The future of auto finance

New customer needs, new players, new revenue streams—new opportunities

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Introduction

The automotive industry is in the midst of the greatest disruption in a century. Almost everything is changing—how vehicles are powered (from internal combustion engines to electric propulsion), how they are built, and how they are driven, serviced, and acquired. All of these changes present challenges and opportunities for players in automotive finance. In this paper we look at how the auto finance industry is responding to these changes and how the competitive landscape is rapidly evolving. Winning in the new world of auto finance will require business and operating model strategies that center on customer experience, mastery of data and analytics, and accelerated digital transformation.

The future of auto finance: opportunities and challenges
How to compete in the new world of auto finance
How KPMG can help

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Market dynamics

New kinds of cars. Electric propulsion is the most dramatic change in the automotive industry in a century, opening new financing opportunities, such as for replacement batteries or home charging equipment. "Connected" cars bristling with computers and sensors can also provide auto finance opportunities—for example, for content and software updates.

New ownership models. Consumers have expanding choices of how to acquire and use cars: purchase (with or without loans); leasing; rentals; ride-sharing (Uber, Lyft); car-sharing (Zipcars by the hour); and subscription.

The triumph of digital distribution. Consumers research and select new cars online while often arranging financing online as well. For auto lenders to profitably grow share, they will need to invest in digital capabilities that meet evolving customer expectations and seamlessly integrate into the car ownership ecosystem.

A changing economy. Inflation and rising interest rates are impacting automotive finance, with more consumers stretching to make car payments. The average auto payment is already more than $700. Some lenders are pulling back from the sector amid rising default risk while others, leveraging more advanced risk analytics, are taking greater share of the market.

Four critical capabilities for success. To compete in the new world of auto finance, lenders must deliver a great customer experience, become a connected organization, master data and analytics, and accelerate digital transformation. Those who meet changing car buyer needs can tap into new growth.

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The future of auto finance: opportunities and challenges

Auto finance is a $160.5 billion business in the U.S.[1] A total of $1.5 trillion in loans have been made on new and used vehicles, making auto lending the third-largest category of consumer debt after home mortgages and student loans.[2] More than 100 million Americans have an auto loan.[3]

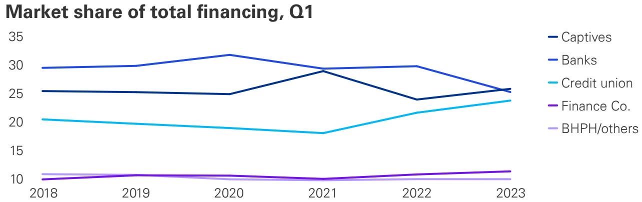
It's a big market which has been relatively stable for the past several years. But that is changing. Traditional financing companies—banks, captives, credit unions—are competing more than ever to gain or hold share. New entrants, like fintech lenders, are complicating the competitive landscape.

Many banks have pulled back or exited auto lending, allowing gains by captives to overtake them in market share for total financing. By offering lower rates, credit unions have also closed in on banks as car buyers looked to find the best deals on loans.

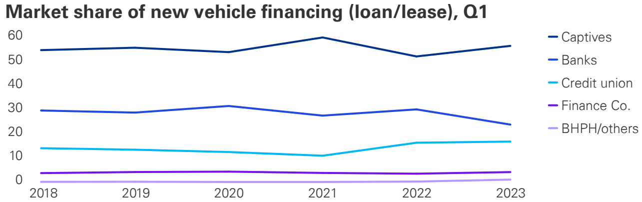
The auto finance landscape: Market shares have been shifting in recent years

Captives	Captive lenders continue to dominate the financing of loans and leases for new vehicles, which helped them to overtake banks in market share for total financing.
Banks	With many banks reconsidering their market strategy and some reducing or exiting the indirect business, they lost market share for both new and used vehicle financing.
Credit unions	Credit unions have grown their market share of used vehicle loans by offering lower rates, as buyers look for the best loan deals to help offset higher vehicle prices.
Finance Co. (fintechs)	With user-friendly apps and portals for consumers, fintech lenders are a growing source of direct lending.
Buy here pay here/others	In-house financing's market share remained relatively flat for total financing, with the uptick in new vehicle financing offsetting the slight reduction in used vehicle financing.

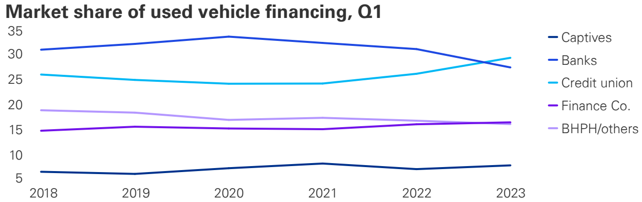
Market share of total financing, Q1



Market share of new vehicle financing (loan/lease), Q1



Market share of used vehicle financing, Q1



Source: Experian

[1] Source: "Auto Leasing, Loans & Sales Financing in the US - Market Size 2004–2029," IBISWorld, February 21, 2023

[2] Source: Ryan Kelly, Chris Kukla, Ben Litwin, and Ashwin Vasan, "Enhancing public data on auto lending," Consumer Financial Protection Bureau, November 17, 2022

[3] Source: Consumer Financial Protection Bureau, op cit.

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But more shifts are likely as the effects of higher sticker prices and interest rates hit auto shoppers. Already, the share of new cars acquired by leasing has dropped from 28.9 percent to 17.5 percent.[4] With the average interest rate on an auto loan topping 7 percent, subprime borrowers, who typically pay no more than $400 per month, could be priced out of the market.[5] Delinquencies are surpassing pre-pandemic levels.[6] Banks have started to increase their reserves in anticipation of an increase in defaults, while captives continue to rely on strong underwriting standards and risk-based pricing to manage in a more challenging environment.

Lenders who find ways to profitably cater to higher-risk consumers can tap into new growth.

The current turbulence and longer-term shifts in the auto market create both risks and opportunities for auto finance companies. Lenders that figure out how to meet changing car buyer needs—including finding ways to profitably cater to higher-risk consumers—can tap into new growth.

[4] Source: "Why Leasing Matters - June 2023," S&P Global, June 30, 2023

[5] Source: "Latest Edmunds data shows out of reach new vehicles likely are for subprime consumers," SubPrime Auto Finance News, July 5, 2023

[6] Source: Abigail Ham, "Auto loan delinquency rate surpasses recession-era highs," Automotive News, June 20, 2023

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1 New kinds of cars mean new financing opportunities

Electric vehicles (EVs), connected cars, and (eventually) autonomous vehicles will influence future lending practices and create new opportunities. KPMG projects that by 2030 as much as 40 percent of all vehicles sold could be electric powered.[7]

The connected vehicle, outfitted with the latest in smart technology, will present lenders with new financing opportunities.

EVs present some novel financing opportunities. Automakers such as Tesla, Ford, GM, Stellantis, and Volkswagen are all offering home charging stations, which can be financed by the OEMs or banks.[8] To reduce monthly payments for lease customers, Ford introduced a lease option for the Mach E and F150 Lightning with a balloon payment at the end.[9] There are additional opportunities for EV-related lending. The body and mechanics of EVs will outlast the life of the batteries that power them, creating a potential financing option for replacement batteries. For example, a Tesla Model 3 battery can cost up to $20,000 for a vehicle that retails at around $43,000.[10] Auto finance companies could explore an opportunity to provide a separate lease for batteries, as well as other high-cost components.

The connected car—a vehicle fitted with the latest smart technologies such as artificial intelligence and GPS for predictive maintenance, in-car payments, energy/traffic management, etc.—will present lenders with new financing opportunities. Charges for content and software updates could be folded into loans and leases, for example.

2 New ownership models: shifts in how consumers acquire and use vehicles

A growing number of consumers are opting out of car purchases altogether and using rideshare or car-share services such as Uber and Lyft, or Zipcar. These services are particularly attractive to young, urban dwellers looking to avoid the expense and effort that go into owning a vehicle—purchasing, maintaining, parking, insuring, etc. How much these alternatives to car purchases will impact overall vehicle demand is a subject to debate. However, expect alternative ownership models to gain more traction as the cost of car ownership continues to rise.

The global ride-sharing market is expected to grow from $84.3 billion in 2021 to $242.7 billion in 2028, at a compound annual growth rate of 16.3 percent.[11] Car-sharing was only a $2.9 billion business in 2022, and is projected to expand at more than 20 percent annually from 2023 to 2032.[12] Car subscriptions, under which consumers pay a monthly fee for access to a car as needed, is another ownership option. A KPMG survey found that 84 percent of automotive executives believe vehicle subscriptions will become an alternative to purchasing and leasing.[13] Car subscriptions require considerable initial investment in capital and marketing efforts to build demand and brand awareness. While the model is still evolving, it has seen some promising early results in Europe.

Eighty-four percent of automotive executives believe vehicle subscriptions will become an alternative to purchasing and leasing.

[7] Source: "Auto leaders prepare to seize big opportunities: Will they choose the right road?" KPMG International, 2022
[8] Source: OEM – original equipment manufacturer; Source: Dan Avery, "You can now get a bank loan to finance your home EV charger," CNET.com, February 12, 2023
[9] Source: Ford.com
[10] Source: Nick Carey, Paul Lienert and Sarah Mcfarlane, "Scratched EV battery? Your insurer may have to junk the whole car," Reuters, March 20, 2023
[11] Source: Ride Sharing Market Size, Fortune Business Insights, December 2021
[12] Source: Car Sharing Market Size, Global Market Insights, May 2023.
[13] Source: "Industry leaders foresee dramatic changes: Where the opportunities may lie," KPMG International, 2021

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3 New ways of acquiring financing: accelerated shift to direct lending

Today, indirect lending accounts for 80 percent of all auto loans in the U.S.[14] The margins are thin due to the dealer participation in originating the loans. Technology, however, is allowing lenders to participate in the online customer shopping experience by identifying the specific vehicle, then presenting the customer with a direct auto loan offer.

EV brands such as Tesla, Rivian, and Lucid have built direct-to-consumer sales models using showrooms and online ordering and purchase. They also sell leasing and financing online. Ford is offering online ordering for its EVs.[15] Only 11 states permit the direct-to-consumer vehicle sales, but that may change as part of the EV transition, potentially also accelerating direct lending.[16]

Fintech lenders are also a growing source of direct lending, providing user-friendly apps and portals for consumers. There are also hybrid models, in which most of the work is done online by the consumer and the dealer completes the transaction.

Survival of traditional lenders will require investing in digital capabilities that allow them to meet these new customer preferences, as well as to integrate more seamlessly into car ownership experiences (that is, shopping, buying, maintaining, and upgrading). We know from our work across banking and lending markets that these investments have potential for a significant return. Customer centricity is a high priority: 78 percent of respondents in a KPMG survey said they are investing in "digitally enabled technology architecture" and "experience centricity by design."[17]

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[14] Source: "Jonathan Lanning, "Evidence of Racial Discrimination in the $1.4 Trillion Auto Loan Market," ProfitWise News and Views, No. 1, Federal Reserve Bank of Chicago, January 2023

[15] Source: Chris Randall, "Ford aims for direct sales model in the USA," Electrive, June 7, 2022

[16] The 11 states are Arizona, California, Colorado, Connecticut, Maine, Maryland, Massachussetts, New Jersey, New York, Oregon, and Washington. Source: Kristy Hartman and Laura Shields, "State Laws on Direct-Sales," National Conference of State Legislatures, 2021

[17] Source: "Future of commercial banking," KPMG International, September 2022

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4 High prices and a more challenging economy

Used car prices have come off their record highs and in June 2023 dropped by 4 percent from year-earlier levels, helping to bring down the annual inflation rate to 3 percent. As supply imbalances in the new car market ease, the excess demand for used cars will fade and new car prices may also moderate.

However, it is not clear if the auto demand will return to a pre-pandemic norm. Even with rising incomes, buying a car is a bigger financial commitment today for American consumers. Thanks to the effects of the pandemic on costs and supplies and the upscaling of models, the average price of a family car in the U.S. in 2022 was $48,000, up from $39,000 pre-pandemic.[18] That's 68 percent of median household income. Back in 1973, a Ford LTD cost $3,833, or 36.5 percent of median household income.[19] In 2022, the average car loan was nearly six years, and the average monthly payment was $700 for a new car and around $500 for a used car.[20]

Auto lenders are finding new ways to meet the needs of buyers in this environment, including nonprime borrowers.

How much will higher costs of ownership cut into car sales? According to J.P. Morgan Research, the seasonally adjusted annual rate of U.S. light vehicle sales is expected to slightly increase from 14 to 14.5 million in 2023—a modest improvement from 13.9 million in 2022, but still well below the 17 million sales in 2019.[21]

The upshot: auto lenders could face a market of fewer customers—and more of them who must stretch to make payments. As noted, some lenders have responded by raising credit requirements or by pulling back from the sector. Other players are finding new ways to meet the needs of buyers in this environment, including nonprime borrowers.[22] A recent innovation: vehicle equity loans (VELs) modeled on home equity loans. Owners of older vehicles with substantially paid-down loans and built-up equity can borrow against the equity in their cars. Fintechs have developed ways to qualify subprime borrowers using nontraditional data such as rent payment histories. Some fintechs are working with traditional lenders; others are competing as direct lenders, including by refinancing traditional loans.

[18] Source: "Average new-vehicle prices up nearly 2% year-over-year in December 2019, according to Kelly Blue Book," Automotive World, January 3, 2020.

[19] Source: Jonathan Lanning, "Evidence of Racial Discrimination in the $1.4 Trillion Auto Loan Market," ProfitWise News and Views, No. 1, Federal Reserve Bank of Chicago, January 2023

[20] Source: Chris Randall, "Ford aims for direct sales model in the USA," Electrive, June 7, 2022

[21] Source: A commissioned study conducted by Forrester Consulting on behalf of KPMG, April 2021

[22] Source: "Non-prime lending: One size doesn't fit all," KPMG LLP, 2022

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How to compete in the new world of auto finance

How will these auto industry dynamics and trends create opportunity for auto finance companies? We see four critical capabilities for lenders in the changing world of auto finance:

Deliver a great customer experience

Auto financing companies can do more to meet evolving customer expectations. Car buyers are researching, shopping, and (increasingly) ordering and buying online. They expect lenders to provide the same type of online experience that they get when buying other goods and services. That means offering customers an integrated buying experiences with finance being part of the auto buying platform where shoppers can get financial literacy support, perform research, finance, buy, and insure their cars in one place. To succeed in this environment, auto lenders will need to offer the kind of hyper personalization that shows they understand their customers as individuals. Competing on rates and terms is no longer enough. Auto lenders must demonstrate an intimate understanding of their customers' needs, address their specific circumstances, and provide a seamless path to purchase.

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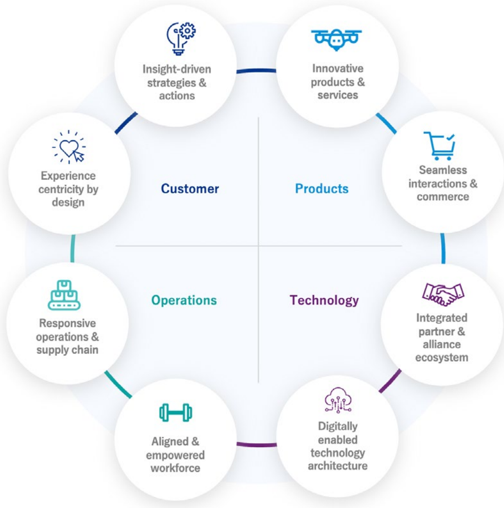
Become a connected organization

The second opportunity and challenge for lenders is the integration of the car-ownership ecosystem—that is, the extension of the customer experience from sales through ownership and servicing. A lender's ability to integrate into their potential customers' shopping, buying, and maintenance processes will become table stakes for effectively competing in certain segments of the market. A connected approach to a customer-centric enterprise—what we call a "Connected Enterprise"—allows people, data, and technology to interact easily, creating new levels of productivity and value creation. This Connected Enterprise model will require lenders to undertake organizational change to expand the use of digitized processes and share data more efficiently to meet customer expectations, create business value, and drive sustainable growth in a digital world.

Connected Enterprise capabilities



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Master data and analytics

There are many ways in which data analytics mastery, including the latest advances in artificial intelligence (AI) such as generative AI, can position auto lenders for profitable growth. In addition to improving the customer experience in traditional lending, lenders can use advanced data analytics to target new segments and develop new products based on new vehicle types and ownership models. Lenders may also use consumer and vehicle data to head off trouble—is the customer who missed a regular service appointment and has taken on more credit-card debt becoming a default risk? Can the loan be saved by offering a temporary reduction in the monthly payment? Auto lenders will also need to use AI and data analytics to develop new products for new ownership models such as subscriptions and to target new types of customers.

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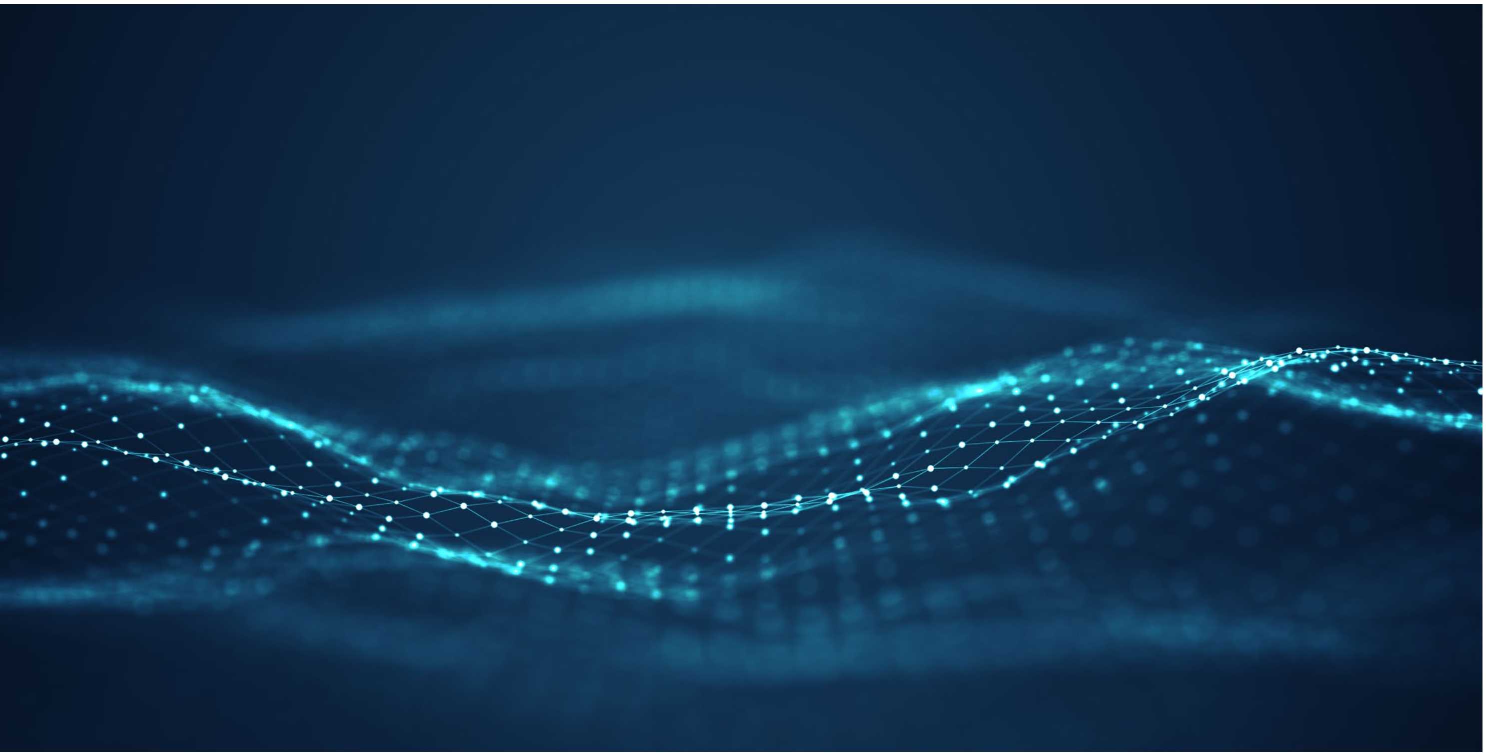
Accelerate digital transformation

To become connected organizations that use data and analytics to develop new products and deliver competitive customer experiences, auto finance companies will need to accelerate technology transformations. They will need to modernize (or work around) outdated IT architectures and platforms and become more agile in their ability to adopt new technologies. This transformation needs to include modernizing point-of-sale, loan origination, and servicing platforms, and creating robust data aggregation and predictive modeling capabilities. Auto lenders just starting technology transformation projects are already behind and will need to accelerate their transformation to be competitive.

This transformation needs to include modernizing point-of-sale, loan origination, and servicing platforms.



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How KPMG can help

Auto lenders are at a disadvantage with legacy business process and technology. KPMG has extensive experience advising auto finance clients across the spectrum, including captives, banks, and fintechs. While there isn't a "one size fits all" answer, KPMG has developed assets and tools that can facilitate an accelerated transformation in the following areas:

1. Customer-centric digital operating model strategy: We help lenders grow through enhanced customer experience. Leveraging our concept of the Connected Enterprise and leading practices—relationship-based pricing, loyalty rewards programs, and deploying enabling technology—we work with lenders to reimagine and define new digital delivery models designed for sustained profitability.

2. Data and analytics solution design and delivery: We can enhance customer centricity, profitability, and risk management through delivery of our data and analytics solutions, including KPMG Signals Utility, Market Vibrancy Index, and Borrower Retention Model.

3. Digital transformation solution delivery: We help accelerate platform modernization efforts by leveraging our vendor relationships and delivery expertise. The KPMG Auto Lending Playbook accelerates design and delivery of new "future-ready" business strategies and operating models.

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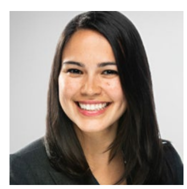

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Ana is a leader in the Lending Transformation Practice. She specializes in delivering strategic solutions for her clients. She has extensive experience leading both banks and nonbanks through large-scale business and technology transformations. She also manages the firm's relationship with a number of auto lending technology providers.

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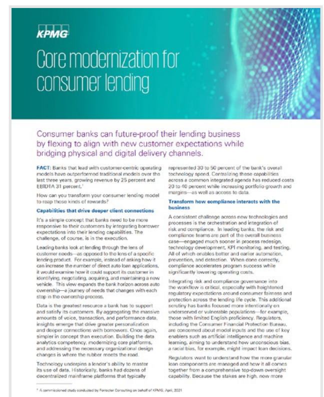

Core modernization for consumer lending

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