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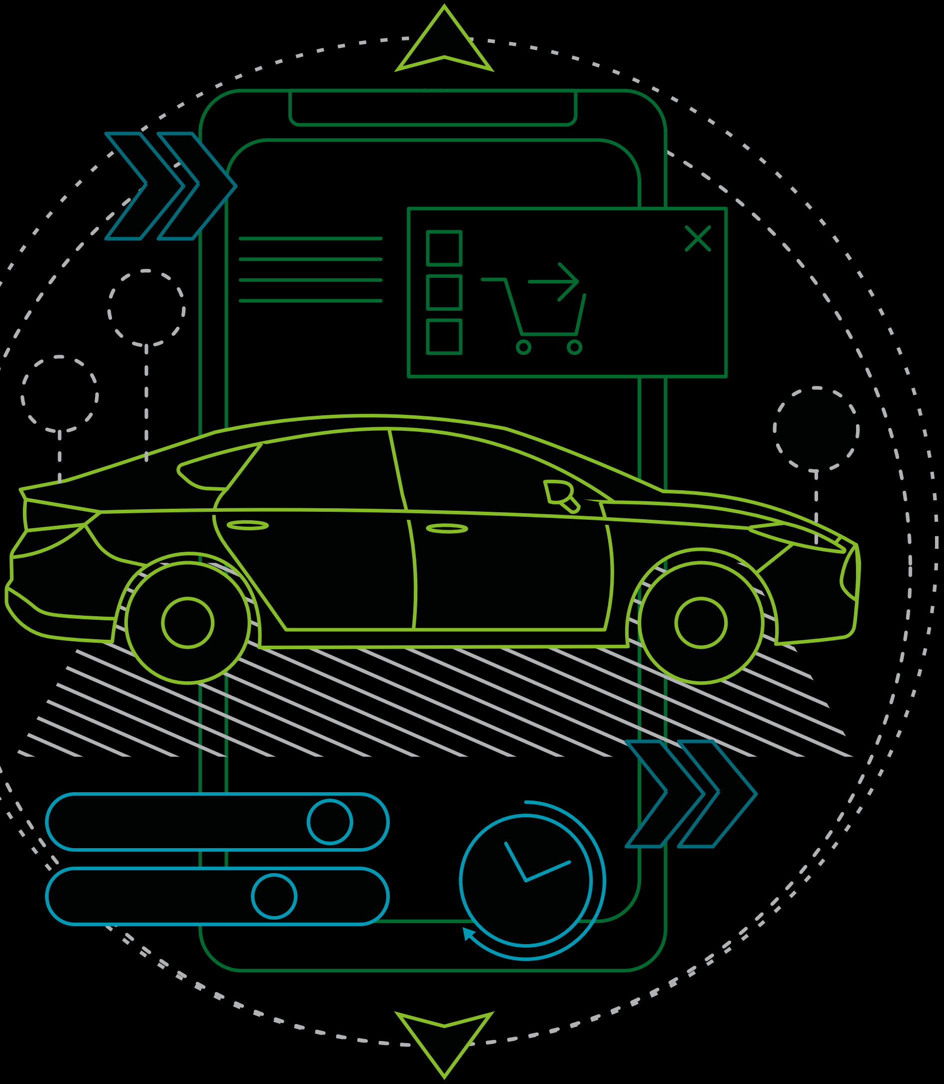
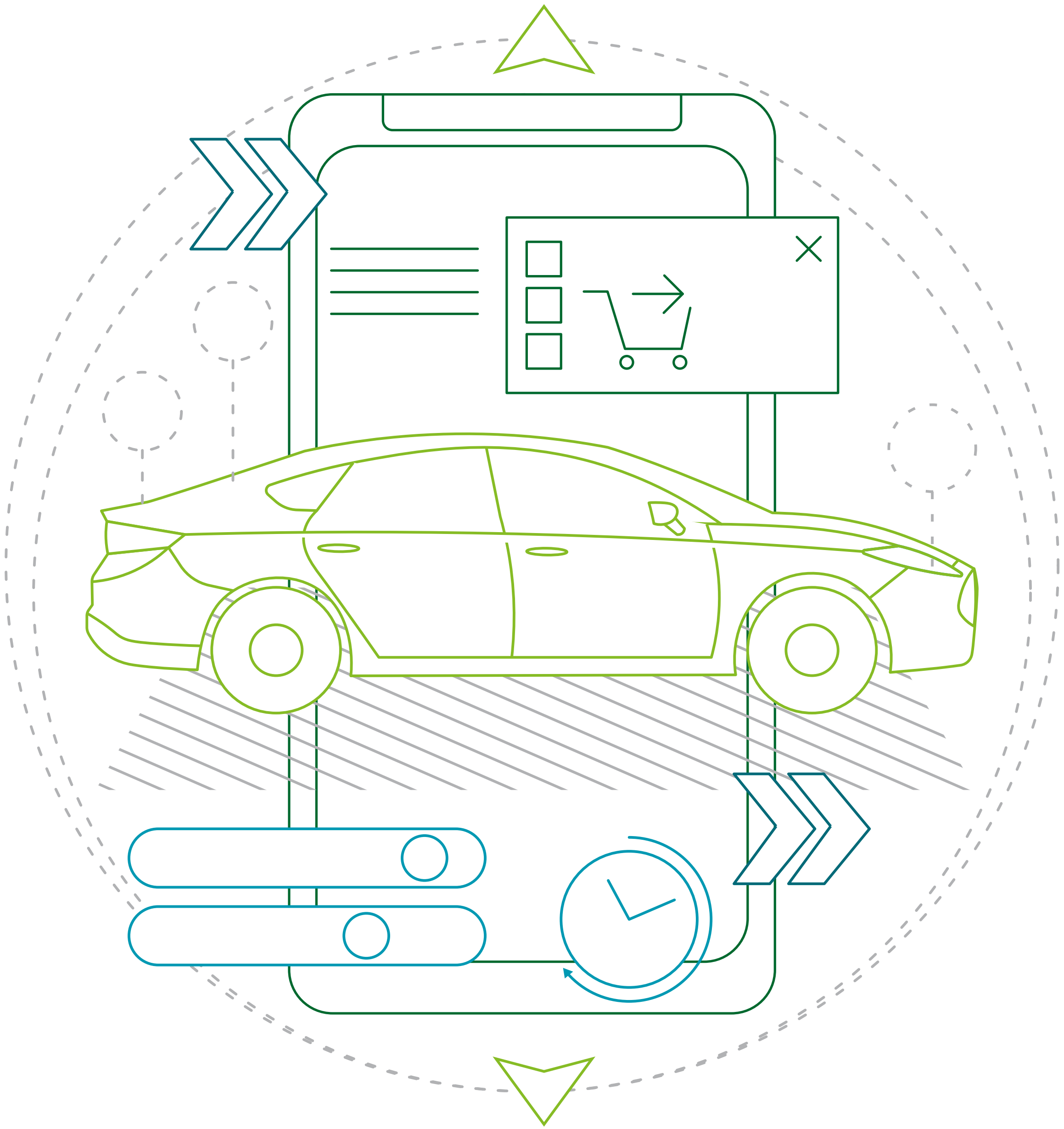


Vehicle-as-a-Service

From vehicle ownership to usage-based subscription models

MAKING AN IMPACT THAT MATTERS since 1845

Content



Executive Summary

With private and corporate customer demand moving to flexible and usage-based models, we expect **>€22bn in new annual auto financing to shift towards the vehicle subscription market** in EU5 by 2025 – and it is up for grabs by new players.

To excel in this market, subscriptions need a **holistic product strategy** based on specific features (e.g., hassle-free, all-in bundling of services and repeat extensions). Simply offering an **adaption/variation of existing leasing or rental products will fall short**.

Incumbent players can utilize vehicle subscription as **building blocks to master the transformation** from one-off asset sales to vehicle-as-a-service models. This is the key to optimizing asset utilization and **revenue performance across multiple vehicle lifecycles**, but they will have to overcome silo thinking to get there.

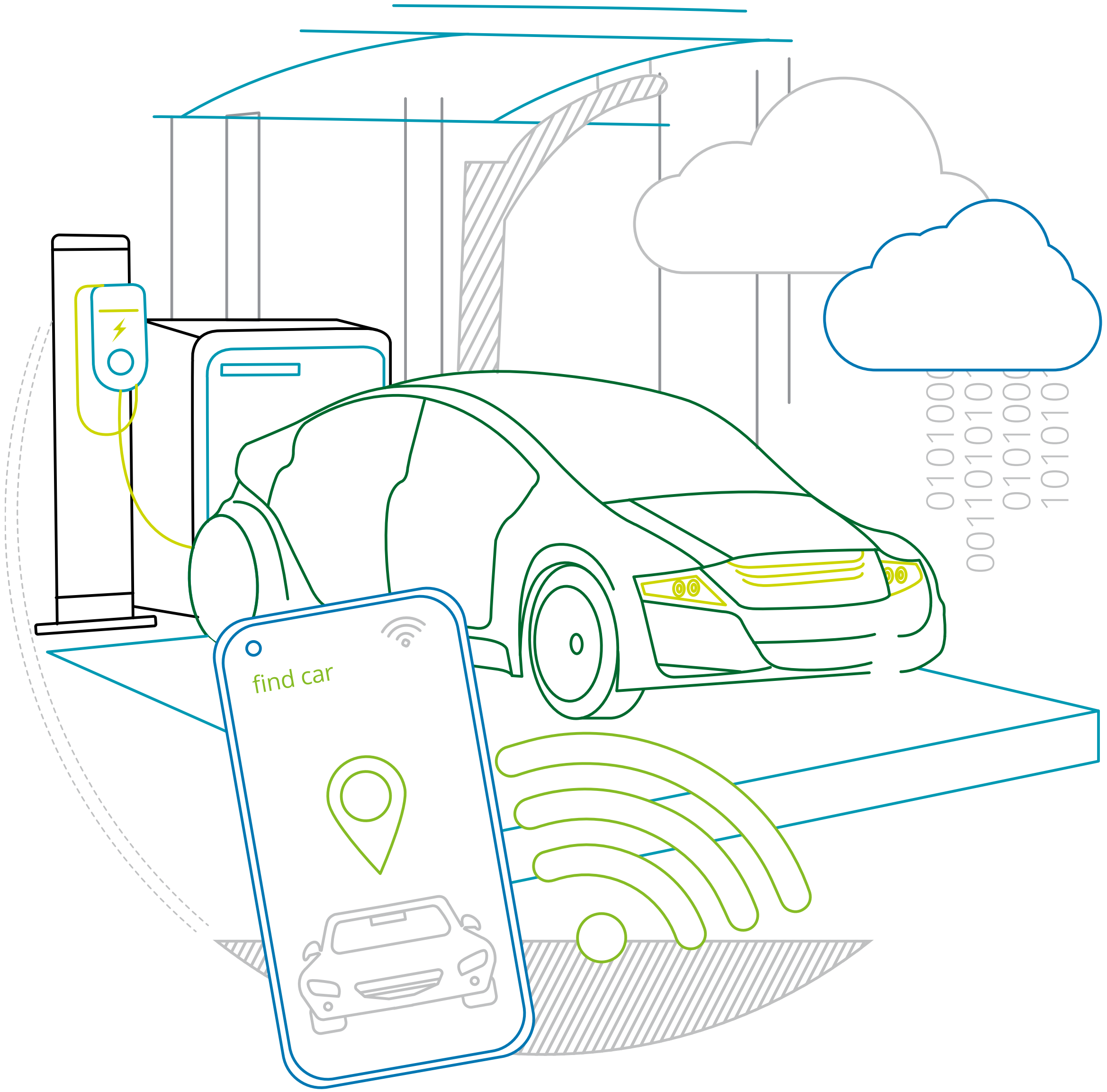
The most successful players today **are new entrants** with a **customer-centric focus**, a **superior customer experience** and a **convenient digital journey** featuring a multi-brand solution.

Players in the competitive arena can differentiate with their **core business model** (own vehicles vs. management of 3rd party fleet and new vs. used vehicles) and their **brand strategy** (own brand only vs. own brand plus white label offerings for vehicle owners).

To succeed with subscription products, providers need to develop **new skill sets**. There is no need to develop the entire range of functionality in house – they can build future operating models relying on **partnerships and acquisitions**.

The Rise of Subscription Models

Customer demand is shifting from ownership to usage-based models



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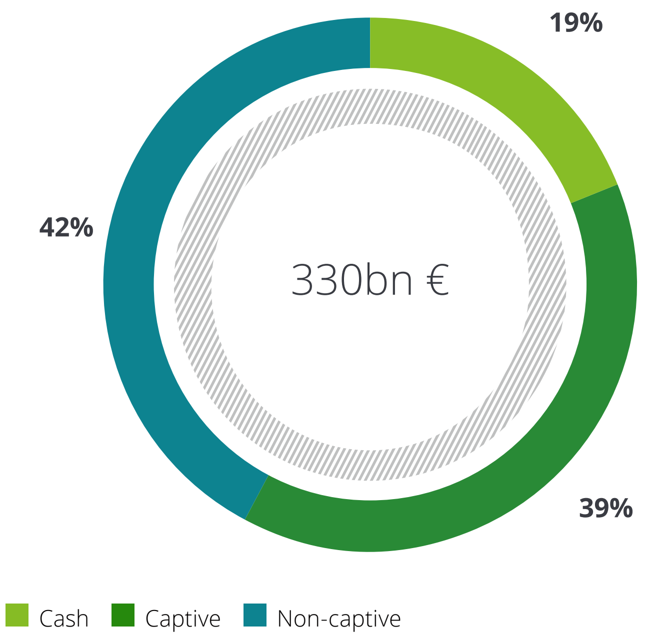
In recent years, we have seen a steady decline in the importance and appeal of car ownership. Cars have lost their image as status symbols – and not just for millennials. Owning a vehicle comes with responsibilities and long-term commitments that many people are no longer willing to accept. In a dynamic world, where people are constantly on the move and our life circumstances change rapidly, consumers see conventional car financing and leasing contracts as a burden rather than a benefit.

To date, about 82 percent of all new vehicle sales (on average approx. €330bn) in Europe's five major markets are financed by either a captive or a non-captive financial institution. This figure demonstrates just how vital today's auto finance industry has become for OEM groups and in particular for their vehicles sales targets.

Today's customers increasingly see vehicle ownership as a burden.

Fig. 1 – Auto finance market segmentation in EU5 (in 2019)

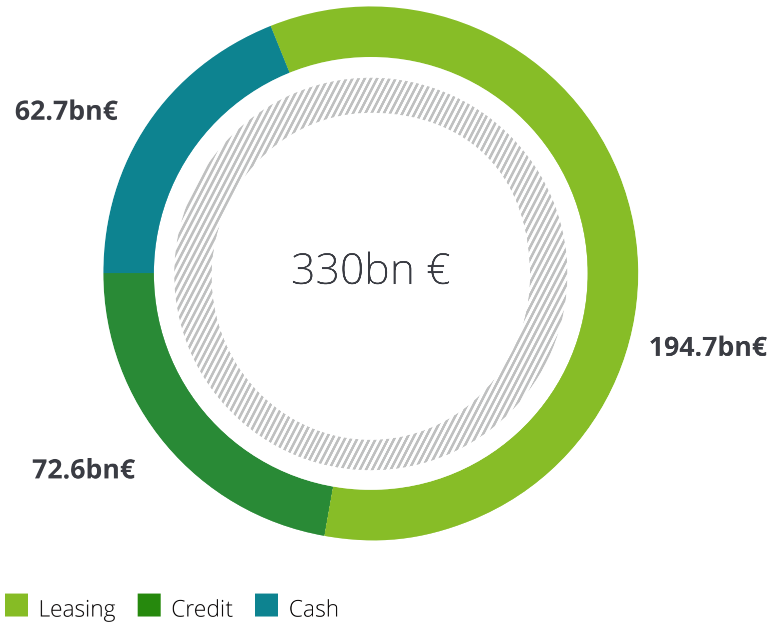


Source: Deloitte Analysis

Mobility services such as ride-hailing and car-sharing offer an alternative to car ownership, but they also have their downsides: low availability at peak times and in certain locations, high costs for long trips or rental periods and the fact that you cannot leave personal belongings in the vehicle – to name just a few. In other words, while they offer an alternative (or an addition) to public transportation, neither ride-hailing nor car-sharing are real substitutes for car ownership. So far, those of us who want the upsides of a personal vehicle have not found a true alternative to buying or leasing a car – until now. Vehicle subscriptions have the potential to combine the best of both worlds, and we expect strong growth in the subscription market segment as a result.

The global COVID-19 pandemic is further accelerating this dynamic. With the skepticism about public and shared mobility resulting from the virus, an idea that was previously more subliminal has become mainstream: the level of comfort and hygiene people associate with a personal vehicle is almost impossible to replicate. While the global pandemic did not put an end to private and corporate mobility needs, it has certainly changed consumers' mobility preferences and further increased demand for flexible models like vehicle subscriptions. What consumers ultimately want is a service that makes their lives easier. That is why "one-stop-shop" solutions are flourishing. They offer in-person consultation and personalization options as key components of the sales journey and give consumers "peace of mind" as well as total transparency and cost control.

Fig. 2 – Auto finance product segmentation in EU5 (in 2019)



Source: Deloitte Analysis

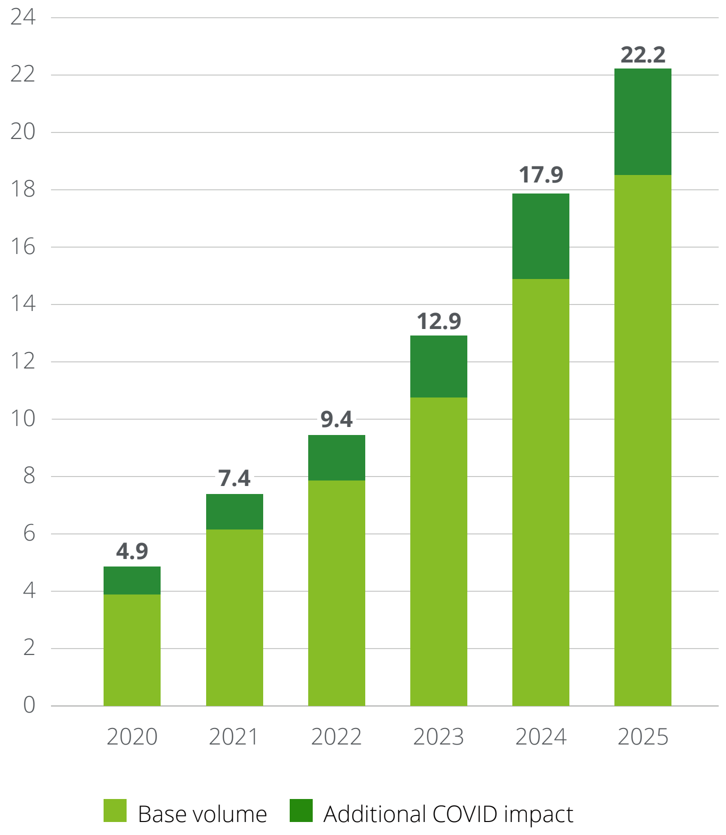
By 2025, more than €22bn of new annual auto financing will shift to the subscription segment – and it's up for grabs by new players.

Our base case scenario estimates that 8 percent of all new vehicle registrations in the relevant customer segments* will be based on subscription models by 2025. In a disruptive scenario fueled by the increased demand for personal mobility during the COVID-19 crisis, the market share for subscriptions could increase upwards of 10 percent. We expect total European vehicle sales to remain flat after they recover from the current crisis, so we can only expect to achieve growth on this scale at the expense of other (existing) market segments. The majority of subscription sales will probably displace former leasing business, which is the auto finance product on today's market that comes the closest in terms of service and flexibility for end customers.

That means more than €22bn of new annual car financing will be up for grabs for new subscription providers by 2025 (i.e., more than 10% of today's leasing market segment – see fig. 2). And this market shift is expected to continue to accelerate in the 2nd half of the decade.

Subscriptions are not only a relevant channel for new cars. We also expect a significant share of used vehicles to be offered in a subscription model in their second or third lifecycle.

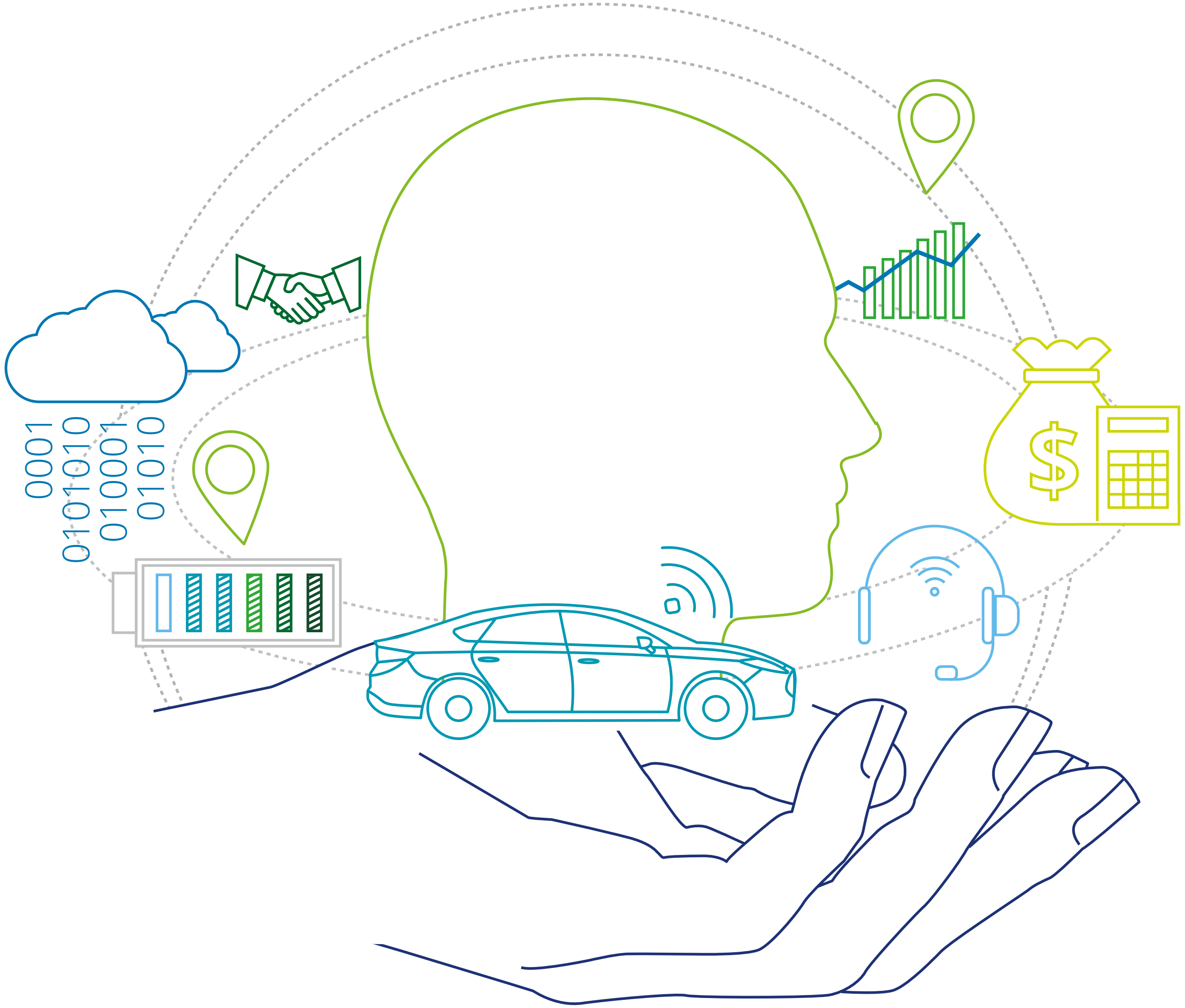
Fig. 3 – Subscription share of new vehicle registrations in EU5 markets for private & corporate customers* (in €bn)



Source: Deloitte Analysis; *) excluding OEM & Rent-a-Car segment

The Best of Both Worlds

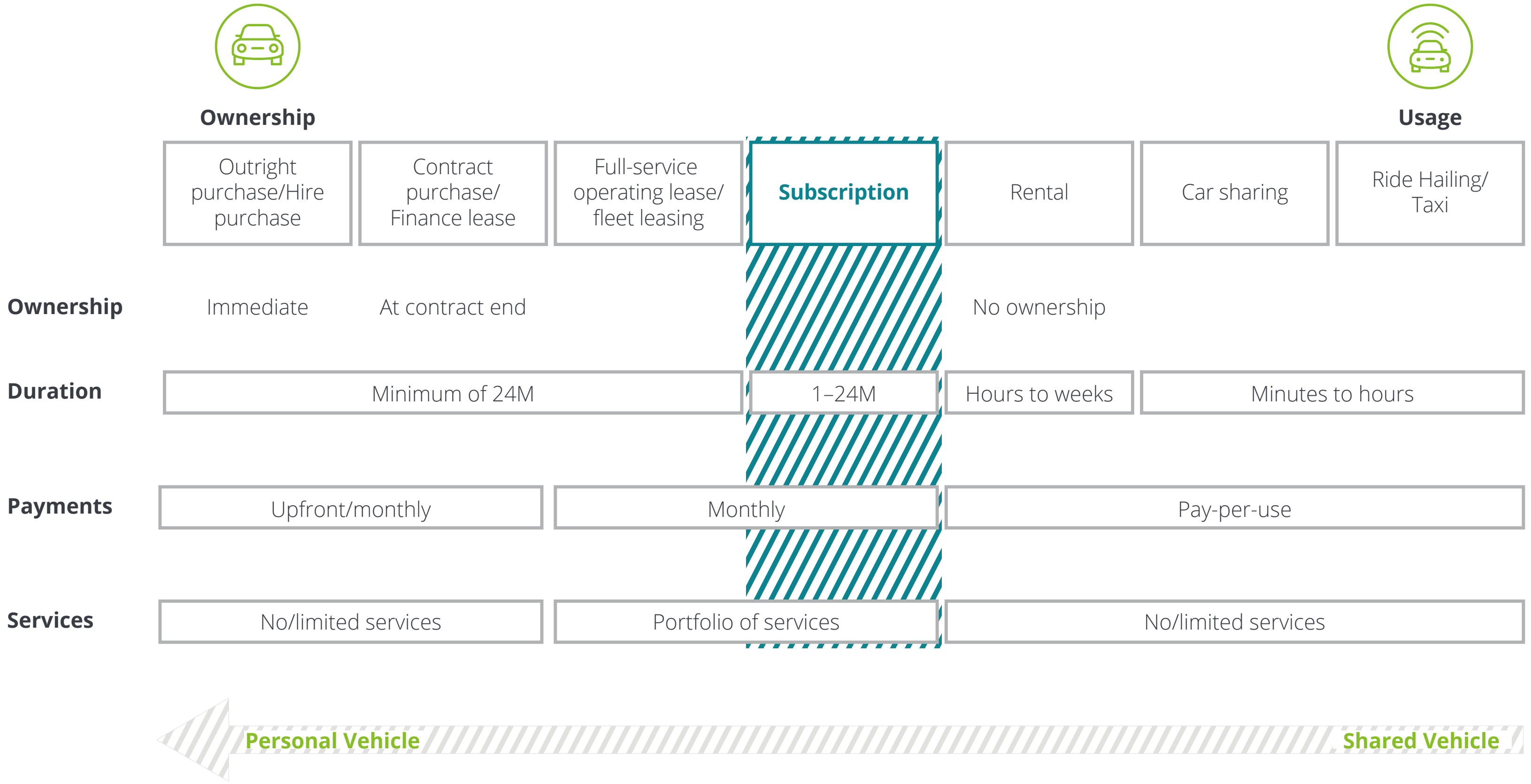
Vehicle subscriptions offer the advantages of having your own personal vehicle without the disadvantages of ownership



Vehicle subscriptions work similarly to other well-known subscription models, e.g., from the music industry: customers pay a flat monthly fee that grants them access to a vehicle (or music) that they can use as they please (within the terms of the contract). Once customers no longer need the vehicle (or music), they have the flexibility to terminate the contract or to upgrade or downgrade to a different vehicle category/type (or account type) that better suits their needs.

This gives customers the advantages of leasing/buying (i.e., their own personal vehicle for a certain period) combined with those of car-sharing/ride-hailing (i.e., flexible mobility without a prolonged financial commitment or the hassle of vehicle maintenance) in a single convenient product. As a result, subscriptions offer a "happy medium" within the vehicle-based mobility product portfolio.

Fig. 4 – Vehicle-based mobility product portfolio



Source: Deloitte Analysis

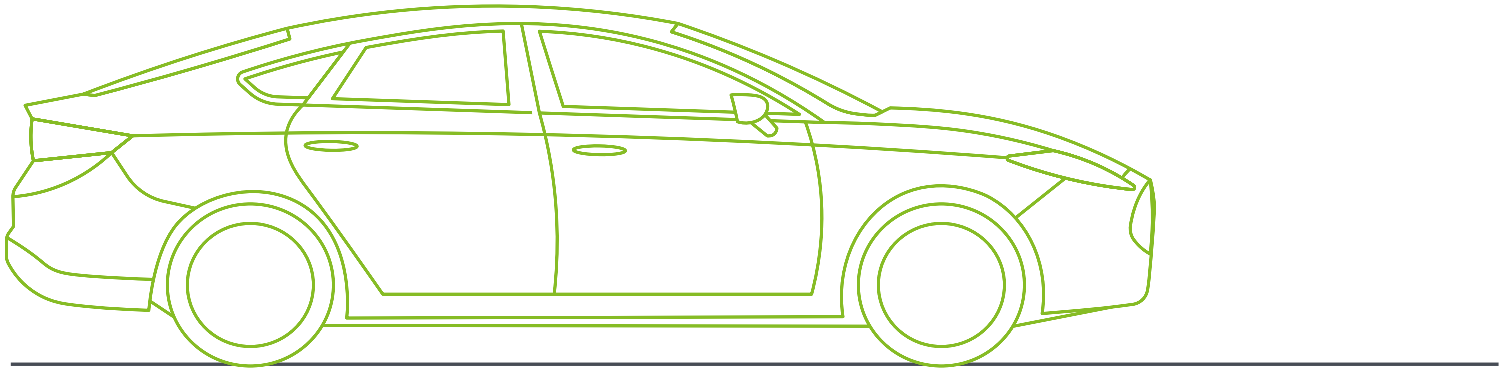
Even though customers may dismiss subscriptions as just a slightly modified combination of existing auto finance products, providers should not underestimate the challenges of building a winning subscription product.

Today's market leaders are new entrants with products designed completely from scratch. This has allowed them to be laser-focused on the customers and their needs without the limitations of an existing product portfolio.

That's why we believe the best way to make this value proposition more compelling for customers is to adopt a dedicated strategy for their subscription products.

It is also important to give the specific features of a subscription product due consideration. This ensures that subscriptions are less a recycled leasing deal and more a fully-fledged product with a well-defined purpose in the overall strategy.

For providers to succeed in the long run, they need to move from a siloed view of individual products to a holistic business model that optimizes asset utilization across the entire customer and product base.



Core Value Propositions of Subscription Models

Digital experience

Give customers a highly intuitive and seamless digital process for vehicle orders (without the typical break points of the conventional process).

Convenience

Include all relevant services in the subscription model (vehicle registration, tax and insurance as well as all required maintenance and repair services) to give customers peace of mind while operating the vehicle (their only responsibility is to remember to refuel!).

Availability

Make sure subscription vehicles are ready to be picked-up/delivered within a few days/weeks, to contrast with the long wait associated with new vehicles.

Simplicity

Structure your offerings in a self-explanatory and modular way to ensure that future customers are not overwhelmed by a huge variety of options, and that they can easily configure the car and complete the contract in just a few clicks.

Flexibility

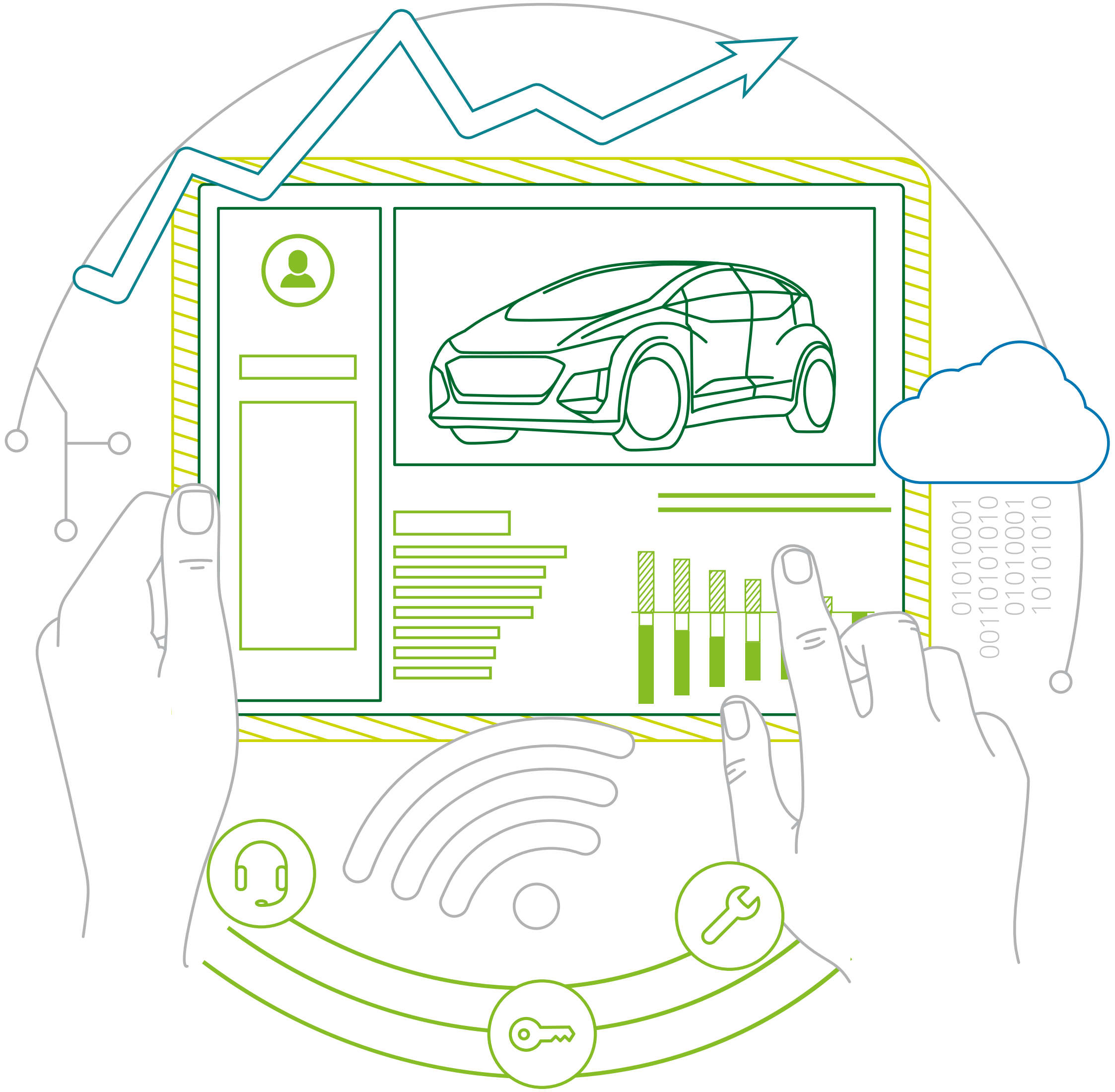
Offer a certain level of flexibility above and beyond relatively short minimum terms and notice periods, allowing customers to adapt their subscription model to their changing mobility needs.

Continuity

Forget about those fixed expiration dates common with lease agreements and trigger "endless" contract renewals and customer relations instead.

Subscription in Detail: Product Features

Continually optimize the features of your subscription model to ensure that the customer always comes first



Superior customer experience and a convenient digital journey are expected by today's mobility customers.

Incumbent players with obvious constraints (e.g., legacy IT systems, rigid processes and established product portfolios) find it particularly difficult to develop and launch new usage-based products such as subscriptions. To provide guidance and help simplify the development process, we have identified eleven universal design choices that draw a clear contrast between subscriptions, leasing contracts and long-term rental.

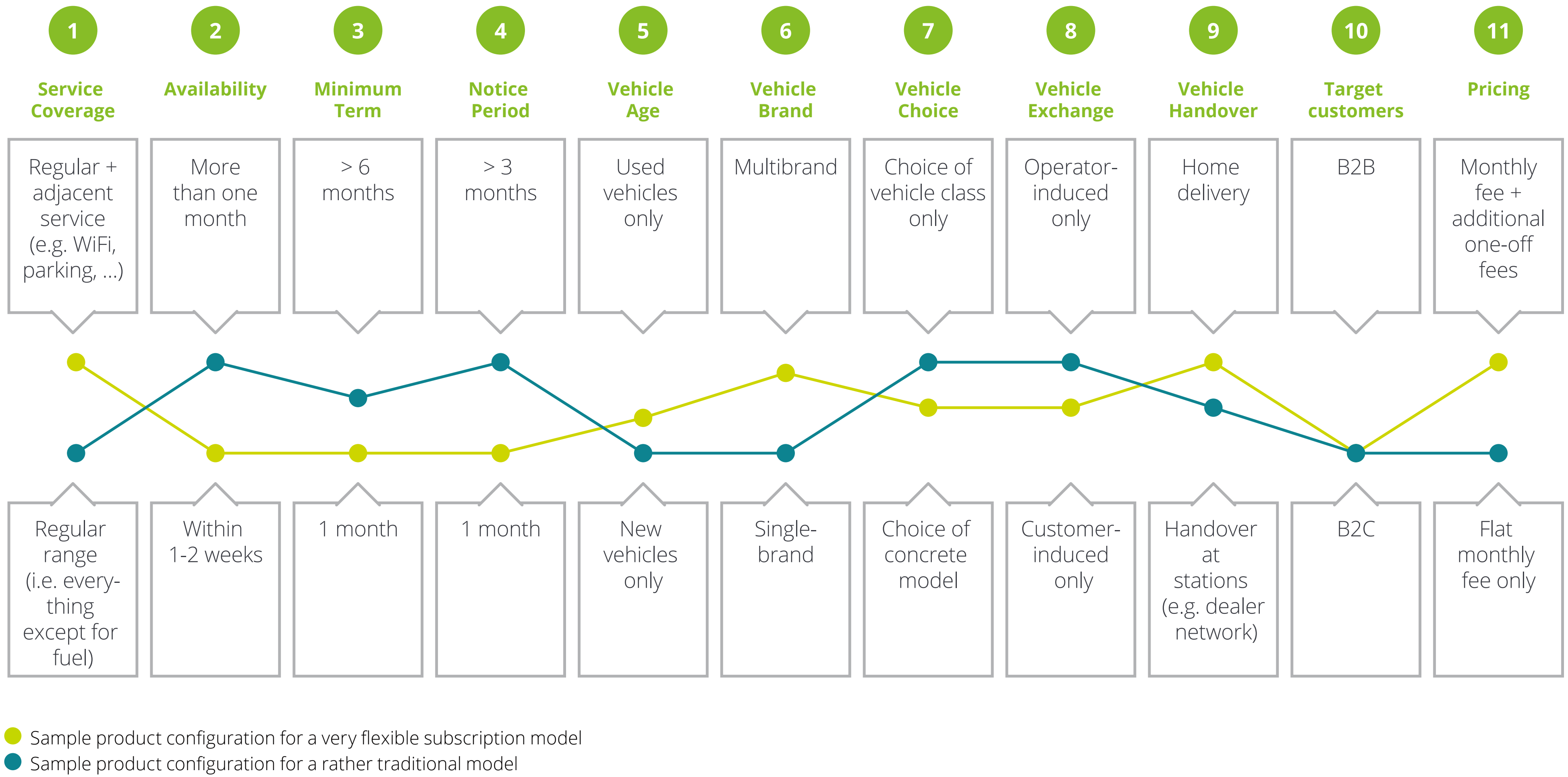
The way you configure these eleven design choices will impact both the market success (revenues) and the degree of internal complexity (costs). Offering a feature like frequent vehicle exchanges might make the subscription product more attractive, but it also means having a significantly higher number of vehicles in your fleet.

The same goes for vehicle choice. Being able to choose from different car configurations might appeal to customers, but it will limit your flexibility in terms of redeploying the vehicle for a second subscription and drive up your planning and logistics costs.

In the end, it comes down to a strategic trade-off between more flexibility for customers and higher costs. If customers are not willing to pay a premium for additional flexibility in your subscription model, it is not very likely to succeed.

Customer centricity is the key to success for any subscription offering. It is up to providers to continually improve their products and keep optimizing the product features on the basis of hard customer data.

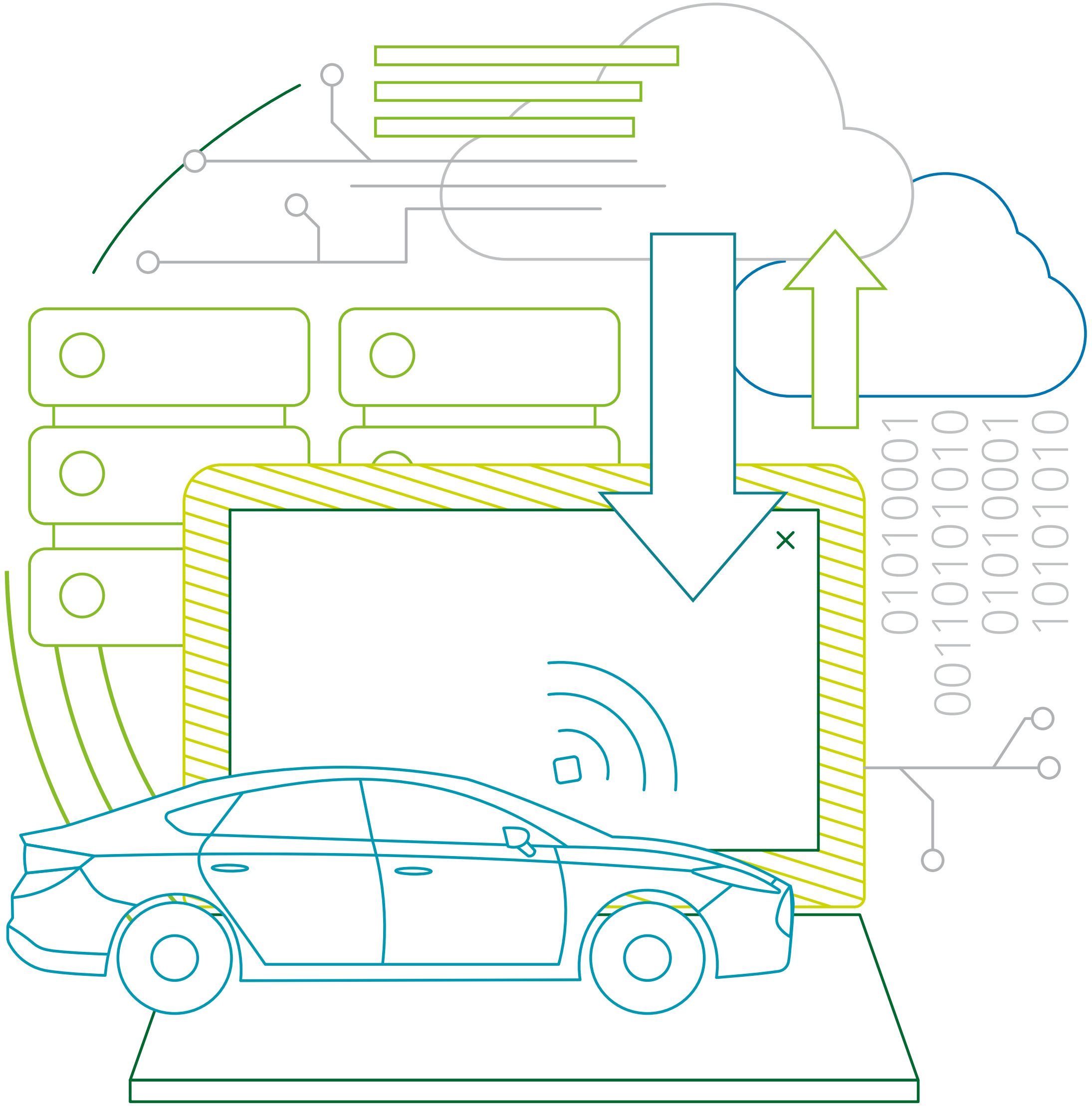
Fig. 5 – Subscription Product Design Spectrum



Source: Deloitte Analysis

Market Landscape: Player Archetypes

On today’s market, success comes to players that engage customers with competitive online offers



To date, sales channels in the automotive industry have been linear and well-protected from new entrants. Indirect sales via established dealer networks have been the industry standard for B2C sales. Common exceptions to this rule are largely in the B2B segment, whether it is selling through other intermediaries (e.g., independent leasing and fleet management companies) or direct sales to large corporate customers.

Scarce real-estate and an asset-heavy sales model that relies on bricks-and-mortar showrooms created high barriers of entry for new players looking to start a vehicle sales operation.

Now, the times have changed. With digital direct sales channels on the rise, a new multi-billion-euro market has emerged. The force driving this change – moving from personal one-off vehicle sales to digital, usage-based models – is creating opportunities for new players to enter the market and challenge incumbents. Several different provider archetypes are shaping the emerging market for vehicle subscriptions. Though they have some traits in common, there are two key differentiation factors:

Main Business Model

Operating an own fleet of vehicles vs. managing fleets (mainly) owned by 3rd parties

Brand Strategy

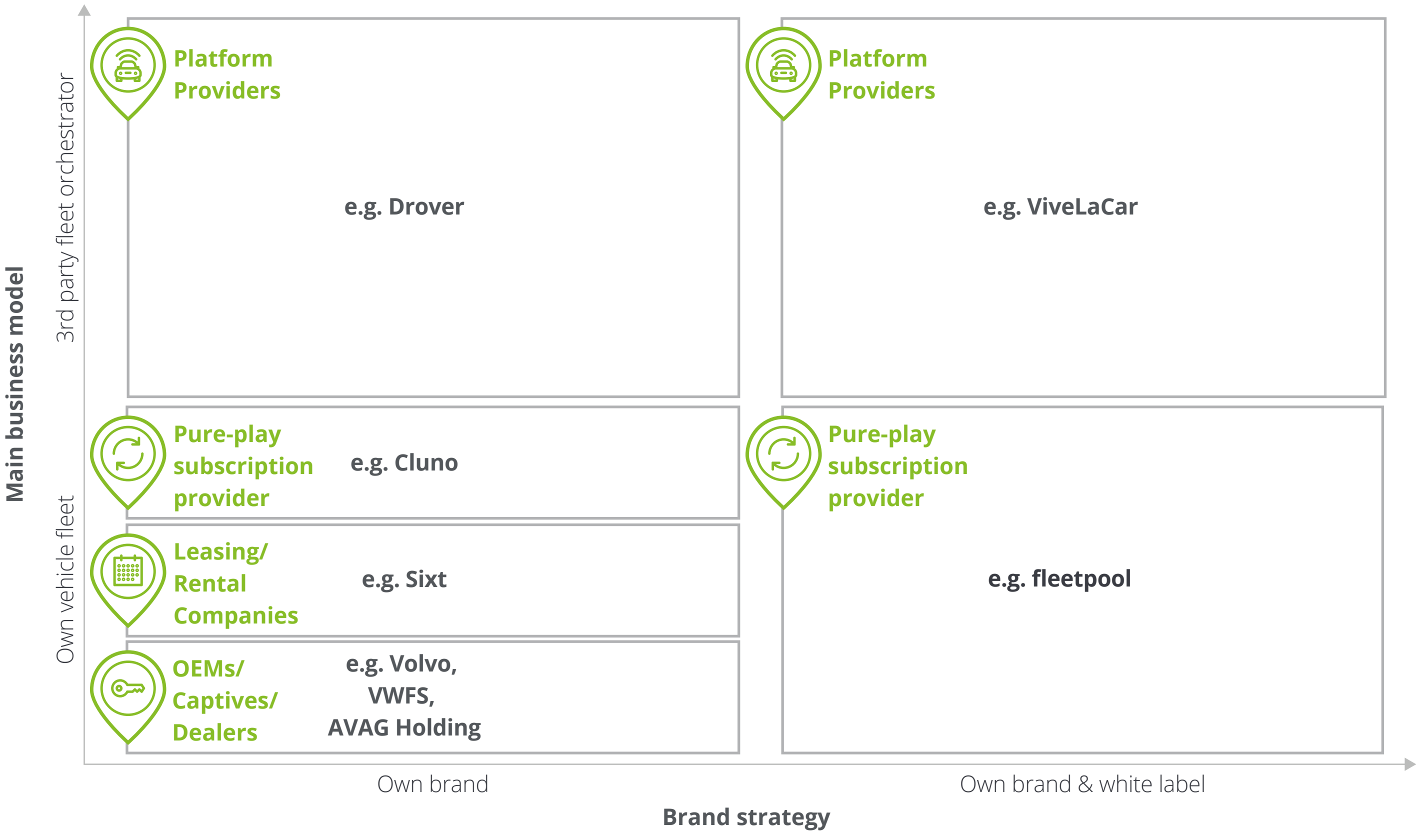
Going to market predominantly with own-brand vs. operating own-brand cars as well as private label solutions

Go-to-market models in the subscription world are quite diverse and sometimes still subject to the individual player's corporate heritage.

Existing players from OEMs, dealers and captives to leasing and rental companies often see subscriptions as a supplementary product line enabling them to better utilize their existing vehicle fleets, in most cases with their own existing brands. Pure-play subscription providers such as Cluno are fully dedicated to subscriptions based on a fleet of vehicles under their own brand. Other pure-play providers like fleetpool started offering their own vehicles under their own brands, but then expanded into offering white-label solutions for other providers such as OEMs.

Platform providers are typically asset-light. They either provide a platform under their own name where vehicle owners utilize their cars (e.g., Drover) or they allow dealer groups or other vehicle owners to provide subscription products under their name and manage the operational side of the business on the owner's behalf.

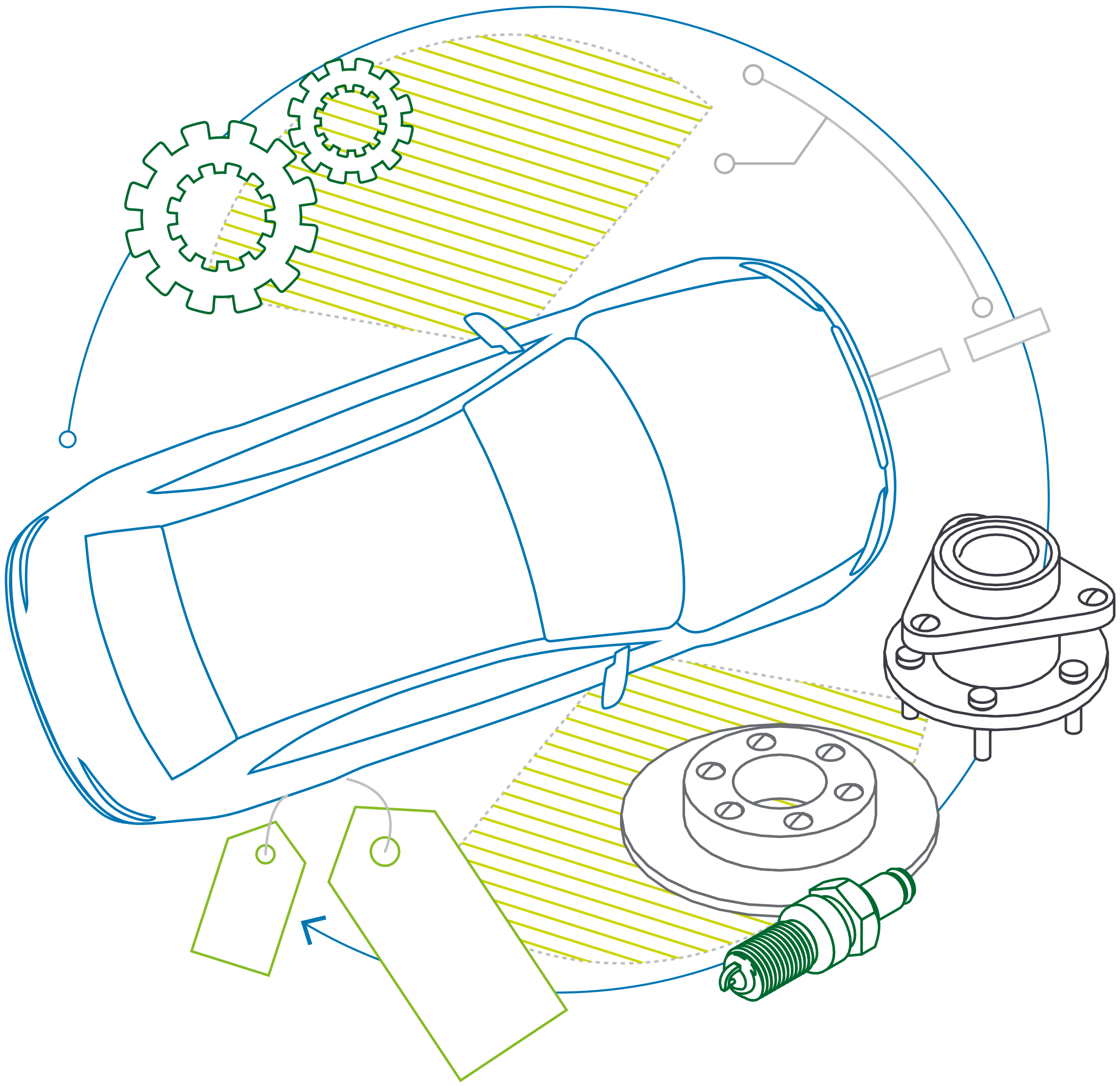
Fig. 6 – Player Archetypes



Source: Deloitte Analysis

Optimizing the Customer & Vehicle Lifetime Value

Subscriptions add the most value when they are part of a broader mobility services portfolio



Offering several mobility products and services helps unleash the true strategic value of subscriptions. As part of an end-to-end mobility product mix, subscriptions generate profits on their own, but not only.

Subscription business models can also act as strategic building blocks that allow companies to optimize asset utilization across the entire vehicle lifecycle. In the past, the business model options were quite limited. Car companies either sold a new vehicle directly to the end customer or leased the vehicle and then remarketed it as a used vehicle after the lease agreement expired. Today's customers are demanding more flexibility, which is putting pressure on vehicle ownership and therefore on traditional one-off sales models.

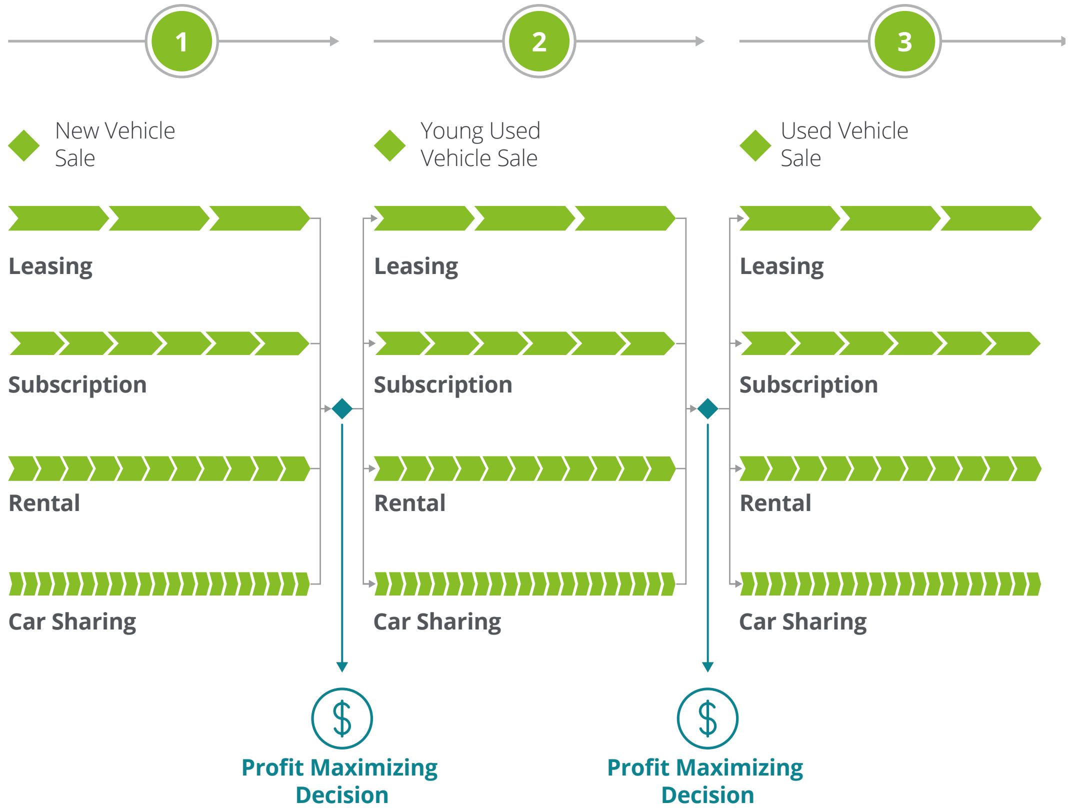
Declining margins have forced OEMs and their captives to re-focus on the 2nd and 3rd vehicle lifecycle to compensate for lost margins from the 1st cycle. As a result, companies will have to keep the vehicles in their fleets much longer than before, looking to re-deploy multiple times to capture profit pools over the total asset lifecycle.

For these vehicle-as-a-service business models to work, however, decisions about which vehicle should be used for which channel at what point in time will be crucial. Before the start of each vehicle lifecycle, providers will have to make an informed decision about the most profitable (next) cycle for each individual vehicle.

Offering a wider variety of options will make it easier to cater to each customer's individual mobility needs, increasing the likelihood that providers can retain the customer and fully utilize the asset value.

Vehicle subscriptions are an important addition to the product portfolio, in that they provide a "happy medium" between short-term vehicle deployment (e.g., as part of a car-sharing fleet) and a long-term commitment (e.g., with a lease agreement). This gives providers more leeway for future business models focused on asset management.

Fig. 7 – Vehicle lifecycles: sales vs. usage-based deployments (simplified)



Source: Deloitte Analysis

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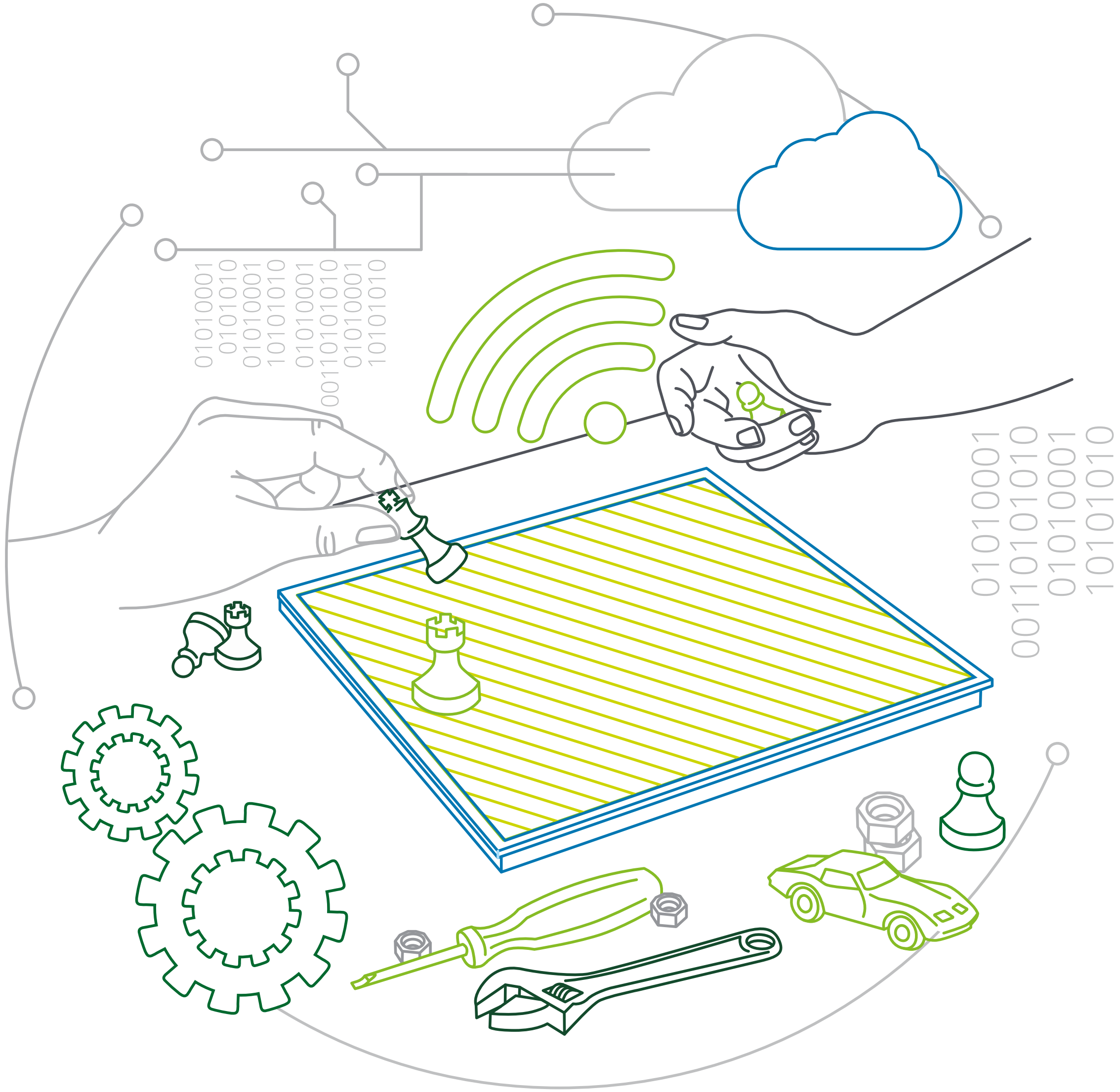
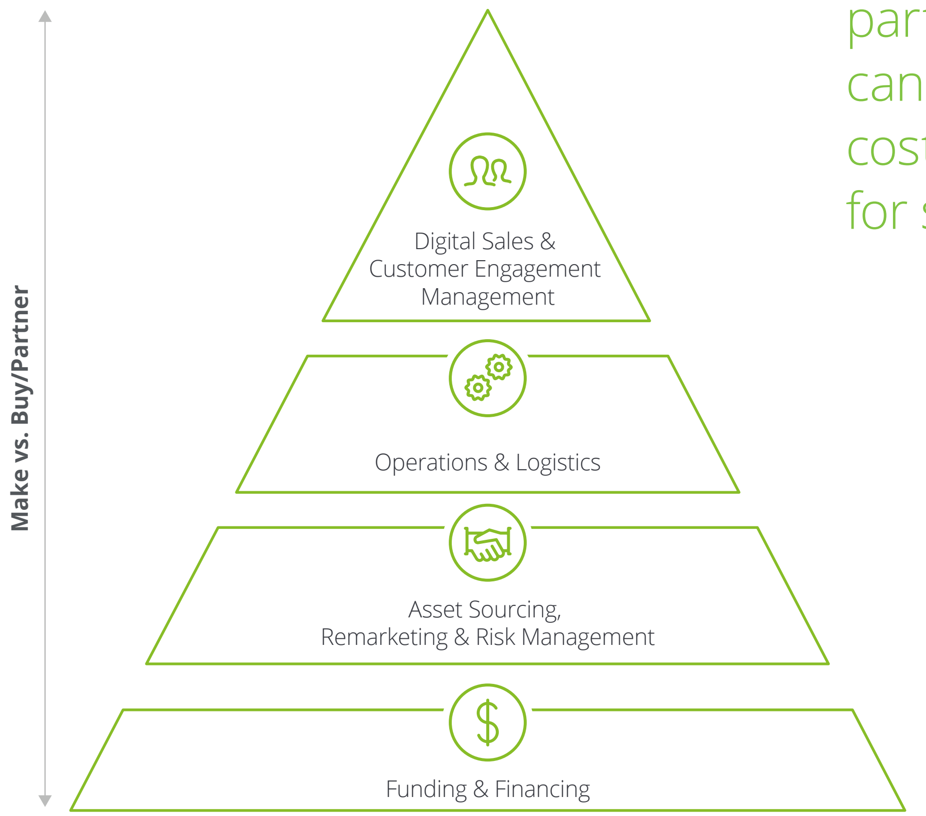
Critical Capabilities & Operating Model Design

Providers do not need to develop all of the necessary capabilities in house if they find the right partners



Whatever the final design of the subscription product, providers must establish certain capabilities to generate profits with a subscription model. Although they will ultimately require full functionality, the real question is how best to structure each operating model. For many providers, it will not make sense to be active across the entire value chain, but rather to partner with other companies that can assume responsibility for some of the necessary steps at a low price. Where this is the case, providers will need to manage and integrate the various service providers in a way that gives the customer a seamless experience.

Fig. 8 – Capability pyramid



Source: Deloitte Analysis

Operating models relying on partnerships and acquisitions can significantly optimize the cost base and be a strong lever for subscription profitability.

Funding & Financing

Customers do not own the vehicles in a subscription model, which means another entity has to have them on their books. Where the subscription provider and the asset owner are the same entity, the provider must either have sufficient financial resources to fund its growing balance sheet or access to cheap debt capital or external funding at a minimum.

Asset Sourcing, Remarketing & Risk Management

In order to maintain a low-cost base over time, subscription providers need to source their vehicles at a competitive price, closely manage residual value (RV) risk and ensure that asset utilization and vehicle resell rates are high. Let's examine these core capabilities in more detail. There are two main success factors for vehicle sourcing: sourcing the right vehicles and sourcing them the right way.

Depending on the final product design (please refer to the previous chapter for our eleven design principles), providers need to have the right vehicles for their target market position and customer base (without ignoring the cost of sourcing, RV risk and maintenance costs). The potential range is huge: from budget to premium vehicles, from compact cars to large SUVs and from new to used vehicles. The crucial factor for all of these decisions is knowing what the customer wants!

When it comes to sourcing vehicles the right way, rental companies and Captives will have a structural advantage over low-scale start-ups. Not only do they have large (discounted) purchase volumes and mature procurement departments, but also economies of scale with regard to processes. Good multi-brand spot deals (e.g., large insolvency buy-outs) can provide a much better cost advantage than sourcing directly from OEMs (even if sourced on a cost-of-goods-sold basis).

Once the right vehicles are in the fleet, the next critical factor for profitability is a high utilization rate. This correlates directly with pricing. If utilization is too low in the current fleet, the provider can drop prices temporarily to increase subscription sales. Dynamic pricing is therefore an important lever to sustain high utilization rates and stay competitive. After all, the more satisfied and engaged your customers are, the longer they will keep their vehicle without taking the option to exchange it. In the end, fewer vehicle exchanges will also lead to higher asset utilization rates.

Rental/leasing companies and Captives have another structural advantage in terms of utilization. As subscriptions are not their only business model (e.g., rental, leasing, financing, etc.), they have the flexibility to move the vehicles between their respective product plans based on current demand. Vehicle subscriptions in this scenario do not just generate profits on their own; they also offer a strategic advantage for the rest of the business.

Lastly, providers move vehicles to another phase of the lifecycle at the end of each subscription cycle. In order to make an informed decision about where the asset will generate the most profit in the next phase, subscription providers need to invest in data analytics and residual value management tools. These tools will provide ongoing transparency about the residual value and the aggregated cash flows that any vehicle might generate in a further subscription/ rental/car-sharing cycle – or if it would be more profitable to sell the asset outright.

Operations & Logistics

Providers with a dense retail network will have more available vehicles and lower logistics costs, giving OEMs, dealer groups and rental companies a clear competitive advantage.

Companies with just one or a couple of fleet bases will have to offer new services such as home delivery and pick-up. These services may, however, mean high cost components, particularly for short contract durations. Providers must also provide efficient vehicle cleaning and refitting after every subscription cycle. And in addition to vehicle operations, they have to maintain robust underlying IT systems. The provider's system landscape, particularly old legacy systems, might not be equipped to handle such a diverse range of tasks.

Digital Sales & Customer Engagement Management

To offer the flexibility that is particularly appealing for younger customers, providers must offer a digital subscription sales journey. This requires a digital sales platform robust enough to handle all necessary steps from the online application to credit checks and e-signatures in a user-friendly way.

In such a highly competitive market, effective and efficient direct customer engagement and marketing is the key to securing market share at a comparably low price. Customer satisfaction and experience are extremely important levers for customer retention, in particular with subscription contracts that are flexible and easy to quit.

Providers require a deep understanding of the actual customer base and their requirements to move all of these levers. Strong data analytics systems are the key to generating the kind of insights they need to engage customers with the right offers (discounts, upgrades, extras) at the right time on the right channel. In this context, start-ups may have a head start compared to incumbent players, as they usually have a more up-to-date digital infrastructure.

Who is best positioned to win in the long run?

While new entrants are currently leading, incumbents have the potential to catch up by configuring the right sustainable model

07 | Who is best positioned to win in the long run?

Today, mainly new players are attracting attention with their subscription models. They gained an early-mover advantage, acquired customers and experience and developed more digital maturity. Although the large leasing & rental companies may be lagging behind at the moment, Captives and OEMs may still win the day in the end.

Yet, we should also not just assume that incumbents have what it takes to win. Having a favorable starting position to launch their own subscription offers is one thing, making the right choices to prevent the competition from outpacing them is quite another.

Benefits of incumbents

- Large financial resources and existing fleets to quickly scale an offering
- Expertise in asset management and remarketing
- Established retail network (incl. vehicle stock) that they can leverage to ensure geographic coverage
- Strategic advantages when it comes to combining a subscription model with their other auto financing products to maximize asset utilization rates of the available car park
- Existing brands that customers trust

Urgent action items for incumbents

1

Get up to speed with state-of-the-art **digital sales**, superior **customer engagement and data analytics.**

2

Build a thoughtful subscription offering that **aligns with the overall product strategy.**

3

Manage all sales channels in close alignment to **maximize customer and vehicle lifetime value** across all products and overcome the traditional siloed view.

4

Optimize asset pool utilization using analytics-based dynamic pricing.

5

Build a **multi-brand strategy** (particularly relevant for Captives and OEMs).

Complementary reading

Future of Captives

What are the core businesses for Automotive Captives in 2030?

For this study, Deloitte used a scenario-based approach and consulted board-level experts from the world's leading Captives to develop four extreme yet plausible scenarios, to address this question.

Whatever the scenario, Deloitte expects the asset-based financing business to decline in relevance. New mobility services and flexible leasing offerings, on the other hand, will increase substantially and account for the majority of the profits generated by 2030.

Omnipresence of Service & Direct Sales in Auto Finance

How new products and sales models threaten Captives' market positions

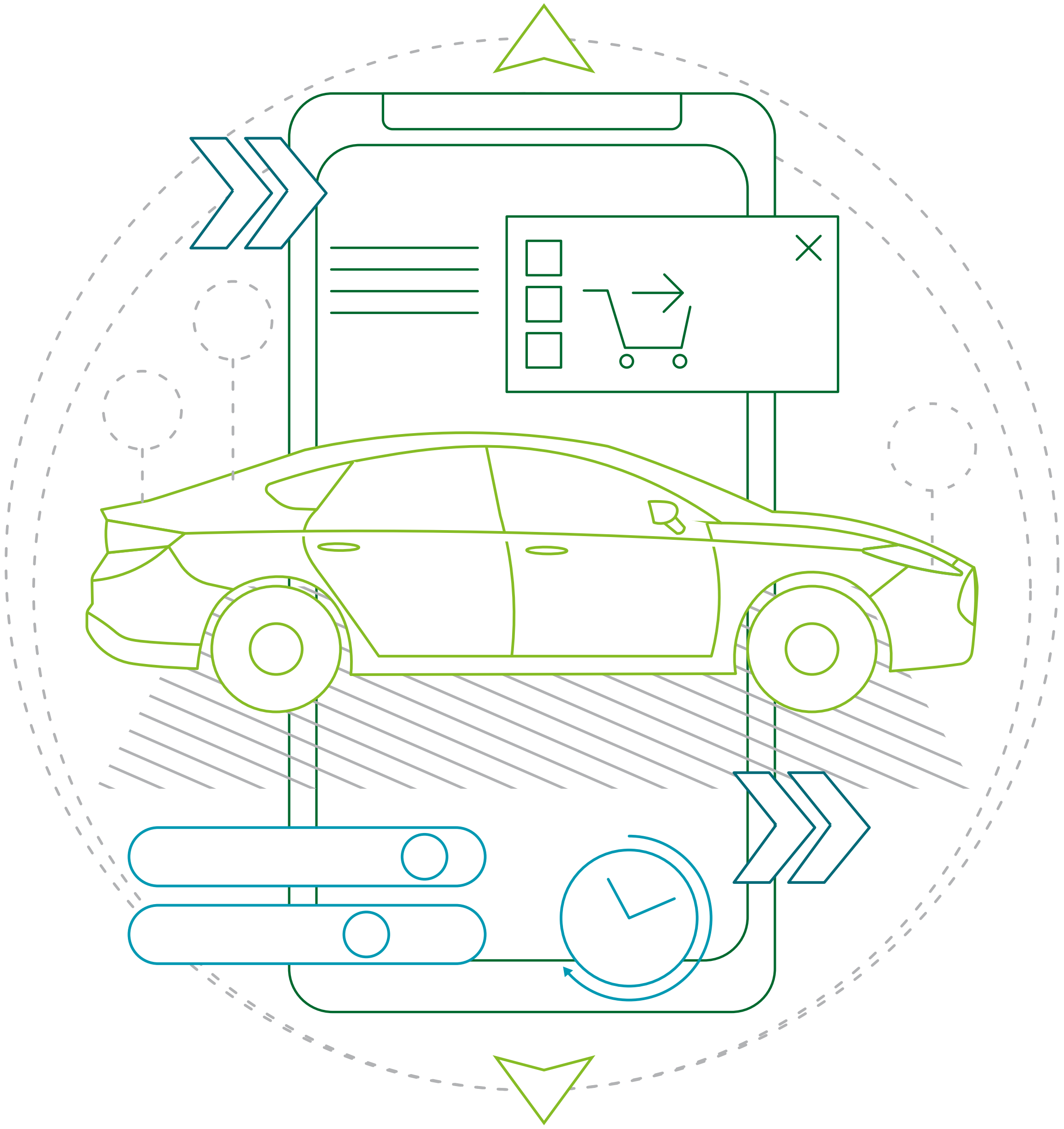
The European auto finance market is facing disruption, putting 25 percent of incumbent Captives' new annual business volume at risk by 2025.

In this study, Deloitte provides an in-depth look at three promising fields of action for Captives and non-Captives looking to take market share from incumbents or defend their current market position in a predatory competitive environment:

1) Develop new direct sales models
2) Increase customer centricity and
3) Offer new flexible products/services (like subscription models).

Conclusion

A new market is already taking shape – the time to act is now!



The automotive trend away from ownership towards usage-based models is gradually picking up speed. While mobility offerings such as car-sharing are clearly the answer for short-term mobility with maximum flexibility, we have seen a gap in the market for mid-term flexible mobility solutions. That gap is now being filled by vehicle subscription models, which are expected to account for more than 10 percent of new vehicle registrations for private and corporate customers by 2025 in Europe's core markets. Digital sales channels have started to break down traditional barriers of entry in the vehicle sales business. And what is emerging is not just a new form of vehicle ownership, but also a new set of market players. Start-ups developing intelligent digital platforms for fleet management or companies heavily backed by venture capital are poised to disrupt the market and capture market share from incumbents (e.g., OEMs, Captives, LeaseCos).

Yet these incumbents are still capable of winning the day, maybe even generating the most profit from current market trends in the end. With their vast experience in related products such as leasing and long-term rental, existing players already have some of the necessary capabilities in place to quickly scale a new subscription business. Shifting from a siloed product view to a holistic subscription offering they can leverage the strategic advantages of subscription to supplement existing leasing, rental, car-sharing and used vehicle sales. For incumbents, that means subscription is not just a new product that can generate profit on its own, but also a key element in the strategy to optimize customer and vehicle lifetime value across products and channels. If, however, they do not succeed in building a competitive digital platform that can effectively manage direct sales as well as customer relationships, they may be relegated to working as asset managers for a new tech-based platform provider.

Some mobility services have been hit hard by the global pandemic, further intensifying the trend towards subscriptions and opening up opportunities for new providers every day. There are already several companies in a favorable position to capture a significant share of this new market. Too late to hesitate – the time to act is now!

Vehicle subscription models are here to stay, promising to transform the vehicle finance market as we know it.

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