

WHY THE DECLINE IN AUTO RETAIL FINANCE?

by Toby Procter

“The total auto retail finance market, including point of sale and direct lending, lost half its value in the past five years”

The government's older car scrappage scheme is budgeted to create 300,000 extra new car sales in this fiscal year and, who knows, it may produce similarly spectacular results to those in Germany. But most of those extra sales will need financing, which is still problematical.

The scale of the problem with auto retail finance is the subject of Trend Tracker's latest research report, The UK Retail Car Finance Market 2009, which tracks data from 2003 and forecasts the market to 2014. The report clearly shows just how hard the financing of car purchases has been hit by the so-called credit crunch.

The total auto retail finance market, including point of sale and direct lending, lost half its value in the past five years and finance market volume, in terms of the total number of loans and finance transactions for both new and used car purchases, fell by 52% from 2003 to 2008.

But before jumping to the conclusion that car finance has caused all the problems in the new and used car markets, it is as well to consider that the rot set in long before financing became an issue. The retail component of the new car market

declined by 11% in 2008 compared to 1999, but was 29% down in 2008 from the peak 1.25 million new sales in 2003. The used car market has been considerably more resilient - down by an estimated 5% between 2003 and 2008.

So a major reason for the decline in retail car finance - including both direct lending and point of sale - has been the fall in the retail market for new cars for other reasons including availability and cost of credit. And, although used car sales have been firmer, many used cars are sold at relatively low prices and therefore financing is not required.

DIRECT HIT

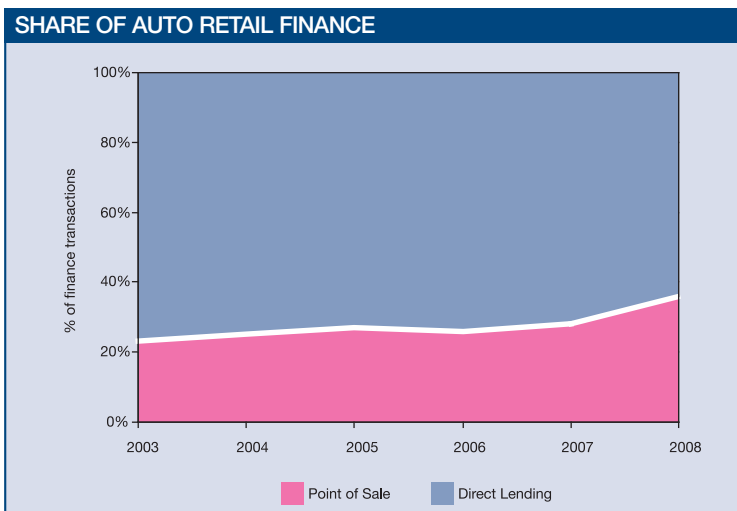
More recently with the onset of the 'credit crunch' and then the recession, a lack of available credit - especially personal loans - has impacted on new car sales particularly. The direct car finance market (comprising both unsecured and secured personal loans), fell in value by a massive 63% between 2003

and 2008 and 60% in terms of volume.

A sizeable proportion of the decline in direct car finance is attributable to the amount of personal debt that had built up among UK consumers. But the paralysis of the money markets since the scale of the sub-prime exposure of US lenders was first uncovered has certainly played a major part.

To a certain extent, point of sale finance companies have stepped in to make up for this dearth of direct loans and the penetration of point of sale has clearly risen since 2007. However point of sale lenders are equally constrained by the money markets. So, until the money markets start to function again, we can expect the retail new car market to remain depressed and little growth in used cars.

Competitors in the retail motor finance



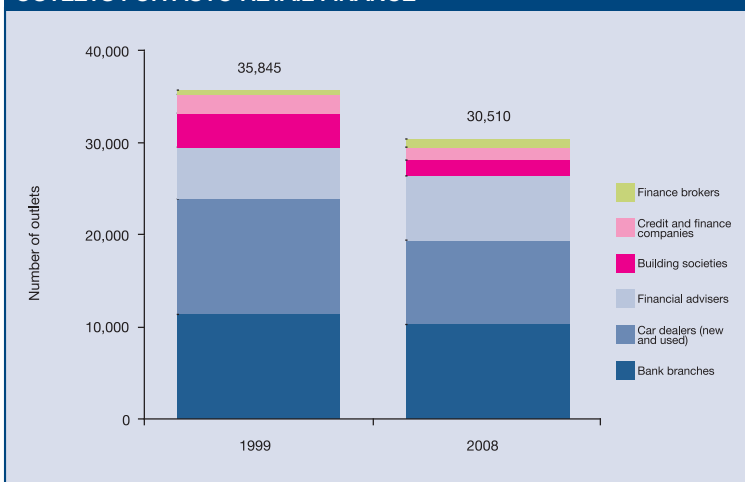
market comprise vehicle manufacturers' captive finance houses, independent finance companies, the high street banks and building societies, and other direct lenders. The number of independent finance companies operating in the UK motor finance market has declined over the past decade, due largely to consolidation effected by mergers and acquisitions.

The independent finance companies rely on their mostly bank parents for long-term funding; but these banks need to shore up their own balance sheets before they can help their subsidiaries. This, coupled with banks' present difficulty in raising funds cheaply in the wholesale markets, raises questions over the long-term future of some of their motor finance subsidiaries.

FINANCE OUTLETS

Another factor that may constrain the pace of re-growth in auto retail finance is the long-term declining trend in the number of places

OUTLETS FOR AUTO RETAIL FINANCE



Source: Trend Tracker

although it has increased marginally in recent years - mainly due to an increase in the number of financial advisers and brokers.

The distribution channels that have experienced the largest decline in outlets have been building societies, finance companies, and car dealers. Where building societies are concerned, the decline has been largely due to the conversion of many of them into banks through de-mutualisation. Of course the direct lenders can resort, as so many already have done, to the

where it can be sold. In 2008, there were 30,510 physical outlets in the UK from which car finance products could be sold, 15% fewer than the 35,845 present in 1999.

Bank branches make up the largest proportion of these (34%) with 10,400 outlets, followed by 9,210 new and used dealerships. Dealers account almost exclusively for point of sale finance products, primarily hire purchase or PCP loans secured on the vehicles they sell.

The long-term trend in the distribution structure for car finance products is for the number of outlets to continue to decline;

internet as their distribution outlet of choice.

However, there are signals from the data covered by Trend Tracker's report that point of sale finance can reclaim some of its traditional share of car finance demand, provided auto retailers don't place too much emphasis on margin and rate spread rather than sales penetration.

There has long been a common complaint among point of sale lenders and auto retailers that direct lender competitors - particularly those that major on headline rates compared by the internet comparison sites - don't, in practice,

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“Trend Tracker does not expect the auto retail finance business to recover its peak volume of five years ago in the next five years”

lend to many borrowers on the terms they advertise. Auto retailers may find some satisfaction in noting that the Office of Fair Trading is conducting a consultation on the terms of an investigation it plans into direct lenders' practices.

SLOW GROWTH

The main difference between the current recession and the previous two downturns in 1991/92 and 1981/82 is that the first two featured high inflation and high interest rates; whereas we're now experiencing falling inflation (turning to deflation in March), historically low interest rates and a shortage of credit on offer.

More people may have wished to buy cars than were able to in the previous recessions, as borrowing becomes easier when inflation erodes the value of repayments. But that cuts no ice when repayments are unaffordable because of high interest rates. Right now, new car (and car finance) demand is still descending from a peak of four years ago and money is relatively affordable for those in work, but in scarce supply.

If the increase in disposable incomes for the half of all mortgaged households with variable rate mortgages helps fund repayments on car loans - and if the £2,000 scrappage incentive results in a significant increase in new car demand - growth could be kick started in the car market.

But, as around half of all cars are purchased using some form of credit, and the car finance suppliers need confidence to return in the money markets and willing customers need finance, Trend Tracker does not expect the auto retail finance business to recover its peak volume of five years ago in the next five

AUTO RETAIL NETWORK SPECIAL OFFER

'The UK Retail New Car Finance Market 2009' is published by Trend Tracker at £1,450 + VAT, which includes a hard copy, PDF file of the report and a 15-slide Powerpoint summary. Members of Auto Retail Network can take advantage of a special price of £1,250 + VAT - a discount of £200, until June 17, 2009 - by phoning Francis Marshall on 01572 724687. For more details about the report and a contents list go to www.trendtracker.co.uk

years.

The confidence that will be crucial to recovery - between banks and among consumers - will not increase in predictable percentage steps over the next five years. And if it does not improve soon, it could spoil the scrappage scheme 'party'.

Trend Tracker's report on auto retail finance cautions that, although the market (including direct and point of sale) will grow in value by 50% between now and 2014, it will still be below the market's value in 2005.

In terms of volume - numbers of advances - the retail car finance market is forecast to grow more slowly, by 38%, over the coming five years. And some of the forecast market value increase will be accounted for by a 9% increase in average loan and transaction value.

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BLACK HORSE ABSORBS BOS DEALER FINANCE

Bank of Scotland Dealer Finance is to be absorbed into Black Horse, the auto retail finance arm of Lloyds Banking Group, as a result of the takeover of HBoS by Lloyds-TSB. The company has confirmed it will cut 985 jobs over the next two years, after review found the business was "no longer financially viable".

The banking group, which is 43% owned by the government, said 200 jobs in Speke could be affected, along with 340 jobs in Chester. The union Unite said it was in talks with Lloyds and would oppose any compulsory redundancies.

These are the first major job cuts resulting from the merger which created a banking giant employing 140,000 people. Unions fear there will be more.

Chris Sutton, Black Horse managing director, will be managing director of the new business and George Grant, former BoS Dealer Finance director, has left the company. Other staff are facing a job selection process.

Bank of Scotland Dealer Finance will not write any new loans after September.