Roland Berger Spotlight

November 2017

Debunking myths.

We challenge three common misconceptions about the impact of the coming changes in the automotive industry on the European vehicle leasing and fleet management market.

Roland Berger

navigating complexity

The automotive industry is preparing for a paradigm shift. A major disruption of the status quo is expected in the next 10 to 15 years. The changes that lie in store will be triggered by a combination of developments in four dimensions: new mobility, autonomous driving, digital and electrification.

These four dimensions, which we refer to by their acronym MADE, will have a decisive influence on the business of European leasing and fleet management companies – firms such as ALD, Alphabet, Arval, Athlon, LeasePlan and Sixt Leasing. The companies in question provide corporate and private customers with end-to-end services including vehicle procurement, fleet management, repair and maintenance services, insurance and vehicle remarketing.

But there's a problem. Misconceptions abound with regard to the influence that MADE will have on fleet management companies. Typically, industry pundits are overly pessimistic: They see the coming changes as risks rather than opportunities.

We take a rather different perspective. Below, we debunk three common myths about the disruption that lies ahead and what it means for industry players. We set the record straight about the (in our view positive) impact of MADE on leasing and fleet management companies. And we separate the myths from the reality using hard evidence, our industry expertise and in-depth analysis of European markets.

Myth #1

Myth: The emergence of a subscription economy and accelerating trends toward usership rather than ownership will lead to a reduction in the number of vehicles on the road, thus a shrinking leasing and fleet management market.

Reality: Cars have in fact been undergoing a 50-year evolution from ownership toward usership. Current developments are just the latest chapter in a trend that has fueled the growth of the leasing and fleet management sector.

A shift toward subscription and pay-per-use models is clearly observable in many industries. Companies in different sectors have successfully migrated from selling products to providing "products-as-a-service", be it in the area of music (Spotify), movies (Netflix) or data storage (Dropbox). The automotive industry adopted this trend away from ownership and toward usership early on. In fact, the shift has been ongoing in the industry for at least 50 years, and continues today. Leasing was initially just a financial service but now allows customers to outsource the ownership and entire management of their vehicles – from procuring them to maintaining, remarketing and upgrading them. Leases are also increasingly moving away from fixed terms to flexible durations.

The emergence of phenomena such as ride hailing, car sharing and car pooling is simply the next stage in the evolution of the car-as-a-service continuum. Some analysts believe that these trends will lead to a reduction in overall vehicle ownership. That is probably true. However, we are convinced that it will also lead to a significant increase in the volume of fleets and in vehicle usership, both trends that leasing and fleet management companies are ideally positioned to benefit from.

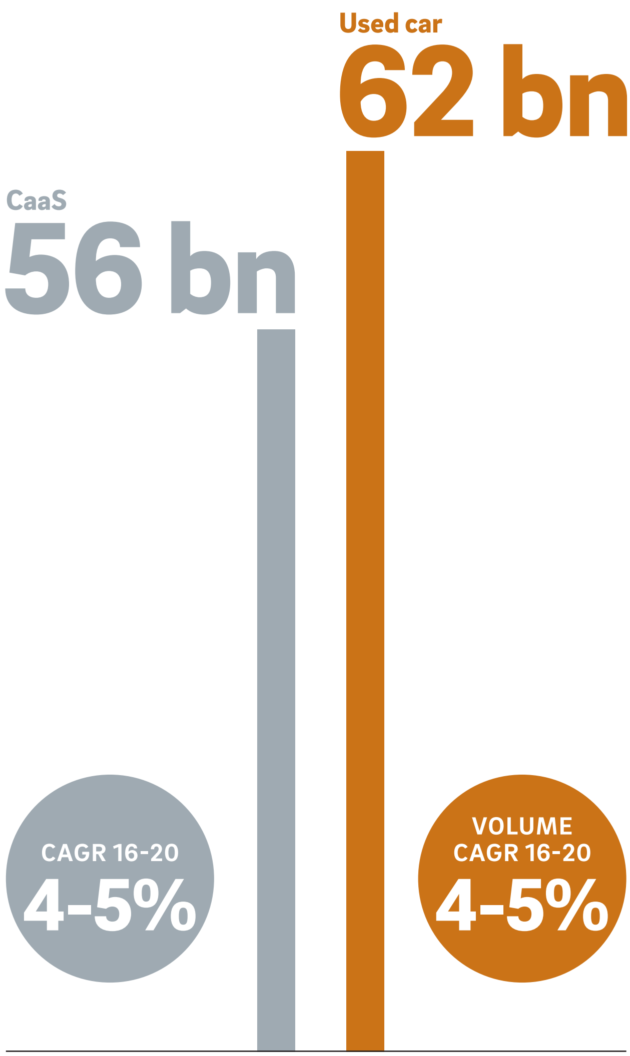
How strong will growth be? Between 2000 and 2016, the European leasing and fleet management market grew at a stable rate of around five percent a year, to approximately EUR 56 billion.[1] → 01 Growth is expected to continue at about the same speed until 2025, driven by significant increases in the size of fleets and demand for fleet management services from players such as Uber, Lyft and other fast-growing mobility platforms. These companies operate asset-light business models and do not count fleet management among their core capabilities. As these players look for full-service leasing packages for asset lifecycle management, this new segment for leasing and fleet management companies is expected to grow significantly, at rates of more than 50 percent a year

1 Figures refer to the passenger vehicle market in the EU-18: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

CaaS

All long-term subscription based mobility solutions (i.e. vehicle leasing) with integrated services

Figure 01: The total Car-as-a-Service (CaaS) market and used car market for passenger vehicles in 2016 for EU-18



Source: Roland Berger

until 2025. By then, it is expected to make up approximately eight percent of the European leasing and fleet management market.

Myth #2

Myth: Engine technology is developing at an ever-increasing pace. This creates a risk that leasing and fleet management companies will be left with a growing number of obsolete vehicles.

Reality: In fact, despite technological advances, today's vehicles will not become obsolete fast enough to impact leasing and fleet management companies. Leasing and fleet management companies own only the newest models and completely renew their fleet every three to four years. Their exposure to technology risk is therefore very limited.

In typical consumer goods industries, rapid technological developments translate into new products becoming obsolete very fast. A new smartphone loses half of its value after six months and up to 85 percent after two years. With new engine technology and autonomous vehicles developing rapidly in the automotive industry, one might expect the same thing to happen to passenger vehicles.

We do not believe that it will. Vehicles can be seen as being made up of three distinct parts: the core basis (chassis, tires, and so on), the consumer interface (dashboard, entertainment system, and so on) and the engine technology (traditional gas and diesel engines, electric drive systems). The core base of vehicles is not expected to change significantly in the coming years. Consumer interfaces are likely to undergo major alterations, but this will increasingly be a matter of software updates. Engine technology is developing rapidly, but from a very small base. The share of electric vehicles entering the three-to-four-year-old used vehicle market will probably be below one percent of volume by 2020 and below five percent by 2025 – a fast growth rate but not one that will have a substantial effect on the used car industry in the coming decade.

In addition, leasing and fleet management companies typically own only the latest models, and renew their car parc every three to four years. Average development cycles are still more than four years. Consequently, the companies in question are not burdened down with outdated technology. The regulation of diesel vehicles is also less of a risk to leasing and fleet management companies than to other market players. Current regulations mainly affect older diesel vehicles, with just six percent of Europe's low emission zones (LEZ) and ultra-low emission zones (ULEZ) imposing restrictions on Euro 6 diesel vehicles, and 13 percent imposing restrictions on Euro 5 diesel vehicles. The majority of today's three-to-four-year-old vehicles already meet Euro 6 standards, so we do not expect leasing and fleet management companies to be affected strongly. → 02

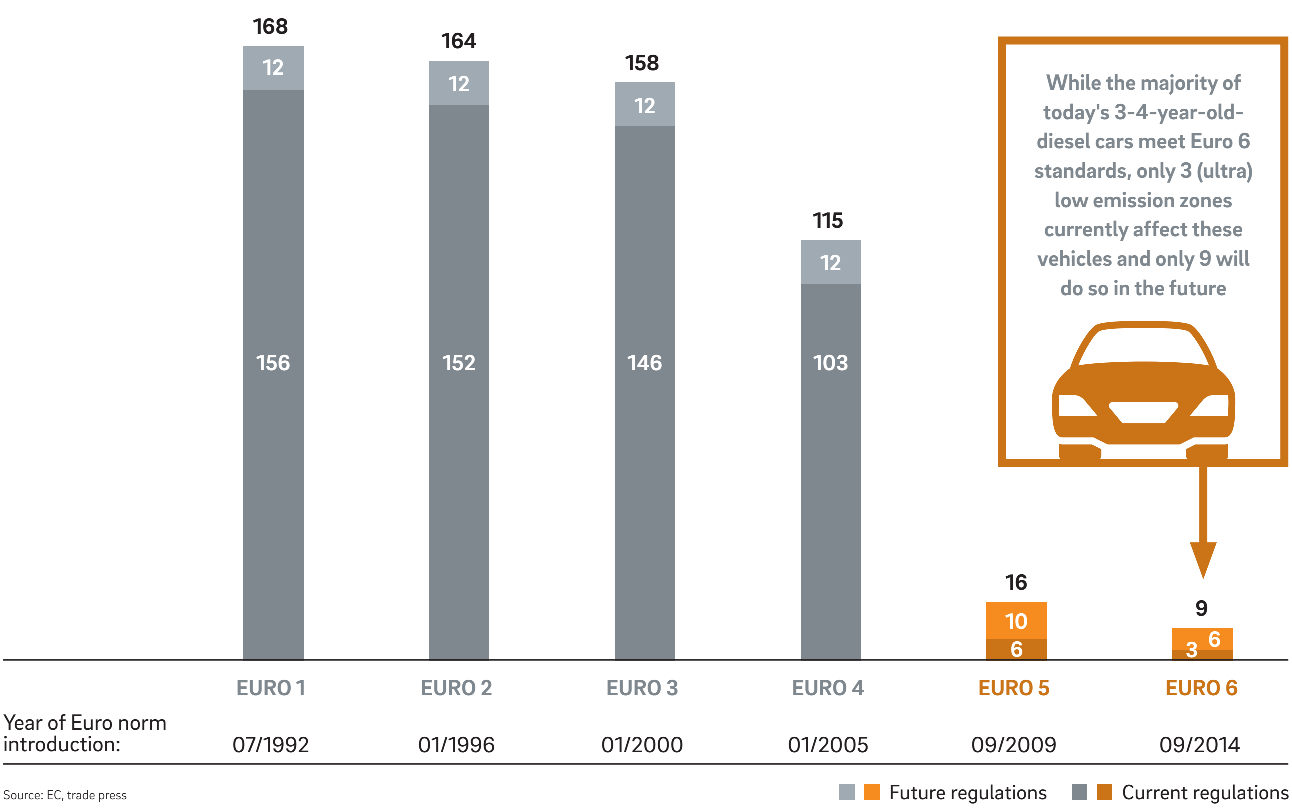
Myth #3

Myth: Leasing and fleet management companies only operate in one market, namely the leasing and servicing of cars. Selling cars at the end of their leases for their residual value is a risk rather than a source of real profit. → 03

Reality: In fact, vehicle remarketing is no longer just a residual part of the business model of leasing and fleet management companies: It is a huge, untapped opportunity. Leasing and fleet management companies can become leaders in used vehicle markets by embracing digitization and globalization, disrupting and disintermediating traditional wholesale and auction channels. The used vehicle market is as big as the leasing and fleet management market is today. → 01

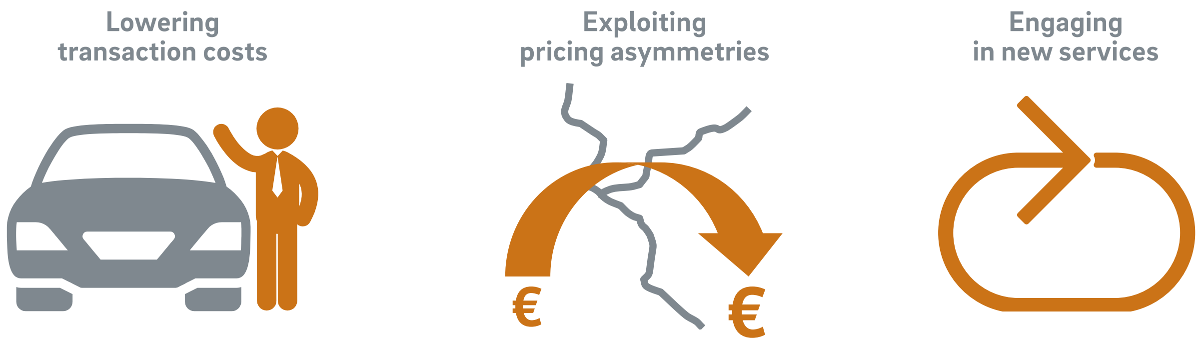
Leasing and fleet management companies currently sell the vast majority of their used vehicles through auction and wholesale channels. Historically, this approach has been driven partly by the desire to dispose of cars quickly, and partly by the complexity and local nature of used vehicle markets. But things are changing. Digitization and globalization are increasing the transparency

Figure 02: Number of ultra-low emission zones (ULEZ) and low emission zones (LEZ) for passenger vehicles and light commercial vehicles in the EU by Diesel Euro norm



Source: EC, trade press

Figure 03: Changing perspective on residual value



of markets as never before. New online players such as Auto1.com and Autoscout24 are offering vehicles on a pan-European scale. The traditional barriers in the used vehicle market are rapidly breaking down.

Leasing and fleet management companies are in an enviable position to take advantage of these developments. They can bypass intermediaries and sell their used vehicles directly to consumers, thereby capturing a larger share of the value chain. They are already among the biggest resellers of used vehicles in Europe, with a large, guaranteed supply of cars. In addition, they are trusted sellers, with detailed data on vehicles' histories and the ability to offer extensive services and warranties to buyers. They have the capability to sell, lease or rent used vehicles, and extensive repair and maintenance networks with which to service them. In a nutshell, they can transform the used vehicle buying experience by approaching consumers directly, and in so doing radically boost their profitability.

Moreover, the breaking down of barriers in the used vehicle market allows international leasing and fleet management companies to maximize the resale value of their vehicles by selling them cross-border. Potential for arbitrage arises from differences in local consumer preferences, continuous changes in the balance of supply and demand, and the sheer complexity of international trading. Digital technology makes it easier to exploit these opportunities, and internationally operating leasing and fleet management companies are in a particularly good position to do so. The potential upside is thus much larger than the residual value "risk".

Myths are there to be busted. The four dimensions mobility, autonomous driving, digital and electrification (MADE) are not a risk for leasing and fleet management companies – they are a not-to-be-missed opportunity. By taking the right strategic action, large, service-oriented, international leasing and fleet management companies can be the winners, not the losers, of the coming disruption.

READ ON

In December 2017 we will publish an in-depth report on the European vehicle leasing market, examining the market structure and size, trends and drivers, and key success factors. If you would like to receive a copy, please send us your details at europeanleasingstudy@rolandberger.com

MADE by RB

We believe that the combination of developments in four dimensions (mobility, autonomous driving, digital and electrification) is likely to trigger a major disruption in the automotive industry in the next 15 years. In 2017 we brought together our experts from all around the world to try to make this new future and its implications more concrete, and to offer the best support possible to key decision-makers in the automotive industry.

For more information on MADE, see https://www.rolandberger.com/en/Dossiers/MADE.html

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