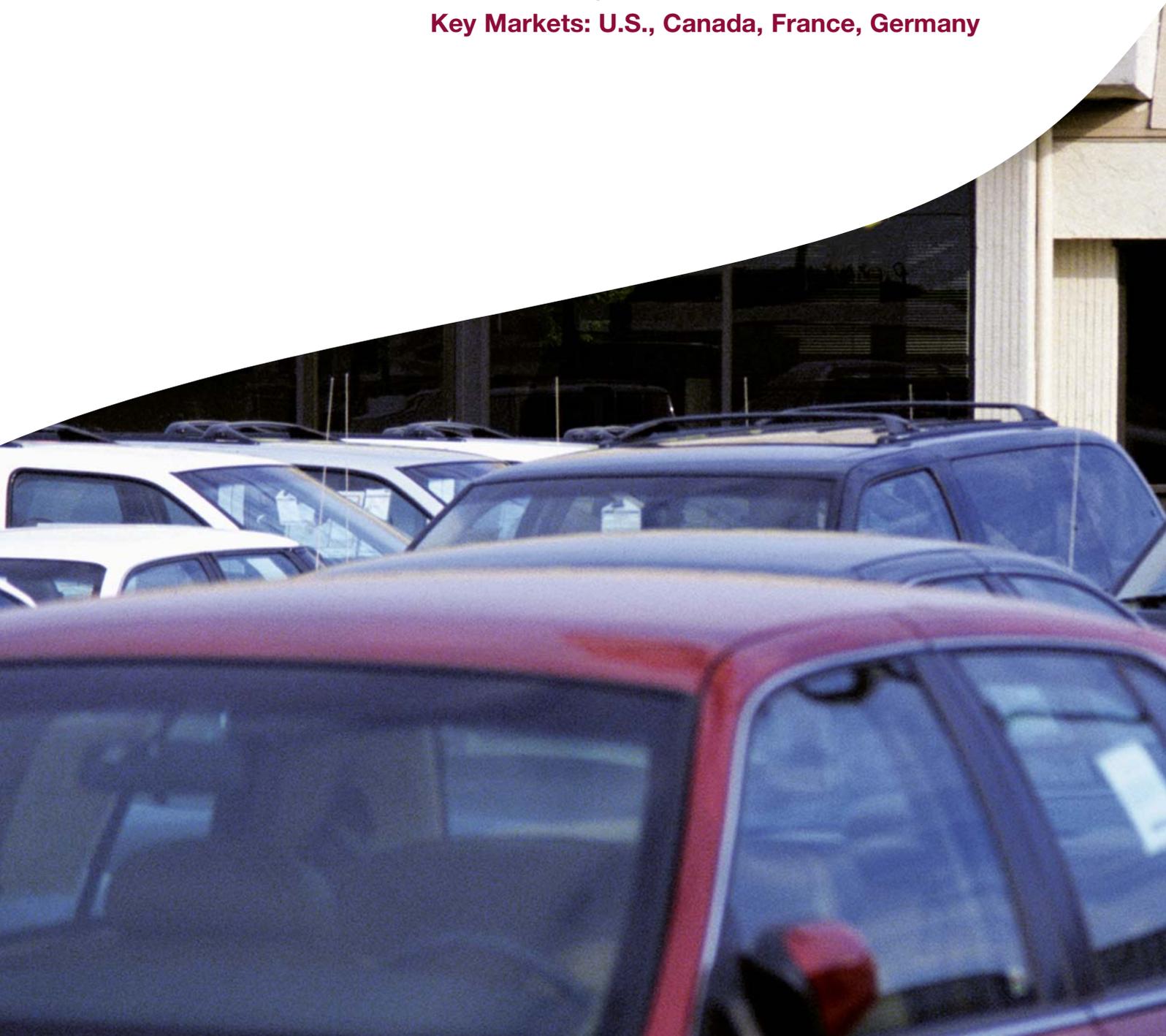




the way we see it

The Anatomy and Physiology of the Used Car Business

A Global Analysis With Particular Reference to Four Key Markets: U.S., Canada, France, Germany



Contents

Introduction	3
Executive Summary	4
Market Overview: Highly Contrasting National Markets	7
Global Trends Affecting the Used Car Business	12
Comparative Analysis of the Four Markets	15
Success Strategies in the Used Car Business	23
Conclusion: A New Approach to Used Car Sales	30

Acknowledgments

The data contained in this report was collected by the Car Internet Research Program II (CIRP II). All analysis and interpretation of the research and data has been made by CIRP II in collaboration with Capgemini. The research and writing of this study was led by Professor Christian Navarre, together with Alina Kotov, Lihsin Hwang, Jean-Yves Barbier and Magdalena Jarvin. Translated from the original French by Karen Twidle.

The Car Internet Research Program II is sponsored by: Capgemini, PSA Peugeot Citroën, Renault SA and The University of Ottawa.

Introduction

Until recently, car manufacturers and dealers have tended to focus on their new vehicle business to the exclusion of used cars, often viewing the used vehicle trade as an unwanted byproduct of new car sales and a necessary cost of doing business. It seemed obvious that new cars, with their higher sticker prices and wealthier buyers, should be the focus of dealers' sales efforts. Incentives have been used to move the new car inventory, which was tirelessly promoted by both dealers and original equipment manufacturers (OEMs).

Over time, however, competition in the new car market has resulted in a surprising new state of affairs: used cars have begun to add more to dealers' bottom lines than sales of higher-status new cars. Moreover, as the quality and reliability of used cars have grown, consumer attitudes have also evolved. As a result, manufacturers have begun paying greater attention to the crucial role used vehicle management plays in improving residual values, new car sales and the building of manufacturers' brands. This attention is likely to continue to grow; indeed, investing in used car management is increasingly becoming a necessity in a market characterized by relentless competition, slimming margins and ever more demanding consumers.

This report examines the used car business worldwide, with a particular focus on the United States, Canada, France and Germany, to find out what drives the used vehicle business, how and why OEMs and dealers compete

in it, and how they can be more successful in taking advantage of the opportunities it offers.

Indeed, these opportunities are vast: Fueled by greater longevity, the used car market worldwide has grown significantly. In France, for instance, used car unit sales increased from 4.7 million to 5.4 million between 1990 and 2005, at the same time as new vehicle sales declined from 2.3 million to 2.07 million units.¹

Franchised dealers' used vehicle operations now act as a hedge against uncertainties in the new vehicle market and even support new vehicle sales. Moreover, the management of used inventory can have a significant impact on a brand's image and residual values, making it more important than ever for manufacturers to take an active role in their dealer network's used vehicle management.

In short, the used car business is here to stay. With declining margins in the new car business and the aging of vehicles on the road, it is likely to be a growing and increasingly important component of franchised dealers' sales, both in North America and in Europe.

This report provides a detailed picture of the used car business and its role in the global automotive industry.

¹ Comité des Constructeurs Français d'Automobiles (CCFA).



Executive Summary

Buying a new car is the end point of a process that, on average, takes six months² and involves much research and complex decision-making. In the past, the power struggle between customers and dealers generally played out in favor of the latter.

The development of the Internet has changed the power struggle between dealers and consumers. Buyers can now potentially gain the upper hand. Customers are increasingly knowledgeable about cars, their quality, residual value, prices applied, finance charges, availability, and, more and more frequently, the exact profit margin that the dealer makes in closing a deal. Dealerships have had to adapt. The most shrewd and dynamic have managed to turn customer intelligence to their advantage, by focusing on what consumers really want, namely transparency and respect. (For more on this, see “Inside the Customer/Dealer Relationship,” published by CIRP and Capgemini, 2006.)

Has the used car market changed in the same way as the new car market? Although in some countries, used car sales represent two or three times the volume of new car sales, there are very few studies that fully explore the used car business.

The four main countries were chosen for this study for the following reasons:

- The United States and Canada are part of an integrated economic system, with the majority of the population speaking the same language and affected by similar trends, constraints and influences. The same brands are found in both countries, with competition around the same models. Distribution is also carried out in both countries by the same system of exclusive dealerships.
- France and Germany both work within the same European regulatory framework in terms of car distribution. The two countries have strong national traditions in the automotive industry and develop brands that have worldwide coverage. Distribution networks are well developed.³

Key Findings

Our research identified a number of key findings that characterize the development of the used car business:

- **The importance of the used car market is growing significantly.** In both the U.S. and France, for example, the used-to-new vehicle ratio (which demonstrates the level of used market activity) has increased since 1999 from 2.4 to 2.6, showing a steady growth of used vehicle sales by volume. In addition,

used vehicle sales in the U.S. are today more than twice as profitable for dealers as new vehicle sales (roughly 2.7% profit margin, compared with 1.2%). Moreover, the used vehicle financing and insurance segment is often the most profitable operational unit of a franchised dealership, posting 11.3% profitability in 2005 in the U.S.⁴

- **The key to growth will be transparency and symmetry of information,** as consumers continue to apply the same approach to research and collection of information in their search for used vehicles as they do in the new car buying process. We expect to see greater use of the Internet, more savvy consumers and more product proliferation. As with new car sales, the relationship between dealer and customer will need to be based on respect and trust, as well as ease of purchase. Such a symmetrical relationship will presume that buyers and sellers possess the same information by which to determine a product's quality. For example, the growth of CarMax has been partly attributed to this approach.
- **The Internet is increasingly becoming the information source of choice for used vehicle buyers.** Although consumers still use local

² CNW Marketing Research, Inc., Purchase process Wave IX.

³ In the case of Europe, and for a small number of variables, there are differences between data stemming from two main sources: Datamonitor and the ICDP research program. These differences are explained where necessary.

⁴ CNW Marketing Research, Inc., Document 925: Profit margins at dealerships.

newspapers and word-of-mouth when researching used car purchases, they are turning to the Web in increasing numbers, highlighting the importance of having a strong Internet strategy for used vehicle programs. A recent study from J.D. Power points out that more than twice as many late-model used vehicle buyers in the U.S. find the vehicle they purchase through the Internet than through both newspaper and magazine classified ads combined.⁵ Dealers that have focused more attention on multi-channel communication strategies are beginning to reap benefits, with an increasing number saying their Web activities have improved sales and extended their trading range.⁶

■ **The maturity of the used car market varies considerably according to country,** and geographic proximity does not necessarily result in similar used car markets. It was initially hypothesized that the markets in Canada and the United States would be similar to each other and different from the French and German markets. However, in many cases these relationships did not hold and surprising patterns emerged. Each national market has its own peculiarities, which are a combination of socio-cultural, economic and historical circumstances. For example, the used-to-new ratio is similar between France and the U.S., with Canada being surprisingly low.

- **The most important success strategy in the used car business may be the development of trust-inducing initiatives such as certified used vehicle programs.** These programs provide the best protection against channel competition and allow dealers to improve margins significantly while offering an additional source of revenue for OEMs. In the U.S., where the certified vehicle market is strongest, sales of manufacturer-certified vehicles have more than tripled between 1997 and 2006, totaling approximately 1.5 million units in 2005. Other countries are moving in this direction as well.
- **Franchised dealers are in a strong position to benefit from growth in the used vehicle market,** supported by OEM involvement in marketing and certification programs, access to high-quality off-lease vehicles, online inventory pooling and a more professional image in the mind of the consumer. In the United States, franchised dealers earned higher gross profits on used vehicle sales than independents,⁷ had the highest closing ratio (with 44% of visitors making a purchase, compared with just 27% for independent dealers),⁸ and benefited from significantly greater customer loyalty,⁹ with more repeat customers across all vehicle age groups.



⁵ J.D. Power and Associates, 2006, Used Autosshopper.com Study.

⁶ Waller, Hwang and Navarre, "The 335 Kilometer Franchise," CIRP (Car Internet Research Program), November 2005, p. 32.

⁷ CNW Marketing Research, Inc., Document 34: Gross profit: Used vehicles.

⁸ CNW Marketing Research, Inc., Document 197: Shoppers who became buyers – new, used.

⁹ CNW Marketing Research, Inc., Document 997: Used vehicle loyalty to dealership.

- **Used and new vehicle sales are interrelated and complementary;** both are a function of dealer excellence. Successful dealerships tend to have strong sales in both the new and used vehicle departments. An American study found that new vehicle sales per dealer correlated positively with used vehicle sales, despite the counter-cyclical nature of the used car business.¹⁰
- **Management of new car incentives is critical to ensure profitable used and new businesses.** With the increase in the quality and image of used vehicles and the popularity of certified programs, late-model used cars are increasingly becoming a substitute for new vehicles and vice versa. As a result, incentives in the new vehicle market act to depress used vehicle prices, lowering residual values and new vehicle sales prices and reinforcing the incentive cycle. This impact is particularly pronounced for late-model used vehicles and for more expensive (and image-conscious) market segments.¹¹
- **Greater professionalism will increasingly characterize the international used vehicle market over time.** Although less professional players can survive in the used car business when the sales cycle is long and purchase quantities are small, eventually the cream will rise to the top. This presents a tremendous opportunity for automotive companies.

Key Findings in Individual Markets



United States

- The United States has the most developed auction and wholesale market, resulting in the highest share of independent dealers of the four countries studied. Dealer attitudes toward the used car business tend to be the most entrepreneurial and growth-oriented.
- The American car market is also characterized by a more developed “car culture” than the others. As a result, emotional factors tend to play a bigger role in the used car buying process.
- The U.S. has the highest vehicle ownership per capita of all markets studied; moreover, multiple vehicle ownership is common and consumers change vehicles relatively often.



Canada

- Canadian consumers tend to be more risk averse than their counterparts in other markets. They are also more cost-conscious, with monthly payments a major driving factor behind purchase decisions.
- They tend to keep vehicles longer than in the United States, resulting in a less active used vehicle market.
- Use of online channels, such as eBay, is less developed. It seems that Canadian dealers display a risk-averse attitude toward investing in online distribution.



France

- The French used vehicle market has exhibited very strong growth in the past decade, reaching a level of activity equal to the American market.
- French dealers display the strongest aversion to selling “older” vehicles: Only 17% of the vehicles they retail are 4-plus years old; in contrast, 41% of vehicles sold by U.S. dealers (and 47% of those sold by Canadian dealers) are 6-plus years old.
- Consumers in France show the greatest propensity to shop for certified vehicles, making certified programs an important differentiating factor in this market.



Germany

- Germany has the most advanced online used vehicle market, used heavily by both sellers and buyers.
- Used vehicles in Germany already have the longest warranty among all markets. As a result, certified vehicles are not a strong differentiating factor in this market.
- Since 2003, dealers’ share of the used vehicle market has been recovering from six consecutive years of decline.

¹⁰ CNW Marketing Research, Inc., Document 116m: Same store new-used sales.

¹¹ CNW Marketing Research, Inc., Document 521: New prices impact on used prices.

Market Overview: Highly Contrasting National Markets

The accompanying table (Used Vehicle vs. New Vehicle Market Sales – A National Comparison) looks at new car and used car sales by unit volume for eight countries. The ratio of used car sales to new car sales acts as an indicator for the expansion of the used car market.

The used car market is most active in the United States, France and the UK. In these markets, the used car business generates considerable economic income. In contrast, the used car market is weaker in Canada, Japan and Spain.

The case of Canada and the United States shows the extent to which two national markets, strikingly similar when it comes to new car sales (same brands, same cars, same distribution channels), can differ markedly in terms of their used car market. This notable difference can be partially explained by Canadian consumer habits and attitudes. It would seem Canadian consumers are more cost-conscious, risk averse and inclined to keep their cars for longer. The difference is also due to the higher degree of conservatism among

Canadian dealers, in contrast to the entrepreneurial drive and taste for innovation more characteristic of their American counterparts.

The drive to expand the used car market, the will to ensure transaction transparency, the capacity to develop long-term competitive positioning, market intelligence and understanding depend for the most part on dealers and manufacturers. These factors can change far more quickly than the socio-cultural elements involved in consumer behavior. Furthermore, as long as they have the necessary strategic will, manufacturers have the power and wherewithal to weigh heavily on the structure and development of markets.

Explaining Used Car Market Performance

The case of Japan is both specific and extreme. Due to a number of reasons, the market has the lowest used-to-new ratio. The Japanese market is subject to rigorous environmental and road test regulations, in addition to high disposal costs, which makes it relatively expensive to own older vehicles. The consequently

high depreciation rates make Japanese used vehicles far more suitable for the export market. However, it is difficult to say whether the relatively high cost of ownership is more or less important than the socio-cultural factors, which also make used car ownership less desirable in Japan than in other markets. Japanese consumers generally prefer to buy new products, viewing used goods as linked to lower social status.

In fact, each national market is colored by the socio-cultural setting. Beyond the impact of culture, however, it is necessary to examine the way markets work in economic terms.

Market theory is based on the idea that prices act as indicators of the quality of products bought and sold. In principle, the higher the price of a product, the higher its quality, and vice versa. Classical economic theory also posits that buyers and sellers possess the same information by which to determine the quality of a product under transaction. This is defined as a symmetrical relationship between buyers and sellers.

Used Vehicle vs. New Vehicle Market Sales – A National Comparison

	UK	U.S.	France	Germany	Italy	Canada	Spain	Japan
New Car Sales	2,567,000	16,995,000	2,070,000	3,320,000	2,262,383	1,583,000	1,517,490	5,852,067
Used Car Sales	7,701,308	44,138,000	5,400,000	6,650,000	4,586,894	2,300,000	2,080,754	5,984,800
Used Car/New Car Ratio	3.0	2.6	2.6	2.0	2.0	1.5	1.4	1.0

Source: CIRP, adapted from various sources, including CNW Marketing Research, Inc. (U.S.), DesRosiers (Canada), Japan Automobile Dealers Association (Japan) and Datamonitor (France, Germany, Italy, Spain, United Kingdom)
Note: All sales in units. All data for CY2005, except Italy, Spain, and UK, which are CY2004.

However, for some goods, including used vehicles, sellers can decide not to reveal the real value (in terms of quality) of what is being sold. This means it becomes possible to put a good quality price on mediocre quality goods (“lemons”).¹² Buyers are in no position to determine the real quality of what they are buying. Sellers, on the other hand, are well aware of the quality of what they are selling. This situation is a typical one of asymmetry between buyers and sellers, which is to the latter’s advantage.

If price no longer functions as an indicator of quality, if there is asymmetry between buyers and sellers, and if the latter are unscrupulous leading to buyer caution, markets tend to underperform as both prices and volume decline. For the market to expand, sellers must ensure that they gain consumer confidence by getting rid of, or at least minimizing, asymmetry of information.

Assessing the Purchase Quality

Buyers have two main strategies by which to ascertain the real quality of what they wish to buy.

1. **Secure the transaction.** This amounts to the consumer buying goods only when the seller relinquishes his hold on information and agrees to reduce information asymmetry by giving the buyer real quality guarantees. Note that this type of behavior is motivated by long-term, rather than short-term, gains. The solution lies for the most part in the hands of the seller.

2. **Secure the relationship.** In the absence of a transparent transaction, the buyer tries to gain information about the seller’s integrity. A seller who has a solid reputation for honesty stands to lose much by veering away from the right path. The solution here lies essentially with the buyer, who will choose a potential seller among family, friends, acquaintances and networks.

Undoubtedly, buyers will try both strategies. However, it is clear that strategies based on securing the transaction are the easiest to implement for professionals (especially dealerships) if their starting point is long-term gain.

Securing the Transaction

The automotive industry has come up with many ways to secure a used-vehicle transaction, including:

- **Incentives such as sizable warranties, free car repairs, breakdown service or a “satisfied or reimbursed” policy.** It is increasingly prevalent for car dealers to include a warranty on a used car. Of course, these usually cover a short time-span (9 to 12 months), compared with the longer guarantee periods provided by manufacturers for new vehicles (two to three years, sometimes more). In the case of cars that move more slowly, dealers might consider special pricing or a lower financing rate. In the case of a “satisfied or reimbursed” policy, customers can change their decision and return the car during a short time period after the purchase (usually around one week).



¹² Akerlof, George A., Nobel Prize winner 2001, theorized the used car market in the 1970s. The founding publication, and savor the title, was: “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism,” in *The Quarterly Journal of Economics*, Vol. 84, No. 3 (Aug. 1970), pp. 488-500.

- **Manufacturer vehicle certification**, which is a more recent development. In theory, this means the dealer only puts vehicles up for sale when they have undergone extensive and in-depth inspection (generally more than 100 inspection points). Any repairs deemed necessary after the inspection are carried out. Here, the manufacturer acts as a guarantor.
- **Transparency in sales.** Some dealerships recommend and encourage prospects to have recourse to independent assessment tools onsite. An increasing number of third parties are making the most of this development to offer consumers tools to help them assess the quality of what they buy (these are usually paid services, but they are increasingly being offered free of charge). Examples include the Kelley Blue Book in the U.S., Black/Red Book in Canada and Argus in France. In addition, we have found that in some markets OEMs are providing dealers with data on previous vehicle owner and service history.

The impact of these provisions, when they are offered by the dealer, is to reassure the customer by making prices once again act as quality markers. This in turn pushes prices and sales up over the long term. Of course, this means that the cost of the transaction is higher for the dealer, which initially results in a lower profit margin. It is therefore in the seller's interest to ensure the initial quality of products he or she markets.

Governments, under pressure from consumer groups, can also force the salespeople to become more transparent,¹³ notably through mandatory technical reviews, where the buyer is informed about the state of the car; online availability of insurance company records, so consumers can ascertain whether or not a car has been through serious accidents; heavy fines for fraudsters (for example, rigging the odometer); and professional used car sales organizations with regulated access, member training programs and a common ethical charter.

Securing the Relationship

In the middle of the 1990s, Paul DiMaggio,¹⁴ a Chicago School sociologist, observed that the real buyer is very different from the purely rational and abstract buyer of economic theory. Individuals are rooted in networks and receive their education against a specific socio-cultural backdrop. This leads them to carry out economic exchanges according to the conventions and customs of their given background. The buyer facing informational asymmetry can offset the disadvantage by gathering information on the seller's honesty, or again by "doing business" with people the buyer knows and who are from a similar culture, social background, religious faith, nationality and so on.

DiMaggio shows that in the case of used car sales, half of the buyers (in the U.S.) will use their personal networks to assess not the quality or reliability of the car but that of the car seller.



¹³ For example, through U.S. consumer law known as "Lemons Act."

¹⁴ DiMaggio, Paul, and Louch, Hugh (1998), "Socially Embedded Consumer Transactions: For What Kinds of Purchases Do People Most Often Use Networks?" *American Sociological Review*, vol. 63 (4), pp. 619-636.

Sales Channels

There are three categories of sellers in the used vehicle market: franchised dealers, independents and private sales (consumer-to-consumer or C2C). The accompanying table (Used Vehicle Market Shares by Distribution Channel – A National Comparison) shows market shares for seven countries.

The data demonstrates that:

- The market share for franchised dealers varies from 26% in the UK to 50% in France, almost double.
- According to Datamonitor, the strength of franchised dealers in France may be partially due to the strong and growing market of rental fleets, which are generally remarketed through franchised dealers. Manufacturer and leasing fleet disposals represented 10.3% of used vehicle sales in France in 2004, compared with 6.3% in Germany.
- The C2C channel accounts for almost half of sales in most of the European countries.
- Professionals (both franchised dealers and independents) are particularly prevalent in North America, where they have a relatively significant market share at the expense of the private (C2C) channel.

The traditional franchised dealer is in a unique position. Following a new car sale, dealers almost always have the potential of a used car to put up for sale.¹⁵ The car taken back will be resold with relative ease or difficulty, depending on the state it is in. Obviously, it is in dealers' interests to acquire the

most recent, good quality cars, of the same brand that they represent. Data gathered on different markets shows that franchised dealers have indeed specialized in the sale of cars that are 3 to 4 years old or less.

To create an attractive used vehicle offer for prospects, it is therefore essential for dealers to dispose of the vehicles that are the hardest to sell and potentially to obtain good quality vehicles that are easier to sell quickly and profitably.

In our experience working with automotive companies, we have found that good dealers differentiate among channels to which they sell, based on vehicle age and attractiveness. They will sell in the showroom, via third parties or to other professionals.

Wholesalers and auction markets are the means by which the used car supply redistribution occurs (unless there is access to recent, good quality cars). Wholesalers act as speculators, exploiting differences between local markets to generate profit.¹⁶ Auction markets, when they are well developed, boost the role of wholesalers, thereby promoting constant refurbishment of dealers' used car supplies.¹⁷ Auction market expansion increasingly depends on the behavior of "leasers."

Depending on the country, leasers, who have a stock of recent cars in generally good condition and with monitored mileage, tend to either reserve their cars at the dealers, if they are the manufacturer's financial arm, or work on the downstream side

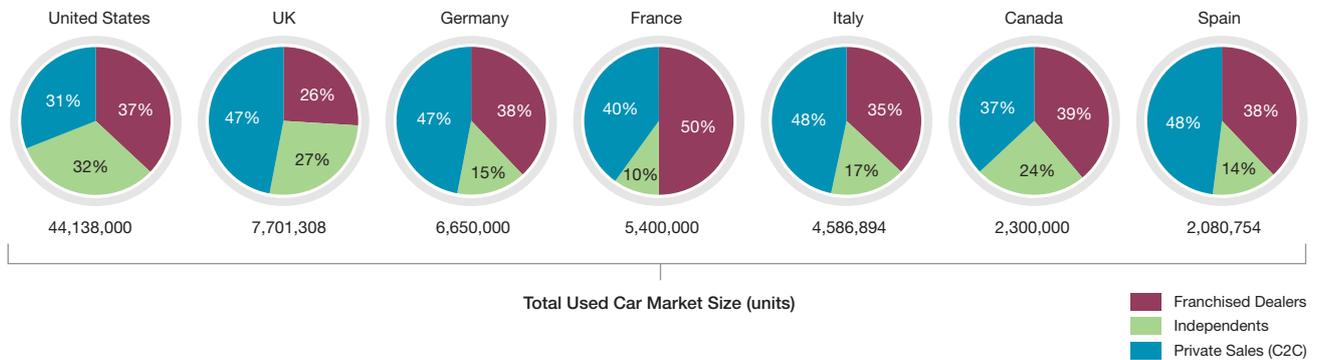


¹⁵ Note that this used car does not have to be of the brand that the dealer represents. Indeed, selling used cars is a multi-brand business.

¹⁶ In Canada, the average margin made by a wholesaler is \$400. It is estimated that wholesalers lose money on 40% of the transactions, break even on 20% and make a profit on the remaining 40%.

¹⁷ For example, in Canada and the U.S., where these markets are especially mature, dealers only sell roughly 60% of the cars they have taken back. This means that 40% of cars taken back are sold on to wholesalers or auction markets, and replaced by new acquisitions. (CNW Marketing Research, Inc.)

Used Vehicle Market Shares by Distribution Channel – A National Comparison



Source: CIRP, adapted from various sources, including CNW Marketing Research, Inc. (U.S.), DesRosiers (Canada) and Datamonitor (France, Germany, Italy, Spain and United Kingdom)

to try to harness dealer profits, since in this hypothesis, the two are in direct competition with one another. Alternatively, they may have recourse to auction markets (seen as efficient) to sell stock at the best price and with a minimal transaction cost.

In cases where these support markets are underdeveloped, dealers find it difficult to redistribute their supply. Business opportunities are thereby few and far between. Total used car sales will tend to hover around the minimal level, which, depending on the trade-in rate, is close to the number of sales in the new car market (as in Japan, where the used car/new car ratio was 1.0).

The market share for traditional dealerships therefore depends on the latter's access to efficient professional markets. However, dealers find it difficult to sell their oldest used cars. It follows that the oldest cars are sold predominantly on the private market. Unable to assess the quality of very old cars, consumers choose to rely on their networks. This explains why the private market constitutes such a large distribution channel.

In between the traditional vehicle dealers and the private market, there is a space for independents. Because they do not have the same access to trade-ins, sole privilege, or the competitive advantages of franchised dealers that are affiliated with OEMs, independents can develop business only if they can access efficient professional markets. Dealers specializing in used vehicles are often wholesalers whose strategy is to get closer to the end user.

The more the used vehicle market is professional, organized and ethical, the bigger the possible market share of independents. When independents have access to the newest used cars, notably through developed and open auction markets, they can compete directly with the franchised dealers. The activeness of auction markets in North America partially explains why the market share for independents is substantially larger than in the case of their European counterparts.

Global Trends Affecting the Used Car Business

A number of global trends and their consequences are altering the used vehicle business in all the markets we studied:

Improved new vehicle quality and durability. The longer lives of vehicles in each country studied have resulted in a growing used vehicle market, in addition to reducing the potential for service revenue during the first several years of a vehicle's life (during which customers are more likely to go to dealers for service). In Europe, for example, some sources estimate that each vehicle now has as many as an average of four owners throughout its life, which gives dealers the opportunity to sell the same vehicle more than once.

Availability of information on the Internet. Customers in all markets now have greater access to research material than ever before, from dealer invoice prices to vehicle history reports, thanks to the Internet, and they are more than willing to take advantage of it. According to Florian Zettelmeyer, the Internet lowers prices for consumers in the new vehicle market for two distinct reasons: first, by informing them about

the invoice price of dealers, and, second, by helping them obtain lower prices through the referral process. This combined effect leads to a 1.5% price reduction (equivalent to 22% of dealer gross profit).¹⁸ The posting of used vehicle prices for visitors of third-party websites likely has a similar impact on used vehicle buyers, who are becoming more knowledgeable and better able to assess the value of a used vehicle and to shop around for an acceptable price in a competitive auto market.

Declining new vehicle margins. Global overproduction of vehicles, increased competition among brands and ever more demanding consumers have led to increasingly high levels of discounts offered to new car buyers, both by dealers and manufacturers. In the U.S., for instance, total new vehicle discounts more than doubled between 1995 and 2005.¹⁹ Used vehicles, which provide dealers with an additional source of revenue and often higher gross margins, are required to maintain a level of profitability that is no longer easily achievable through new vehicle sales and service businesses.



¹⁸ Zettelmeyer, Florian, et al., "How the Internet Lowers Prices: Evidence from Matched Survey and Auto Transaction Data," 2005.

¹⁹ CNW Marketing Research, Inc., Document 101m: Incentive by month – 1990 to present.

This requirement to sell used vehicles to compensate for declining sales and service revenue from new vehicles is even stronger in the European Union, where Block Exemption rules are creating more competition for franchised dealers in the profitable service business.

Increasing channel competition.

Third-party listing websites, complete with multiple photos, detailed descriptions and vehicle history reports to reassure used vehicle shoppers, have made it easier for consumers to sell vehicles of all ages in the private market. In addition, franchised dealers in the U.S., in particular, are also increasingly under pressure from the independent dealer segment, where new business models such as CarMax are retailing more of the late-model vehicles traditionally sold by franchised dealers (see sidebar, “New Business Models Emerge: CarMax”).

New Business Models Emerge: CarMax

In the latter half of the 1990s, a distinct business model for used sales appeared in the United States, started by CarMax: used car superstores, the big-box retailers of the automotive market. This model was built around no-haggle pricing, a no-pressure atmosphere in the store, and a large selection of reconditioned, high-quality cars, which offered customers a certain level of security by providing inspections and warranties.²⁰ Other groups, such as AutoNation and Asbury, exited this business by 2000 in favor of buying new car franchises (new cars were more profitable at the time), and today CarMax is the only remaining automotive group specializing in used vehicles.

CarMax enjoys considerable profitability, with a 2.1% net profit in 2005 (up 31% from the previous year). CarMax tends to sell newer and more expensive used cars than the average independent dealer, and competes in a higher-value niche similar to franchised dealers. In 2005, its average used car retailed for \$15,663²¹ with an average gross profit of 11.5%, or \$1,817. In 2003, its customers had an average income of \$37,729 – only slightly below that of franchised dealers.²²

A 2003 survey of CarMax customers revealed that they were more likely to have also shopped at a franchised dealer's used car lot (55% of men and 27% of women) than at an independent's (16% of men and 5% of women).²³ They chose to shop at CarMax because of its good reputation (26% of men and 24% of women), because they had the buyer's desired car (26% of men and 14% of women), or because they had the widest selection (18% of men and 21% of women), available financing (14% of men and 21% of women) or best price (14% of men and 19% of women).

After CarMax introduced a technology-based inventory management system in its dealerships, the effect of positive word of mouth spiked. While this may not be the only reason behind CarMax's success, CEO Austin Ligon admits that the company's biggest problem during the difficult period from 1996 to 2000 was not knowing which vehicles to stock or the optimal price to pay or charge.²⁴ After competitors exited the business, CarMax's investment in inventory management technology finally made the no-haggle concept work.

²⁰ CarMax, “About Us,” www.carmax.com.

²¹ CarMax 2005 Annual Report, Consolidated Financial Statements (Part II, Item 8).

²² CNW Marketing Research, Inc., Document 659: CarMax demographics.

²³ CNW Marketing Research, Inc., Document 503: CarMax perception study.

²⁴ Forbes, February 2006, <http://www.forbes.com/business/forbes/2006/0327/098.html>.

At the same time, the Block Exemption rules in Europe are expected to lead to more service-only dealers taking on the sale of used vehicles to compensate for lost new vehicle revenue. This will likely result in a European used vehicle market with increasingly higher competition from independent dealers and more similarities to the American market.

Increasing manufacturer involvement in remarketing.

The used vehicle business is moving up-market in all four countries studied due to an increased supply of high-quality off-lease and other late-model vehicles. The profile of used vehicle buyers is changing to include a greater number of older and higher-income buyers.²⁵ Dealers and manufacturers have seized the opportunity to increase remarketing sales with manufacturer-certified pre-owned vehicles, which command a significant premium in the market and sell quickly.

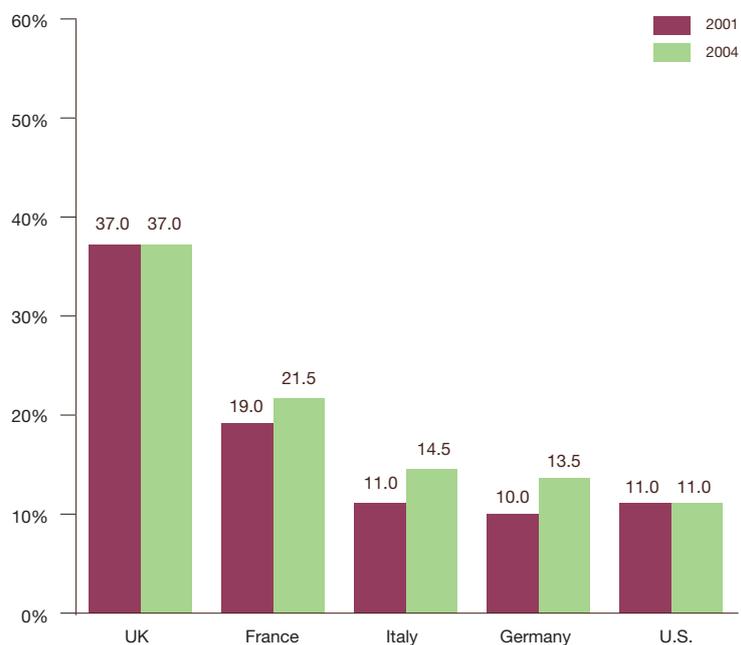
Greater consumer sophistication.

The pace of consumer change has accelerated rapidly due to consumers' increasingly sophisticated buying behavior and knowledge stemming largely from the availability of information on the Internet. Most consumers today have bought and sold several cars and are increasingly demanding when they purchase a new or used vehicle.

²⁵ For instance, between 1980 and 2002, the average used vehicle buyer in the U.S. increased from an average age of 23.4 years old to 29.4 years old, with an individual income of \$24,944, up from \$15,208. (CNW Marketing Research, Inc., Document 390: Typical Used Car Customer)

Dealer Network Concentration

Market Share of the 50 Largest Groups (% group registrations/total registrations)



Source: ICDP and national sources

Dealer Groups: One Response to Competition

Across Europe and North America, dealer groups have emerged as an increasingly important player in the used car business. This is most true of Great Britain, followed by France, with significantly lower dealer group penetration in Germany and the U.S. Their business model takes advantage of various economies of scale – they share technology, marketing and other resources.

In the United States (the only market where this data was readily available), the average sales per dealership of the largest dealer groups were not always higher than the 1,730 vehicle national average (based on CNW data). However, in general, the larger dealer groups have succeeded in achieving higher profits than traditional one-off dealers (2.5% of revenue, pre-tax, vs. 1.6% for all dealers, according to the National Automobile Dealers Association). Several of the biggest auto groups are focusing particularly on training and IT investments (such as inventory management systems for used car stocking) to improve future profitability.

In our experience, we have found that some of the most successful dealer groups invest in process quality, such as rapid lead qualification and transparency across their network, and focus on placing vehicles according to demand.

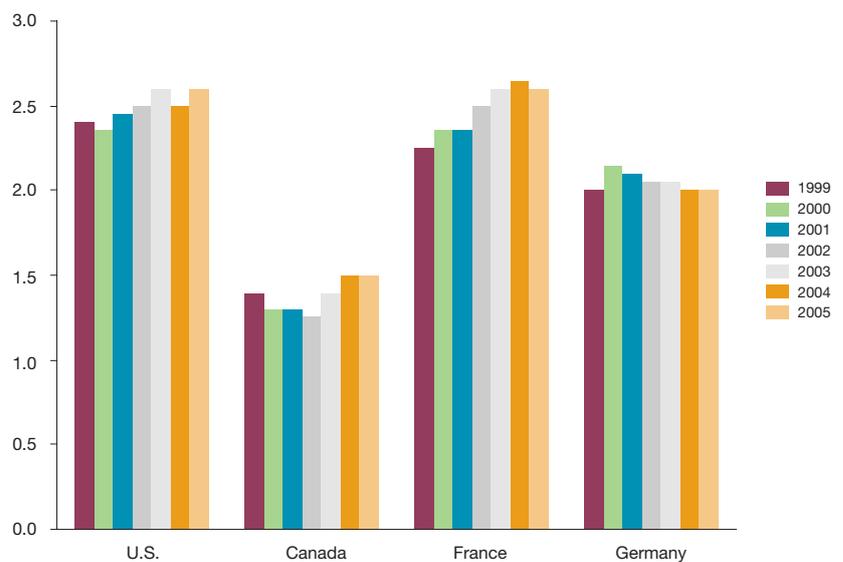
Comparative Analysis of the Four Markets

Our research found that despite the global trends in the used car business, each national market has its own peculiarities, yet surprising similarities exist as well. In the case of France and the U.S., for example, there are many differences between the markets, but the used-to-new sales ratios are the same at 2.6 (see the accompanying chart: Used-to-New Vehicle Ratio: Year-Over-Year National Comparison). Similar to the U.S., the French used vehicle market has been strong in recent years, as the average age of vehicles on the road continues to increase.

In France, although both the used and new vehicle markets are close to saturation, the new vehicle business has been shrinking after reaching a record high of 2.2 million units in 2001, while the demand for used cars has remained high. Due to the weakened economic situation in France in recent years, consumer confidence has been relatively modest, which may have favored the used car business.²⁶

Moreover, longer-term changes in the habits of French consumers have contributed to the recent growth in the used/new car ratio.²⁷ Vehicle penetration has risen, making multi-vehicle households more common and helping to fuel a more active used car market. This has been especially evident in the percentage of transactions made with vehicles older than 5 years, which, according to the Comité des Constructeurs

Used-to-New Vehicle Ratio: Year-Over-Year National Comparison



Source: CIRP

Français d'Automobiles (CCFA), has risen from 48% of total used car sales in 1990 to 60% in 2005.²⁸

The new vehicle market in Germany has shown a modest increase in sales volume from 2003 to 2005, recovering from several years of decline; however, the used vehicle market has continued to show some negative growth. Among the factors contributing to this are market saturation (there is already more than one vehicle for every two people) and relatively higher used vehicle prices, compared with other countries.

The Canadian market, on the other hand, had an anomalously low ratio of used to new vehicle sales at 1.5. Interestingly, this has not always been the case. In 1995, the used-to-new ratio in Canada was 2.3. It has fallen consistently over the past decade, as the proportion of new car purchases increased from approximately 30% to 40%. This has been largely due to the rise in the popularity of leasing during this period (from 29% to 45% of new vehicle purchases), as leasing became increasingly affordable in comparison to buying a used vehicle.

²⁶ Datamonitor, "Used Cars: Global Industry Guide," November 2005.

²⁷ CCFA, www.ccfa.fr/publications/pdf/analystat_2006_afrance.pdf, p. 37.

²⁸ CCFA.

The lower monthly payments of leasing, partly due to the sales tax that is paid on the full value of financed vehicles, appeal to cost-conscious Canadian consumers, decreasing the demand for used vehicles. At the same time, their propensity to keep vehicles longer than Americans (approximately eight years, rather than five years, according to DesRosiers) has resulted in fewer used vehicles entering the relatively less active Canadian market.

The following pages provide a comparative view of key aspects of the used vehicle market, including vehicle age, sales channels, used vehicle sourcing, the consumer research and buying process, and regulatory issues.

Age of Used Vehicles

Both France and Germany have a large percentage of used vehicles less than 1 year of age, compared with their North America counter-parts (10% to 11% vs. 1.9% of used vehicles about 1 year old in the United States). This could be largely attributable to the fact that in Europe, vehicle manufacturers can pre-register new vehicles and sell them as used vehicles. Surprisingly, among the four countries, the U.S. has the largest proportion of older vehicles. This may be attributable to higher leasing rates in Canada, as well as a more active market in the U.S. where the average number of vehicle owners till scrap is

Share of Total Used Vehicle Sales by Vehicle Age

	U.S.	Canada	France	Germany
<1 Year	–	–	10%	11%
1-5 Year	29%	43%	31%	30%
5+ Years	71%	57%	59%	59%

Source: CIRP, adapted from CNW Marketing Research, Inc., DesRosiers, Datamonitor

higher than in Europe (13 owners vs. four in Europe²⁹). In addition, the average vehicle age on the road in the U.S. (12.1 years³⁰) is significantly higher than the average vehicle age in Europe (8 years³¹).

Channel specialization by age has developed similarly across all four markets studied, despite different economic conditions and regulatory frameworks. This implies that consumers' need for the establishment of trust through dealing with either professional retailers for late-model vehicles, or social networks for older used vehicles, is true for both North American and European consumers.

However, franchised dealerships in North America are more willing to deal with relatively older vehicles, compared with European dealers. This is especially true for French dealers, where only 17% of used vehicles sold are more than 4 years old.

Sales Channels

Franchised dealer networks in both Europe and North America have experienced consolidation in recent years, a process that has been historically characteristic of the automotive industry and is likely to continue. In the United States, for example, the number of franchised dealers declined by 22% to 19,311 between 1990 and 2005.³² To put this into historical perspective, between 1960 and 1975 the number of franchised dealers declined by 35%.³³

In Europe dealers have experienced high rates of consolidation, largely due to the Block Exemption legislation, which came into effect in 2002. Sources indicate that between 2002 and 2004, the number of franchised dealer sales outlets in France declined by about 17%, while the number of German outlets declined by approximately 18%.

²⁹ CNW Marketing Research, Inc., Document 831: Number of vehicle owners till scrappage for the U.S.

³⁰ CNW Marketing Research, Inc., Document 392: Average vehicle age.

³¹ European Automobile Manufacturers Association (ACEA), European automobile industry report 2006.

³² CNW Marketing Research, Inc., Document 270.

³³ Thomas G. Marx, "The Development of the Franchise Distribution System in the U.S. Automobile Industry," *The Business History Review*, Vol. 59, No. 3, Autumn 1985, pp. 465-474.

Franchised Dealer Sales Overview (2005)

	U.S.	Canada	France	Germany
Number of Outlets (approx)	19,311	3,488	12,250	21,057
New Vehicle Sales	16,995 M	1,583 M	2,07 M	3,32 M
Used Vehicle Sales	44,138 M	2,300 M	5,40 M	6,65 M
Total Vehicle Sales	61,133 M	3,883 M	7,47 M	9,97 M
# Households (millions)*	112	11.56	25.6	39.2
# Vehicles/Household	0.55	0.34	0.29	0.25
New	0.15	0.14	0.08	0.08
Used	0.39	0.20	0.21	0.17
# Households per Dealer	5,800	3,314	2,090	1,862
Franchised Market Share	37%	39%	50%	38%
Average New Sales/Dealer (units)	878	454	169	158
Average Used Sales/Dealer	852	258	220	120
Total Average Sales/Dealer	1,730	712	389	277

Source: CIRP, using data from CNW Marketing Research, Inc., DesRosiers and HWB International (GMAP European Car Distribution Handbook 2003)

*U.S. Census Bureau, Statistical Abstract of the United States: 2006, <http://www.census.gov/prod/2005pubs/06statab/pop.pdf>, Table 32, p. 37; Statistics Canada, <http://www40.statcan.ca/01/cst01/famil53a.htm>; INSEE, http://www.insee.fr/en/fic/ficdoc_frame.asp?ref_id=ip1060; Federal Statistical Office Germany 2005, <http://www.destatis.de/basis/e/bevoe/bevoetab11.htm>.

Notably, **independent dealerships** (which are significantly more prevalent in the United States than in the other markets) have taken a bigger hit. The independent dealer count declined by 30% between 1995 and 2005 (from 63,897 to 44,702), as their unit sales per dealer increased by 44% (compared with 11% and 23% for franchisees, respectively).³⁴ This likely reflects the difficulties small independents face as they struggle to find a niche in the face of a more competitive private market and the superior shopping experience offered by franchised dealers.

One thing all of these markets have in common, however, is that the smaller outlets are the ones more likely to close. This is to be expected, considering that the impact of lower new vehicle margins on profitability requires higher volumes of new and used vehicle sales to compensate. It is expected that this trend will continue in all of the markets studied, particularly in Canada and Europe, as competitive pressures continue to raise the costs of doing business.

The relatively low sales per dealer figures in some markets are an indication that consolidation will likely continue (see accompanying table, Franchised Dealer Sales Overview). France and Germany sold only 389 and 277 total cars per sales point, respectively, compared with 1,730 total vehicles in the United States. In reality, the discrepancy is smaller than these numbers indicate.

The number of European sales outlets is difficult to compare to the United States, because of different structures in terms of the prevalence of multi-brand dealerships, the existence of sales-only vs. service-only outlets in Europe, among other factors. However, no matter how this number is calculated, the conclusion remains the same: There is a strong discrepancy between the throughput of European and American dealers, due to a higher saturation of dealers in a European market that is less active than its American counterpart.

It is therefore likely that competitive pressures will push the dealership networks in Canada and in Europe toward a level that is more consistent with what has been observed in the United States. In the U.S., due to competitive pressures, the dealer net profit margin is only about 1.7%,³⁵ even with a relatively small number of dealerships and a focus on high-margin revenue sources.

³⁴ Franchised sales per dealer refer to the increase in total unit sales (used and new); used car units sold per outlet increased by 18%, while new sales increased by 29%. The number of independent dealers declined from 63,897 in 1995 to 44,702 in 2005, as their unit sales per dealer increased from 221 to 318 units. (CNW Marketing Research, Inc., Document 270)

³⁵ National Automobile Dealers Association (NADA) Annual Report 2006.

The U.S., France and Germany all have experienced growth in **consumer-to-consumer** market share. ICDP notes that the reasons for a rising private market in Europe include:

- Independent Internet sites are the main facilitators for the private channels (e.g., Autoscout and Mobile.de).
- Customers have a very strong price orientation.
- The poor “value-for-money” image of franchised dealers encourages the C2C market.
- Poor financial structures of many dealers: German dealers have an average equity capital of around 12% of total assets. This minimizes dealers’ flexibility and constrains their attitude to risk.

The major difference between the U.S. and Germany, however, is the trend of average transaction prices on the used vehicles sold through the C2C market. While transaction prices have increased in the U.S. recently, in Germany, the average transaction price of a used vehicle sold through the C2C channel decreased. This reflects the fact that the C2C channel in the U.S includes more younger and higher-end used vehicles. In contrast, in Germany the channel specializes in older vehicles. Canada is the only country where the C2C market share actually declined, from 45% in 1996 to 37% in 2005.

Used Vehicle Sourcing

In recent years, German and British dealers were most likely to source used vehicle inventory (with 39% and 38% of inventory, respectively, actively sourced in 2003), followed by France at 33% and Italy at 19%. The low level of active sourcing in Italy is likely due to the general weakness in the used vehicle

market in that country, where consumers are not as favorably disposed to buying used vehicles as they are in the other three markets. In the United States, the same proportion (59%) of used vehicle inventory as in France came from trade-ins, while the German proportion of vehicles sold from trade-ins declined to 46% as dealers pursued active remarketing strategies. U.S. dealer inventory obtained from trade-ins subsequently declined to 53% of total inventory by 2005. Canadian proportions have been estimated to be in the same range.

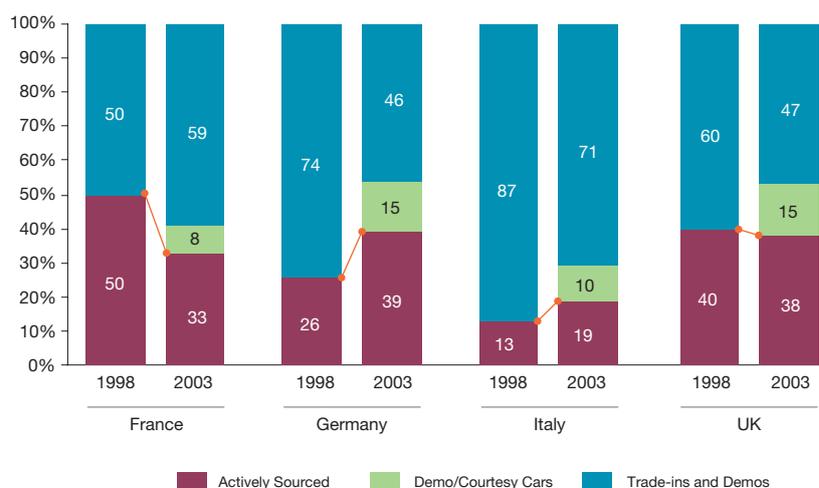
The proportion of new sales made with trade-ins in the United States was 46% in 2003 (declining further to 42% in 2005),³⁶ which was comparable to the 46% and 47% in France and Germany, respectively. In Canada, the proportion of sales made with trade-ins has been estimated at about one-third, but precise data is not available.

The proportions of used vehicle sales made with trade-ins were remarkably similar as well (just over 30% in France, Germany and the United States in 2003).³⁷

The Consumer Buying Process

The process of buying a used vehicle is generally shorter, compared with buying a new vehicle. In the U.S, research shows that buying a new car takes on average six months whereas buying a used car takes just 2.31 months.³⁸ In France, as used car intenders considered “better availability” to be an important factor for buying a used vehicle, consumers were inclined to take less time for the shopping process. In Canada, the process is slightly shorter than in the U.S. while in Germany it remains unclear. Both French and Canadian consumers consider price/incentives an important factor for buying used vehicles, while Americans care more about vehicle model/type.

Percentage of Used Cars Retailed



Source: ICDP

³⁶ CNW Marketing Research, Inc., Document 920: Trade-in at dealerships.

³⁷ ICDP research report 03/04, “Used cars: A new model?,” p.79 for France and Germany; CNW Marketing Research, Inc., Document 920: Trade-in at dealerships for U.S.

³⁸ CNW Marketing Research, Inc., Purchase process Wave IX.

The shorter buying cycle for used cars has serious implications for lead management, requiring faster lead qualification and response times.

A global consumer survey conducted by Capgemini in 2006³⁹ revealed that:

- Cash-back incentives were most likely to be important for German used vehicle customers (50% of German used vehicle buyers considered incentives as an important factor vs. 33% of Americans and 25% of the French).
- The reliability of the brand and price of the vehicle were important for used vehicle customers in all three markets (Canada was not included in the study), with approximately 90% of used buyers rating these factors as important.
- The option for additional warranty coverage or service was more important to Europeans than to Americans: Only 37% of American used buyers rated it as important, compared with 49% of Germans and 53% of the French. This may help account for the higher proportion of French buyers who are planning to buy a certified vehicle.

Dealers' investment in Internet advertising has increased in all four countries. However, studies from both North America and Europe indicate that the Internet hasn't completely replaced traditional print advertising. Print is still the most important information source for used vehicle buyers in most of the countries, although use of the Internet is growing rapidly.

Capgemini's "Cars Online 06/07" survey shows that European used vehicle buyers reported being more likely to use dealers as an information source. Only 17% of used vehicle buyers

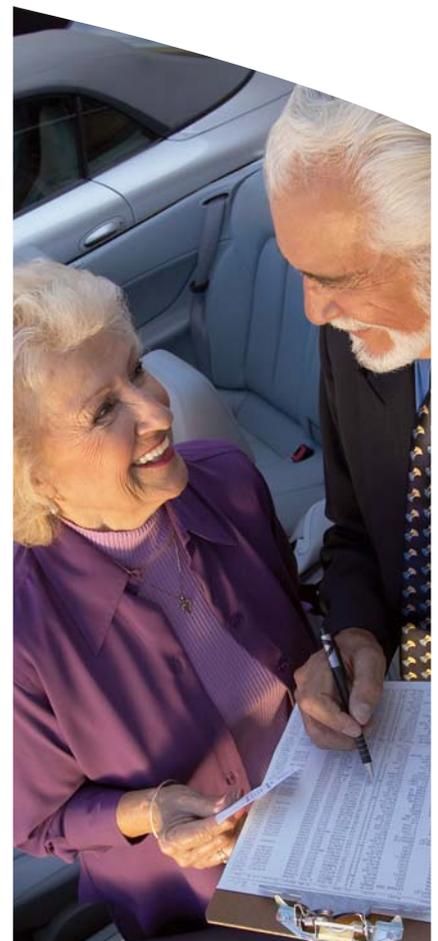
in the United States planned to refer to manufacturer-specific franchised dealers, compared with 40% in France and 30% in Germany. American and German used car buyers were both more likely to consult family and friends (48% and 49%, respectively) during their next purchase than French used vehicle buyers, only 29% of whom planned to consult this source.

French used buyers were least likely to consult information websites (only 35%, compared with 46% in Germany and 47% in the U.S.). Furthermore, American used buyers were less likely to consult manufacturer Internet sites; only 27% of respondents vs. 40% in France and 50% in Germany.

Independent e-tailer sites were much more likely to be used by German customers. As many as 47% of German used buyers planned to consult independent e-tailer sites for their next purchase, compared with only 16% of French and 19% of American used vehicle buyers.

Automotive publications were much more likely to be used by Europeans: 40% of used buyers in France and 38% in Germany planned to use this information source, compared with only 21% in the United States.

However, American used vehicle buyers were the most likely to use independent car valuation services (e.g., Kelley Blue Book, Edmunds.com) in the shopping process (62%), compared with 34% of German and only 11% of French used vehicle buyers. In fact, the difference in the use of independent car valuation services is probably the single largest difference in the use of the various information sources among the three markets.



³⁹ Capgemini, "Cars Online 06/07."

eBay Phenomenon and Internet Impact

eBay Germany, although entering the market four years later than eBay Motors U.S., acquired one of the largest online classifiers in Germany – mobile.de – and has become a major competitor in Europe. It is also one of the reasons behind the growth of the private market in Germany. eBay Germany now has an inventory more than four times larger than that in the U.S. In addition, in 2003, globally eBay’s “virtual stock turn,” a ratio between the number of used car transactions and the size of the database at one time, was 28, compared with 0.8 for Autoscout24 and 7.0 for La Centrale.⁴⁰

In terms of Internet activities, not only does eBay Germany outperform eBay in the other three countries, but Germany also leads in several other metrics. Based on Capgemini’s “Cars Online” research, Germans were more likely than other consumers to use the Internet to research vehicles (among used vehicle buyers, 97% planned to use the Internet for research in Germany vs. 84% in the U.S. and 74% in France). German used buyers were also the most

likely to visit third-party websites (e.g., Autobytel, Cars Direct) when researching vehicles: 89%, compared with 75% of French and only 48% of American used buyers.

It is interesting to note that substantially fewer vehicles are listed on the eBay Canada website. This may be due in part to the tendency of Canadian consumers to be risk-averse. eBay’s business model initiated with a transaction platform somewhat similar to the C2C market, where information asymmetry is in favor of the seller and buyers have to make trade-off decisions between risk and price; it appears that Canadian consumers are less likely to take the risk. This phenomenon could be accounted for by cultural reasons, and is also reflected in the shrinking share of the C2C market in Canada (down from 45% in 1992 to 37% in 2005).

In addition, according to eBay U.S., the most popular cars sold on the site are the Ford Mustang, Chevrolet Camaro and Chevrolet Corvette,⁴¹ indicating that vehicle culture plays a role as well.



The Impact of eBay

	U.S.	Canada	France	Germany
Current eBay vehicle listings (located within country)	35,000	507	22,300	161,400

Source: CIRP, adapted from eBay U.S., eBay Canada, eBay France, eBay Germany
 Note: eBay Germany owns mobile.de and offers cross-listing to customers of each for a fee.

⁴⁰ ICDP research report 03/04, “Used cars: A new model?” p. 57.

⁴¹ USA Today, August 25, 2005, “Buyers kick virtual tires on eBay Motors auction site.”

Used Vehicle Financing

Our research identified a great deal of difference between consumers in the U.S. and Canada in terms of financing their used vehicles. The distinct financing behavior is, to some degree, similar to the way the two parties finance their new vehicles. Three out of four Americans use financing to purchase their used vehicles, while in Canada, 63% of used vehicles buyers use leasing or financing. U.S. consumers have a higher tendency to purchase with direct financing where they arrange their own financing without dealer involvement. In

Canada, banks are not permitted to compete in the leasing market and, as a result, consumers are more likely to use dealer financing.

Except in France, where the ratio has remained stable for consumers to purchase with a financing package, the other three countries show a trend toward increasing use of dealer financing.⁴² This trend indicates that the financing packages offered by dealers have become competitive with direct lenders and provide consumers one-stop shopping to shorten the buying process.

Used Vehicle Financing Method in North America

	U.S.	Canada
Cash	24%	38%
Lease	2%	5%
Loan	75%	58%

Source: CIRP, adapted from CNW Marketing Research, Inc., DesRosiers 2005

Direct vs. Indirect Financing

	U.S.	Canada	France	Germany
Direct	60%	48%	67%	50%
Indirect	40%	52%	33%	50%

Source: CIRP, adapted from CNW Marketing Research, Inc., DesRosiers, ICDP

⁴² See CNW Marketing Research, Inc., Document 544: Direct-Indirect Financing for U.S.; DesRosiers, The Canadian Automotive Finance Market for Canada; and ICDP 03/04 for France and Germany.





Regulatory Impact

Government regulation is one of the most influential factors affecting the development of the used vehicle market in a given country. It is linked to various socio-cultural issues that differ across nations; as a result, it is difficult to make direct comparisons among the four countries investigated.

However, there is a trend in these countries to promote the transparency of the used vehicle business through regulation. For example, in the United States, the “Car Buyer’s Bill of Rights” forces dealers to reveal vehicle history along with a copy of the inspection report when selling certified used vehicles and provide a two-day sales contract cancellation option.⁴³ A similar law governing product liability was introduced in Germany in 2002.⁴⁴

Other regulations have contributed either to increasing channel competition or to protecting the market from growing channel pressure. For example, in Canada, banks are not allowed to directly lease passenger vehicles to consumers (as a result, OEMs have become the only player with access to a large volume of off-lease vehicles), while the revision of Block Exemption legislation in Europe has provided used vehicle buyers with greater vehicle selection through multi-brand dealerships.

In the U.S., government regulations have favored dealers by prohibiting manufacturers from owning a dealership or acting in the capacity of a dealer.⁴⁵ Moreover, any direct sales by automakers are prohibited in the United States.

In 2004, we examined the degree of acceptance among consumers for buying a vehicle directly from a manufacturer’s website. While consumers from both the United Kingdom (10%) and the United States (19%) showed a degree of acceptance for buying a vehicle, the chances of this regulation being lifted are slim due to heavy lobbying by auto dealers.

⁴³ California Department of Motor Vehicles (DMV) announcement of Car Buyer’s Bill of Rights, http://www.dmv.ca.gov/pubs/brochures/fast_facts/ffvr35.htm.

⁴⁴ DAT report 2006 kfz-betrieb.

⁴⁵ OUT-LAW News, “Texas bans Ford selling cars on-line,” <http://www.out-law.com/page-1945>.

Success Strategies in the Used Car Business

The development of online tools for buyers and sellers has made the used car market more competitive, all the while providing dealers with new opportunities to improve operations and capture profitable sales. The most important success strategies OEMs and dealers must pursue in order to take advantage of these opportunities are to:

- Continually improve the customer experience, from the Internet to the showroom.
- Rationalize customer relationships through Customer Relationship Management (CRM).
- Perfect online promotion and merchandising efforts to reach prospects and existing customers.
- Manage inventory and pricing with network-wide IT solutions.
- Maximize high-margin sales opportunities.
- Optimize certified used vehicle programs.

1 Improve the Customer Experience

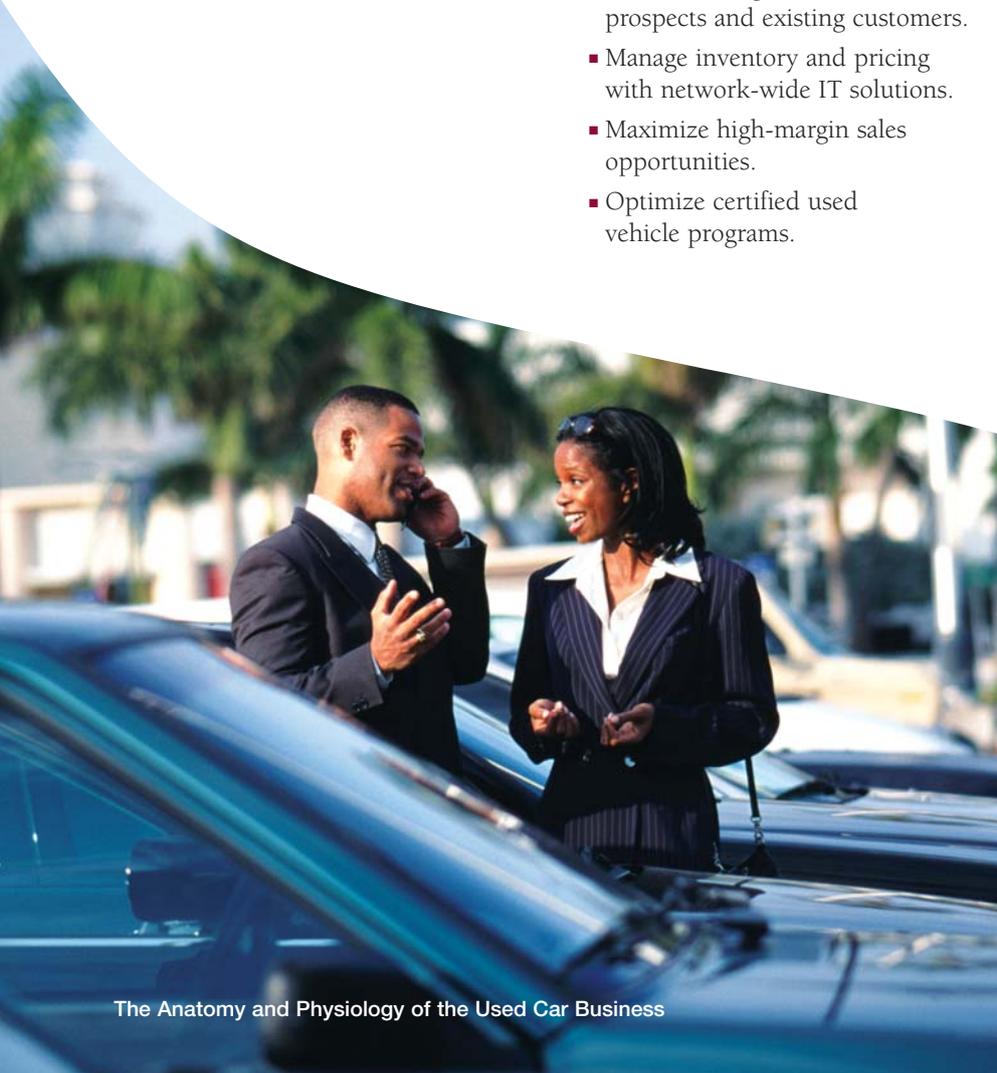
To establish a trust-based relationship dealers must provide customers with transparent information (price books, visible quotes listed, no-haggle strategies, etc.) and to ensure online/offline consistency of information. This includes making pricing information available, both in online listings and with clear pricing signage on cars for sale on the lot. While some customers like to haggle, most consider the haggling process stressful.

Salespeople should be trained to adopt an attitude of assisting customers and being available to provide information and discourage a “hard-sell” approach, which stereotypically characterizes used car sales.

In addition, visual cues, both online and offline, should inspire trust and communicate an image of professionalism. The ultimate goal is to establish trust, which is a major competitive advantage for dealers, and to emphasize those features of the dealer’s service offering that independents and private sellers cannot provide.

2 Rationalize Customer Relationships Through CRM

Traditionally, used car salespeople have a three-week to one-month threshold in terms of customer follow-up, after which time customer relations tend to become sporadic and haphazard. Various IT-based CRM tools, which bolster customer-centric marketing, enable this process to maximize sales opportunities. These tools optimize both information processing and the cost of customer relations. Analytical tools for data storage and retrieval can facilitate



daily operations by simplifying information management and automating profitable decision-making processes.

The potential to optimize revenue from customers throughout their shopping cycles using CRM tools is vast. Some dealers, for instance, have found that satisfied certified vehicle buyers are likely to return for a new vehicle for their next purchase.⁴⁶ Noted Norm Olson, Toyota's manager of retail sales operations and certified used vehicles, "From our surveys, 76% of consumers who bought a certified vehicle in April indicated their next purchase will be a Toyota. They're pretty happy campers. That's the way we keep building sales into the future."⁴⁷

Analyzing such customer trends and optimizing the targeting of promotions accordingly can greatly increase the return on promotional spending by dealers and manufacturers.

Putting more emphasis on CRM may mean moving away from a product-centric approach, which can bring with it certain difficulties in implementation, such as creating new types of partnerships and new economic models. It involves investing now for future returns that are not easy to quantify. This requires an organizational emphasis on the crucial role of information systems for developing customer relations, instead of seeing used sales as one-

time transactions. These changes require organization-wide cultural shifts that must be supported by training and support from the top.

3 Perfect Online Promotion and Merchandising

Use of the Internet during the vehicle buying cycle continues to climb, with approximately eight out of 10 respondents indicating that they use the Web to research vehicles.⁴⁸ And it's not just manufacturer sites they're visiting. In North America, for example, dealer website visits increased by 70% in the past four years.⁴⁹ It's important, therefore, that dealers post their entire inventory – new and used vehicles – online to reach prospects.

The Internet is now familiar enough for customers to want to use it extensively; moreover, widespread broadband access enables the targeting of a mass market with sophisticated websites and cognitive choice-facilitating tools. Indeed, customers are often one step ahead of professionals, who are still far removed from the Internet 2.0 culture increasingly being embraced by their customers. The growth of consumer tools such as the Internet, blogs, chat rooms, search engines and online reviews can lead to faster growth of the professional dealers by accelerating the growth of consumer sophistication and rising expectations.

It is essential to increase response time for Internet-generated leads, which has traditionally been too



⁴⁶ "Auto Execs Highlight Importance of Pre-Owned Departments," Auto Remarketing, May 16, 2006, <http://www.autoremarketing.com/ar/news/story.html?id=4969>.

⁴⁷ Ibid.

⁴⁸ Capgemini, "Cars Online 06/07."

⁴⁹ AutoRemarketing.com, "Study: Buyers Visiting Dealership Web Sites Grow 70%," April 25, 2006.

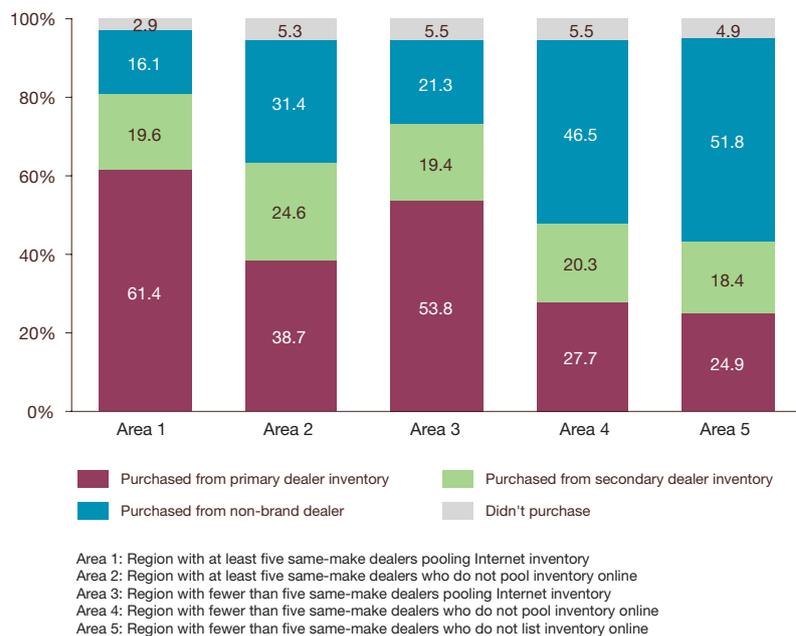
slow, to help reap the benefits of this method of customer contact. Capgemini's "Cars Online 06/07" research found that almost 40% of consumers said they expect a dealer or manufacturer to respond to a request for a quote via e-mail or the Web within four hours, up from 29% the previous year.

In our experience, we have found that dealers in some countries use the Internet as an alternative sales channel, for instance selling less attractive vehicles to third-party sites. They also increasingly use tools such as Google AdWords to highlight their own sites and vehicle stock.

An online promotion and merchandising program also should include online inventory pooling. Online inventory pooling, especially within a given geographical area, is essential not just for building sales, but for avoiding lost sales. It has become a must-have necessity, rather than a nice-to-have expenditure.

The need to manage inventory effectively to achieve faster turnover is even more significant for dealers' used vehicle operations than for new sales for two major reasons: Not only is the cost of holding inventory high in and of itself, but used vehicles also depreciate with every day spent on a dealer's lot while the cost of "lot rot" cuts into dealer margins. ADESA estimates that \$426 in reconditioning investment is needed, on average, when a vehicle is held in inventory over 90 days in the U.S.⁵⁰

Effectiveness of Online Inventory Pooling



Source: CNW Marketing Research, Inc.

One way for dealers to reduce the risks of holding used inventory is to pool inventory online.

Using the United States as an example, a recent CNW study⁵¹ demonstrates that online pooling of inventory among dealers in a geographic area has two important benefits:

1. Customers are far less likely to purchase a competing brand (only 16.1% vs. 31.4% in areas with five or more dealers).

2. Customers shop around less (61.4% buy from the first dealer they visit vs. 38.7% in areas with five or more dealers).

Moreover, the cost of not listing inventory online is high: In regions with fewer than five dealers who did not list inventory online at all, as many as 51.8% of shoppers bought from a competitor.

⁵⁰ ADESA (a provider of wholesale vehicle auctions and related vehicle redistribution services for the automotive industry in North America), "Supply Sources – Dealers," Global Vehicle Remarketing, 2006.

⁵¹ CNW Marketing Research, Inc., Document 399: Effectiveness of online inventory pooling.

4 Manage Inventory and Pricing With Network-Wide IT Solutions

Companies must invest in IT-based inventory management solutions. OEMs should enable dealers to share their inventory information online so they can transfer vehicles between dealerships to help optimize product offerings in different regions.

Some manufacturers have introduced software to help dealers calculate the margins on certified vs. non-certified vehicles and to learn which vehicles sell better in their markets to help them maximize inventory management. Other training, including mentoring, is also used to improve dealers' used vehicle operations.

Break-even trade-in values and pricing should be determined for each vehicle by combining up-to-date market pricing information with dealership cost information, so that target margins can be met. This process should be completely automated and applied across the entire distribution network.

It is essential to develop reactivity in customer information systems with daily database upgrades, coupled with channels to filter out cars that are "outside quality norms" or that would incur prohibitive repair costs. This requires better control over the information chain through working with sophisticated IT tools, including non-redundant one-click administration; and managing supply diversity by developing open, multi-brand approaches.

5 Maximize High-Margin Sales Opportunities

Financing opportunities are not currently maximized in most markets. For some high-margin categories of used cars, promotional financing, which is normally reserved for new car sales, may be a profitable strategy, but should be viewed as a revenue center and not as a loss leader to stimulate sales.

It may be as profitable for franchised dealers to sell slightly older cars (4 to 5 years old) as late-model vehicles. Consider the durability of today's 5-year-old cars, which are still likely to provide customers with a quality experience and could take advantage of the online sales and promotional capacity already in place. While dealers in Europe, particularly in France, tend to avoid vehicles older than 3 years, North American dealers have found them to be a profitable opportunity. The dealer's orientation and consumer expectations in the dealer's local market must be taken into account, however. As discussed earlier, strategies undertaken by dealers are in many cases a result of socio-cultural factors that cannot be reduced to a simple economic logic.



6 Optimize Certified Used Vehicle Programs

Certified vehicles provide a high-margin sales opportunity for dealers, involving lower inventory costs, faster turnover and higher residual values, thus supporting a dealership's new vehicle business as well.

As such, certified used vehicle programs may be the most important success strategy, as they provide the best protection against channel competition and allow companies to improve margins significantly. Sales of manufacturer-certified vehicles, as measured by CNW, have more than tripled between 1997 and 2006, totaling approximately 1.5 million units in 2005 in the U.S.⁵² That

growth, while slowing, continued in the past year. Unit sales of certified used cars and trucks in the U.S. in 2006 rose almost 2% to 1.6 million.⁵³

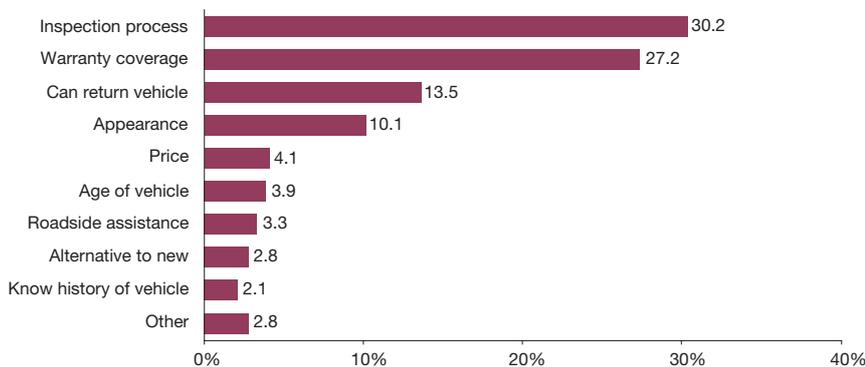
According to J.D. Power, 2005 certified used vehicle sales accounted for 41% of franchised dealer used sales and commanded a \$1,680 premium.⁵⁴

Consumer interest in certified vehicles is significant: According to CNW, as many as 94% of consumers intending to buy a 1- to 3-year-old vehicle said they would consider purchasing a certified off-lease vehicle.⁵⁵ And a 2006 Edmunds.com survey revealed that as many as 85% of both new and used vehicle shoppers would consider or have considered buying a certified vehicle.



Why Consumers Buy Certified Used Vehicles

Of the following reasons for selecting a certified vehicle, which do you consider most important?
(% of used car buyers saying)



Source: CNW Marketing Research, Inc.

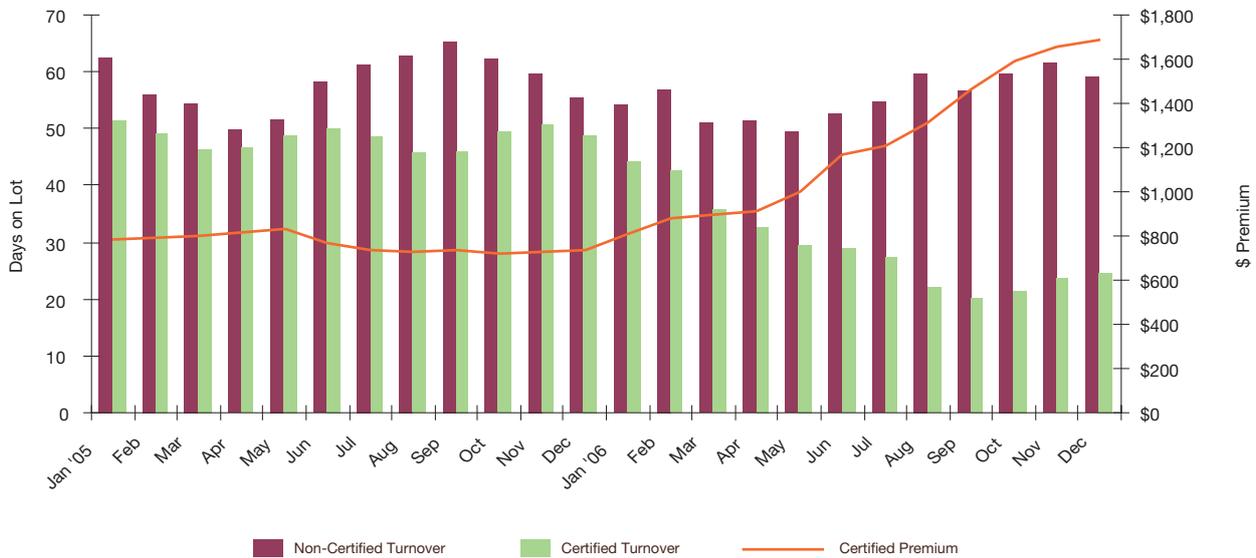
⁵² CNW Marketing Research, Inc., Document 331: Certified used vehicles.

⁵³ "Certified used-vehicle sales rise in '06," *Automotive News*, January 22, 2007, p. 40.

⁵⁴ "The Best Used Cars," Matt Vella, *BusinessWeek Autos*, July 5, 2006.

⁵⁵ CNW Marketing Research, Inc., Document 192: Consideration of used vehicle types/sources.

**Certified vs. Non-Certified Turnover and Premium in the U.S.
2005-2006**



Source: CNW Marketing Research, Inc.

Certified pre-owned (CPO) vehicle buyers have higher satisfaction rates than other used car buyers⁵⁶ and are more likely to return to the same brand or dealer for their next purchase than other used vehicle buyers.⁵⁷ This is essential for increasing dealership income, since there is an important relationship between customer satisfaction and future revenue. In fact, J.D. Power found that almost 90% of used vehicle buyers who reported receiving outstanding service intended to return to that dealer for future service. Toyota, for example, counts on this to help bring in first-time customers and drive future demand. An internal survey showed that 46% of its CPO buyers

have never owned a Toyota before, and 76% of CPO buyers indicated their next purchase would be a Toyota.⁵⁸

In part because of their high levels of satisfaction, certified buyers are more likely to return to the dealership for routine maintenance, leading to higher service revenues. At Chrysler Group, for example, 43% of CPO buyers return to the dealership for maintenance, compared with just 24% of non-certified customers.⁵⁹ Moreover, dealers have the opportunity to generate significant financing revenues on certified vehicles, given their relatively high average prices.

⁵⁶ CNW Marketing Research, Inc., Document 641: Miscellaneous used vehicle information.

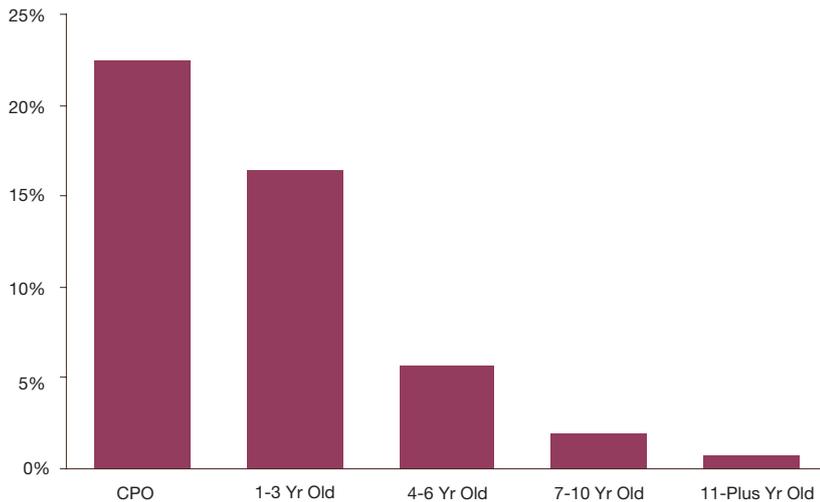
⁵⁷ CNW Marketing Research, Inc., Document 997: Used vehicle loyalty to dealership.

⁵⁸ "Used car brands keep dealers in control," *Automotive News*, February 6, 2006.

⁵⁹ "What Does it Take to Drive Successful Certified and Pre-Owned Sales?" Jennifer Reed, June 27, 2006, *Automotive Remarketing*, <http://www.autoremarketing.com/ar/news/story.html?id=5149>.

Loyalty to Franchised Dealer

% returning for another certified pre-owned (CPO) vehicle



Source: CNW Marketing Research, Inc.

Certified Vehicle Challenges

Despite the advantages of certified vehicle programs, there are also challenges:

Limited inventory supply. As fewer certifiable off-lease vehicles are available on the market, dealers are finding that there are not enough vehicles to meet demand.⁶⁰ Almost one-fifth of customers who considered a CPO vehicle had to forgo this option because it was not available in their desired model.

For example, to help meet demand, Toyota recently expanded the requirements for certifiable vehicles (increasing the permissible mileage

and age), but there is a limit to how much the standards can be expanded before the other benefits of certification begin to erode.

Competing certification programs.

Many independent dealers, as well as some franchisees, have their own certification programs, often complete with inspection check, limited warranty and the ability to return/exchange the vehicle.⁶¹ These programs are not backed by the manufacturer and are usually less generous, but many consumers (57%, according to an Edmunds survey) do not know the difference between manufacturer and independent certification. Although

independent certification programs do not result in additional obligations for the manufacturer, if a customer has a problem with a “certified” vehicle sold by an independent dealer, the manufacturer’s brand may still be damaged.

Customer awareness of certification.

A 2005 J.D. Power survey showed that the majority (64%) of CPO vehicle buyers only became aware of the certified program at the dealership. This points to the need for manufacturers and dealers to educate consumers about the benefits of certified vehicles, whether through advertising, in person or on the Internet.

⁶⁰ CNW Marketing Research, Inc., Newsletter, August 2006.

⁶¹ “Used car brands keep dealers in control,” Automotive News, February 6, 2006.

Conclusion: A New Approach to Used Car Sales

The used vehicle market has grown in size and importance in the past decade and is poised to continue to do so in the future. A successful used vehicle strategy on the part of automakers and dealers is becoming essential to their operations and is increasingly recognized as such.

Sales of new and used vehicles are strongly interrelated; used sales affect residual values and new vehicle pricing, in addition to relationships with customers and the strength of brands. In short, used car sales have a significant effect on many aspects of an automaker's sales and cannot be ignored. OEM involvement on the levels of inventory management and used vehicle branding is crucial for enabling dealers to carry out successful remarketing programs.

Impact on OEMs

A dealership's used vehicle business impacts manufacturers on three major levels:

- **Loyalty:** Satisfied buyers are more likely to buy their next new vehicle from the same manufacturer and to provide positive word-of-mouth. This principle works the opposite way as well, as a used vehicle sale may either build or erode loyalty.
- **Profitability:** Relatively new, high-quality vehicles traded in at the dealership not only provide significant margins, but also act as a source of profitable financing, insurance and service revenues.

- **Pricing power:** Residual values impact the attractiveness of trade-ins and new vehicle purchases, restricting the ability of manufacturers to price new vehicles and determining how much they must rely on incentives to stimulate demand. Strong used vehicle sales and inventory control can lead to stronger new vehicle sales and higher profitability for manufacturers and their dealer networks.

While national used vehicle markets differ in character and structure due to a variety of socio-economic factors, this report identified six core strategies that are essential for growing dealers' used vehicle sales:

- Continually improve the customer experience, from the Internet to the showroom.
- Rationalize customer relationships through CRM.
- Perfect online promotion and merchandising efforts to reach prospects and existing customers.
- Manage inventory and pricing with network-wide IT solutions.
- Maximize high-margin sales opportunities.
- Optimize certified used vehicle programs.

In all markets, the dealers and manufacturers with successful used car operations make strategic investments in technology to improve customer experiences and build the trust that forms the basis of their ability to compete with lower-priced independent dealers and private sellers.

Creating positive encounters with customers and building long-term relationships based on trust is ultimately rooted in transparency. The information available to consumers online has greatly reduced information asymmetry in an irreversible way, thereby changing the rules of the game. The obfuscation and stereo-typical sales orientation, which characterized the market in the past, are no longer possible in a competitive market where consumers not only have higher expectations of the used car transaction, but are able to have their expectations fulfilled at forward-thinking dealerships.

Responding to Change

Consumer attitudes to used vehicles have become more sophisticated as vehicles themselves have improved in quality and reliability. The tools used by consumers have also evolved, resulting in the need for dealers and manufacturers to fundamentally change their approach to the sale of used vehicles, as this report has shown. While these changes involve significant financial investments, they hold the potential for great returns and are, in fact, necessary in today's market. Dealers and manufacturers face a rapidly evolving car market; they must evolve with it if they do not wish to be left behind.

About Us

About the Car Internet Research Program II (CIRP II)

The Car Internet Research Program II (CIRP II) is an industry and academic-sponsored automotive research program directed at understanding how new information and communication technology will impact the automobile industry.

Administered through the University of Ottawa, CIRP is sponsored by a variety of industry stakeholders that include: Capgemini, PSA Peugeot Citroën, Renault SA and The University of Ottawa.

About Capgemini and the Collaborative Business Experience

Capgemini, one of the world's foremost providers of Consulting, Technology and Outsourcing services, has a unique way of working with its clients, called the Collaborative Business Experience. Backed by over three decades of industry and service experience, the Collaborative Business Experience is designed to help our clients achieve better, faster, more sustainable results through seamless access to our network of world-leading technology partners and collaboration-focused methods and tools. Through commitment to mutual success and the achievement of tangible value, we help businesses implement growth strategies, leverage technology, and thrive through the power of collaboration. Capgemini employs approximately 68,000 people worldwide and reported 2006 global revenues of 7.7 billion euros.



For more information please contact:

**Car Internet Research Program II
(CIRP II)**

Christian Navarre
+1 613 562 5800 ext. 4688
navarre@management.uottawa.ca

Capgemini

United Kingdom/Global

Nick Gill
+44 1 483 645699
nick.gill@capgemini.com

France

Eric Piat
+33 (01) 49 01 80 04
eric.piat@capgemini.com

Germany

Christian Hummel
+49 (0) 69 9515 1626
christian.hummel@capgemini.com

North America

Mohit Takyar
+1 313 887 1474
mohit.takyar@capgemini.com

www.cirp.uottawa.ca

www.capgemini.com

