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The Future of the Canadian Automotive Sector

Introduction

The verdict is in: Canadian customers are demanding a digital future for their automotive purchasing and leasing experiences. Digital platforms are capable of providing superior user experiences: they are simpler, seamless and time-saving.

“People feel that they can buy pretty much anything online,” explains Murad Baig, Chief Innovation Officer at [NETSOL Technologies](#) and Chief Product Officer at [Otoz Mobility](#). “The growth in digital-only car sales is a natural extension of the broader adoption of online retail.”

Clearly, customers are growing more adamant about making their car acquisition a frictionless experience, leading more of them to pursue digital options. However, digital transactions for car sales present a few unique logistical differences between retail in other sectors. This white paper will map out the future of auto lending, and provide insight into the consequences and opportunities of digital lending.

Impact of the COVID-19 Pandemic: An Increase in Digital Engagement

Prior to the pandemic, auto finance companies, dealers and Original Equipment Manufacturers (OEM) were slow to adopt a digital approach to the shopping, financing, and servicing journeys. While consumers frequently researched online and compared financing options, the full transaction was rarely completed without visiting a dealership. This no longer appears to be the case. According to the National Automobile Dealers Association (NADA), 16% of US sales in 2021 were completely online.

In Canada, the same trend seems to be occurring. According to data from Statistics Canada, the COVID-19 pandemic has accelerated the pace of this online transition by 4-6 years.

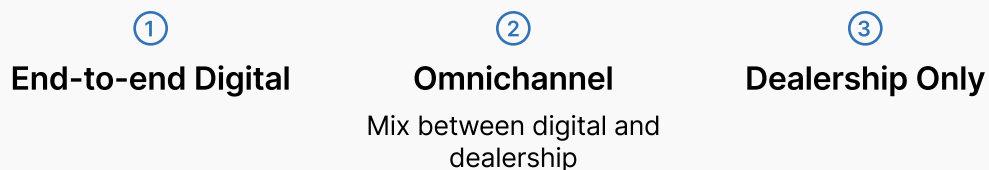
Motor vehicle and parts dealer (441)

Method	2016	2017	2018	2019	2020 (Jan. to May)
In Store	99.6	99.4	99.1	98.5	98.2
E-Commerce	0.4	0.6	0.9	1.5	1.8

Although Canada has not seen the same pace of growth in digital adoption as compared to other sectors, there was still considerable growth.

This change in consumer behavior is likely to continue as more Canadian consumers see what a convenient experience digital acquisition is. Consumer demand for digital will continue to grow, alongside a range of mixed models. The graphic below outlines some of these models:

Models of Acquisition



In each of these models, it's important to provide integrated technology to enable tracking the transaction progress between on- and offline elements without disrupting the customer exercising their choice of channel at any point in time. In particular, the hybrid model must have a robust technological infrastructure in place to ensure the seamless functioning of each transaction.

The move towards fulfilling and executing agreements electronically is a consumer preference here to stay; the trends accelerated by the pandemic's initial impact will be sustained by innovative fintechs that continually update and improve upon their models.

Companies should note that lead submissions from customers who have a previous purchase history with a brand are 3x as likely to result in a sale versus new customer lead submissions. However, as the pandemic winds down, consumers will increasingly find that new technologies are able to offer a compelling online journey. Thus, many consumers of the future may fully transition to using end-to-end digital solutions. This shift will be accelerated by technology adoption and changes to the nature of the OEM/dealer relationship. Furthermore, we will see the emergence of alternative mobility models such as:

1. Agency: The dealer functions as an agent of the OEM.
2. Build-to-order business: Involves a dealership customer submitting an order form and then waiting for the automaker to make the vehicle to specifications.
3. Direct: Allows customers to purchase or lease vehicles directly from a website; Vroom, Carvana, and Cazoo are all examples of this.
4. Short-term rentals: Customers are able to rent between a period of 12-24 months, typically with no mileage limits.
5. Subscriptions: Subscribers have access to multiple makes and models, often with roadside assistance perks and the ability to switch vehicles each month. An example of this is the Hertz "My Car" subscription program.

Online-only upstarts such as Vroom, Carvana, Clutch, Shift, Curbie, DriveAxis, CarDoor, Kazoo, Canada Drives have dominated the early eCommerce market for used vehicles. However, these companies only provide one of the five sales models mentioned above. In the online/direct space, **overwhelming feedback** demonstrates that Tesla provides the best customer experience. Yet customer satisfaction falls significantly post-sale when there is no one to follow up with them. OEM franchise dealers—dealer groups in particular—are best positioned to provide fully digital, in-store or omnichannel experiences for both new and used vehicles, along with the post sale service capabilities the upstarts lack. The infrastructure investments for inventory, reconditioning, delivery, marketing, F&A, etc. is already in place for this dealer group, providing a huge advantage.





Room for Improvement

Where many Canadian dealer groups have failed is in adding an eCommerce (or digital retailing) tool to their sites. The used-car startups have pulled ahead by focusing on the improvement of the digital experience. Vehicle merchandising is of utmost importance, creating an online showroom to draw customers in and display all their options. In contrast, OEM stores make it a secondary focus. Some US dealer groups have modeled this focus on digital - Asbury and Lithia's brands, Clicklande and Driveway, respectively are the separate eCommerce arms of larger dealer groups. One company, AutoIQ, has taken the view that "to become successful in this space, a unique customer experience is required." Their **virtual dealership** includes a dedicated sales team, a new company managing logistics across its locations, and is focused on vehicle merchandising. Says Paul Stock, President of AutoIQ, "[this infrastructure] makes us better at our core in-store business, attracting new customers through our digital offering, and ensures we are prepared for the upcoming market shift to a higher proportion of sales being online." By providing in-

store new or used vehicles across 17 physical locations within 100 miles of 90% of Ontario's populations as well as a strong online presence, AutoIQ emerges as a leader in the Canadian automotive market space. Ultimately, customers are loyal to companies that can provide an efficient and seamless purchasing experience; companies that establish themselves as such will stand out from their competitors.

Dealer Resistance to Digital Fulfillment

A low friction process is not always in the dealer's interest. The major difference between automotive lending and other lending areas is the asset: the vehicle. And since the vehicle still comes from the dealer, a lot of power is in the dealer's hands. Fintechs can more closely partner with auto dealers to ensure that customers are presented with all their financing options, and that they understand the vital criteria—beyond the interest rate—involved in each purchasing decision. Yet resistance from both dealers and buyers is a major impediment to broader adoption of a fully digital process. There are several underlying reasons behind this resistance. The graphic below outlines some key pain points in the dealer relationship:

-  **Negotiation-driven flexibility of a car's price**
-  **Technology integration challenges inherent in the shopping, financing and contracting process**
-  **The transition to servicing**
-  **The valuation and processes required for used vehicles or transactions involving a trade-in**

These challenges are likely to be overcome through a combination of technology integration, alternative models of ownership, new options for mobility or potential changes to the OEM/dealer/customer relationship.

From the perspective of the dealer, the completion of a fully digital transaction may not align with the dealer's financial interests (either in perception or in fact). The dealer's interests in offering additional services, different vehicles or financing options may not be served by a digital process. As such, dealers and OEMs have traditionally gravitated towards offering an initial digital shopping experience with the consumer ultimately visiting a dealership to complete the transaction.

While some buyers find the dealer experience off-putting, others may think a digital journey reduces their ability to negotiate for the best price and financing. Dealers certainly rely on the idea that a vehicle is a significant expense, but is also an emotionally involved purchase. Many consumers feel the need to physically engage with the vehicle before concluding a transaction. These buyers place a higher value on the physical experience of driving and evaluating the vehicle as well as the dealer's guidance and ability to answer questions. Further, consumers may view new vehicles of the same make and model as essentially interchangeable; when selecting from a used inventory, buyers are more likely to look for signs of excess wear or vehicle condition issues. These concerns are more readily revealed and addressed in- store or during a test drive.

Despite these challenges in the current dealership model, fintechs have the tools necessary to address any hesitation and to shift transactions more fully into the online space, to the ultimate benefit of the end consumer.

Fintech's Upperhand in the Digitization of Dealerships

This trend toward digitization in the auto lending marketplace is a huge opportunity for fintech auto lenders and their partners. Fintechs have consistently led the charge in the adoption of new technologies. Auto fintechs have implemented changes in order to increase transaction speeds, provide more seamless user experiences and increase market reach for lenders. Now, they have the potential to shape the future of auto lending and lead the industry through digital innovations. This trend is apparent in the US, with 57 digital retail vendors being represented at the National Automobile Dealers Association, making their presence felt within the industry. Fintech representation in Canada is progressing along similar lines, accelerated by the COVID-19 pandemic.

For fintechs to more directly connect with consumers, the dealer relationship might look differently in the future than it does today. Still, the move away from traditional auto retailing and lending presents some unanswered questions about the future of the marketplace. For one thing, how will the current dealer-dependent model evolve? Further, how will fintechs address new fraud, compliance and legal risks that come with digital lending, and how can integrated partnerships with banks evolve into mutually beneficial relationships?

Technology - Dealer, OEM and Finance Company

From a technology perspective, systems must support the process from shopping, selection, trade-in valuation, purchase/lease, financing, contracting, loan or lease servicing and end-of-term events. For stakeholders, all of these steps are critical from a financial standpoint. For the OEM, the dealer, their floor plan financing providers, and the end consumer, these steps are also crucial, and the complex flow of money between these parties must be managed correctly. Finally, end-of-term events must be considered: whether through a trade, release of collateral, an insurance claim, return of the vehicle and remarketing activities.

The technologies across this life-cycle are typically siloed and delivered by a wide range of overlapping and competing systems providers. OEMs, dealers, fintechs, banks, captives or independent finance companies will have to overcome financial obstacles to integrate systems. Another option is to work with point providers in the fintech space who can deliver more capability across the value chain.

Research from NETSOL demonstrates that in Canada dealers are twice as likely to retain a customer when re-engaging one year out from contract expiry versus 90 days, and three times more likely if they waited until contract expiry. In this new environment, if dealers (and OEMs/FIs) do not have an effective marketing strategy, they might be outpaced by digital innovators.

Industry participants must consider the risks involved in a fully digital process and the challenges of digital and physical processes intersecting. Dealers and lenders will operate in an environment that is increasingly both digital and physical. The methods involved and technologies at play may differ between the two. The vehicle purchase and financing process is complex; lenders and dealers need to verify identity, validate borrower credit, handle registration, tax payments, and maintain the lender's security interest. While digital fulfillment is more convenient, it must also ensure an

error-free process that produces a legal, compliant agreement. Fintechs have a key role to play in addressing these issues.

Technology can support the replacement of often arduous and time-consuming physical experiences. It can be leveraged to build trust and address the consumer hesitation inherent in any significant financial commitment. This is not the role of technology alone – it must be done in conjunction with innovative and transparent business processes, and fintechs will need to constantly consider these elements.

Anticipating Broader Trends: Changes in Car Ownership, Car Sharing, Mobility Models, Market Integration & More.

Looking even further into the future, auto lending fintechs should prepare for the eventuality of a very new conception of car ‘ownership.’ Within the next few decades, a typical loan might be for a shared vehicle, a parking space or a self-driving car. Consumers may opt for short term rentals, subscriptions and new methods of mobility. A recent [study by Deloitte](#), projected that soon, 35% of the total auto finance market could ultimately be in commercial, versus consumer, transactions.

According to Director of Digital Experience Design at Gensler, Rob Bischoff, “Electrification and digitization in all their forms are the main technological tasks and continue to require high funding,” and “COVID-19 has once again made it clear that we must be more careful with our environment if we want to avoid causing enormous damage to ourselves in the long term.” With electrification and digitization top of mind, Daimler has introduced its newest S-class model and all electric sedan. These cars were designed to be environmentally friendly with innovative EQ technology.

Tesla is an ideal case study for trends in electrification. At every stage in physical production, Tesla has a role: its factories build the car, the batteries and develop software for the vehicle. In addition, they capture enormous amounts of data that provides insight into how each vehicle is being driven. This has the potential to affect vehicle insurance, servicing and ownership models. Additionally, it opens the path to other models of ownership based on how consumers want to access mobility, such as short term rental, subscription or shared vehicles. Tesla is building a foundation that allows them to control their ecosystem around mobility, which is fundamental to the potentiality of a future with autonomous cars.

Tesla isn't the only company aggressively retooling to adapt to the demand for new technologies. Ford's latest endeavor to create six distinct business entities—Ford Blue, Ford Model e, Ford Pro, Ford Credit and Ford Drive—is designed to compete with both new EV companies and established automakers. **According to Jim Farley**, Ford Motor Company CEO, "[Ford] is going all in, creating separate but complementary businesses that gives [the company] start-up speed and unbridled innovation..."

If these models develop further, the role of the finance provider, the OEM, the dealer and the insurer will shift. A growing number of vehicles may not be sold directly to consumers – but to mobility businesses (or held by OEMs) who will provide new mobility services around the vehicle. Current market participants in automotive financial services and their technology vendors must decide if they want to become pure suppliers to these providers (which will certainly marginalize their importance and reduce available profit margins) or take the bolder step into the new business models, taking on different operational risks and balance sheet impacts.

Additionally, mobility services and digitization are changing the traditional life cycle of a car. A car is normally sold to a consumer or business and managed through its first lifecycle. The vehicle can later enter the used car market. Manufacturers are now looking to retain and reuse vehicles over multiple usage cycles. This process involves

selling the same car to many people, through a range of services or models: leasing, subscriptions, short-term hire, and car sharing. Manufacturers are transforming themselves into mobility providers, enabling them to support a wide range of use cases offered through digital platforms that access a wealth of transportation options.

Regarding the vehicles themselves, while the car remains at the heart of these services, their role is changing. Analysts have coined the term ACES, referring to cars being Autonomous, Connected, Electric and Shared, with the three most important current elements being Connected, Electric and Shared. A car might start its life being leased by a consumer or business. Alternatively, it could be part of a car subscription service, car-sharing fleet, or hired by a taxi or an Uber driver. Fleet owners may then switch its role, depending on market demand.

Connected cars will share data about their usage to inform the role they are allocated to and support app-based services, such as hourly rental and car sharing. In turn, the role of the dealer could change to focus on service delivery. This would require a shift in arrangement with manufacturers, possibly resulting in an agency model in which the dealer functions as an agent of the manufacturer. Manufacturers are moving away from selling products towards selling experiences. Furthermore, under the agency model, the role of the dealer would change; they will have stock coming in, but that stock could be used for other things, such as subscription services. In these models, the dealer's role shifts from a seller to a mobility provider.

With respect to technology, suppliers have historically integrated the market along singular point-to-point lines, with technology products focused on either dealers or lenders. With platform driven technology, multiple providers of products and services can be represented and placed in the sales process. One can anticipate the next generation of technology as focussed on providing a range of buyer or mobility options, but with a different starting point in the process. This development would redirect more of the power and control in the process to the consumer. If the

propensity for flexibility already demonstrated by fintechs indicates an ability to adapt to changing circumstances, auto lending fintechs will certainly thrive.

Looking Ahead: How to Stay Competitive

The widespread consensus amongst Canadian customers is that personal mobility (a combination of the transitional buy, lease, and newer car riding and sharing experiences) should be a frictionless experience. Automotive lending enables mobility experiences in traditional models where opportunities in digitization are enormous. Dealer relationships, transaction speed, and the data used to determine credit risk will be updated by fintechs seeking to optimize the process for consumers and broaden the base reached by auto loans.

Paul Stock, CFO & VP of Operations at AutoIQ says, “Auto dealers are facing imminent and large changes to their business models. The continuing growth of BEV, and its impact to both sales and service, eCommerce, a shift to Commercial/Fleet Business and potential OEM agency models, amongst others.” The path forward, according to Stock, is to embrace the change and focus on areas that dealers will continue to have influence over in the future. This will insulate against future impacts of the change—used cars, the end-to-end eCommerce/omnichannel experience, service, commercial & fleet expertise, and the scale to invest in an electrified infrastructure.”

Preparing for future change while staying up-to-date on the most effective ways to service a customer is key to growth and continued relevance in an ever-developing sector. The future of auto lending is raring to go: are you going to rev the engine or get left in the dust?



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