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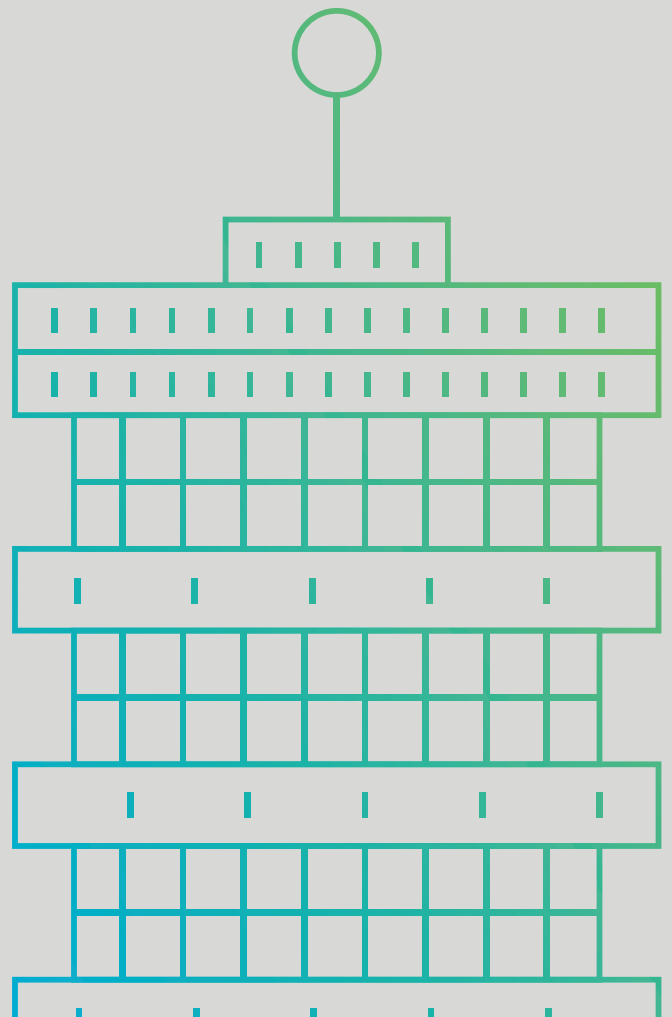
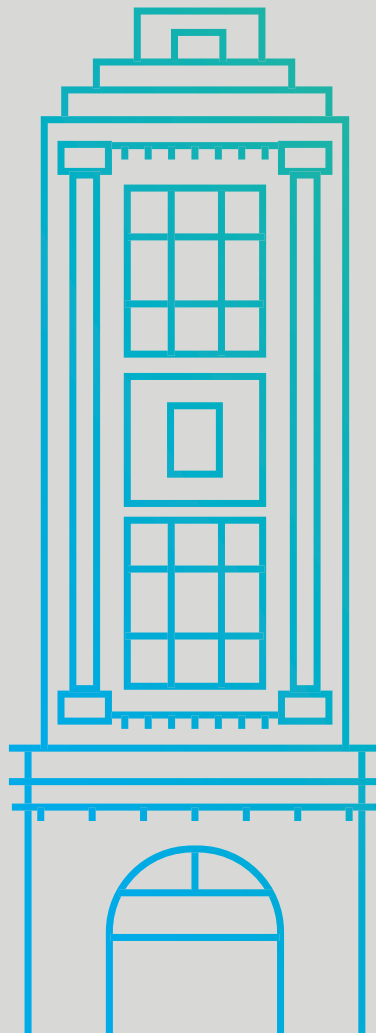
Digital by design

Transforming the auto finance sector
in the wake of the global pandemic



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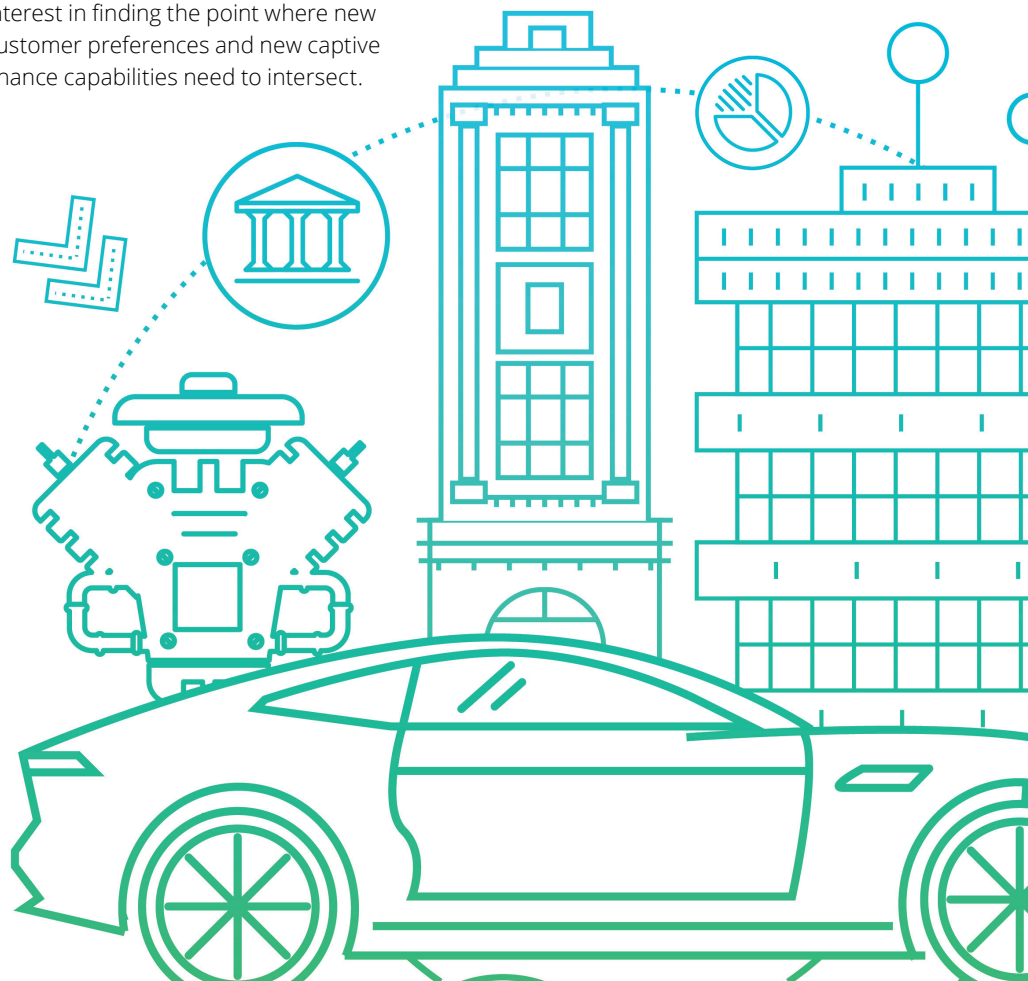


Automotive captive finance companies know their future is digital. Even before the disruptions of 2020, they were actively looking to expand beyond traditional revenue sources of individual vehicle loans and leases, dealer and commercial lending, and white label insurance products. Many captives were also eyeing opportunities to use innovative digital platforms and tools to serve customers' broader financial needs.

The COVID-19 pandemic and the effects it sent rippling through the global economy have not only sped the timetable for digital adoption, but also changed its focus. From the customer perspective, seamless digital service that combines shopping for a vehicle, buying one, and financing it into a single experience is no longer a nice-to-have novelty, but a foundational necessity. Captives can no longer take it for granted that consumers want them to deliver those advantages in person, or even over the phone. Nurturing and managing customer relationships digitally requires not only new tools and channels, but a new ability to span geographies on a 24/7 basis.

Operationally, captive finance companies are trying to weigh which functions associates can carry out while working remotely, and they are sorting out the implications this shift will have on real estate, the use of service centers, and the reassignment of tasks to lower-cost jurisdictions.

These changes are happening against a backdrop of several other shifts occurring at the very heart of mobility and vehicle ownership. COVID-19 is altering the trajectory of these trends as well. Many companies in the industry have an urgent interest in finding the point where new customer preferences and new captive finance capabilities need to intersect.



Building—and keeping— a position of strength

Automotive captive finance companies are a potent force in the auto lending business. In 2019, original equipment manufacturer (OEM) captives had around 42% market share, including 78% of market share for leases.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.

The pace of digital transformation was heavily disrupted when the pandemic hit last year. One day, incremental change was unfolding; the next day, offices were closed, dealerships were quiet, and customer needs were put on hold. As the crisis lengthened from weeks to months, it became increasingly clear the system was not likely to return to its old path.

As a result of the pandemic, the vehicle retail process will likely be significantly more complicated, with a bifurcation of customer expectations between physical and digital experiences. Data from the Deloitte 2021 Global Automotive Consumer Study suggests that, while most consumers still value an in-person purchase experience, there will be a segment of consumers that wants a virtual buying process even after the pandemic is firmly in the rearview mirror (figure 1).²

The definition of lifetime customer value has also shifted, with an increased premium on combining new value channels into a single point of contact to buy or finance a vehicle, insure it, and manage all the data and service accounts that come with it. It also involves maintaining the customer service linkages that cement loyalty. The higher a customer's potential lifetime value across all these revenue streams, the more important it has become to offer a compelling digital experience to manage them all.

These new circumstances generate a number of critical questions for captive finance companies. How can digital technologies and data analytics be used to drive more customer-centricity through the organization? Which types of products and services should captives offer? How can they expand upon their existing capabilities to execute on their future vision? Answering these and other foundational questions can help digital captives develop compelling value propositions that differentiate them in the mobility management and consumer financial services marketplaces.

Figure 1. Most preferred method for US consumers to acquire their next vehicle



Source: Deloitte 2021 Global Automotive Consumer Study.

1 Big Wheels Auto Finance, 2019.

2 Deloitte, 2021 Global Automotive Consumer Study, January 11, 2021.

Now is the right moment for digital OEM captives

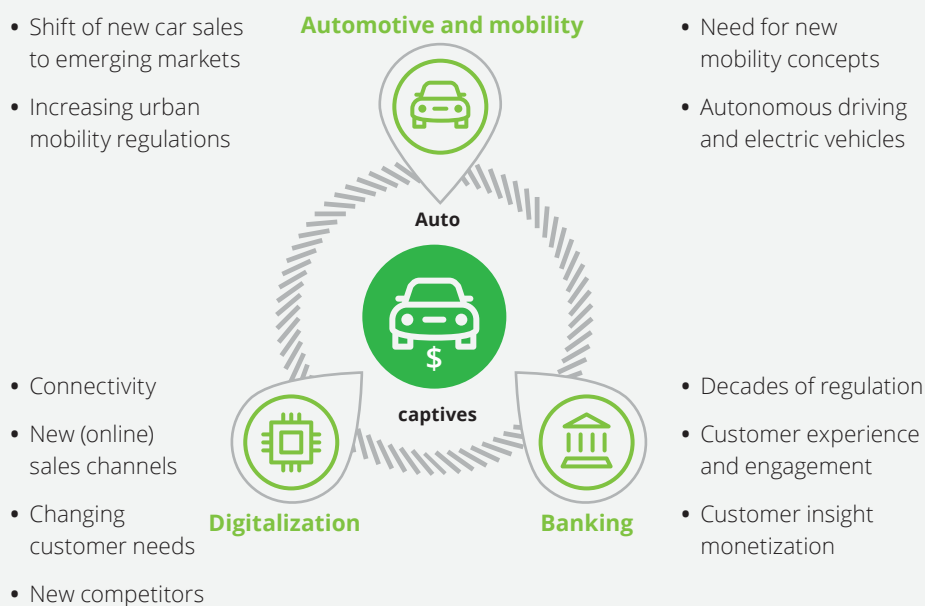
For decades, the automotive OEM captive finance business has been stable and lucrative. Today, however, the status quo is being challenged by the future of mobility (FOM), regulatory changes, financing digitalization, and other disruptions (figure 2).

Going forward, value in the FOM ecosystem will likely be derived from consumer-centric data 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.³ It's likely that captives will face more industry disruption in the next 10 years than they have in the previous 30 years.⁴

Deloitte's *Future of captives* study⁵ 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 customer transaction to many transactions per month; likely several per day in the not-too-distant future (e.g., 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.⁶

To create the digital channels that deliver these services and the operational structures that make them work, captives should look past digital as a capability they simply overlay on their existing structure. Instead, they should regard digital as the new thing they become—embracing a digital-first mindset that looks beyond internal divisions, external boundaries, and old assumptions about who does what and where in favor of a holistic, operational strategy focused on driving value directly to the consumer.

Figure 2. Disruptive forces in the captive finance market



Source: Deloitte's *Future of captives: What will be the core businesses for automotive captives in 2030?* February 2018.

3 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>.

4 Deloitte Center for the Long View, *Future of captives: What will be the core businesses for automotive captives in 2030?* 2018, <https://www2.deloitte.com/de/de/pages/consumer-industrial-products/articles/future-of-captives.html>.

5 Ibid.

6 Deloitte, *Sitting in the driver's seat*.

Developing a future value proposition

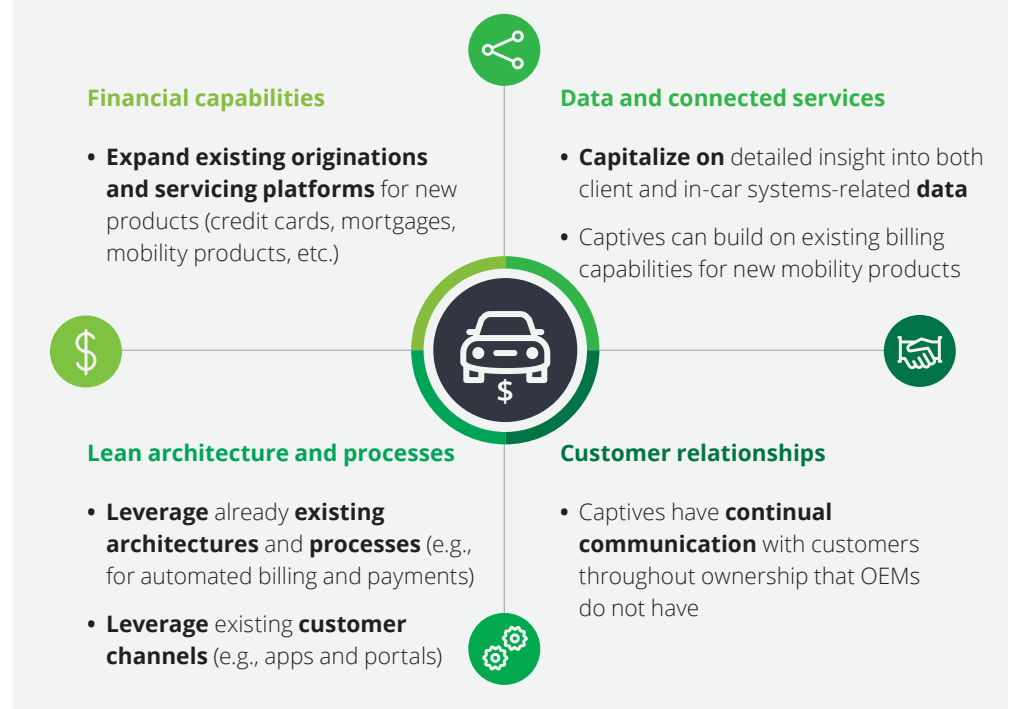
Captive finance companies seeking to protect market share and grow revenue should take steps now to strengthen their future value propositions against disruptive entrants that have already launched mobility-related services into the marketplace. Many of the entrants encroaching on captives' turf are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

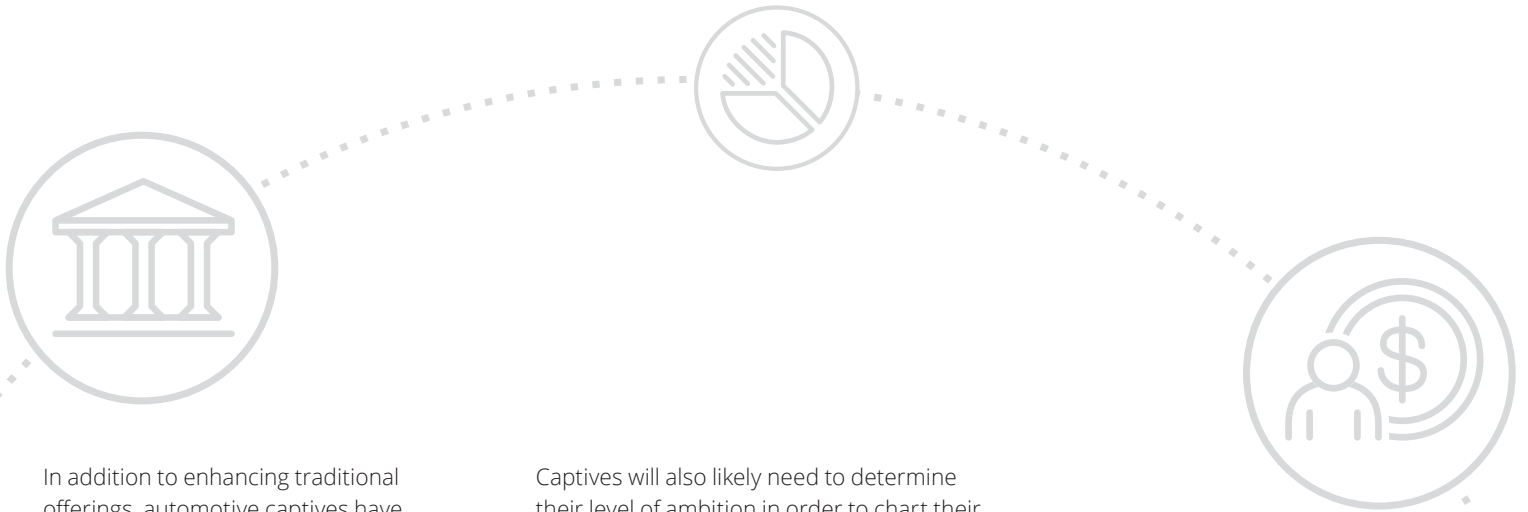
Fortunately, captives have existing assets that can help to deliver tomorrow's financing solutions (figure 3), as well as a life trigger and a stronger brand identity than many other financial services players. Consumers' multiproduct requirements at the moment they purchase a car create a natural cross-sales opportunity. Additionally, auto OEMs have new monetization opportunities stemming from the skyrocketing volume of in-car transactions as connected cars become a vehicle for consuming services (e.g., data connectivity, e-commerce, and streaming content).

The disruptions brought on by the global pandemic have also had the unintended effect of increasing captives' flexibility in some ways. For example, when financing decisions happened across a desk at a dealership once every several years, that dictated when and where business could take place. However, when people demand contactless, "always-on" service across an expanded spectrum of finance and service offerings, that opens the door to regionalize service centers, or even to move some operations across borders. Competencies in one place can enhance customer value everywhere the company has customers.

When customers execute regular vehicle purchases, advances in technology and data analytics still provide an opportunity for digital captives to improve the end-to-end user experience by enabling a seamless, omnidigital process that extends from initial research through delivery.

Figure 3. OEM captives have existing assets to deliver tomorrow's financing solutions

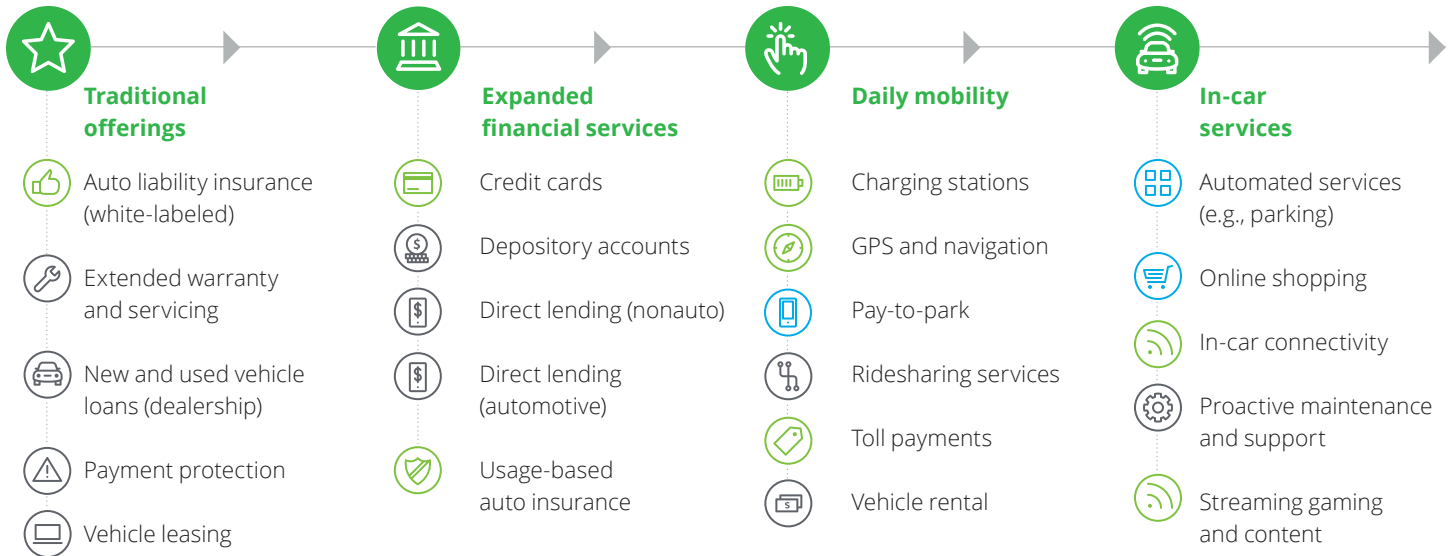




In addition to enhancing traditional offerings, automotive captives have opportunities to own or support a broader set of financial services, daily mobility needs, and in-car services (figure 4).

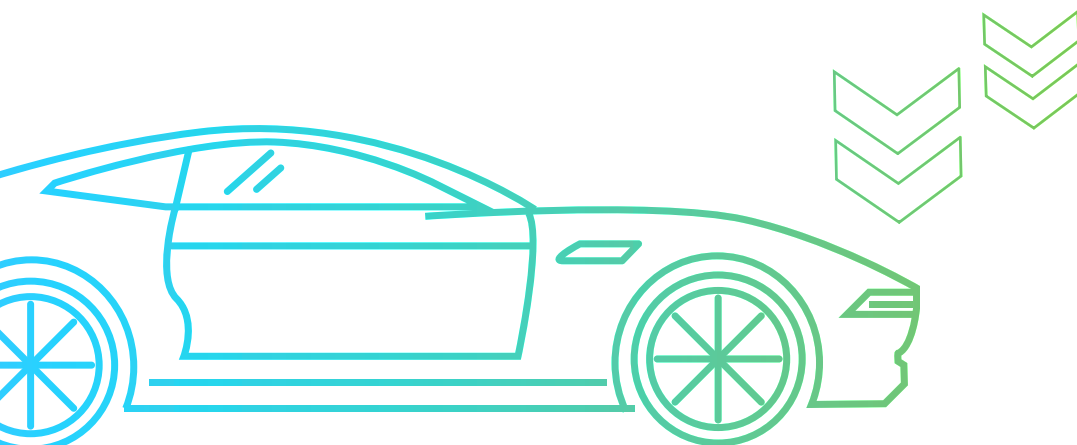
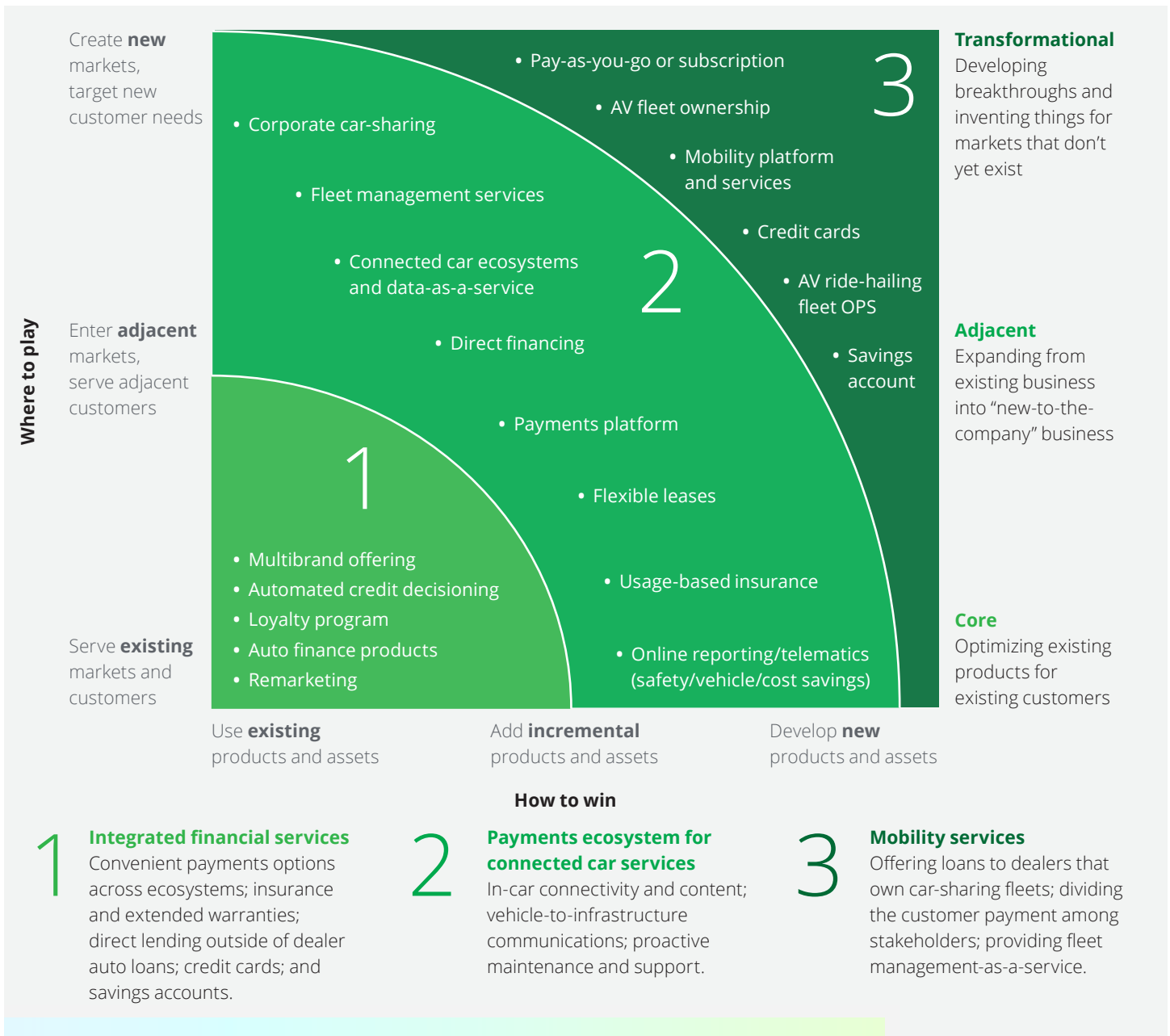
Captives will also likely need to determine their level of ambition in order to chart their strategic growth path. The following figure outlines three potential strategic options for compelling captive value propositions by their ambition level.

Figure 4. Potential auto captive offerings in the future of mobility



○ Owned offerings ○ Owned or partnered ○ Third-party (fee revenue)





Figure 5. Innovation can be classified into three ambition levels







Key focus areas for digitizing captives

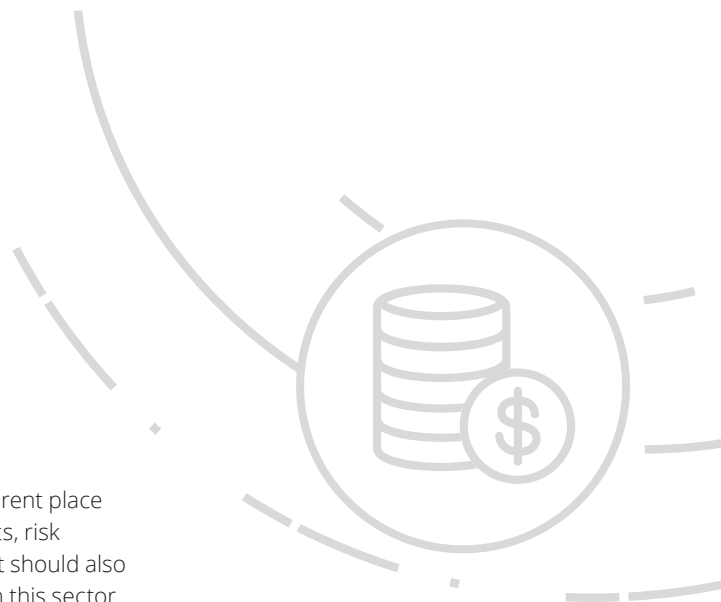
Since digital captives' future value propositions are likely to extend beyond traditional vehicle loan and lease offerings, captives may lack a number of capabilities and operating structures that will be necessary to achieve their desired end state. Figure 6 shows focus areas auto captives may consider.

Figure 6. Digital captives' future value propositions considerations

Focus area	Considerations and steps
Business model 	<ul style="list-style-type: none"> • Refocus dealer and captive profit model from hard asset (car) sales and leasing to ancillary products and services, including mobility services • Define customers' lifetime value and offer products and services based on each customer's needs at that point in time • 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 	<ul style="list-style-type: none"> • Identify what activities and workforce capabilities will be key to executing FOM vision • Assess which talent profile is required to complete these activities (e.g., human vs. digital talent and contractors vs. employees) • Establish a global delivery model (GDM) that brings in significant cost savings and standardization of operational delivery through centralization and consolidation • 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 industrial loan company (ILC) charter, new talent considerations will apply for ILC offerings (e.g., chief risk officers, new product specialists)
Digital platforms 	<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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

Focus area	Considerations and steps
Data strategy 	<ul style="list-style-type: none"> • 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., bank-level standards for privacy, integrity, cybersecurity)
Ecosystem 	<ul style="list-style-type: none"> • 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
Legal entity structure and charter type 	<ul style="list-style-type: none"> • If pursuing a full ILC strategy, obtain an ILC charter. Securing an ILC charter is difficult and takes at least two to three years (due to regulatory environment uncertainty, banks may be hesitant to move in this direction). 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 • 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. • If offering insurance products, obtain a license to operate as an insurance charter <ul style="list-style-type: none"> – Required in corporate headquarters state and each state where insurance is sold • Partnership or white-labeling insurance products may be an easier strategy than self-offering
Regulatory compliance 	<ul style="list-style-type: none"> • 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); and additional payments regulation if captives own credit card or 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 7).

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. It should also be noted the need for change in this sector was evident long before the pandemic derailed global markets. Going forward, that need stands in even sharper relief, and its role in securing lasting value is likely even greater than anyone anticipated.

Figure 7. 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 (e.g., subscription, payment processing, or credit card, etc.)?
- Which channels (e.g., indirect via dealer, direct, fleet, or 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, the OEM, and dealers?
- Do we pursue an industrial loan company (ILC) charter?



What capabilities must we have?

- Information technology?
- Data science, artificial intelligence, and analytics?
- Transaction services?
- Operational and process capabilities?
- Organization talent and team capabilities?
- What 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?

Contact us

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