NEUE REIHE »Mobilität für Deutschland«

# Vehicle-as-a-Service

## From Vehicle Ownership to usage-based Subscription Models

Individual car ownership has served its time. Young people especially but also older ones no longer want to fulfill the responsibilities of owning or leasing a car. New mobility solutions are needed that go along with the modern urge of flexibility and sustainability. But neither ride-hailing nor car-sharing are appropriate substitutes for car ownership. Vehicle subscriptions are an upcoming trend that, indeed, might be able to combine the best of both worlds. The authors outline the great potential of this new concept of mobility and how it works. (Red.)

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

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

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The global Covid-19 pandemic is further accelerating this dynamic. While it did not put an end to private and corporate mobility needs, it has certainly changed consumers' mobility preferences and further increased demand for flexible models. What consumers ultimately want is a service that makes their lives easier. That is why "one-stop-shop"-solutions such as vehicle subscription are flourishing.

### Market Outlook

Our base case scenario estimates that eight percent of all new vehicle registrations in the relevant customer segments – excluding original equipment manufacturer (OEM) and rent-a-car segment (RaC) – will be based on subscription models by 2025. In a disruptive scenario fueled by the increased demand for personal mobility during the Covid-19 crisis, the market share for subscriptions could increase upwards of ten percent (see figure 1). The majority of subscription sales will probably displace former leasing business, which is the auto finance product on today's market that comes the closest in terms of service and flexibility for end customers.

That means more than €22bn of new annual car financing will be up for grabs for new subscription providers by 2025. Yet subscriptions are not only a relevant channel for new cars. It is also expected that there will be a significant share of used vehicles to be offered in a subscription model in their second or third lifecycle. This market shift is expected to continue to accelerate in the 2nd half of the decade.

### The Best of Both Worlds

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

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

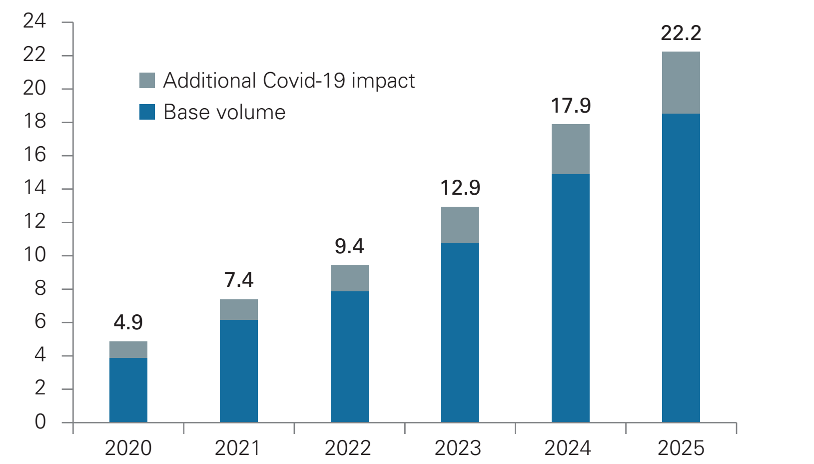
To ensure that subscriptions are less a recycled leasing deal and more a fully-fledged product, a compelling value proposition based on a dedicated strategy for subscription products has to be created. Some core value propositions for subscription models are mentioned in the following:

- **Digital Experience:** Give customers a highly intuitive and seamless digital process for vehicle orders (without the typical break points of the conventional process).
- **Simplicity:** Structure your offerings in a self-explanatory and modular way to ensure that future customers are not overwhelmed by a huge variety of options.
- **Convenience:** Include all relevant services in the subscription model to give customers peace of mind while operating the vehicle.
- **Flexibility:** Offer a certain level of flexibility above and beyond relatively short minimum terms and notice periods.
- **Availability:** Make sure subscription vehicles are ready to be picked-up/delivered within a few days or weeks in order to contrast with the long wait associated with purchasing new vehicles.
- **Continuity:** Forget about those fixed expiration dates common with lease agreements and trigger "endless" contract renewals and customer relations.

## Subscription in Detail – Product Features

To provide guidance and help simplify the subscription development process, eleven universal design choices (see figure 2) were identified that draw a clear contrast between subscriptions, leasing contracts and long-term rental.

Figure 1: Subscription Share of New Vehicle Registrations in EU-Markets for Private and Corporate Customers* (€bn)




* excluding OEM & Rent-a-car segment

Source: Deloitte Analysis

The way you configure these eleven design choices will impact both the market success (revenues) and the degree of internal complexity (costs) leading to a strategic trade-off between more flexibility for customers and higher costs. If customers are not willing to pay a premium for additional flexibility in your subscription model, it is not very likely to succeed. Customer centricity is the key to success for any subscription offering.

To date, sales channels in the automotive industry have been linear and well-protected from new entrants. Indirect sales via established dealer networks have been the industry standard for business-two-consumer sales. Scarce real-estate and an asset-heavy sales model that relies on bricks-and-mortar showrooms created high barriers of entry for new players looking to start a vehicle sales operation.

## Market Landscape – Player Archetypes

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

Existing players from OEMs, dealers and captives to leasing and rental companies often see subscriptions as a supplementary product line enabling them to better utilize their existing vehicle fleets, in most cases with their own existing brands. Pure-play subscription providers are fully dedicated to subscriptions based on a fleet of vehicles under their own brand.

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

## Optimizing Lifecycles

Offering several mobility products and services helps unleash the true strategic value of subscriptions. As part of an end-to-end mobility product mix, subscriptions generate profits on their own, but not only. Subscription business models can also act as strategic building blocks that allow companies to optimize asset utilization across the entire vehicle lifecycle.

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

For these vehicle-as-a-service business models to work, however, decisions about which vehicle should be used for which channel at what point in time will be crucial. Before the start of each vehicle lifecycle, providers will have to make an informed decision about the most profitable (next) cycle for each individual vehicle (see figure 3).

Vehicle subscriptions are an important addition to the product portfolio, in that they provide a "happy medium" between short-term vehicle deployment (such as part of a car-sharing fleet) and a long-term commitment (for example, with a lease agreement). This additional option makes it easier to retain customers and fully utilize the asset value.

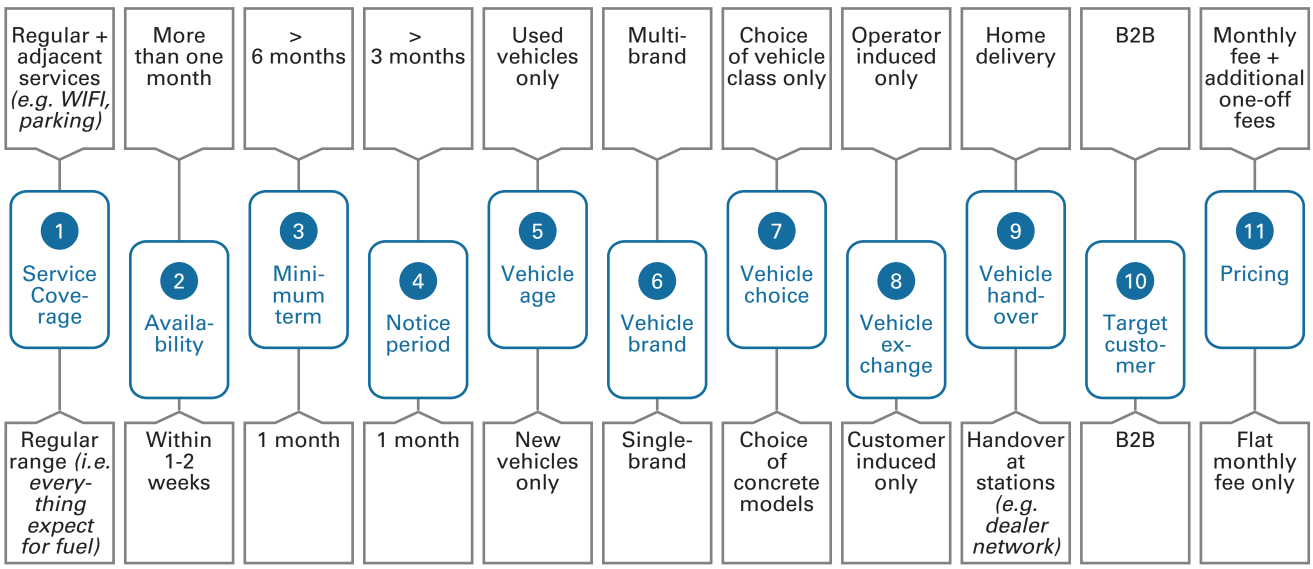
## Critical Capabilities and Operating Model Design

Whatever the final design of the subscription product, providers must establish certain capabilities to generate profits with a subscription model. Although they will ultimately require full functionality, the real question is how best to structure each operating model.

For many providers, it will not make sense to be active across the entire value chain, but rather to partner with other companies that can assume responsibility for some of the necessary steps at a low price. Outsourcing is an important keyword for that purpose.

- **Funding and Financing:** Customers do not own the vehicles in a subscription model, which means another entity has to have them on their books. Where the subscription provider and the asset owner are the same entity, the provider must either have sufficient financial resources to fund its growing balance sheet or access to cheap debt capital or external funding at a minimum.
- **Asset Sourcing, Remarketing and Risk Management:** In order to maintain a low-cost base over time, subscription providers need to source their vehicles at a competitive price, closely manage residual value risk and ensure that asset utilization and vehicle resell rates are high.

Figure 2: Subscription Product Design Spectrum

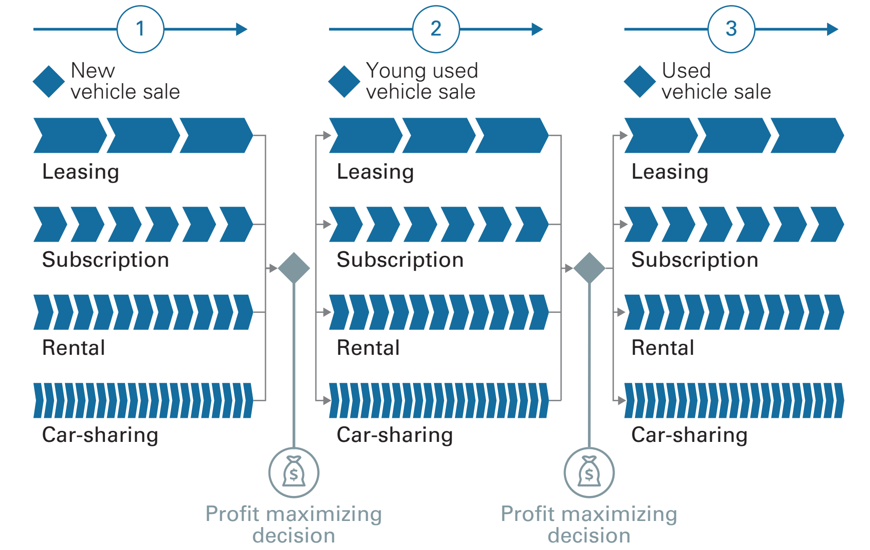



Source: Deloitte Analysis

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

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

Figure 3: Vehicle Lifecycles – Sales vs. Usage-Based Deployments (simplified)




Source: Deloitte Analysis

## Action Items for Incumbents

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

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

Therefore, incumbents need to act on the following items:

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

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

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

› Optimize asset pool utilization using analytics-based dynamic pricing.

› Build a multi-brand strategy (particularly relevant for captives and OEMs).

## Who Is Best Positioned?

The automotive trend away from ownership towards usage-based models is gradually picking up speed. While mobility offerings such as car-sharing are clearly the answer for short-term mobility with maximum flexibility, we have seen a gap in the market for mid-term flexible mobility solutions.

That gap is now being filled by vehicle subscription models, which are expected to account for more than ten percent of new vehicle registrations for private and corporate customers by 2025 in Europe's core markets. Start-ups developing intelligent digital platforms for fleet management or companies heavily backed by venture capital are poised to disrupt the market and capture market share from incumbents (meaning OEMs, Captives, LeaseCos).

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Yet these incumbents are still capable of winning the day, maybe even generating the most profit from current market trends in the end. With their vast experience in related products such as leasing and long-term rental, existing players already have some of the necessary capabilities in place to quickly scale a new subscription business. Shifting from a siloed product view to a holistic subscription offering they can leverage the strategic advantages of subscription to supplement existing leasing, rental, car-sharing and used vehicle sales.

If, however, they do not succeed in building a competitive digital platform that can effectively manage direct sales as well as customer relationships, they may be relegated to working as asset managers for a new tech-based platform provider. There are already several companies in a favorable position to capture a significant share of this new market. Too late to hesitate – the time to act is now.