InsightReport 2021

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DRIVING OPPORTUNITY: DEPLOYING GROWTH MINDSET ON THE JOURNEY TO 2030

Business strategy for 2022 and beyond

BUSINESS STRATEGY FOR 2022 AND BEYOND

Preparation is key for success

"Costs need to be taken out of supply, distribution, and retail if the sector is to effectively support the transition to electric and autonomous vehicles."

Owen Edwards, Head of Downstream Automotive, Grant Thornton UK LLP

The market is rapidly changing for both the upstream and downstream. This has been largely driven by technological advancements, evolving regulation, increased environmental requirements, and the need to significantly reduce costs in the uncertain markets caused by the 2020/21 pandemic.

As can be seen from both the new and used forecasts for both cars and light commercial vehicles, the market is expected to recover. However, there continues to be underlying trends shaping the pattern of this growth. Consumers are moving away from saloon vehicles to SUVs and 4x4s; the shift from ICE to EV is accelerating; there is growth in connected and autonomous technologies; and we are seeing changes in the way people want to own or use vehicles.

With such rapid movement in the automotive market, companies must evolve. However, this evolution needs to be thought through carefully, with the strategy for 2022 and beyond being key to the future growth and profitability of businesses in the automotive sector.

The market

It is likely COVID-19 will continue to impact nations worldwide, becoming a fixture much like winter flu and other communicable diseases. There is every possibility, as we write this report, the UK could see further localised lockdowns in response to the inevitable depression of immune systems and resistance over the winter months. Organisations will need to prepare to keep trading whether in a physical, digital, or hybrid capacity.

Whatever happens, cash generation remains key, with cash conservation particularly important when trading conditions get tough. We advise businesses to keep open lines of communication with funders and owners, banks, shareholders, suppliers, and customers. With the possibility of needing to respond quickly to emerging announcements, a three-month rolling strategy and business plan which focuses on reducing cost and increasing revenue will be essential.

Upstream consolidation

We expect further consolidation in the parts providers for automotive manufacturers as they aim to reduce costs and improve their supply chain efficiencies. Increasing in scale can enable parts providers to offer more service, grow revenues, and gain economies of scale. This has been successfully done by the likes of BorgWarner acquiring Delphi and developing exposure to EV technology.

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We also expect to see further consolidation in the manufacturers. We've already seen PSA acquiring Vauxhall/Opel and FCA. More is on the way to deliver economies of scale and technological advantages.

Technology and regulation

Changes in technology are also creating great upheaval in the market. The move from ICE to EV will be one of the big trends from now until 2035 and beyond. In order to meet the UK Government's zero tailpipe emissions by 2035, manufacturers need to be planning now for the development and launch of EVs. However, prior to the launch of any vehicle, whether EV or ICE, to the market, there is the requirement of at least seven years of planning, design, development, and manufacturing.

Companies that provide ICE components will be starting to plan for the required change to either provide EV parts or consider how they may diversify away from a mature and declining (in the medium to long-term) ICE market. If the process of business planning is not well underway by 2022, there is the risk that companies will be playing catchup. Losing the first mover advantage will potentially affect the profitability of a company.

Downstream consolidation

Inevitably there will be winners and losers in the changing marketplace. Further reduction in cost is expected in the distribution and retail operations. This could be the disposal of businesses, for example, the sale of Ford of Europe's Denmark distribution channel to Hedin Group AB. We would expect this trend to continue in some of the smaller global markets, providing an opportunity to independent distribution companies. The disposal of such business operations enables cost reductions while generating cash to invest in EV and CAV projects.

The dealer market will continue to consolidate, although there may be some delay in significant acquisitions in the later months of 2021 and into 2022. Potential purchasers will be trying to determine the outcome of manufacturer strategic moves. For example, Stellantis has indicated a restructure of the dealer network, terminating all European contracts with two years' notice; Mercedes-Benz is developing agency relationships in several European markets; and VW is making moves towards the agency model.

Impact of the genuine agency model

The move to the genuine agency model is being tested or reviewed by most of the manufacturers in the UK and Europe. With such a direct selling approach, this means there could be a significant shift in how dealers work with both the manufacturers and their customers. We believe there are positive and negative outcomes for both dealers and national sales companies (NSC). It is difficult to determine which route the NSC will take: a genuine agency approach or non-genuine approach, which is a hybrid of genuine agency and current

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franchise model. However, we do know it will take time to successfully implement the agency model and that each NSC will require a separate strategy as no one agency model will be suitable for all NSCs and their dealer networks.

With such uncertainty, this makes it very difficult to develop a business strategy. Nevertheless, as with all disruption, there will be opportunities for those in the market that focus on their longer-term consolidation strategy and become a key partner to the manufacturers. In all cases, there is a requirement to continue to trade and maintain a close relationship with the manufacturers.

Is the dealer dead? No, is our answer. Regardless of whether an NSC chooses the genuine or non-genuine agency model, there will still be the requirement for dealers to provide customer experience within a physical showroom, undertake test drives, provide valuable experience of helping the customer chose their vehicle, hand the vehicles over, and post new car sales services etc. There have also been rumours that the restructuring of some brands could lead to a multi-franchise model, which is already prevalent in some Nordic countries. In many cases, this approach has increased dealers' profitability, with more brands per dealership generating more sales. In addition, an increased throughput of vehicles sold or handed over, in businesses which are highly operationally geared will drive an upside for profits, with the potential return on sales of well-run operations being between 2-5%.

Furthermore, there is also the potential for vertically integrated retail or handover, with the manufacturer or NSC owning both the distribution and the retail/handover activity. This is already seen in some smaller markets across the world. Again, we believe from the existing evidence that, when operated correctly, this type of business model can generate an enhanced return on sales in excess of 6%, versus standard UK dealer margins of between 0.5% and 2%.

Impact of technology on downstream

The growth of EV is going to have an impact on both new and used vehicle markets. While the current market share for new EV is fairly small, it has accelerated rapidly in the past two years. The current customer journey for EV sales is underdeveloped for new and used cars, as is the post-sale and aftersales process. Both manufacturers and dealers will have to continue to invest in both physical EV infrastructure at the dealer sites as well as the customer journey.

To date, there has been little in the way of bespoke strategy or sales process for selling used EVs. The market is still small and used electric vehicle prices are still finding their level. With so few EVs in the used car market, is it very difficult to determine used vehicles prices for such models – hence residual value setting is challenging. Nevertheless, as this market inevitably grows over the next decade, both new and used sales customer journey strategies will be required by NSC, dealers, independents, and car supermarkets. Additionally, there also needs to be an investment in maintenance and repair facilities, in line with any health and safety requirements that are needed for servicing and repairing EVs.

Beyond retail

Increasingly, companies are looking at different ways to grow revenue and profit or reduce costs. One strategy which is being pursued is vertical integration. The growth into related markets, for example, the purchase of subscription business, Drover, and logistics business, SMH Fleet Solution by Cazoo, will allow organisations to not only sell vehicles, but also offer subscription services, and manage their own storage, infrastructure, and reconditioning. Consolidating these businesses are likely to take time, but will enable the likes of Cazoo to maintain control of these service in house.

The market is constantly changing. There will be further effects from COVID. Technological change continues, whether driven through environmental concerns, the financial impetus of ESG policies, regulation of the automotive sector, or demand from consumers. With such rapid change taking place, businesses must plan for the future, developing and evolving new business models to cater to the market changes. Furthermore, such change can be supported by well-practiced advisors who have experience of guiding companies through challenging times.

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