. Do they seek core, adjacent, or transformational options?

Figure 4 graphs three potential strategic options for compelling captive value propositions by their ambition levels.

Figure 4. Innovation can be classified into three ambition levels



1 **Integrated financial services**
Convenient payments options across ecosystems, insurance and extended warranties, direct lending outside of dealer auto loans, credit cards, and savings accounts

2 **Payments ecosystem for connected car services**
In-car connectivity and content, vehicle-to-infrastructure communications, and proactive maintenance and support

3 **Mobility services**
Offering loans to dealers that own car-sharing fleets, dividing the customer payment among stakeholders, and providing fleet management-as-a-service

Key focus areas for digitizing captives

Since digital captives' future value propositions are likely to extend beyond traditional vehicle loan or lease offerings, captives may lack a number of capabilities and operating structures that will be necessary to get to their desired end state. Focus areas to address include the eight areas below.

Focus area	Considerations/steps
Legal entity structure and charter type	• If pursuing a full industrial loan company (ILC) strategy, obtain an ILC charter – Captives can expand to a more wide-ranging business model by offering high-yield savings products, making additional types of loans, issuing credit cards, etc. – ILC deposits would allow captives to be more competitive with banks on cost of funds in some instances and also diversify funding sources to boost resiliency during periods of financial stress. Securing an ILC charter is difficult and takes at least two to three years (due to regulatory environment uncertainty, captives may be hesitant to move in this direction). • If offering insurance products, obtain a license to operate as an insurance charter – Required in corporate headquarters state and each state where insurance is sold – Partnership/white-labeling insurance products may be an easier strategy than self-offering
Business model	• Refocus dealer/captive profit model from hard asset (car) sales and leasing to ancillary products and services, including mobility services • Offer products and services that support consumers' daily and life-event financial needs: core banking, lending, cards, and payments processing • Develop new strategies to help maximize value of assets (e.g., utilize cars on lot through car rental or ridesharing services)
Talent strategy	• Identify what activities and workforce capabilities will be key to executing FOM vision • Assess what talent profile is required to complete these activities (e.g., human vs. digital talent and contractors vs. employees) • Determine how to attract, retain, and develop the desired talent profile via comprehensive talent strategy (e.g., employee learning and flexibility programs) • If using an ILC charter, new talent considerations will apply for ILC offerings (e.g., chief risk officers, new product specialists)

Focus area	Considerations/steps
Digital platforms	• Explore new, third-generation core banking platform options that create greater flexibility for current and future products • Transform digital front end into holistic mobility platforms that facilitate service requests, parking, ridesharing, lease payments, and more • Enhance customer engagement platforms to manage employee interactions with customers across channels
IT infrastructure	• Invest in future-state artificial intelligence (AI) applications to power customer insights and customized experiences • Enhance systems integration with partners (e.g., dealer inventory management) to provide unified customer experience
Data strategy	• Manage existing and new data (e.g., collect, organize, share, and use) • Leverage data to gain wallet share and revenue (e.g., cross-sell financial products, fuel-connected car services, loyalty programs) • Protect data (e.g., adopt bank-level standards for privacy, integrity, cybersecurity)
Ecosystem	• Align interests with OEM and dealer network to provide an integrated digital journey involving all parties • Ensure dealer profitability when captives offer additional products and services • Cultivate a portfolio of diverse financial and connected car services organically or through outsourcing, partnering, and/or acquisitions – Financial services: Resources include insurance companies, credit card networks, and banks (if not pursuing an ILC charter) – Connected car services: Partner with an existing platform or develop in-house platform and charge transaction fees
Regulatory compliance	• Captives are currently regulated by the Consumer Financial Protection Bureau (CFPB) and state regulations • With expanded financial services offerings, captives also may be regulated by insurance commissions (if offering insurance products); the Federal Deposit Insurance Corporation (FDIC) and state banking commissions (if digital captive is an ILC); additional payments regulation if captives own credit card/payments platform • Additional compliance burdens include onboarding legal documents, customer verification, and ongoing know your customer (KYC) checks for financial products • Captives must prepare for new data-oriented regulatory schemes being developed by state and international regulators (notably, the California Consumer Privacy Act and the EU General Data Protection Regulation)

Where to play and how to win

With so many potential places to play and ways to win, captives should carefully evaluate various alternatives before selecting their path forward (figure 5).

As prospective digital captives consider their future in an expanded financial services landscape, it is important to remember two things: each potential path forward presents advantages and disadvantages; and each digital captive will start in a different place based on its brand equity, assets, risk tolerance, and strategic vision.

Figure 5. Building the playbook

What is our winning aspiration?

- What is the purpose for your digital initiatives?
  - New business growth
  - Cost reduction
  - Experimentation
- What is your level of ambition?
  - Core business improvement
  - Expansion to adjacent areas
  - Transformation

Where will we play?

- What is your differentiated offering and value proposition?
- What existing capabilities do we have that support our ambition?
- Which products (i.e., subscription, payment processing, credit card, etc.)?
- Which channels (i.e., indirect via dealer, direct, fleet, smart cities)?
- Which customers will we target?

How will we win?

- What is the current landscape of captive, mobility, and digital banking providers?
- What are key offerings and services?
- What existing capabilities can we build on?
- How do we align the captive, OEM, and dealers?
- Do we get an ILC charter?

What capabilities must we have?

- Information technology?
- Data science, artificial intelligence, and analytics?
- Transaction service?
- Operational and process capabilities?
- Organization talent and team capabilities?
- Investment or capital requirements?

What management systems do we need?

- What is the target operating model?
- How do we expand our existing architecture to support our aspirations?
- What is the business case for digitization?
- How do we ensure the flexibility of our systems required to adapt to change?

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Endnotes

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2. Deloitte, "Sitting in the driver's seat: OEM captive finance companies are positioned to disrupt the automotive insurance market," 2019, https://www2.deloitte.com/us/en/pages/consumer-business/articles/oem-automotive-insurance-industry.html.
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