Report
Roland Berger

PARIS / FRANCE

The online boom in used-car sales

HOW DIGITAL TRANSACTIONS WILL TRANSFORM THE EUROPEAN MARKET

Roland Berger

MANAGEMENT SUMMARY

The European used-car (UC) market was valued at EUR 410 billion in 2020. It is forecast to grow at 3-4% per year in the coming years. The B2C (retail) segment of the UC market represents 40% of volume but 55% of value. Traditional dealers account for 99% of transactions, with online retailers and new retailers (mostly leasers, C2B cash buyers and auction players) having a <1% share.

The European retail trade is highly fragmented. Combined, the top five players account for 6% of total European B2C market volume. This high fragmentation, and dealers' limited investment capacity for developments like digitalization, mean operations remain traditional. Fully digital customer journeys, however, offer a much better experience, alleviating pain points such as multiple point-of-sale visits. Some European used-car players are moving online, but many pain points remain, for example paperwork for financing and same-day payments. No player has yet built a strong trusted brand.

We expect the European B2C used-car market to rapidly move to online sales in the coming years, as has happened in the US, with the share of online sales doubling to 10% by 2025.

Carvana is a good example of a US success story. Its valuation has risen almost 900% since its IPO in 2017, with a current value of EUR 40 billion. To be successful, a digitally oriented business model is required. This will differ significantly from the traditional business model and should be built around six key success factors:

1. Build a strong and well-known brand
2. Adopt a data-driven business
3. Combine online and physical locations
4. Set up advanced refurbishment centers
5. Tightly control logistics flows
6. Ensure vehicle sourcing is efficient and diversified

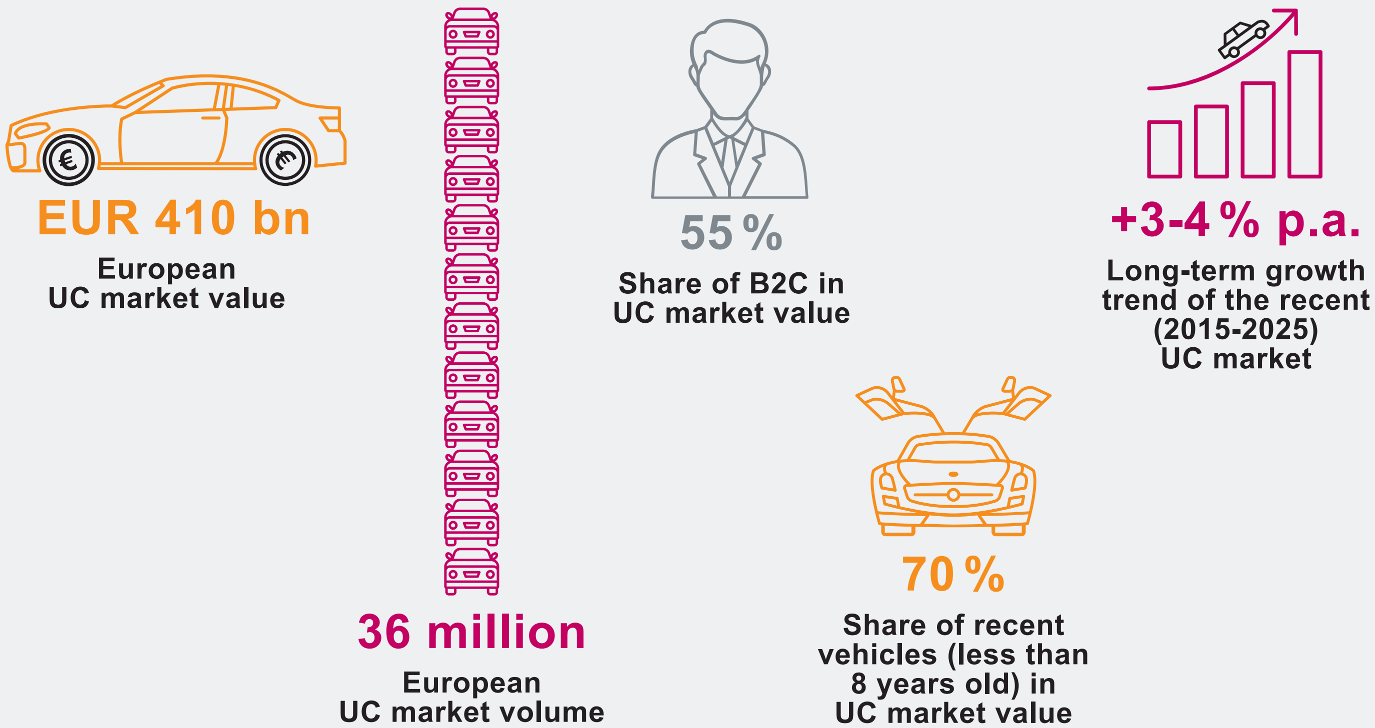
A digitally oriented business model that successfully integrates these key success factors will ensure a competitive online business. But for all the players, these factors represent entry barriers that require significant investment. A lot of players will not be able to make the digital move, which will drive up market consolidation and profitability. Investors are convinced about the digital transformation of the used-car market and are prepared to make huge funds available – more than EUR 1 billion was raised over the past 12 months.

FAST FACTS & CONTENTS

18 %
p.a. online sales growth over 2020-25

1 bn
euros raised for the digitalization of used-car market in 2020

A / Top specs Key figures for the European used-car market in 2020



Source: Roland Berger

1 / Introduction

The European used-car market is thriving. While the coronavirus crisis has undoubtedly affected sales, the long-term outlook is good. The market is currently worth EUR 410 billion and is expected to grow at 3-4% a year in the near term. Yet the industry has a problem. The process of buying a car remains relatively antiquated, as retailers have limited funds to invest in digital sales channels or business models. Most still rely on traditional methods, and this is holding the industry back. Fully online transactions promise to help overcome several existing pain points in the customer journey, such as burdensome paperwork and visits to multiple points of sale. They also promise many additional benefits, not least instant access to a wide range of vehicles and easy price benchmarking. In this report we review the status of the existing European used-car market and its challenges, with a focus on retail, and look at the impact of digitalization and, more specifically, online sales. We outline six key digital success factors relevant to all used-car players, ranging from developing a strong digital brand to creating data-driven business models. We also examine the effects of external funding.

2/ Market overview: An attractive sector with a fragmented competitive landscape

2.1 / A huge, growing and resilient market

Used cars are big business. The European used-car (UC) market was worth an estimated EUR 410 billion in 2020, with a turnover of 36 million units. It has been growing for many years and is forecast to continue doing so at 3-4% per year until 2025 (excluding Covid-19 turbulence in 2020). Volume growth is mainly driven by the vehicle parc size (number of vehicles in use), which in turn is shaped by growing populations and rates of vehicle use per head. Parc inertia helps to make the market resilient. In addition, volume benefits from the growing penetration of leasing solutions, both private leasing and long-term rentals, which increase UC sales frequency. Average prices are also increasing, pushed higher by the rise in new vehicle prices (the result, for example, of more sales of expensive SUVs, the higher prices of hybrid vehicles and tougher regulations) and the falling average age of used cars sold (leasing impact). → A

The UC market can be split into two segments: B2C (retail) and C2C. B2C represents 40% of volume but 55% of value due to its dominance in sales of recent vehicles. The C2C segment represents 60% of volume but 45% of value as it mainly involves sales of older vehicles.

IMPACT OF ELECTRIC VEHICLES ON THE UC MARKET

Boost B2C over C2C: Dealers stand to especially benefit from electric vehicles (EVs). First, most new EVs are leased due to consumer fears over residual values, meaning dealers are likely to secure the majority of used EV sales. Second, potential EV buyers have a greater need for reassurance, something professionals can do much better than private sellers.

Favor UC leasing: As with new EVs, used-EV buyers prefer to lease their vehicle for the same reasons, that is, fear of losing residual value and a greater need for reassurance.

Generate sales of new services: For example, charging unit hardware and installations, charging subscriptions, extended warranty contracts on batteries, etc.

Increased pressure on used-vehicle profitability: Traditional dealers were able to afford limited profits on ICE used-vehicle sales because of high aftersales profits. But this equation does not work with EVs because of their lower aftersales needs. As a result, dealers will have to make the sale of used vehicles more profitable.

Increased competition for battery and high-voltage network maintenance: New entry barriers will restrict access for small and/or non-franchised players.

The B2C shares have increased in the past years and are expected to continue to eat into the C2C shares in the future. This is largely being driven by private leasing penetration, with customers increasingly wanting to limit their commitment and avoid taking risks on a car's residual value in a market that is fast evolving towards electrification and advanced driver-assistance systems.

The recent-vehicles market (less than eight years old), the main target of B2C players, represents 70% of the total UC market value. Following a drop in 2020 due to the Covid crisis, it should recover quickly and grow from 16 million units in 2020 to 17 million units in 2025 (+1.5% p.a.). In value terms, this means a rise from EUR 290 billion to EUR 365 billion (+4.5% p.a.).

2.2 / A fragmented competitive landscape

The used-car retail (B2C) trade is overwhelmingly dominated by traditional physical dealers. Franchised dealers account for 66% of all UC transactions and non-franchised dealers 33%. This leaves just a fraction of the market occupied by two new categories – online retailers and new retailers. → B

As the name suggests, online retailers execute most of their sales process online; examples include UK-based Cazoo and the Aramis Group (Stellantis owns a majority stake). New retailers, meanwhile, are generally established players upstream in the value chain that have started to also sell their vehicles directly, mostly online. They include leasers, C2B cash buyers and auction platforms, such as Leaseplan with CarNext, Arval with Autoselect, Auto1 with Autohero and BCA with Cinch.

Across Europe, the UC retail trade is highly fragmented, with most players operating only in one country. The top five local players in each country account for just a small cumulative market share. The bigger the market, the higher the fragmentation. In Germany and France, for example, the top five players have

THE CHALLENGE FOR NEW RETAILERS

Upstream UC players are increasingly interested in tapping into the B2C retail sector. But despite their experience in the UC market, moving down the value chain is not straightforward and new retailers face three significant challenges:

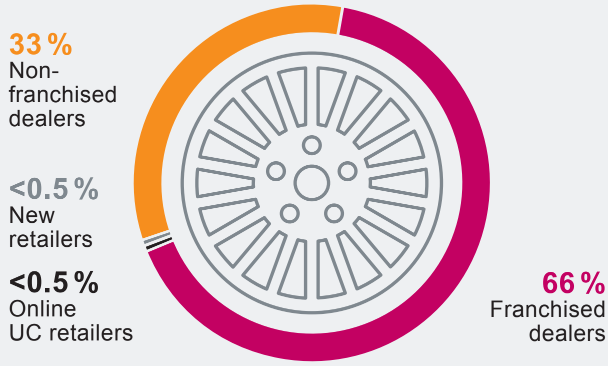
1. Creating a new brand from scratch is not cheap and requires considerable investment.

2. B2C retail is a completely different business from sales to professionals, requiring very different operations, processes and skills.

3. The vehicle mix of upstream players does not always match the mix required for retail (vehicles often have high mileage and utilization).

B / Dominant dealers

The European UC market comprises four B2C player categories, with dealers enjoying the lion's share



Source: Roland Berger

a market share of 5% and 8% respectively, while in the smaller markets of Belgium and Spain the top five represent 13% and 15% respectively.

No player in Europe has a UC market share greater than 2%, despite some (for example, Swiss-based Emil Frey, UK-based Arnold Clark) having a presence in several countries. Combined, the top five players account for 6% of total European B2C market volume.

This high fragmentation, combined with the fact that most dealers have little investment capacity for developments such as digitalization, mean their operations remain very traditional.

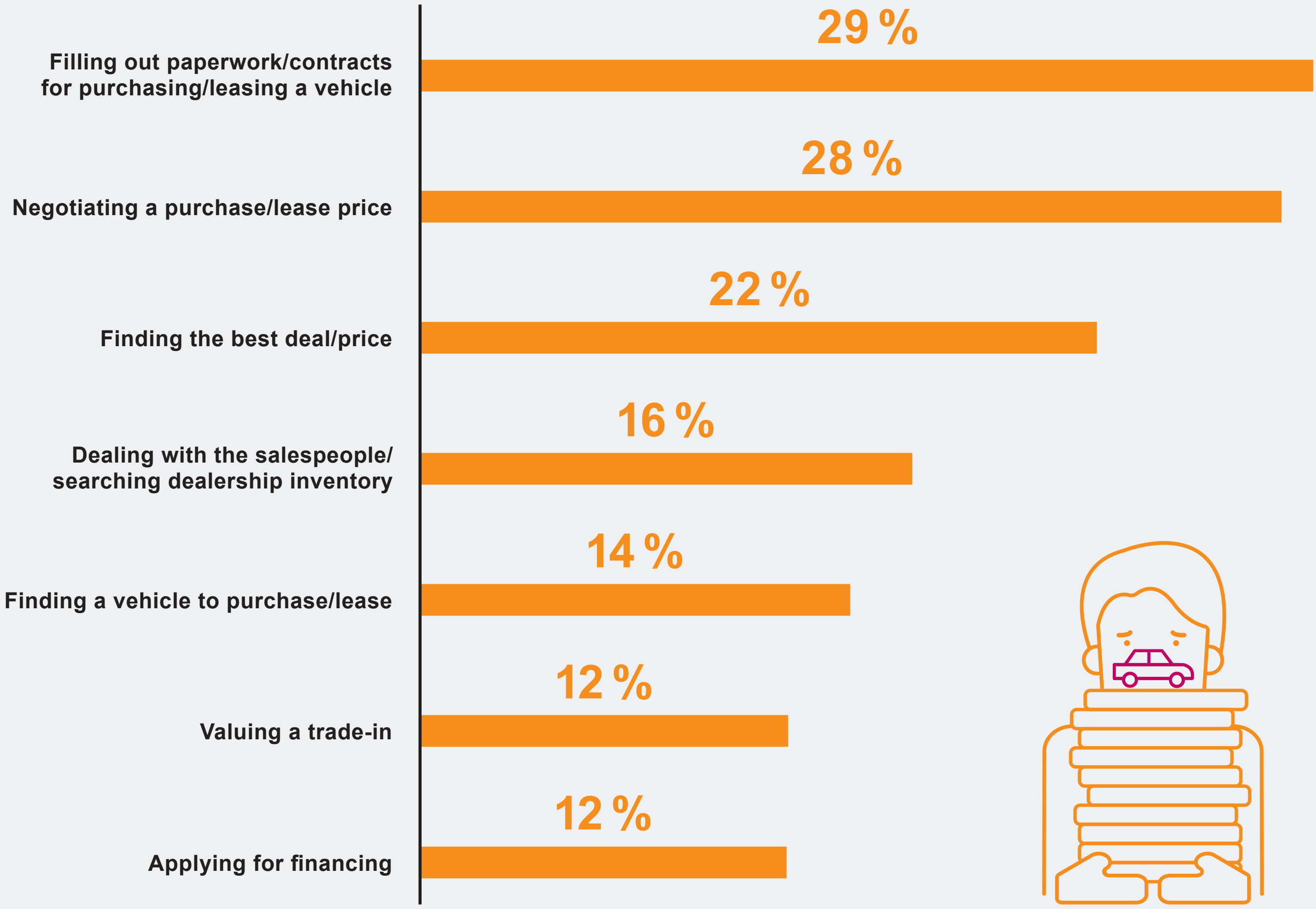
3/ The online boom: How digital sales are revving up the UC market

3.1 / The perils of buying a used car the traditional way

Buying a used car from a physical dealer is rarely a hassle-free process, with numerous pain points along the way. Most potential customers start by researching on the internet. But straight away they face difficulties, with many used-car websites offering a poor user experience and little information, like specifications and photos, on available vehicles. To collect all the information they need, customers often need to visit several different points of sale. This wastes time, and also limits their choice to vehicles available in their locality. Customers also get frustrated when trying to secure the best valuation for their trade-in vehicle, as this often requires several more visits to dealers.

The purchase process is also bumpy. Customers do not like the complexity and amount of paperwork involved, with this ranking as the top frustration among car buyers in surveys. They also dislike the lack of transparency on prices and are reluctant to negotiate. Not having a single point of contact at the dealership to ease them through the sales process is another bugbear. Lastly, customers perceive estimated delivery dates as unreliable and resent the long waiting times involved during the process. → C

C / **Hard sell** There are numerous pain points in the UC purchase process, with customers citing paperwork as the top frustration



Source: CoxAutomotive 2019 study on US car buyers

3.2 / Online sales are set to boom across the UC retail market

Across retail, online sales are helping to smooth customer journeys. More and more consumers are turning to online stores to purchase goods, with more and more product categories being added all the time. This is generating confidence and creating long-lasting purchasing habits, with online penetration rates increasing as a result. The trend is being driven by both young digital natives and older generations trying out online shopping for the first time.

In response, sellers are optimizing customer journeys to make them simpler and more accessible. Technological developments around improved user experiences and easier payments simplify the process, while mobile platforms that enable flexible and passive purchases aid accessibility. In addition, the

Covid-19 pandemic has accelerated the trend towards online purchases, increasing online penetration and changing consumer behavior.

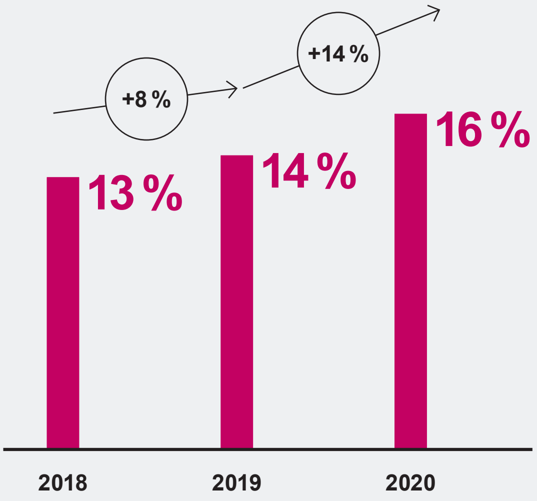
The used-car retail industry is also tapping into the online purchasing trend. Customers are beginning to expect a fully digital journey, and 16% of Europeans (24% of Germans) now say they would be happy to directly purchase a car online. Online sales provide ready solutions for most of the pain points experienced in the traditional UC purchase process. These include instant access to a wide range of available vehicles and tailor-made recommendations; easy price comparisons and benchmarking; less or even no paperwork; and at-home trade-ins and deliveries of vehicles. It's also clear that buyers appreciate a smooth customer interface and journey – the purely online US used-car retailer Carvana has achieved high customer satisfaction ratings, with a net promoter score in 2020 of 82.[1)]

While European used-car players are increasingly moving online, they still have a lot of room for improvement. First, several pain points, such as paperwork for financing or same-day payment, have not yet been fully resolved and digitalized. Second, no player has yet built a trusted brand. Research shows that customers will only buy online in large numbers if they perceive a brand as strong and offering reassuring services, such as a free returns policy or money-

1) Survey by Bazaarvoice cited in "Introduction to Carvana" investor relations document

D / In the driving seat European UC customers are increasingly turning to direct online purchases

Share of respondents answering yes to the question "During your vehicle purchasing journey, will you use the internet to directly purchase a car online?"



Source: Roland Berger Automotive Disruption Radar survey, average of top 6 European countries

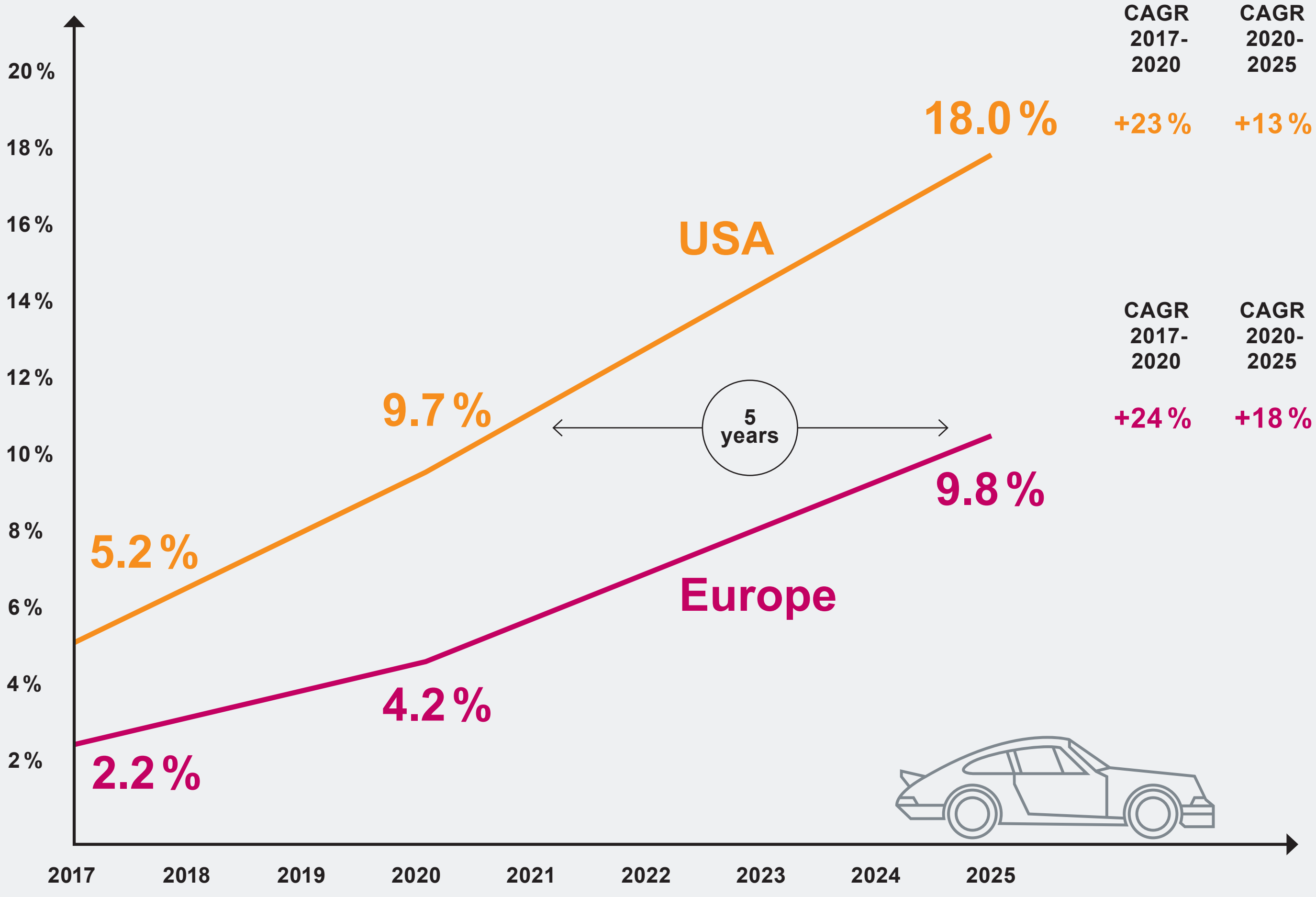
THE COVID-19 CRISIS AND ONLINE RETAIL

"The Covid-19 crisis accelerated expansion of e-commerce towards new firms, customers and types of products. Despite persistent cross-country differences, the Covid-19 crisis has enhanced dynamism in the e-commerce landscape across countries. Meanwhile, e-commerce transactions in many countries have partly shifted from luxury goods and services towards everyday necessities, relevant to a large number of individuals. Some of these changes in the e-commerce landscape will likely be of a long-term nature, in light of the possibility of new waves of the epidemic, the convenience of the new purchasing habits, learning costs and the incentive for firms to capitalize on investments in new sales channels." – Extract from an OECD report on e-commerce in times of Covid-19. → D

back guarantee. No company has yet made such a name for themselves in Europe; indeed, a used car is still viewed by Europeans as an expensive, engaging and risky purchase.

The situation is better in the US. There, penetration of UC online sales is already much higher (we define online sales as strong buyer commitment demonstrated online – reserving a car with a significant deposit, etc. – without having seen the vehicle). For example, Carvana sold 244,000 used cars in the US in 2020, more than 1% of the total UC retail volume, and the share of online UC retail sales is forecast to almost double between 2020 and 2025 to 18%. We expect the European UC market to follow the same fast-growing trajectory, but with a five-year delay, as is common in many other product categories. Online UC sales are expected to double and make up 10% of the European B2C market by 2025. These evolutions will be driven by both the increasing digitalization of the customer journey at traditional physical dealers, and the rapid growth of new online retailers. → E

E / Fast acceleration Online sales (as a share of total UC retail sales) are expected to grow rapidly in Europe and the US



Source: Roland Berger

4/ Moving online: The key factors behind a successful digital transformation

4.1 / Developing a digitally oriented business model

Digitalization doesn't just mean having a slick, best-in-class website. To be a successful online player, companies need a digitally oriented business model, one that differs significantly from the traditional retail model. We have identified six key success factors to help online used-car players develop such a model:

1. **Build a strong and well-known brand:** This will help to reassure potential buyers about making a used-car purchase through an online channel and encourage them not to consider offline alternatives.

2. **Adopt a data-driven business:** The approach should be two pronged. First, players should collect proprietary demand-based data by generating traffic and engagement on their own website, and then strengthen it by adding external market and competitor data, for example prices on rivals' websites. Second, to leverage this valuable data, they must implement advanced data processing to enhance their sourcing/appraisal (e.g. real-time sourcing recommendations based on customer behavior), logistics and refurbishment (e.g. demand-based logistics flows) and sales (e.g. dynamic pricing, lead transformation through systems that recommend the right vehicles to the right customers).

3. **Combine online and physical locations:** Physical points of pick-up and delivery are key for both brand awareness and cost optimization.

4. **Set up advanced refurbishment centers:** Refurbishment is a key value-chain step because it represents a large cost item and because it drives used-car quality. It should be done in-house as it enables differentiation from the competition in two major dimensions. First, the refurbishment process itself, which needs to be lean to optimize costs and lead time (there are major performance gaps between players). Second, the maximization of refurbishment value, requiring detailed consideration of both the value created for customers and the refurbishment cost (what refurbishment needs to be performed using which process?).

5. **Tightly control logistics flows:** The online UC market generates significant logistics flows, whether for pick-ups, home deliveries or transfers to and from refurbishment centers. Close management of them is key to offering cost-effective, fast and reliable delivery and pick-up to end customers.

6. **Ensure vehicle sourcing is efficient and diversified:** The UC market is mainly a supply business; offering the right vehicle mix (in terms of brand,

model, configuration, mileage, age, etc.) to match demand is key to outperforming rivals. To do so, players need to have ready access to the right vehicles at the best prices, and thus need to leverage multiple sourcing channels, such as customer trade-ins, auctions and leasing companies.

A digitally oriented business model that successfully integrates these key success factors will ensure an online UC channel is competitive on vehicle price compared with a traditional offline channel. In fact, competitiveness will continue to increase along with online sales volumes thanks to scale effects (media, IT, logistics, etc.). This price competitiveness, combined with an improved customer journey, will allow the online channel to overtake traditional channels and account for the bulk of the market in the long term.

As well as price competitiveness, the six key success factors also influence competition in the market. Each represents a significant entry barrier, especially the brand creation and adoption of a data-driven business factors. These barriers are relevant for all market players (dealers, online retailers and new retailers) because online retail requires assets that are not necessary for traditional offline sales. The combination of entry barriers and scale effects will create an online market that is much more concentrated and profitable than the current traditional UC market.

WHAT ONLINE UC RETAILERS CAN LEARN FROM AMAZON

Amazon, a forerunner in e-commerce, has become a leader in online retail with a strong brand. Its success is the result of a combination of several elements.

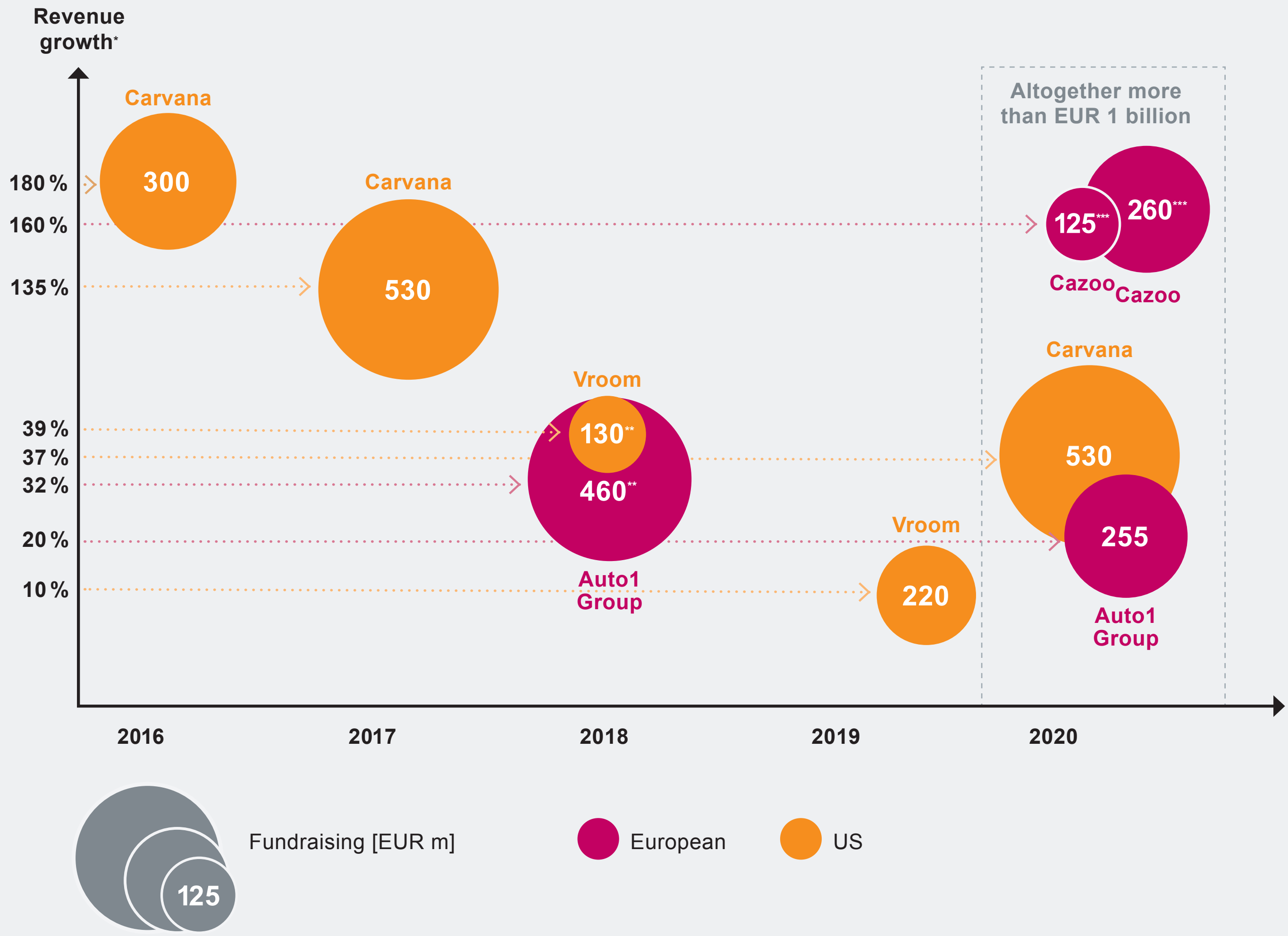
First, the US company has one of the largest online retail offerings in the world, which makes it a go-to platform for a large number of potential buyers.

Second, Amazon's business model relies on a big data strategy. By constantly collecting data and learning from customer insights, it can predict what customers want to buy and streamline its purchasing process by directly recommending specific products.

Third, it is constantly strengthening its supply chain operational excellence through a robust logistics network, relying on successful supplier relationships and (semi)integrated logistics (a mix of own fleet and partnerships). By controlling its product flows, Amazon also maintains control over deliveries to end customers (for example, via Amazon Prime).

Lastly, Amazon understands that few people buy exclusively online or exclusively in store – rather, they value choice. This prompted the company to develop a physical presence, for example with the acquisition of grocery chain Whole Foods in 2017, and the introduction of its cashierless grocery service AmazonGo in 2018. It uses these platforms to promote its products, boost its brand and reduce logistics costs.

F / Investor boost Growing wave of fundraising for the digital European UC players



* Revenues n-1 vs. revenues the year of the fundraising

** Exceptional 2018-2019 revenue growth

*** Exceptional 6-month growth between the two 2020 fundraisings (launch in 2019)

Source: Financial reports/company information, Roland Berger

4.2 / Funding the transformation

While the benefits of digitalization are clear, it doesn't come cheap. But large investments have clearly boosted revenue growth of online UC players. Carvana, for example, raised EUR 320 million in 2016 and followed this up with two further rounds in 2017 and 2020 totaling EUR 530 million. European players have also managed to secure big cash injections over the past two years, with Cazoo and Germany's Auto1 leading the way. Valuations of the new big players have also grown strongly. Carvana's valuation has soared almost 900% since its IPO in 2017 and the US firm is now valued at EUR 27 billion. The valuations of Cazoo and Auto1 have also significantly increased. Such examples show that investors are convinced by digital used-car sales models and are prepared to back them with considerable funds – more than EUR 1 billion was raised over the past 12 months. → F

5/ Conclusion

With vehicle ownership shifting towards leasing, the importance of the used-car market will keep rising in the coming years. In the meantime, the used-car market will be completely reshaped by online sales. It is a very powerful trend, providing a step change in terms of customer journey, while optimizing business efficiency. Online sales will shake up the competitive landscape, with the emergence of new players, and an overall consolidation of the competition. Indeed, they require a digitally oriented business model, which differs significantly from the traditional retail business, and which requires significant investments. These investments will constitute entry barriers that will drive up business profitability for the successful players.

What does it mean for players willing to position themselves in this market in the future? It means that they need to move fast – more so than ever because of the Covid-19 crisis: time is of the essence. And they need to make sure that they will be able to make the necessary investments (alliances could be considered for sub-critical size players). Ultimately, they will either manage to capture significant market share in the profitable and growing online market, or they will struggle with sales growth and profitability.

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