Automotive finance in the age of mobility

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The automotive finance industry is facing massive changes concerning mobility in the not too distant future. These changing dynamics of the mobility ecosystem will require traditional auto finance companies to fundamentally alter their approach. The question is: how will this paradigm shift impact traditional lenders who will need to pivot their strategies?

As consumers opt for the flexibility of shared access to vehicles through ridesharing and carsharing, personal ownership and related consumer financing is expected to decline. Cox Automotive found consumers' attitudes about the need to own a car are gradually changing with four-in-10 consumers saying access to transportation is necessary, but owning a vehicle is not. One-third of consumers surveyed say they are open to new transportation methods rather than owning their vehicle.

For traditional auto financing, the decline in personal ownership is expected to result in a dramatic loss in the volume and size of personal loans. In Phase 3 of the *Cox Automotive Evolution of Mobility Study* released in 2019, it is anticipated that retail auto sales in the U.S. could drop as much as 29 per cent as alternatives to traditional vehicle ownership become more accessible and affordable.

Notwithstanding Canadian adoption rates may have a few years of lag time, the trends typically follow a similar trajectory over the medium term. From a lender standpoint, in the Canadian market, it is anticipated that customers will increasingly become commercial in nature, ranging from fleet companies, rental providers, ride sharing enablers and dealerships that begin to offer subscription-based ownership services.

Traditional Lenders Must Adapt

Traditional banks and finance companies can capitalize on these new dynamics if they remain flexible and reorganize their traditional value chain.

For instance, banks may need to redirect more resources to commercial lending or floorplan divisions and away from consumer loan segments. Captives, primarily focused on dealer driven loans to individuals, will likely need to expand their wholesale floorplan capabilities by making necessary investments or partnering with specialist providers. Floorplan companies will also need to revisit common financing terms built on traditional inventory turn-times and develop alternative finance plans to support longer ownership cycles and more varied vehicle usage.

The shift in the finance model from consumer-to-business to a business-to-business will model focus on fleet owners. Many auto dealers are expected to transform their businesses to offer subscription-based mobility management services. For instance, Clutch Technologies, a company owned by Cox Automotive, enables dealers, OEMs and mobility companies to provide subscription services that allow for greater revenue diversification and strategic advantages as the industry evolves. Naturally, these fleet providers will require more tailored inventory finance solutions which will need to mirror the usage requirement and depreciation of the vehicle.

Evolving Underwriting Requirements

Today's financing market is primarily driven by consumers purchasing cars at dealerships with banks and captives having traditional customer-focused business models with loans underwritten off individual credit scores with lease or finance payments based on income affordability. However, as people increasingly forgo purchasing a vehicle, and opt instead for usage models, the focus will shift on financing commercial owners of vehicle fleets. This shift could pose several challenges to traditional underwriting models, including the reality that credit risk diversification is no longer spread across several consumers but instead concentrated within a smaller group of commercial borrowers.

Because of this new scenario, lenders will need to revisit traditional lending standards to redefine risk appetite for concentration risk and will likely need to accommodate larger loan sizes to fleet companies. In addition, pricing pressure will also become more evident as commercial loans typically dictate more aggressive pricing than comparable consumer loans. Moreover, lenders responding to this changing landscape will need to revise traditional underwriting standards. They will also have to re-think traditional safeguards relating to concentration risk, single name borrower risk, and recognize that lending portfolios will likely face increasing margin compression.

Of course, and similar to how digital retailing entered the industry, this change will not happen overnight. The decline in consumer loans and sizes may likely be experienced gradually by lenders depending on numerous factors. For example, individual loan size per family may decline if two-car families begin to "downsize" to a single owned vehicle supplemented by ride-sharing or subscription use vehicles.

Thriving in the New World of Mobility

With these fundamental shifts in auto finance becoming the new paradigm, lenders should refocus their strategy to adapt to the realities of the new mobility eco-system.

In rethinking their underwriting framework, the lenders' ability to understand risks and rewards of more commercially oriented loans will require a shift away from traditional consumer credit assessments to a more comprehensive understanding of underlying vehicle valuations and borrower business practices. Auto finance companies and underwriting departments will increasingly look to tap into multiple valuation benchmarks and source data analytics on the life-cycle of the car, including when and how a vehicle has been used to date. In Canada, Cox Automotive continues to develop wider valuation tools and insights to support the marketplace and shifting needs of lenders and dealers.

Another facet to address is asset disposition strategies for lenders. This will also become a heightened priority, as these units will likely involve remarketing of heavily depreciated assets due to higher vehicle usage.

Lenders will require greater transparency and visibility on valuations underpinning their increased commercial loan exposure with fleet and other commercial borrowers. With better data transparency, lenders that integrate internal loan management systems with their fleet customers, and remarketing partners will be best positioned to mitigate risk and monitor underlying collateral. At Manheim Canada, we continue to provide vertically integrated remarketing tools to lending institutions, leasing companies and OEM captives to offer greater visibility, control and efficiency in the manner in which they dispose of fleet vehicles.

The shift from traditional consumer-focused lenders to commercial finance organizations

With the anticipated declines in retail auto loans, some lenders may pivot from their traditional consumer credit focus to develop new products and services to diversify revenues. These opportunities could include monetizing existing capabilities to offer solutions to fleets such as payment processing, data analytics, creditor insurance and mobility warranty products. Auto finance lenders could also shift their focus toward the financing of ancillary infrastructure, like storage facilities for off-peak season fleets, charging stations for electric vehicles, and modernization of dealerships.

In summary, it is clear that the automotive ecosystem will undergo fundamental shifts in the coming years and auto finance companies will need to transform their models dramatically to align with new sources of growth. Those players that have the willingness and ability to change their product focus and evolve their business model to diversify into new revenue streams will stand to win in the modern world of mobility. CAW

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