KPMG

Global Captive Finance Study 2017

Automotive finance in transition

Contents

Introduction

Dear readers,

Automotive captive finance companies have grown considerably in recent years, benefiting from high margins and somewhat manageable risk exposures. However, they face major challenges from changes in the market environment, technology and regulation. New market entrants are creating a more competitive environment; digitalization and new technology represent both threats and opportunities to existing players; mobility issues need to be properly addressed; recent and prospective regulatory requirements not only impose additional compliance costs but also require firms to take a more strategic view of how they identify, measure and control risks.

We at KPMG are eager to better understand the impact of this continuously changing environment on automotive captives. Further, we wanted to provide top industry executives with an opportunity to share and compare their views with peers across the market. Can we expect the continuation of automotive captives' impressive success? What will the sector look like five years from now? How are traditional business models changing? Can captives continue to thrive as their customers' sole financing partners and as sales engines for their respective original equipment manufacturers (OEMs)? Or is transformation not only natural, but necessary?

Early this year, we undertook a major survey of automotive finance providers to canvass industry opinions on how current developments in relation to competition, technology and regulation might evolve and on their potential market impact. More than one hundred senior industry executives responded to our survey, representing a large variety of market participants. A wide range of firms were covered in these responses, including not just captives but also banks, fleet management and leasing companies, mobility service providers, white label companies and fintechs. These firms were of varying sizes and spanned the Americas, Europe, Asia-Pacific, South Africa and the Middle East.

The survey generated many important findings, highlighting a number of potential developments in market structure and clarifying areas of action. It confirmed the need for captives to reap the advantages of new technologies and data resources while fully embracing the online world. We also explored the advantages of captives taking a more customer-centric approach and diversifying into new products and services, as well as the potentially pivotal role of mobility services.

We hope you find the study informative.

Enjoy the read.

Ulrich Bergmann
Partner, Financial Services
KPMG in Germany

Global Captive Steering Group

Christian Fitz
Senior Manager, Financial Services
KPMG in Germany

Global Captive Steering Group

Methodology

The survey was conducted online and took place at the beginning of 2017. It was based on a questionnaire comprising more than 40 questions covering various business challenges.

The survey included more than 100 of the top executives behind global automotive finance providers, simultaneously granting these executives the opportunity to share their views with peers across the market.

A wide variety of firms were included in the responses, including not just captives but also banks, fleet management and leasing companies, mobility service providers, white label companies and fintech specialists. The firms these executives represent are of various sizes and from all around the world, providing a truly global snapshot.

The purpose of this study is to improve our understanding of the challenges facing the business models of captives and automotive finance companies in light of ongoing evolution of the market environment.

Company details

About KPMG

KPMG is a network of professional firms with more than 189,000 employees in 152 countries.

In Germany too, KPMG is one of the leading auditing and advisory firms and has around 10,200 employees at 25 locations. Our services are divided into the following functions: Audit, Tax, Consulting and Deal Advisory. Our Audit services are focused on the auditing of consolidated and annual financial statements. The Tax function incorporates the tax advisory services provided by KPMG. Our high level of specialist know-how on business, regulatory and transaction-related issues is brought together within our Consulting and Deal Advisory functions.

We have established teams of interdisciplinary specialists for key industries of the economy. These pool the experience of our experts around the world and further enhance the quality of our advisory services.

About KPMG's Global Captive Steering Group

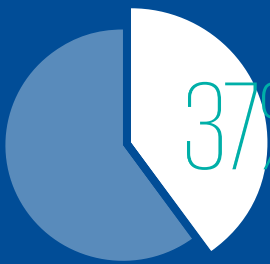
KPMG's global Automotive sector works with many of the largest and most successful automotive companies in the world. Everything relevant to automotive financial services, including captive and non-captive business, is centrally pooled in KPMG's Global Captive Steering Group.

This strong network of designated Automotive Financial Services experts and leading industry professionals has longstanding, global experience in automotive finance and related services. The Global Captive Steering Group works as a cross-functional and international team of specialists to better respond to the needs of the captive finance industry by identifying and analyzing trends as well as developing and delivering strategic solutions and tailored services for our clients. We are present in more than 20 countries globally. The Global Captive Steering Group consists of 20 partners each facing one market. With their international mindsets, KPMG's automotive financial services industry professionals foster global communication and collaboration. Our seamlessly networked Automotive sector and Global Captive Steering Group make KPMG a partner of choice in the fields of captive finance consulting, audit and tax.

Key facts

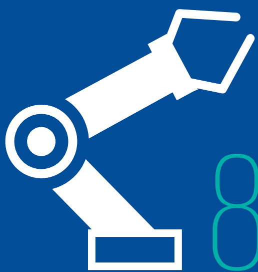
95%

New players
95% say it is very likely that a changing market envi ronment and increasing competition will lead to more differentiation within business models.



37%

Products, services & innovation
37% of the participants expect that new mobility and digital services will contribute up to 40% to the company s net sales in 5 years.



84%

Governance and organization
84% confirm that SSCs are highly relevant to their business model; upcoming new trends like robotics could lead to significant changes.

94%

Digitalization and customer behavior
94% rate their IT architecture as efficient and effective; KPMG s experience is that, especially at captives, substantial invest ments in IT infrastructure and big data capacities are still necessary to replace legacy and heterogeneous IT systems to respond to future customer needs.

§

64%

Regulatory landscape
Investments in regulatory and compliance are costly but inevitable; 64% plan major investments in regulatory and compliance projects (40% or more of investment budget).

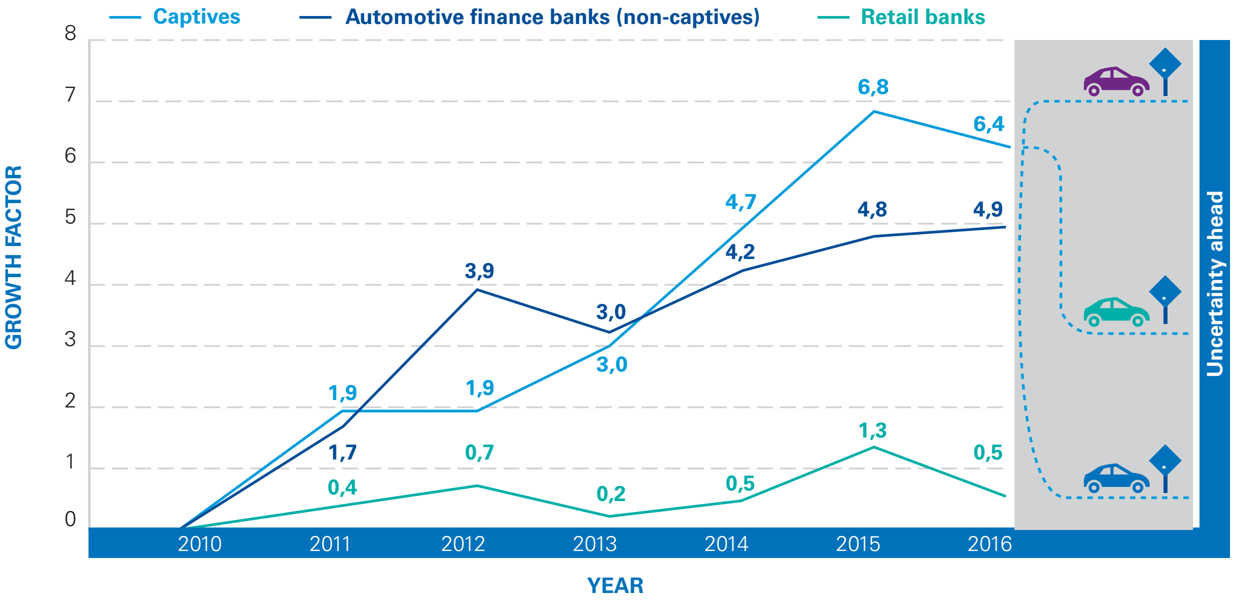
!

TAKE AWAY
The results of the survey emphasize how fast the business environment is changing. This is expected to impact strongly on the business model itself, products and services, IT, sales channels as well as on customers and suppliers, and is expected to include disruptive trends arising from new competitors.
It is time to change.

Changing market environment – don't undermine new players

The automotive financial services market has been a bountiful source of inspirational success stories in recent years. As depicted below, the profit before tax of captives with a focus on automotive finance, has increased by a factor of 6.4 since 2010. Those successes – including their relatively good margins and manageable risk profile structure (especially with the car as a pledged asset) as well as the minimal barriers to entry – triggered an increase in new market entries. Taking into account subsidies (interest, residual value) from OEMs of around 25% profit before tax, the growth factor is still high.

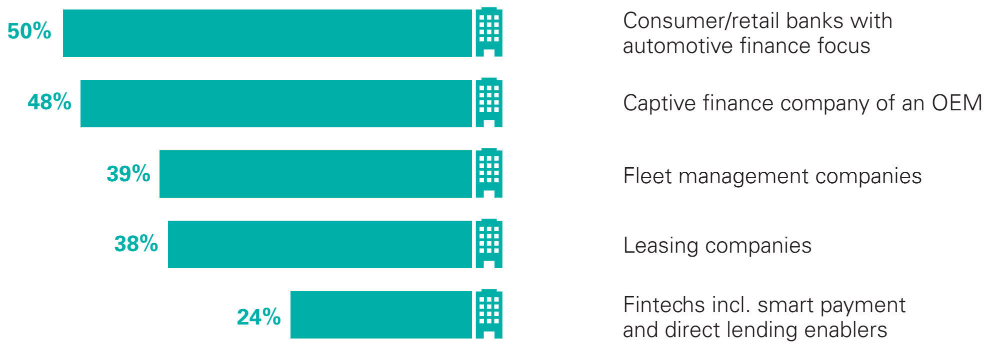
The automotive financial services market has been spoiled with success stories in recent years – how will the journey continue?



Source: KPMG in Germany, 2017

Our survey revealed a broad range of players with a significant stake in different local automotive finance markets beyond captives. While 50% of participants stated that consumer and retail banks with a focus on automotive finance have a significant stake in their local market, captives were not far behind at 48%, fintechs came out at 24%. The company representatives questioned in the survey felt that the competitive environment for automotive finance was strong and would further increase in their local markets. 75% of all participants felt there was strong competition in this sector, while only a minority considered competition quite weak. This high level of competition in the automotive finance market is a challenge for the industry as it could result in decreasing margins for standard products with easy market entry. However, this could also offer opportunities to those automotive finance companies that manage best to reshape their business model.

Which type of automotive finance company has a significant stake in your local market?
(Multiple answers possible)



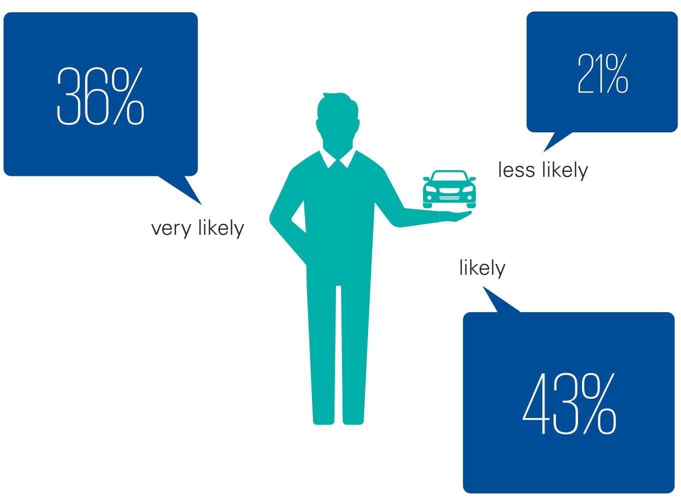
Source: KPMG in Germany, 2017

For captives to win competitive advantage and overcome further challenges including the continuously changing market environment, digitalization and the dramatic change in customer behavior, they have to start a transformation journey. This transformation journey includes a new business model and new partnerships. A new Captive Business Model 4.0 is particularly significant in light of the fact that 79% of all companies represented in our survey anticipate fundamental change in business models currently found in the automotive finance sector. This means captives will also need to re-examine and adapt their current business models.

Captives 4.0 should be innovative and reflect a shift from a product driven perspective to a customer-centric business model with a clear focus on customer needs and expectations.

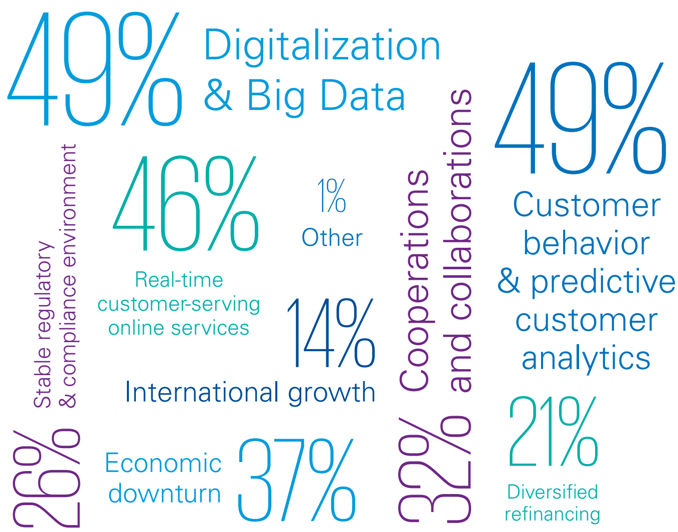
That's why captives need to better understand their customers by analyzing customer related data (together with car related data). Big data analysis and predictive customer analytics will be key to developing future products and services. But what are the factors that the survey participants believe will have a critical impact on their business?

In the next five years, how likely do you consider a major business model disruption in the automotive finance industry?



Source: KPMG in Germany, 2017

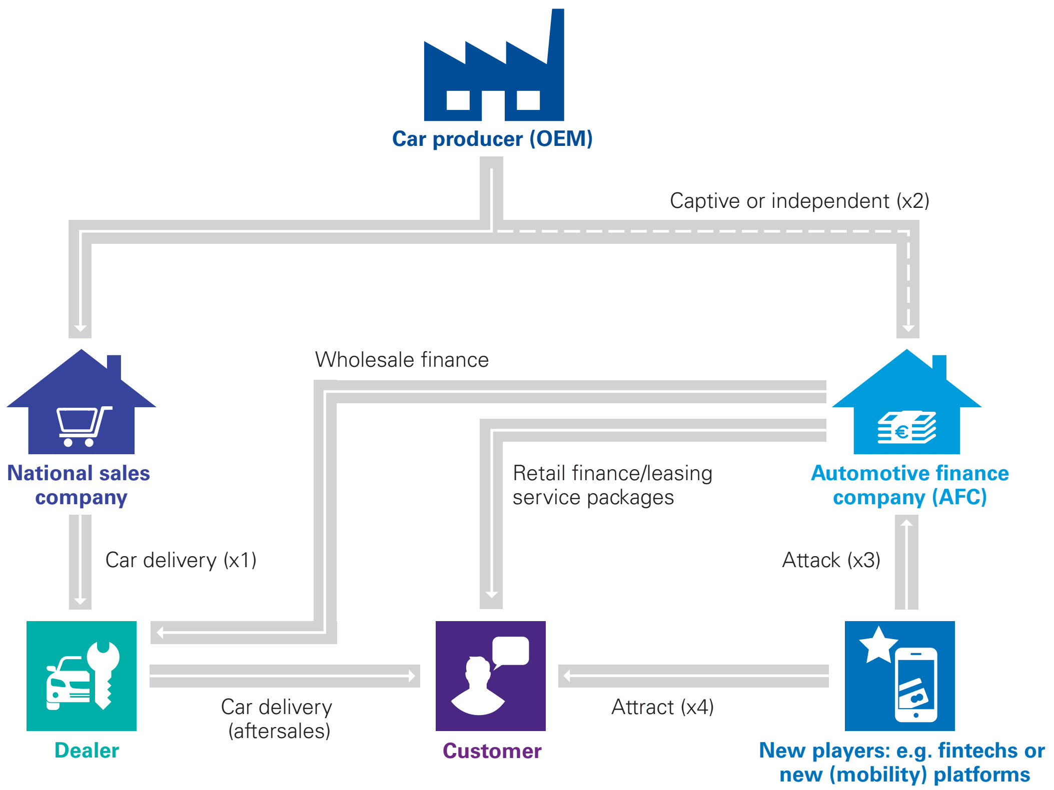
Which of the following criteria would you rate critical in impacting your business? *(Multiple answers possible)*



Source: KPMG in Germany, 2017

Digitalization and big data along with customer behavior and predictive customer analysis were stated mostly as critical factors. Assuming that up to 60% of customers will potentially purchase products and services online, the automotive finance companies need to be prepared to respond to these customer needs accordingly. In the current world dealers are mostly financed by automotive finance companies (wholesale financing). In addition, dealers are also incentivized to support the conversion of customers into leasing or financing customers. Penetration rates of more than 50 % are quite common in the industry. Along with the financing/leasing services, additional services such as insurance and wear & tear services are also offered to customers. In the new world, customers will search for new cars mainly online. The number of dealer visits, as part of the decision making process, will significantly decrease from an average of four visits to less than one visit, prior to the decision. The battle for new customers will be won online. In the new world we could imagine dealers as an agent between OEM, captive and customer as customers increase their direct channels with the captive and OEM (e.g. booking special features such as seat heating for a limited time during the lease term). The traditional customer – dealer relationship as well as the customer – automotive finance company relationship will be replaced by an integrated platform/ecosystem which combines all customer-related services. This platform will enable the customer to purchase/finance/lease cars, book test drives, book trips, purchase car accessories including spare parts as well as manage owned cars online.

Market environment and ecosystem Captives 4.0



x1: Sales and transfer price pressure.

x2: AFC's can be captive or independent of the OEM. Captives receive subsidies from the OEM.

x3: AFC's are attacked by new market entrants as margins are high. Transparency through price comparison platforms.

x4: Attract customers with new platforms.

Source: KPMG in Germany, 2017

For the success of the Captive Business Model 4.0, new partnerships and new skills are required as innovation is a key success factor in a transforming business. That's why we decided to examine where these innovators and challengers were expected to originate from in the automotive finance industry. Besides captives, the four types of automotive finance companies with the most significant share of the local markets (consumer/retail banks with an automotive finance focus, fintechs, leasing/fleet management companies and mobility services providers) were also the most widely regarded as highly innovative and likely to capture market share in the future.

Which of the following market entrants do you rate as the most significant innovators and challengers to the automotive captive industry for capturing market share? *(Multiple answers possible)*

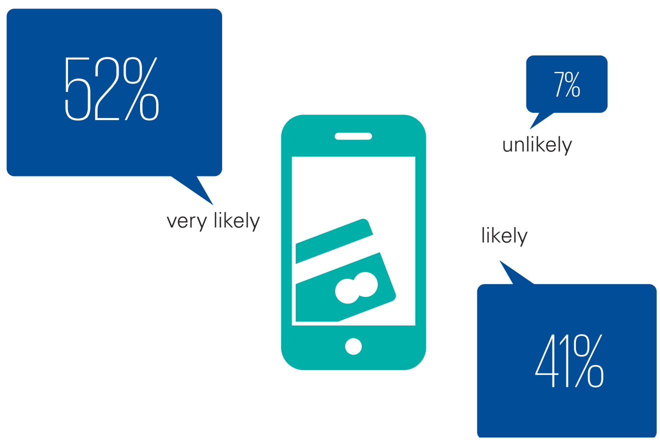
Source: KPMG in Germany, 2017

However, not all disruptive innovators have to be competitors, they can also be great partners. Partnerships are key to the success of the transformation journey ahead of captives. Fintechs in particular will play a major role among new players as they are considered to be particularly strong in innovation and so likely to attract an increasingly large market share over the coming years. With their roots often in finance or IT, it can be anticipated that new fintechs will enter the market, making waves with their expertise and innovation. Indeed, 93% of participants considered it either likely (41%) or very likely (52%) that their company would enter into a collaboration with fintechs over the next two years. Thus, we can conclude that the overwhelming majority of our survey participants support the idea of 'co-opetition', or a 'best of both' approach.

"There is a state of co-opetition. Strategic alliances and collaborations with players from converging industries will be the fundamental force that drives change."

Gary A Silberg
Partner
KPMG in the U.S.

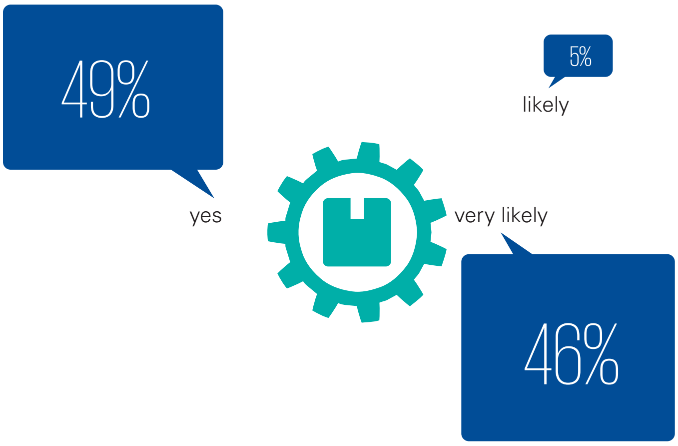
How likely is your company to enter into any form of collaboration with fintechs over the next 2 years?



Source: KPMG in Germany, 2017

According to our survey, automotive finance companies anticipate the need to differentiate themselves better from their competition in terms of their portfolio and strategy. Almost 95% of those surveyed said that it is very likely (46%) or definite (49%) that these drivers will push their company towards better differentiation over the next five years.

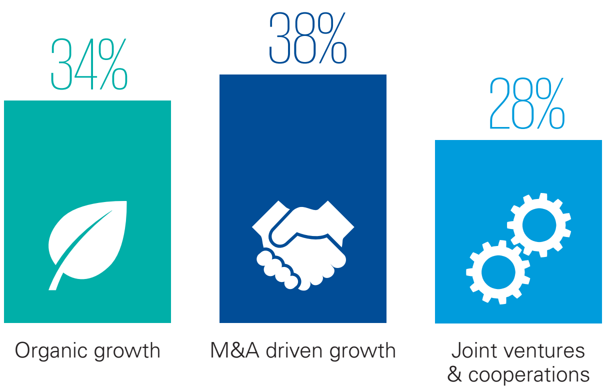
Will competition and an ever changing market environment lead your company to differentiation over the next five years, both in strategy and product?



Source: KPMG in Germany, 2017

However, differentiation is not the only response to increasing competition created by new market entrants. Growth strategies, particularly in new technologies, also play a central role. The results revealed a well-balanced split between inorganic and organic growth, with mergers and acquisitions coming top at 38%, followed by organic growth at 34%, and finally joint ventures and collaborations at 28%. There were some regional variations in our results. This is in part due to regional differences, as global automotive finance companies are barred from entering into joint ventures with local firms in some markets. Either way, it is clear the winning strategy is to consistently adapt the current business model to increase market share.

Which growth strategy is your company pursuing, particularly given the rising number of market players in new technology?



Source: KPMG in Germany, 2017

Transforming the business models alone is not the only critical factor for ensuring the continued success of captives in the automotive sector. Relationships to OEMs are also of crucial importance. At this point in time, it is impossible to say which direction things are headed. Slightly more than half the participants in our survey stated that they expect disruption to tear existing OEMs and their captive finance arms apart, while just under half expect it to facilitate close-knit collaboration.

In our view, it is vital that OEMs and their captive finance arms work closely together if they are to overcome the market threats arising from disruption. Closer collaboration between OEMs and automotive finance subsidiaries will allow both to benefit from sharing knowledge (e.g. residual value information), providing financial services, and collaboration in mobility services (interface between customer and car-related data). In the new area of collaboration, the role of the OEM could be heading towards car delivery and after-sales, whereas automotive finance companies cover the online sales channel (e.g. new cars, service products). Used car sales could be set up jointly as online plattform.

“Companies often feel too comfortable to initiate a business model transformation – and they can end up being too late, as demonstrated by other business models, for example in the telecommunications industry.”

Ulrich Bergmann
Partner, Financial Services
KPMG in Germany

Organization & Governance – how things are done

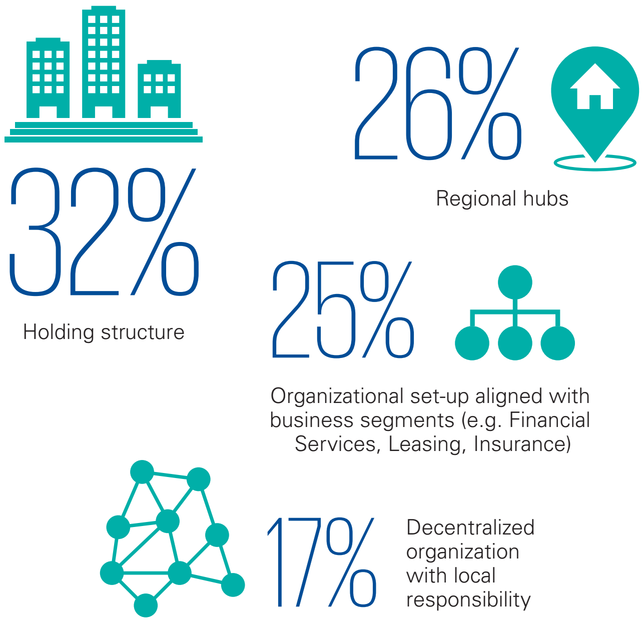
The legal structure and management approach of an organization influences its ability to transform its business model in line with the changing market conditions to gain competitive advantage. That's why we decided to investigate which legal entity structure is mostly used in the automotive finance sector. According to our survey, the most common structure among global organizations is the holding structure at 32%, followed by regional hubs at 26%, an organizational set-up aligned with business segments (e.g. financial services, leasing, or insurance) at 25%, and a decentralized organization with local responsibility at 17%. We also found regional differences, with regional hubs being the dominant structure across the Asia-Pacific and Europe.

"An efficient governance and legal entity set-up will form the basis for competitive advantages in the captive business of the future."

Raimo Werning
Manager, Financial Services
KPMG in Germany

In essence we currently see a mix of different organizational set ups. We expect that the increasingly competitive environment will motivate automotive finance companies to further optimize their governance structure to create a legal entity set-up that is more efficient from both a business and a regulatory perspective.

What best describes your legal entity structure?

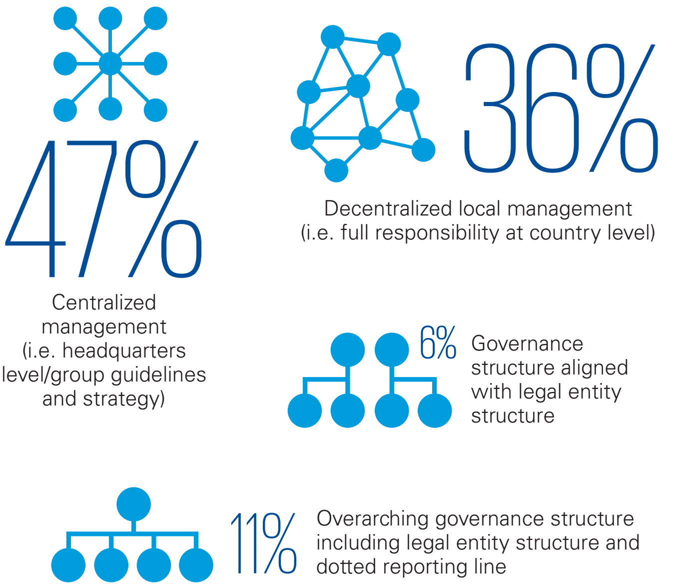


Source: KPMG in Germany, 2017

However, an appropriate and efficient management approach is essential for success during the transformation journey. That's why we asked participants which approach to management their company pursues. Close to half of all participants prefer a centralized management structure, with key decisions made at the company headquarters with group-wide guidelines and strategy. Decentralized, local management (regional hubs with full responsibility at a country level) was the second most common approach. And also here we identified regional differences. In Europe regional hubs with full-decision responsibility at country level is the dominant approach.

The result reflects our view on the best practice in this area. We believe that companies need to implement a high degree of standardization to stay or become competitive in terms of cost per contract and other cost-related KPIs. However, flexibility to local conditions also plays a vital role. Therefore an 80:20 approach can be very efficient and beneficial with 80% central management and 20% local management.

Which management approach does your company pursue?



Source: KPMG in Germany, 2017

Shared service centers (SSC) also have high relevance for the survival against increasing competition. SSCs increase efficiency and effectiveness within the company. This is also confirmed by our survey. 84% of all participants confirm that SSCs are highly relevant to their business model. 40% already operate their own SSC, while another 44% consider it possible that they might introduce SSCs within the next few years. Captives are increasing the maturity of their shared services and outsourcing operations (also known as global business services). They focus on three areas – governance, technology, and increasingly, robotics, which act as critical levers in the drive toward greater efficiency and maturity. In the new world SSCs do not need to be established as separate legal entities. Due to the more advanced technologies we could also see virtual SSCs in the future. Also, for them, common products and processes (including IT) are critical success factors.

"SSCs are crucial in maximizing efficiency and effectiveness and in driving greater business value."

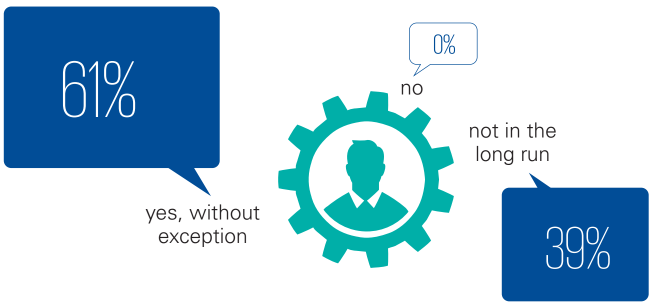
Gernot Gutjahr
Partner, CIO & CFO Consulting
KPMG in Germany

In spite of the different organizational structures and heterogeneous management strategies, 61% of participants assessed their company's current management approach and corporate set-up as fit for the future "without exception" worldwide. A considerable 39% may consider the situation tenable for now but "not in the long run".

Regional fluctuation in the responses to this question were also noticeable here. In Europe only 47% rate their current management approach and corporate set-up as fit for the future compared to the global figure of 61%.

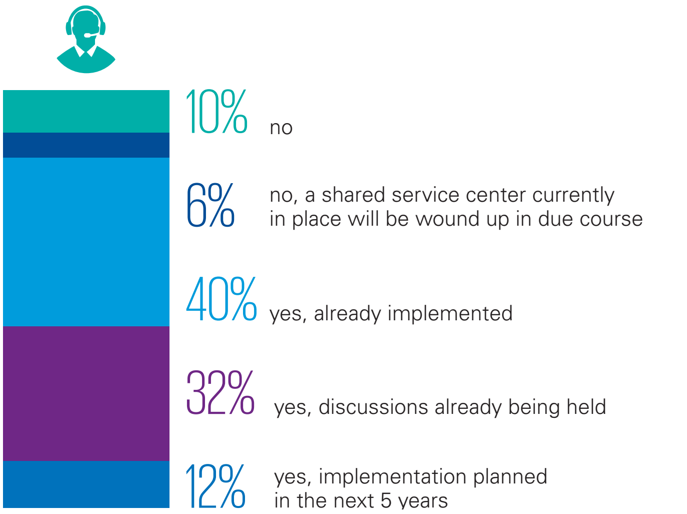
Europeans see room for optimization within their management approach.

Do you consider the current management approach and corporate setup as fit for future?



Source: KPMG in Germany, 2017

Is the idea of a shared service center relevant for your company?

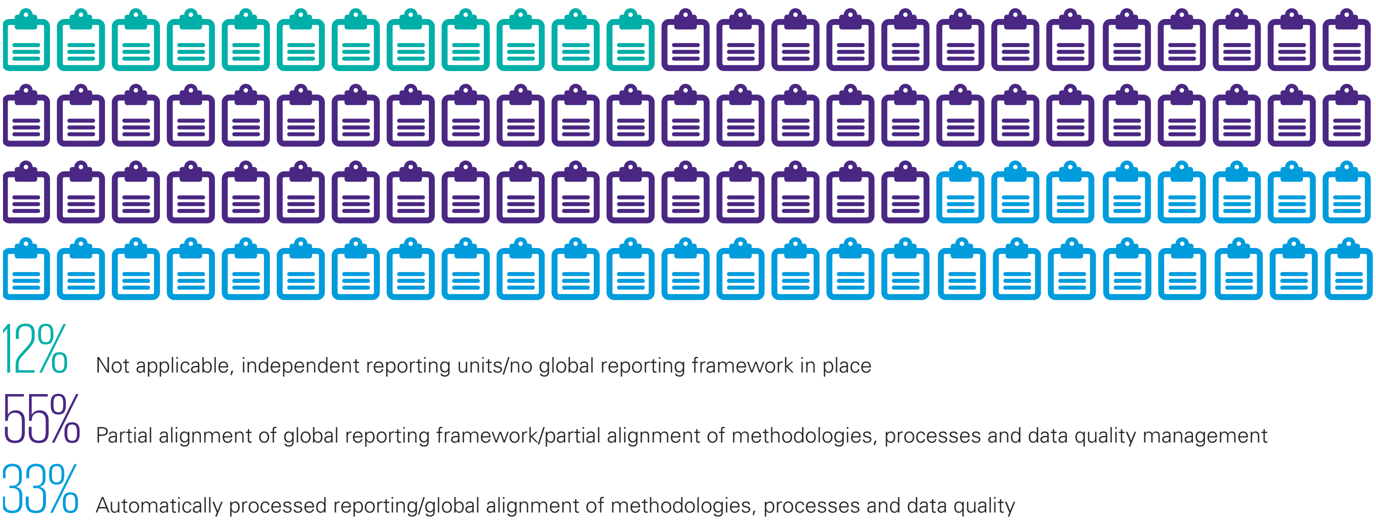


Source: KPMG in Germany, 2017

But what else is relevant for the long-term success of automotive finance companies? We believe that automation is key for the Business Model 4.0. Therefore, we asked all participants for the degree of automation used in their governance and management reporting. Only 33% of all participants stated that they already have automated reporting, global alignment of methodologies, processes, and data quality management processes. Meanwhile, 55% reported partial alignment of their global reporting framework or partial alignment of methodologies, processes, and data quality management.

We believe increasing regulatory pressure will lead to further optimization of reporting and steering processes and will demand integrated data warehouses for risk data aggregation and data quality purposes.

Which structures has your company implemented for governance and management reporting?



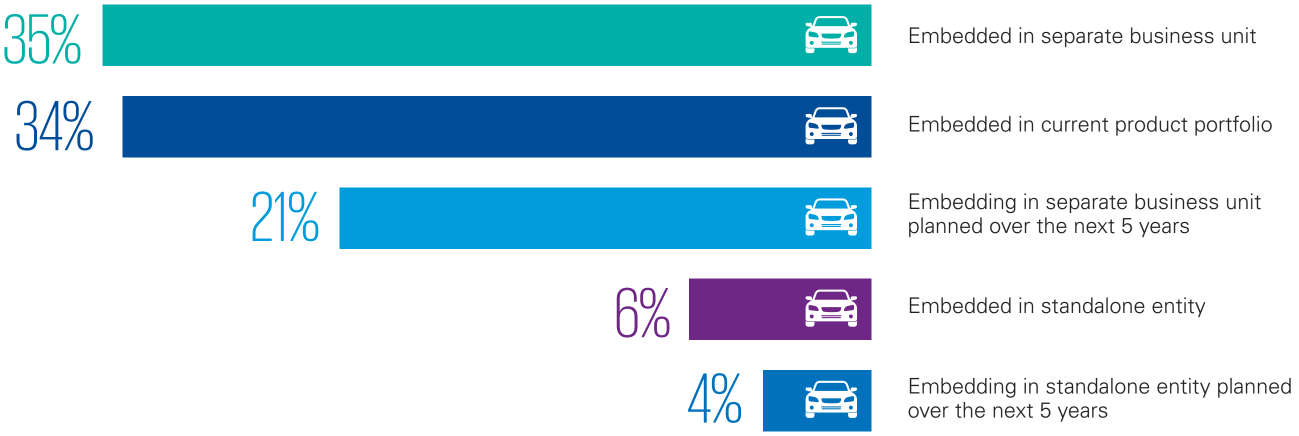
Source: KPMG in Germany, 2017

Another reason why captives need to transform their business model is the new mobility services. That's why we asked our participants what corporate set-up their company is using for mobility products and services, such as rentals, car and ride sharing, and payment solutions. Interestingly, 34% of participants have embedded mobility products and services within their current governance structure.

At 35%, the most common approach was to embed these into a separate business unit, with 21% also planning to do this in the next five years. By contrast, only 6% have embedded these in a standalone entity, with another 4% planning to do this in the next five years.

We believe mobility products such as pay-and-go car use and related products, will become an integral part of product and services portfolios in this area, especially in big cities and megacities. Mobility products will contribute up to 30% of the total revenue stream by 2025. We therefore recommend companies in this area carefully analyze the role of mobility in their company structure and business model.

What is the corporate setup for mobility products and service offerings such as rentals, car and ride sharing, apps, fuel cards and payment solutions in your company?



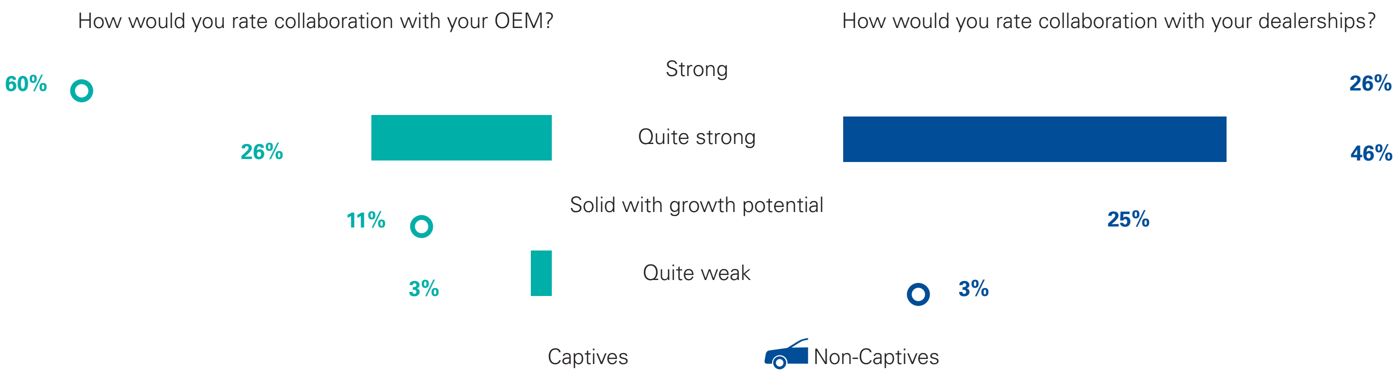
Source: KPMG in Germany, 2017

But who will be influenced by the changing market conditions and the transformation journey? It is not only captives that need to find their place in the new world. Thanks to changing business models, new requirements that must be met by organization structures and management structures, and the increasing pressure of competition, OEMs and dealerships are also facing their own share of challenges.

The transformation of captives to Business Model 4.0 will change the relationship between captives, OEMs and dealers. A large percentage of captives in our survey (86%) rated the current state of collaboration between captives and OEMs as strong or very strong. By comparison, fewer non-captives considered their collaboration with dealerships as strong (72% rated their collaboration as strong).

These relationships will be impacted by the transformation journey. While OEMs need to find their place in the new world of electro mobility and connected cars, captives will face increasing competition from new market entrants and need to adjust to changing customer behavior. The possible result may be a breakdown of the OEM and captive relationship in the future. Captives may become standalone entities in order to survive.

And what will happen with dealers? How will the relationship between non-captives and local dealerships change? These are under pressure for a variety of reasons. These include new competitors entering the market with tempting offers aimed at the dealerships, digitalization increasing online sales and shrinking the power of local dealerships in the sales process, and pressure also from new expensive models such as electric cars requiring dealers to make more substantial investments, possibly leading to further consolidation of dealerships. The consolidation of dealerships in turn could increase the power of dealerships, enabling them to fund themselves via the capital market rather than using a financing solution provided by a captive. Combined with their access to customers, this could help to balance the situation in this competitive market.



Source: KPMG in Germany, 2017

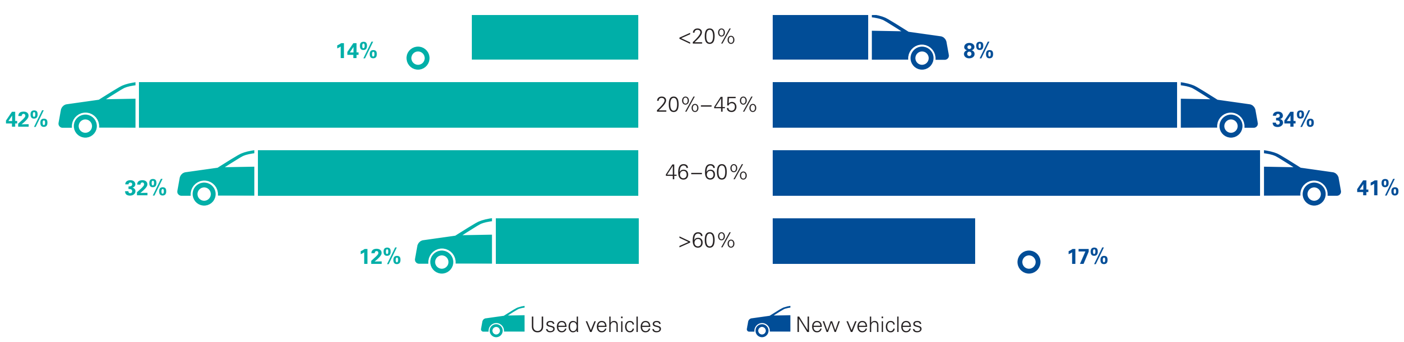
Digital transformation – captive finance in the digital era

How will digitalization and predictive data analytics change the world and influence the automotive finance industry? Those new technologies might benefit or harm captives. They will enable the automotive finance providers to better predict customer expectations and offer new products and services depending on the needs and behavior of the customers. This will make the businesses more efficient and customer-oriented but at the same time pose new challenges because of the increasing competition from innovative and digital startups. That's why we investigated the way traditional automotive finance providers need to transform their businesses to survive in this new digital world.

How has customer behavior changed in the past couple of years? At the most basic level, we can surmise that today's digital customers are very different to those of ten, five, or even two years ago. People are now using the internet around the clock, whenever and from wherever they want. Customers want to be able to communicate and acquire up-to-the-minute information in real time, making financial decisions now rather than tomorrow. In this digital age, customers are increasingly turning to the internet to research and purchase automotive finance products and services. With competitors just one click away, it is vital that captives respond to this strong customer need – a basic in the modern world.

We asked the participants in our survey what percentage of customers in their country they believe are purchasing automotive finance products and services online. We differentiated here between new and used vehicle purchases, as we believed this was likely to differ based on our previous experience in the sector. 41% of all participants believe that finance-related products and services for 46-60% of new vehicles are purchased online. However, fewer customers purchase financial products and services online for used vehicles compared to new vehicles. That's why many captives are currently looking closer and improving their related IT infrastructure, e.g. used car remarketing online platforms and financial services sales channels.

What percentage of customers in your country purchases automotive finance-related products and services online (as of today)?



Source: KPMG in Germany, 2017

Automotive finance providers notice changing customer behavior and the increase in online purchases. This was also confirmed by the responses to our question regarding the participants' opinions of which automotive finance sales channel will dominate the market in five years' time. 40% of the participants believe that the internet and online channels will be the dominant sales channel in five years' time. Interestingly, only 16% of participants believed that captives would be the dominant sales channel in five years' time.

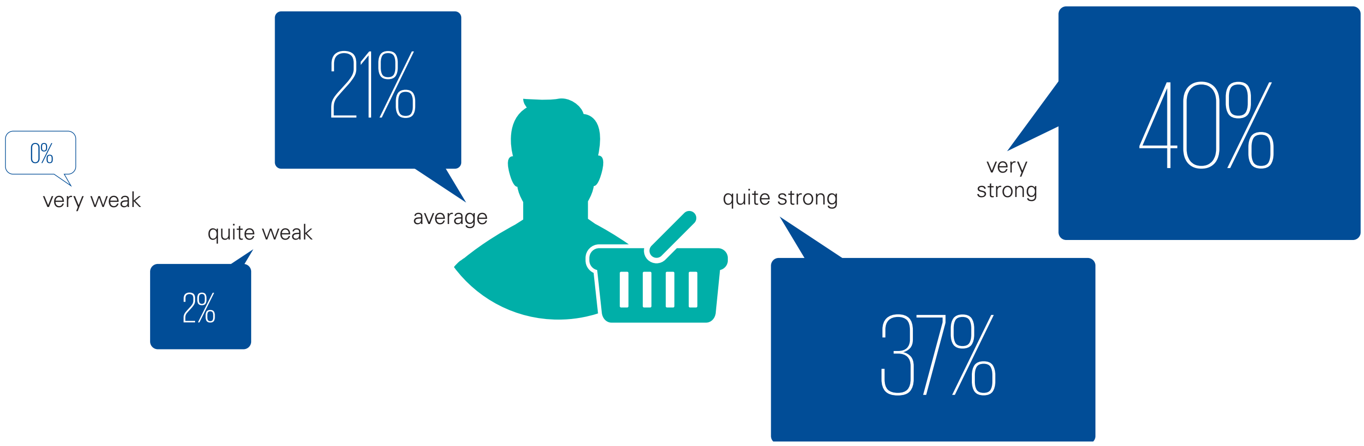
Which automotive finance sales channels will be predominantly used in 5 years?

Source: KPMG in Germany, 2017

The results highlight that online sales are becoming more and more important which confirms captives' need to invest more in their online sales channels and predictive data analytics to respond to customers' expectations.

We asked the participants how well their companies respond to market needs and customer behavior. Most of the participants in our survey were satisfied with their sales organization's responsiveness to market needs and customer behavior. A considerable 77% assessed their customer experience processes as strong while only 21% believed their company's performance is average.

How would you rate your sales organization in responding to market needs and customer behavior (i.e. customer centricity), including processes and applications?

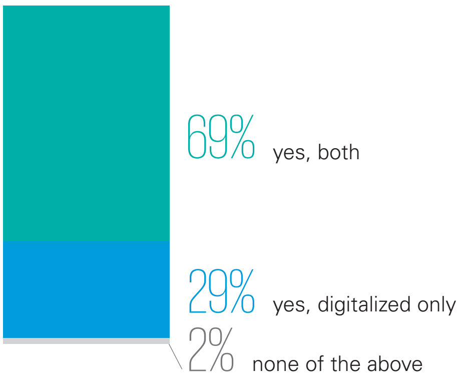


Source: KPMG in Germany, 2017

The digital world and the digital customer are universal trends that have not left the automotive finance sector untouched – finance captives must act now to remain relevant. Captives need to transform their customer journey to an online platform with real time information and that is easily accessible by smartphone.

In order to examine the extent to which captives have kept up with these changes, we asked our participants whether the companies they represent had completely digitalized their front-end applications and processes, including customer contact applications, to offer real-time functionality. Reassuringly, nearly all (98%) had digitalized the customer application process, 69% had implemented real-time processes as well.

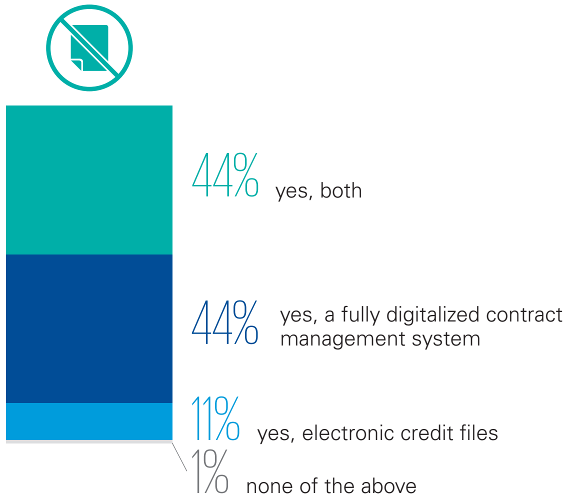
Are your front-end applications and processes including customer contact applications fully digitalized and real-time?



Source: KPMG in Germany, 2017

Digitalization also offers efficiency potential in the back-end, especially when it comes to contract management and credit file systems. 44% of the participants digitalized both contract management and credit file systems, another 44% only digitalized their contract management system while 11% digitalized their credit files system only.

Do your back-end applications incorporate a paperless, fully digitalized contract management system and electronic credit files?



Source: KPMG in Germany, 2017

Fully digitalized back-end processes including electronic credit files are highly beneficial as customer processes increasingly tend to be completely driven by electronic devices. Paper-based processes are no longer enough to satisfy all customers' needs, and finance captives should upgrade these as soon as possible.

When looking at the overall IT architecture, an impressive 94% of the survey participants assess their company's overall IT architecture as fully efficient and effective (48%) or quite efficient and effective (46%). This includes front and back office systems, processes, and data warehouses in respect of their sustainability and ability to adapt to imminent changes in customer behavior and the market environment. Only 6% described their architecture as inefficient and ineffective.

How would you rate your overall IT architecture, including front office, back office, processes and data warehouse, as being sustainable and up-to-speed considering imminently changing customer behavior and market environment?

48% fully efficient and effective

46% quite efficient and effective

6% quite inefficient and ineffective

Source: KPMG in Germany, 2017

This suggests that automotive finance companies covered by our study are perhaps suffering from overconfidence.

"In our view, substantial investments in IT infrastructure and big data capacities are still necessary to replace legacy and heterogeneous IT systems. The transformation of their business model into an open platform for financial and mobility services will enable the automotive finance providers to reap the full benefits of digitalization, better understand their customers' needs and manage all customer touchpoints."

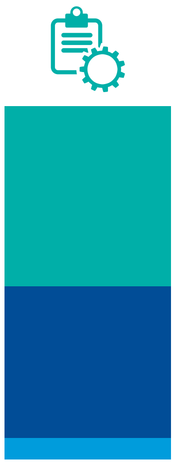
Johannes Riedl
Senior Manager, Financial Services
KPMG in Germany

A digital and leading IT infrastructure is essential to cope with increasing competition, regulatory threats, and business model transformation. IT is a success factor in serving customer needs and gaining efficiency in mass transactions such as retail business. In fact, we have already observed how the captives sector has initiated many projects aimed at restructuring the IT infrastructure and implementing new contract management systems (CMS). Increasing capacities in this area alone demands the investment of extensive time and resources to improve current IT architecture.

Another challenge captive finance providers need to grapple with is the increasing complexity of business processes and regulatory requirements. These demand highly flexible data systems that allow companies to respond promptly to the resulting rapid changes in the market environment. An integrated risk and finance data warehouse is therefore an integral component for any modern captive finance provider, combined with an efficient tool for management, monitoring and steering.

Our survey revealed that half of represented companies have already implemented such a system, while 43% are planning to implement such a system within the next two years. Only 6% do not yet have such a system or any related plans.

Is an integrated risk and finance data warehouse with adjustable reporting processes implemented in your company?



51% yes, already implemented

43% implementation planned within 2 years

6% no/not yet planned

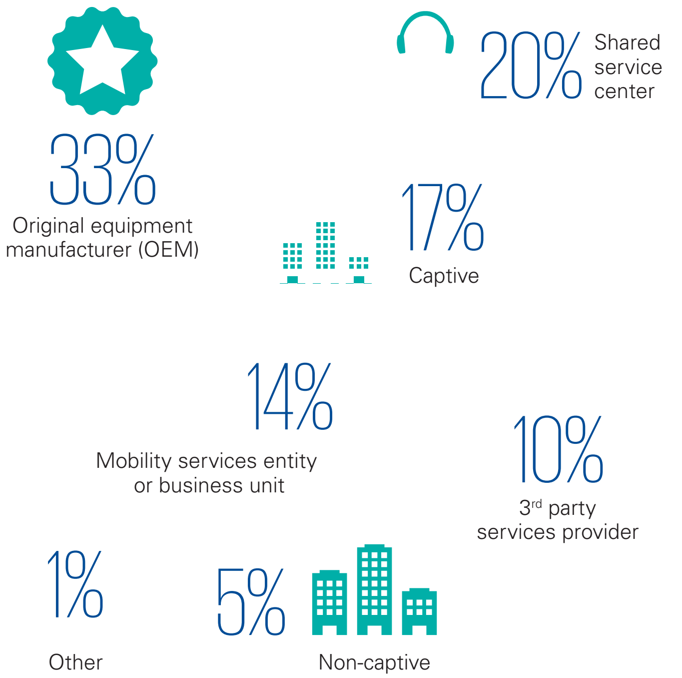
Source: KPMG in Germany, 2017

Obviously, implementing an effective integrated risk and finance data warehouse means that the automotive finance provider must have access to, or even ownership of, the most relevant data. With this in mind, we asked our survey participants which entity or business unit in their company owns and is responsible for customer data and derived insights.

Our survey revealed that customer data is taken care of by a variety of entities in our participants' companies. In one third of the cases, the OEM handles the customer data. In 20% of the represented companies this data is handled by shared service centers and in 17% by the captive themselves.

We believe that captives are the real beneficial owners of and experts in turning customer data into value as they can provide additional services real time to customers and have permanent customer contact for the whole contract and/or customer lifetime. For this reason, we advocate closer collaboration and more data sharing between captives and their respective OEMs.

Which entity or business unit in your company takes care of customer data including big data? (customer data ownership)



Source: KPMG in Germany, 2017

"Data is gold. Security, trust and ownership are key and that different cultures handle data differently has to be considered."

Daniel Chan
Partner
KPMG in China

Products and services – innovation is key for customer experience

The automotive sector as a whole is in a state of transition, with customers expecting new and different products and services better tailored to their needs. Looking deeper at how the automotive finance sector may evolve, we asked participants what products and services they believe their customers will expect to be able to obtain through automotive finance providers in five years' time. The results suggest that financing will continue to form the core business in the future in terms of customer expectations.

Mobility is increasingly being seen as a service, or a commodity available upon request, anytime and everywhere, and fully customized to the customers' needs, which may mean automotive finance captives will need to diversify as customers begin to expect non-traditional services.

"Automotive finance companies need to be passionate about all forms of mobility in the future. Customers need Automotive finance companies not only to cover their mobility needs. They should also offer flexible service packages and payment facilities along the journey."

Christian Fitz
Senior Manager, Financial Services
KPMG in Germany

What does your customer expect to retrieve from automotive finance in 5 years? *(Multiple answers possible)*

38% Finance

31% Leasing

26% Fleet management

Direct banking 26%

All of the named PLUS non-automotive finance services and products 10%

30% After sales services

29% Mobility or other service solutions

27% Insurance

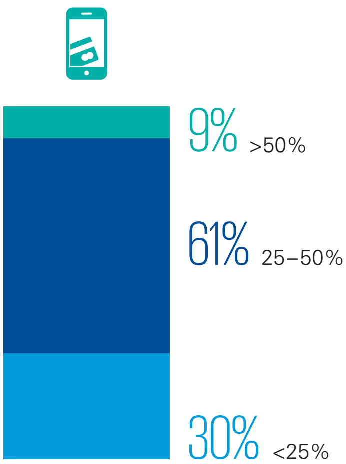
All of the named 10%

Source: KPMG in Germany, 2017

Looking closer at mobility and digital services beyond traditional automotive finance products, we asked our participants how much they believed this area would account for in terms of their company's net sales in five years' time. A significant 70% of participants believed that new mobility and digital services would make up to more than a quarter of their net sales in five years' time.

The results make it clear that a new customer journey which includes fully integrated new mobility and digital services is expected to contribute a significant portion of net sales in the future. This is a new age for which captives must be ready! Transforming their business models as well as investing in IT-landscape, infrastructure and culture will enable captives to satisfy customer needs and ensure a better customer experience.

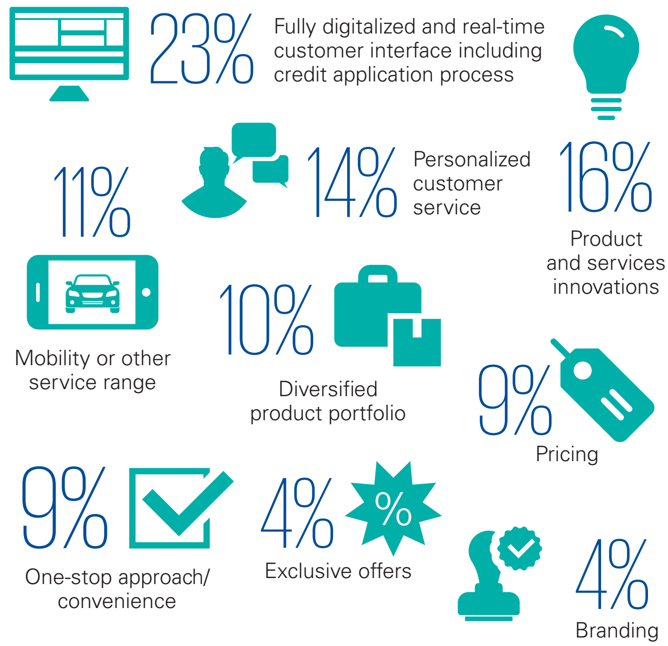
How much will new mobility and digital services contribute to your company's net sales in five years as opposed to traditional automotive financial services products, such as financing?



Source: KPMG in Germany, 2017

To clarify in which direction captives need to transform themselves to ensure a better customer journey, we asked our participants which top three of the defined criteria they believe are driving customer experience in automotive finance in their respective countries. There was quite a spread of results, although fully digitalized and real time customer interfaces, including the credit application process, came out quite clearly in the lead. This is because customers are impatient. They want a fully digitalized, real-time customer interface that even includes digital customer identification (through video and iris scan, for example) and paperless credit applications. Product and service innovations and personalized customer service was the second most chosen answer.

Which are the top three criteria driving customer experience in automotive finance in your country?
(Closed question)



Source: KPMG in Germany, 2017

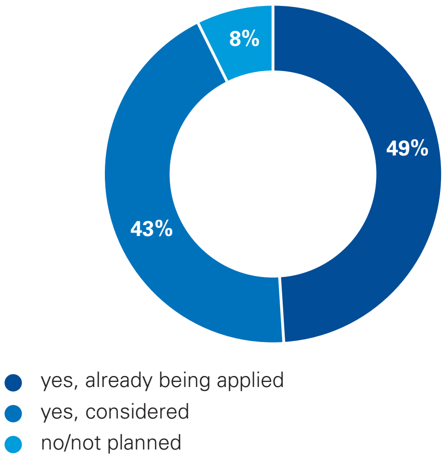
For captives to be able to respond to the individual customer behavior and needs and to offer personalized services, it is essential that they use predictive customer analytics and related data. Investment in integrated data warehouses is required to reap the full potential, to enable captives to obtain valuable customer insights and predictive data.

"Analyzing customer data together along-side vehicle data allows automotive captives to anticipate the needs of their customers and target more efficiently."

Thomas Lechte
Partner, Financial Services
KPMG in Germany

The organizations covered in our survey showed increasing interest in predictive customer analytics. Nearly half (49%) are already applying predictive customer analytics, while a further 43% are considering applying them.

Does your company apply predictive customer analytics?



Source: KPMG in Germany, 2017

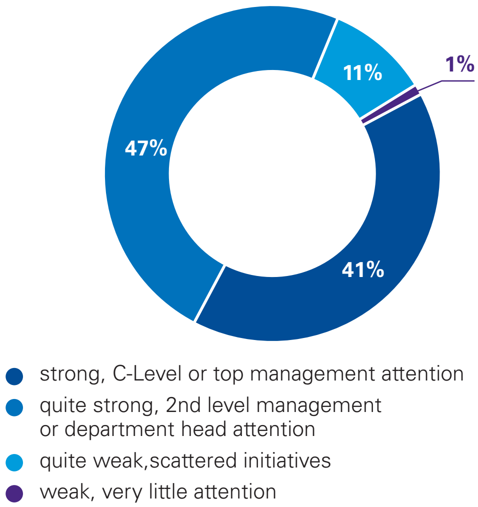
Captives should also offer loyalty programs for collecting customer data which will enable them to offer personalized products and services and make individuals feel special and important. That's why we were curious to find out whether loyalty programs were being considered by automotive finance companies. The results confirmed that 82% had considered the idea, while 11% had gone so far as to implement such a scheme.

We expect more captives to initiate loyalty programs for their customers in the future based on the majority that are thinking about implementing a loyalty program. Unlike some other sectors, captives face the challenge of collating information from different interfaces with the customer: at the level of OEMs, dealers, and captive finance providers. Once these perspectives have been collated and customer touchpoints defined, it would be sensible for all parties to join forces, share data, and pursue a joint customer loyalty strategy.

Another factor that was defined as having a major impact on the customer experience is innovation. A strong commitment to innovation is important in nearly every business including captive finance providers. If innovation is not taken seriously at the top layers of management, there is a risk that a business can stagnate as it is overtaken by more innovative competitors.

We asked our participants what their company's stance was towards innovation management in products and services, and the results were very encouraging. In 88% of companies, innovation is driven by either top or second-level management or department heads.

How would you rate your company's stance towards innovation management in products and services?



Source: KPMG in Germany, 2017

Innovation alone is not a panacea – it must be supported by investment in other key areas – but it is a vital ingredient to ensure captives' survival in an increasingly competitive environment. Innovation must also be encouraged and supported from the very top, and supported by a deep understanding of customers' current and anticipated needs.

The critical role of innovation is also reflected in new organizational structures found in some captives. For example, we are now seeing senior positions created for a CDO (Chief Data Officer), responsible for data governance, data coordination, and data analytics across the entire organization. Innovation cannot be predicted or calculated – but with proper management, it can be encouraged, supported, and increased.

"In our view the creation of such a CDO role is a first step in order to support innovations in digitalization. The key success factor is to consider it as a cultural change and assess whether the mindset of the current organization is fit to support innovation."

Ulrich Bergmann
Partner, Financial Services
KPMG in Germany

Regulatory challenges lying ahead - playing by the rules

Captives face many challenges which they have to overcome to stay competitive and successful. With that in mind, we asked our participants which major changes and challenges they expect to have a significant impact on their business operations and strategic outlook. We asked them to select three major changes and challenges they envisaged as having a local impact in the next five years.

Unsurprisingly, most of those surveyed believe that digitalization and big data will represent the major change and challenge to the automotive finance sector followed by changing customer behavior, predictive customer analytics, new products and services like mobile payments, mobility as well as changes in the regulatory requirements.

Which major changes and challenges will significantly impact your business operations and strategic outlook? Please name three major changes and challenges locally envisaged over the next five years.
(Multiple answers possible)

12% Risk management framework, data warehouses, data governance, data quality

Customer behavior, predictive customer analytics, new products and services like mobile payments, mobility 42%

41% Costs, competition, changing economic environment

Digitalization, Big Data 55%

40% Regulation and corresponding change management processes as well as implementation

Source: KPMG in Germany, 2017

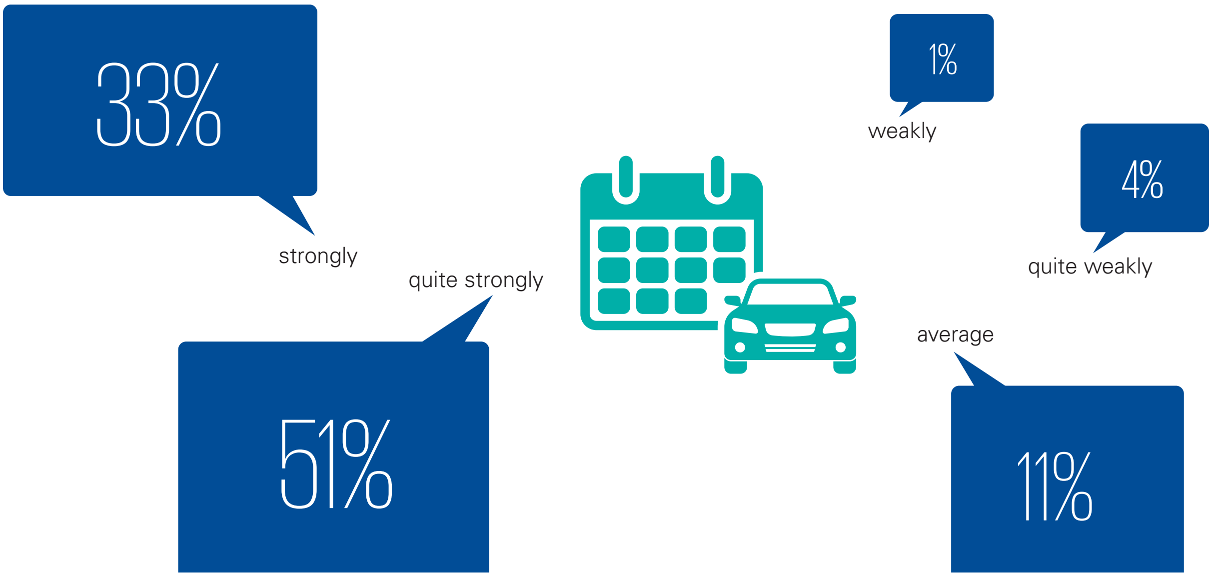
In our opinion, investment in 'new world' technologies (digitalization, new customer channels, big data, and predictive customer analytics) will be key to surviving in an increasingly competitive environment. However, regulatory and data security requirements must also be given due consideration. With the finance market and financial technologies becoming increasingly regulated at the national and international level, stakeholders should be watching developments closely to see how new regulations may affect the automotive finance sector. As an example of today, companies may have experienced the increasing level of customer protection rights across the globe. That's why we decided to examine how the companies represented in our survey assessed the potential impact of regulation on their businesses.

Our survey confirmed that a substantial 84% of the survey participants believe that the regulatory environment will strongly/quite strongly influence the developments and trends in the automotive finance landscape.

"Increasing regulatory requirements and more intensive supervision will further increase regulators' appetite for data. The result will be considerable investment in infrastructure driven by increasing regulation."

Raimo Werning
Manager, Financial Services
KPMG in Germany

How do you think regulation will influence the developments and trends in the automotive finance landscape in your country over the next 5 years?



Source: KPMG in Germany, 2017

As the development of the regulatory landscape is seen as a major driver of the trends in the automotive finance environment, we recommend that captives closely analyze and monitor regulatory developments, anticipate trends, involve themselves in consultation phases and find ways for efficient and effective implementation. Moreover, captives should plan an appropriate budget for regulatory and compliance activities.

That's why we asked the participants what percentage of their company's investment budget will go towards regulatory and compliance activities over the next five years.

The results indicated significant investments, with 20% of the represented companies planning to invest more than 60% of their total budgets in this area. 44% of the represented companies will invest between 40-60% of their total budget in regulatory and compliance activities.

"Automotive finance industry has gained increasing awareness of regulatory authorities over the last years. We do strongly recommend building up resources that are technically able to communicate with regulatory bodies at the same level."

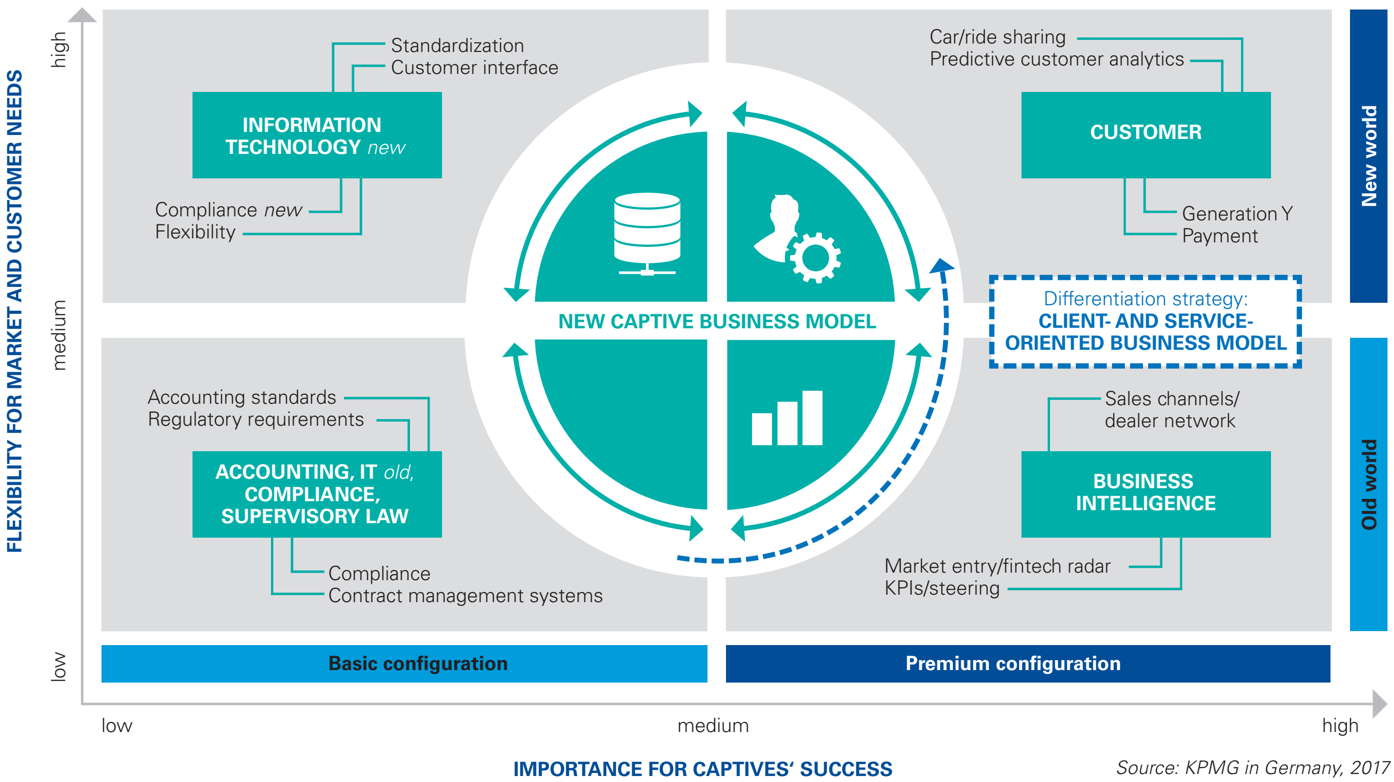
Ulrich Bergmann
Partner, Financial Services
KPMG in Germany

What percentage of your investment budget is shifted towards regulatory and compliance over the next 5 years?

Source: KPMG in Germany, 2017

Unfortunately, other market participants that are currently not as strictly regulated (e.g. fintechs) are currently enjoying a competitive advantage, as they can allocate their investment and project budgets elsewhere, giving them more space to reshape the future with other activities. However, this is very likely to change in the future, and captive finance providers will benefit from early investment in the necessary infrastructure to support current and future regulatory and compliance activities.

Results of the survey – it's time to change



Source: KPMG in Germany, 2017

The survey results underline the opportunities and threats that the automotive finance sector, especially captives, are facing. This industry has been spoiled with success stories in the past couple of years but it's now time for a transformation to stay as successful. Increasing competition from innovative start-ups and new market entries is putting pressure on captives. Captives need to setup their legal structure and their culture to support their transformation journey as well as integrate the new technological trends and digitalize their IT-landscape. Moreover, they need to determine customer needs and expectations to be able to offer new, innovative and personalized products and services as well as follow all national and international regulations.

The respondents highlighted that many different types of new market entrants are expected to capture market share. These include retail banks, fleet management and leasing companies, mobility service providers and fintechs. Moreover, fast growing start-ups and fintechs are challenging and disrupting the automotive finance sector. However, the strong collaboration between OEMs and captives is still a strong advantage, while the transition from ownership to usership offers new players room for business. This is creating downward pressure on margins, especially on standard products and in some niche sectors. Captives are shown to be responding through collaborations, joint ventures as well as mergers and acquisitions.

An appropriate governance structure clearly leads to a competitive advantage and supports the transformation. But what is the perfect structure? Captives have made different choices on where to position themselves on the spectrum between fully centralized and fully decentralized, and have also taken different decisions on the extent to which they use shared service centers and outsource to third parties. There was no clear consensus on whether market developments would drive manufacturers and finance captives apart or necessitate closer collaboration, or on how the increasing use of online services will change dealerships' business models and consequently their relationships with captives.

For captives to be able to overcome the increasing competitive pressure and gain competitive advantage, they should fulfill the customer expectations by integrating new technological trends and predict customer needs. The respondents identified the three aspects where technology and data were having the greatest influence on captives. These were digitalization, the use of big data to understand and predict customer behavior, and the importance of providing online real-time customer service. Respondents recognized both threats and opportunities in these developments. On the positive side, captives were seen as being in a good position to exploit technology and data to drive business opportunities. Efficient and effective technology, high quality data, and data analytics were seen as key to servicing customer needs and satisfying customers' desire to access products and services via digital channels. This would help increase long-term profitability through cost reductions, good data management, careful maintenance and improvement of operational resilience, and strong risk governance.

Digitalization and the growth in online interactions are driving a renewed interest in customer- centricity. Firms are increasingly recognizing the value of understanding and being able to predict customer behavior in the digital age, which can also help them to provide competitive, tailored and real-time products and services. Meanwhile, OEMs are moving away from hardware (products) and focusing more on software (services), which will in turn have implications for captives. Moreover, the survey results also confirmed the rising importance of mobility products and services, especially in major cities.

Another major challenge that captives are facing, is the growing impact of regulation, both now and over the next five years. Regulation is believed to be focusing increasingly on consumer protection – the fair treatment of customers across all stages of the customer journey – and on outsourcing, where firms will need to retain sufficient knowledge and control to meet their ongoing responsibilities. The burden of regulatory reporting is also likely to further increase. Firms are making substantial investments to meet the challenges in this area, but these investments are not always well aligned with business needs.

The results of this survey draw conclusions that pave the way for the new integrated captive business model 4.0, ensuring the future success of captives. It became clear that the success of the future business model for automotive finance companies will depend significantly on providing digitalized, customer-specific financial and mobility services. Big data analysis and predictive customer analytics are the key to developing the products and services that will speak to the markets of the future.

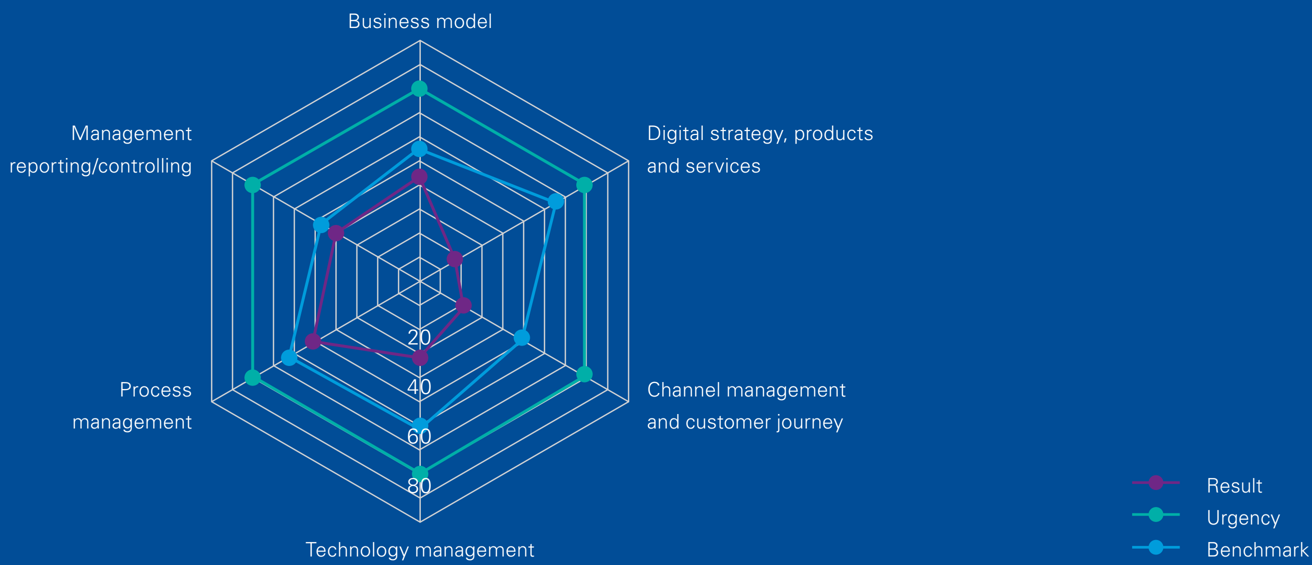
KPMG Atlas

Defining your position and recommending action based on KPMG's Business Model Readiness Assessment (Captives)

The wisdom of crowds:
Interviews with selected employees on different topics such as business model, digitalization, customer channels, process management, technology, reporting and overall management. We then analyze the results in a holistic and multi dimensional manner.

Perspectives and action items – identifying future challenges and key action areas. Based on the target picture defined by you, we work with you to develop perspectives and action items to transform your business model.

Graphic presentation of results (example)



1. Leverage expertise
The expertise of your managers and employees, if required also of your external partners, is channeled into each analysis – the number of participants is unlimited. Interviewing participants from all company levels gives you an overall picture on an issue within your organization.

2. Compare
Once you have completed your Business Assessment, we begin our analysis and supplement your report with the benchmarks relevant to you. You also receive specific recommendations for action from our professionals.

3. Drive transformation
Using an innovation concept tailored to you (including based on creative workshop methods like 'design thinking'), we work with you to develop the objective for a business model

German version: **atlas.kpmg.de/captives**
English version: www.kpmg.com/captivefinance

Contact

KPMG AG
Wirtschaftsprüfungsgesellschaft

Ulrich Bergmann
Partner, Financial Services
T +49 89 9282 1070
ubergmann@kpmg.com

Christian Fitz
Senior Manager, Financial Services
T +49 511 8509 5469
cfitz@kpmg.com

www.kpmg.com/captivefinance

www.kpmg.de/socialmedia