

# **RECESSION, RESIDUALS AND USED VEHICLE OPERATIONS**

## **A practitioner's briefing**

*A report by BCA*



Professor Peter N C Cooke  
KPMG Professor of Automotive Management  
The University of Buckingham





# RECESSION, RESIDUALS AND USED VEHICLE OPERATIONS

## A practitioner's briefing

*A report by BCA*



Professor Peter N C Cooke  
KPMG Professor of Automotive Management  
The University of Buckingham



# Executive Summary

Given the maturity of the UK car market, approaching two million cars will need to be part exchanged or disposed of in the next year to make way for replacement new vehicles.

Further down the used car supply chain, these first-time used cars will be sold to new owners, and there will also be a cascade of transactions as motorists replace their older cars with newer used models. So, even in deepest recession, there will continue to be a pragmatic used car industry.

- With sales around seven million units, the UK has the largest and healthiest used car market in Europe, testimony to its well-developed used car industry infrastructure and strong wholesale market.
- The current recession is hitting used car values hard. The challenge for used car sources – whether a leasing company disposing of large numbers of vehicles or a dealer putting units into the market, is to achieve the best possible prices to ensure potential new car buyers can release sufficient equity from their once-new cars towards buying a new one.
- For business car operators, particularly leasing companies, maximising residual value is of huge importance. The higher the residual value achieved on disposal, the more aggressive leasing companies can be in setting their leasing rates.
- A highly-focused, target market strategy can be crucial and more cost-effective than a scatter gun approach. For example, there is a growing market among older groups who could have 2-3-4 car changes before they decide to give up driving. There is growing number of families with two or more cars, who nearly always buy a used car for their second or third vehicle.
- Each of the principal players in the car supply chain leading to the used car market – manufacturers, leasing companies and dealers – have an integral role. Like any chain, it is only as strong as its weakest link and it is vital that all participants strive to build and sustain a healthy used car market.
- While the current economic climate will undoubtedly persuade some car owners to postpone replacing their car – the high quality and affordability of used cars will convince many motorists to continue to take this step.

For some time, there will clearly be fewer car owners able to or interested in changing their car. However, the UK car market is still in relatively good health – between five and six million motorists are likely to buy a new or used car from either a franchised or non-franchised dealer in the next 12 months.

# Contents

<b>Executive Summary</b>	2
<b>A practitioner's briefing</b>	4
• The challenge is a simple one	4
<b>1; New and used car market status</b>	5
• Largest market in Europe	5
• The used car market is a 'perfect market'	7
<b>2; Relationship between new and used car supply chain</b>	8
<b>3; New car acquisition strategy</b>	8
• A tall order indeed	9
<b>4; Used car pricing – from boom to recession</b>	8
• Balancing supply and demand	10
<b>5; Used car market analysis</b>	11
• Redressing the balance	11
• Used car focus – which group?	12
• Demographic analysis	13
• Some interesting strategic pointers	14
<b>6; Used car inventory management during recession</b>	15
<b>7; Recession, profitability and used car finance</b>	16
• Used car profitability	17
• Sources of finance	18
• A more innovative approach	19
• Financing the family fleet	20
<b>8; Car manufacturers', leasing companies' and dealers' strategy</b>	20
• Car manufacturers' role in used car market	20
• Leasing companies' role in used car market	21
• Lessors may have a strategic impact	21
• Dealers' role in used car market	22
• Will new car volumes beat the recession?	23
<b>9; Some conclusions</b>	23

# Recession, Residuals and Used Vehicle Operations

## A practitioner's briefing

Car residual values have dropped by between 15%–20%, and are unlikely to recover in the eye of the recession. However, business has to go on.

The more pessimistic predictions see the UK new car market struggling towards two million units for 2009. Given the maturity of the car market that means approaching two million cars will need to be part exchanged or otherwise disposed of to make way for replacement new vehicles. Further down the used car supply chain, these first-time used cars will be sold on to new owners, and there will also be a cascade of transactions as private motorists tend to replace their older cars with newer used models.

*Even in the deepest recession there will be a pragmatic used car industry*

So, even in deepest recession, there will be a pragmatic used car industry as long as people are buying new or newer cars. The differences between boom and recession are pretty straightforward. During recession, used car volumes will be somewhat lower than in periods of economic stability and there will also be sustained, severe pressures on residual values. Previous recessions have shown that used car sales have held up better than new car volumes.

### The challenge is a simple one

The challenge discussed on the following pages is a simple one – what steps might practitioners take to alleviate the effects of recession on their used car business and what might they do to mitigate the impact on residual values?

This briefing note is divided into the following parts;

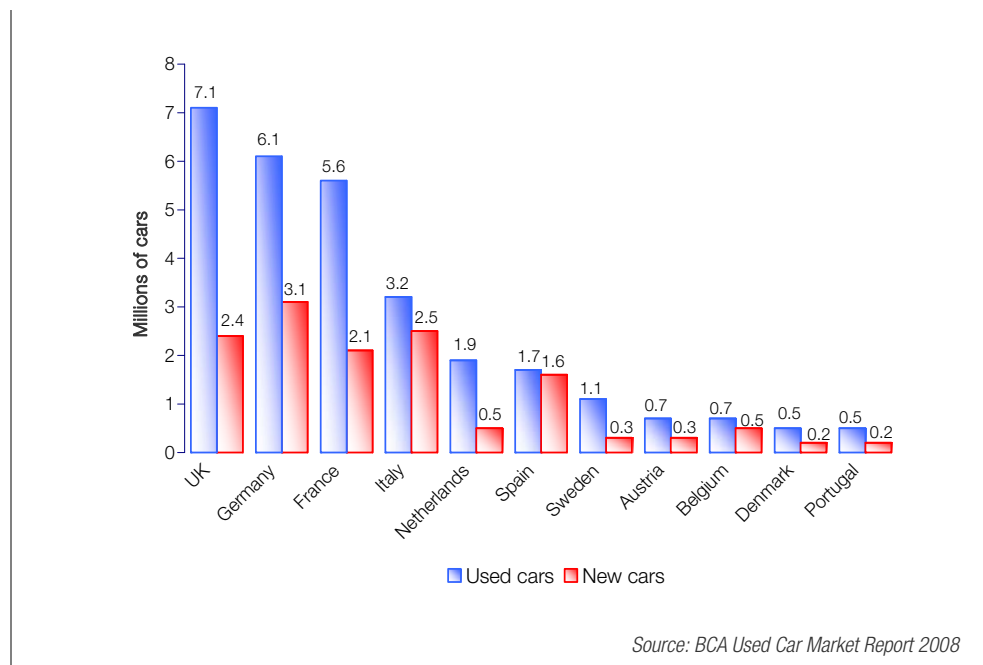
- The relationship between new and used cars
- New car acquisition strategy and the importance of specifying a new car for its eventual sale as a used car
- Used car pricing – in times of economic growth, in periods of ongoing recession and the associated stakeholders
- Strategy and practice associated with used car inventories and vehicle change
- Market analysis and the used car – an overview of used car market segmentation and implications for key stakeholders
- Financial strategies and used cars in times of economic recession and recovery.

It is within this broad structure that the notes on the following pages are offered. The writer does not claim to offer a panacea for low residual values or a way of restarting the used car market, but merely seeks to analyse the situation and highlight steps stakeholders might take to be at the leading edge of the learning curve.

## 1; New and used car market status

Across the major, mature European automotive markets the used car sector is larger than the new car market in volume terms – almost inevitably, as used cars normally pass through several owners before they are finally scrapped. Figure 1 shows new and used car sales volumes in the principal European markets.

**Figure 1; New and used car volumes in Europe – 2007**



### Largest market in Europe

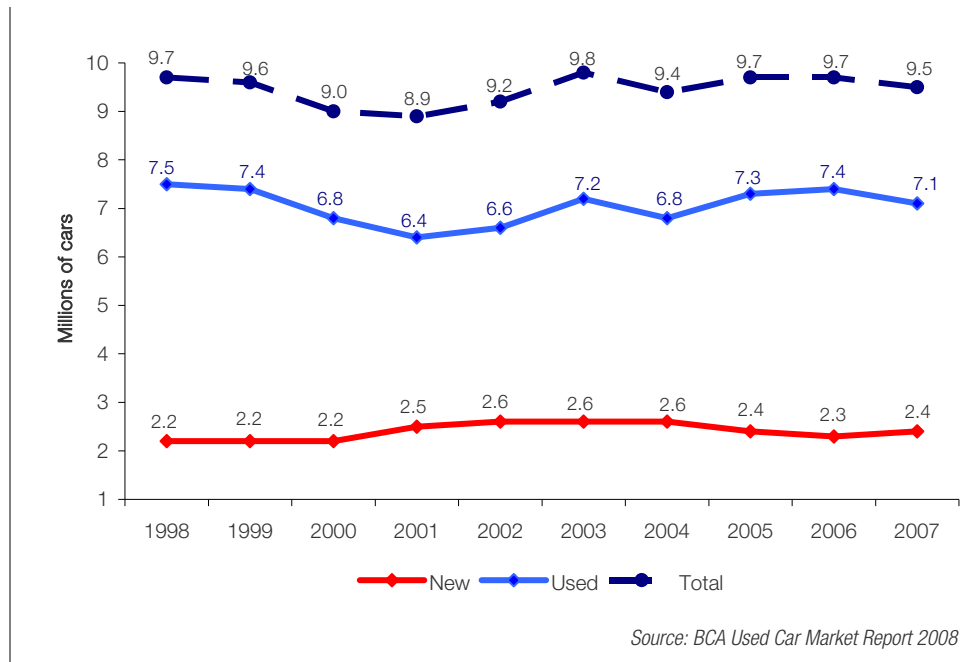
Although its used car volumes slipped 5.2% to 7.1 million units in 2007, the UK remains the largest used car market in Europe, one million units ahead of Germany in second place.

*This underlines the UK's well-developed used car industry*

With a used car sales per 1,000 population of 117, the UK outstrips the other major European markets for used car performance. This underlines the UK's well-developed used car industry infrastructure and strong wholesale market.

The ratio of new:used car sales in the United Kingdom is around 3:1 – and has been quite consistent for at least the past decade as shown in Figure 2 overleaf.

Figure 2; UK; New and used car sales volumes;

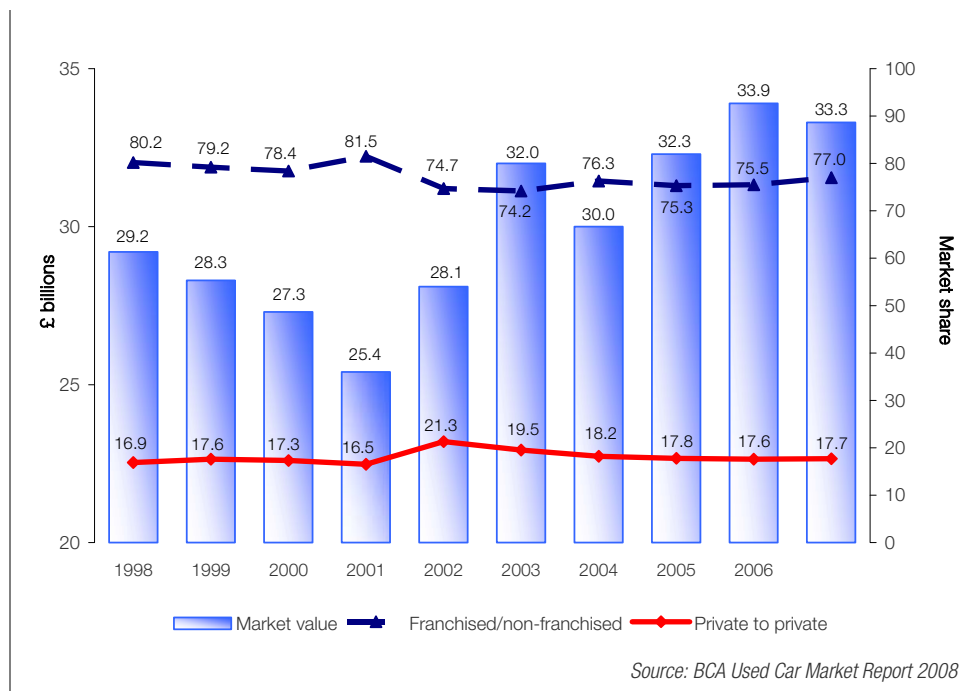


Combined UK new and car volumes slipped from 9.7 million units in 2006 to 9.5 million in 2007, 300,000 cars fewer than the high of 9.8 million reached in 2003.

Although it slipped a little to £33.3 billion in 2007 from a record high of £33.9 billion the previous year, the used car market value was some £300 million higher than the new car sector last year. Franchised and independent used car dealers consistently account for at least three-quarters of the used car market value compared with less than a fifth for the private-to-private sector that consists mainly of older vehicle transactions.

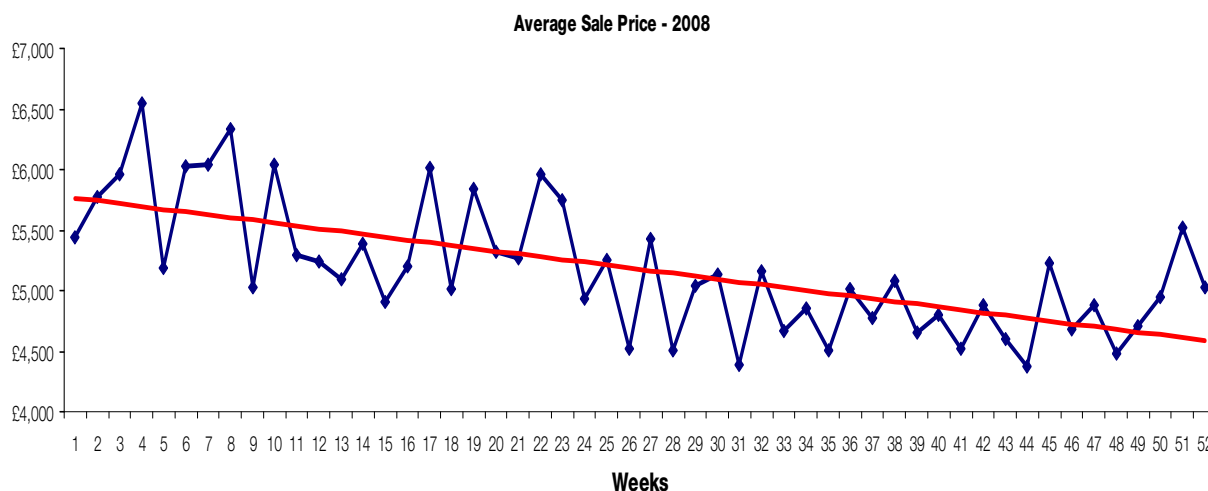
*Franchised and non-franchised used car dealers account for three-quarters of used car market value*

Figure 3; Used car market value and market shares



The recession currently sweeping Europe and further afield is hitting used car values hard. The United Kingdom presents a case in point. Figure 4 shows how average car prices at auction have fallen during 2008.

**Figure 4; Average used car prices at auction – 2008**



Source: BCA

*The challenge is to achieve the best possible prices*

The challenge for used car sources – whether a leasing company disposing of large numbers of vehicles or a dealer putting units into the market, is to achieve the best possible prices to ensure potential new car buyers can release sufficient equity from their once-new cars towards buying a new one.

### The used car market is a 'perfect market'

The used car market is a 'perfect market' in that no two units are quite the same and the size of the market is governed largely by the number of units being replaced, while the price is set by motorists prepared to buy those used units. Average residual values may move in concert driven by a range of extraneous influences – including in no particular order;

- Price and type of fuel used by vehicle
- Existing residual value levels of competitive products
- Vehicle excise duty – VED
- Used car buyers' confidence
- Relative attractiveness of specific models
- Availability of finance/credit to support the acquisition.

The relative impact of these issues may vary between individual types of vehicles, but they will all be there somewhere.

## 2; Relationship between new and used car supply chain

There is a complex and not always fully appreciated relationship between new and used car prices. As mentioned previously, the relationship between new and used cars is a very tight yet dynamic one. In a mature market, the true new car buyer is, in reality, a new car buyer on just one occasion. Thereafter, a new car to that buyer is a replacement vehicle.

Therein lies an important dynamic for the new car market in that modern cars are normally replaced long before they become unreliable. They are changed for a variety of non-economic reasons. In a period of recession, however, users and fleet operators may easily extend the initial operating life with little damage to anything beyond drivers' personal esteem and ego.

Figure 5 shows the nature of the relationship between new and used cars. The car, on its journey from the factory to the scrap yard will be a 'new car' to each new owner – who will normally replace their older or higher mileage car with a newer or lower mileage one.

*That release of capital is a critical phase of the operation and is often overlooked*

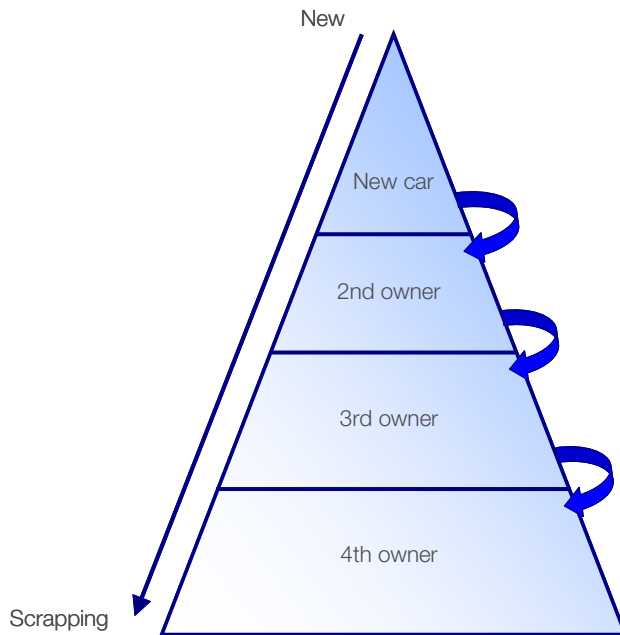
That release of capital from the used car to enable the buyer to acquire a new vehicle is a critical phase of the operation and its importance is often overlooked.

Automotive auction houses and dealer inventories tend to balance out the supply and demand for used vehicles and hence act as a type of 'used vehicle reservoir'.

## 3; New car acquisition strategy

For business car operators, particularly leasing companies, maximising residual value is of huge importance. The higher the residual value achieved on disposal for a particular vehicle, the more aggressive leasing companies can be in setting their rates charged for that type of unit.

**Figure 5; New used car supply chain**



## A tall order indeed

The real challenge is that residual values have to be predicted three or four years ahead. This means forecasting not only the popularity of a new vehicle as a used vehicle, but also the business climate and market sentiment as well as the overall availability of the used car market at that time – a tall order indeed.

*Ensure it will be attractive as a used car in three or four years time*

So what are the issues that might be reflected in selecting a new car to ensure it will be attractive as a used car, in three or four years time? Figure 6 highlights some of the key issues – although the list needs to be tailored to each broad class of car – luxury, 4x4, people carrier, family hatch and so on.

**Figure 6; Issues for specifying ‘new for used’ cars**

• Position in product life cycle	• Popularity as new model
• Fuel consumption	• Petrol or diesel
• Number of doors	• CO <sub>2</sub> emission rating – VED
• Reliability and serviceability	• Principal options fitted
• Road test reviews/comments	• Critical mileages
• Potential market as a first-time used car	• History marque for residual value retention
• Insurance category	• Colour

*For illustrative purposes only*

While one might easily draw up a list of 20 features or concerns companies and private buyers might consider when specifying a new car, with an eye on its ‘afterlife’ in the used car market, one should never ignore driver ethos and attitude towards the car.

The new car ‘specification for used car’ should not be pressed too hard. However, it is important that any fleet new car specification is not too far off what might be considered ‘the norm’ – for example, unusual paint colours; unusual trim/paint combinations or deleting options like air conditioning or automatic transmission on luxury cars.

Specification will often be important, and one might add ‘a popular marque’ to the list – together with aspects such as ‘reliable’ and, when the time comes, ‘available used car sales support’. Of course, much of this is common sense, but regular discussions with an auction house or a professional used car dealer prior to specifying new cars may well earn their keep many times over.

*Of course, much of this is common sense*

## 4; Used car pricing – from boom to recession

Used car prices are different to new car prices. New car prices can be set by the manufacturer and will be broadly followed give or take discounts available or demanded. If new cars are not selling, manufacturers may stop or cut back manufacturing to protect new car prices and crudely balance supply and demand.

## Balancing supply and demand

Balancing supply and demand is exactly the exercise car manufacturers are engaged in at the end of 2008 and early 2009, introducing weeks or months of shutdown in an effort to balance supply against ailing demand and avoid creating unsold inventory.

In the case of used cars, the situation is somewhat different – as there is no way the supply of used cars can easily be cut off. As long as buyers are buying new cars, there will be the cars those new units are replacing entering the used car supply chain. The number of cars becoming used cars for the first time is governed by the number of new cars being bought.

Such an equilibrium theory is the sort of equation to delight economists, but it also has practical implications too.

*An almost infinite capacity for absorbing used cars – at the right price*

In the United Kingdom, the overall used car market is around three times bigger than the new car sector and has an almost infinite capacity for absorbing used cars – at the right price.

The prices the ‘used car buying industry’ is willing to pay for used cars coming to the market for the first time is governed by the supply and demand rules of classical economics. Create a price too high; and there could be insufficient demand to absorb incremental used vehicles. Set the price too low; and there will be unsatisfied demand and the original used cars will be sold for too low a price, with a potential windfall profit opportunity on resale for the next buyer.

However, the free market price for used cars is determined by the next stage of the exercise – ‘what a retail car buyer is willing to pay for a particular car’. Retail buyers are also affected by the economy, their need for a replacement car, availability of finance and their general feeling of economic wellbeing.

*Prices are set by a willing buyer and a willing seller*

Used car prices are influenced by auctions – they are set by a willing buyer and a willing seller. However, trade buyers are savvy. They will seek to achieve the best (lowest) price which, in turn, is controlled by what they believe car buyers are willing to pay and will also leave them a satisfactory profit.

While used car volumes passing through auction have been relatively steady, average selling prices have slipped considerably as the economy staggered towards recession. This downturn in used car prices follows several good years of good supply and demand for used cars, and they will undoubtedly rise again in the future.

The challenge for volume sellers of used cars, fleet operators and leasing companies, is to be able to beat this trend by creating a mix of used vehicles, or vehicles in such excellent condition or attractive specification, that auction buyers are willing to pay above the average for them in the knowledge that retail buyers will pay a premium.

Car manufacturers also have a critical role in the residual price stakes, to ensure their cars are specified so they will be considered as attractive by potential used car buyers – and the market will not be swamped by them.

## 5; Used car market analysis

Previous parts of this briefing have looked at the volume supply side of the used car industry. The used car market is unique in that its product input is predetermined by what new car buyers bought 2-3-4-5 years previously – although these acquisitions may have been made under very different economic and competitive conditions to the current market situation.

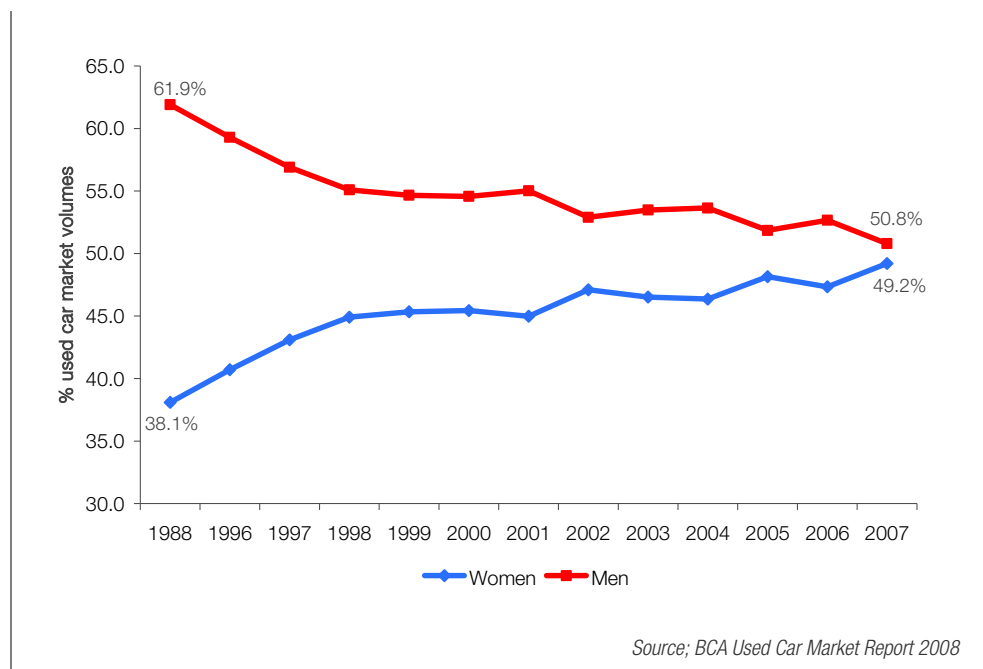
It has also been stressed that the used car market is so heterogeneous it is more difficult to segment and target it in a similar fashion to the new car market.

The following paragraphs seek to refute such an argument and present a case for used car retailers to analyse their local markets and customer bases to profile their clients – and to stock used vehicles to meet the needs of these profiles.

### Redressing the balance

It has long been a truism in the motor industry that ‘used cars are for the boys’. While that might once have been the case, nothing could now be further from the truth. Over the past decade, there has been a steady move – some would claim stampede – to redress the balance between male and female buyers of used cars. Consider the trend in Figure 7.

Figure 7; Used car buyers by gender



*Hugely important for the used car supply chain*

The implications of this shift are hugely important for the used car supply chain and, in particular, used car retailers. Figure 8 outlines some of the higher-level implications for dealers.

**Figure 8; Implications of gender split of used car buyers**

- Do you have a clear policy/approach to attract female used car buyers?
- Do you stock used cars which may be of special interest to female used car buyers?
- Why is the motorist buying a car – is it to be the first or second car in the household?
- Are your car salespeople able to build empathy and sell to female used car buyers?
- Do you have a marketing programme focusing on female used car buyers' unique needs?

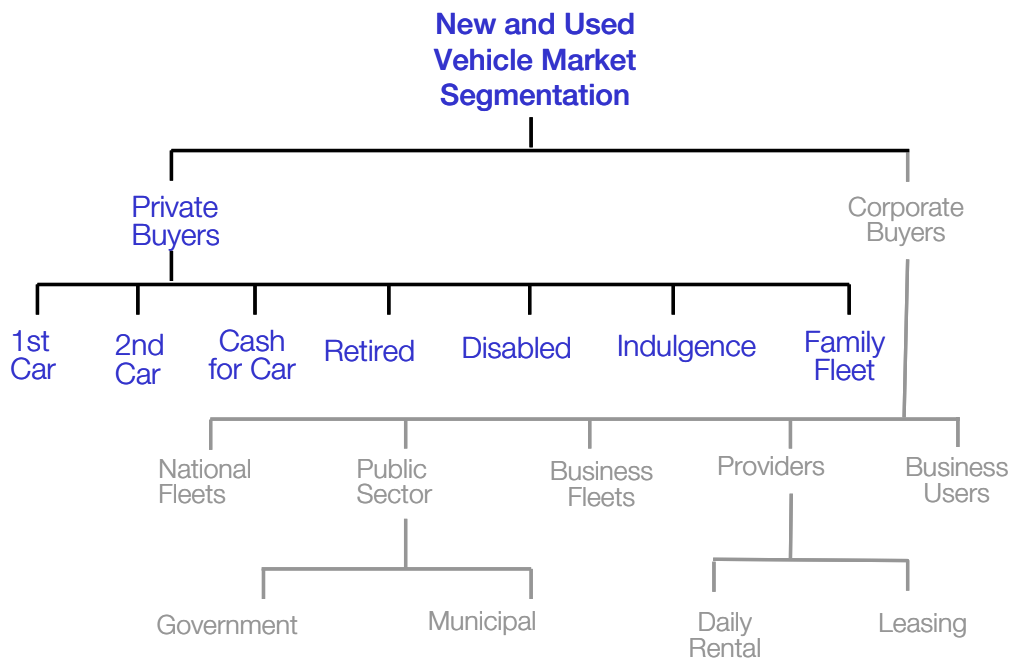
*For illustrative purposes only*

As every good sales manual says, a large part of success is having the right attitude towards prospective buyers – how does that work with female used car buyers?

**Used car focus – which group?**

While half of new cars sold in the United Kingdom each year are bought by fleets, nearly all used cars are bought by private buyers. These motorists can be segmented in the same way as new car buyers. Figure 9 shows the split between a range of different private buyers of both new and used cars.

**Figure 9; New and used car market segments**



*For illustrative purposes only*

*Each of these groups may have subtly different needs*

Each of these groups may have subtly different needs and, in periods of recession, could be more likely buy a used car rather than a new car when they become aware of the excellent value offered by used cars.

Each of these private buyer groups has different requirements and expectations. Consider some of them;

- 1st car in household; may be new or used; what are the household requirements for this type of unit?
- 2nd car in household; is this the family runabout – a 4x4 to take kids to school or a more versatile saloon or estate car or people carrier?
- Cash for car; in recession this may well be a quality used car rather than a new vehicle?
- Retired; good access; ample space for friends, dogs and activities; opportunity to sell support services – growing segment; probably recession-proof as long as there is low inflation?
- Disabled; perhaps Motability users; access is important; may need space for mobility aids – reliability is critical – remember VAT status?
- Indulgence; that ‘out of character’ car as a second or third car in the household – maybe a sports car, soft top or aggressive 4x4; happy to salve conscience by buying used during recession?
- Family fleet; cars for teenagers – increasing numbers as more live at home during college or university education?

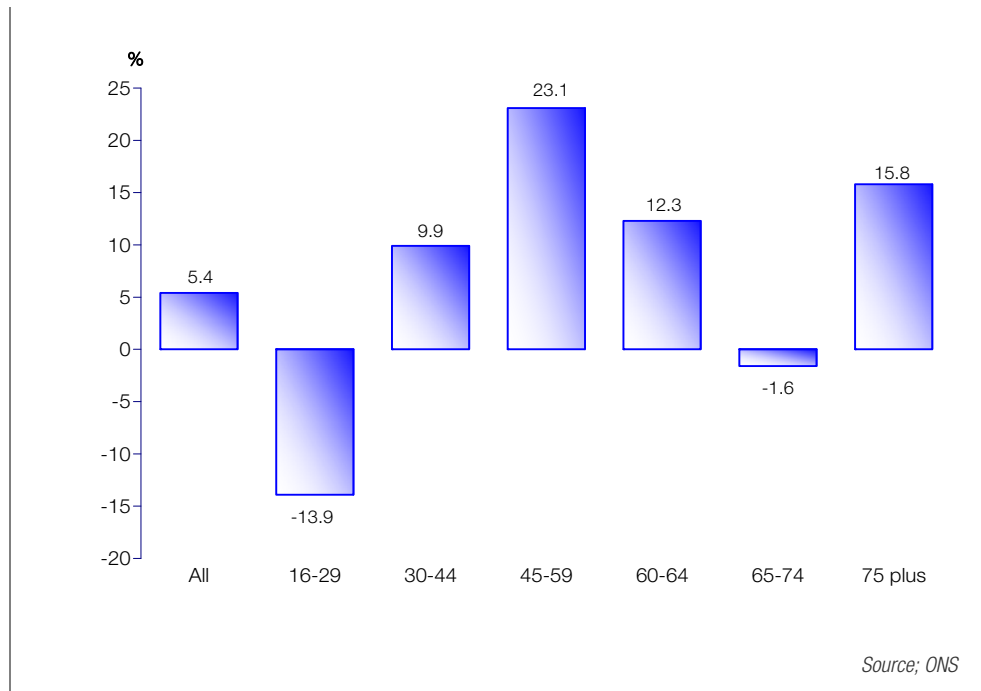
### **Demographic analysis**

One reads regularly of the ‘demographic time bomb’ about to hit mature economies. There is a growing ageing population as shown in Figure 10 overleaf.

Clearly, there is a rising market among older groups. While ‘pensioners’ were once expected to live for 3-4 years after retirement, life expectancy is now well into their 80s. Healthy ‘pensioners’ will keep driving ever longer and could have 2-3-4 car changes before they decide to give up driving.

Figure 11 overleaf reflects the changing age groups of used car buyers over the past decade, indicating some tectonic shifts in buying patterns for used cars.

**Figure 10; Population age groups, 2006 vs. 1991**

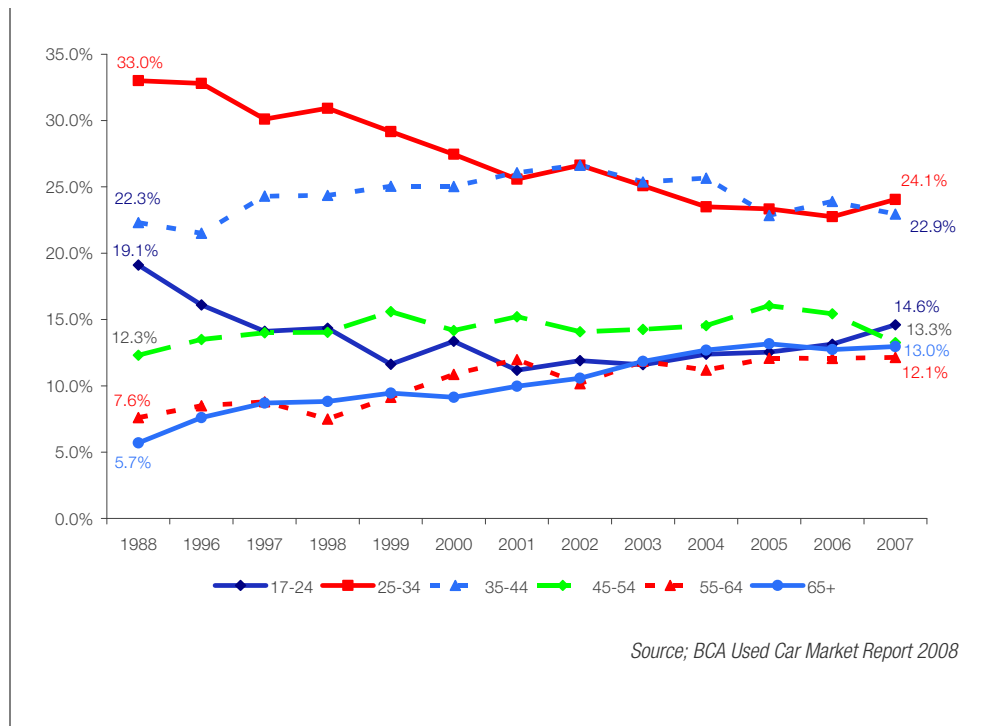


**Some interesting strategic pointers**

*Look at the rate of change in different age categories*

Careful analysis of this pattern, can offer some interesting strategic pointers with regard to local market comparisons and sales opportunities. For example, look at the rate of change in some of the different age categories and apply market requirements to those evolving segments. Equally, there are messages for both leasing companies and car manufacturers in terms of used car buyers.

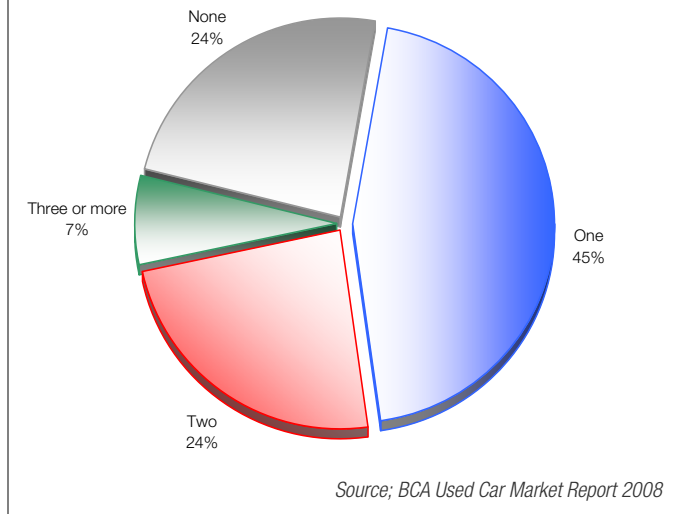
**Figure 11; Demographics of used car buyers**



One further point of potential interest to franchised dealers and used car retailers is the number of cars in a household.

Figure 12 shows the results of the consumer research undertaken for the BCA Used Car Market Report. While 45% of households have access to one car, 24% own two cars and 7% have three or more cars in the family.

**Figure 12; Cars in household**



As many households own two cars as have access to no car at all. As a matter of course, relatively few households would always buy a new car for their second vehicle and even fewer would buy new as a third car, unless it was for some specific purpose.

*A growing number of families with two or more cars*

The message is a clear one – ‘there is a growing number of families with two or more cars, of which one or more is usually a used car’. What are the marketing opportunities this offers – the family fleet? This will be discussed later in the briefing.

## 6; Used car inventory management during recession

Dealers hold sales records of hundreds if not thousands of their new and used car customers; they also have access to further data on their local markets. From this, they should be able to build a clear profile of their market and the opportunities it offers. They can also extrapolate this data to pinpoint which sectors offer the best opportunities during a period of recession.

While dealers may decide to ‘focus on every market opportunity’, this might be unwise based on recent experience in other retailing sectors – consider Woolworths.

*Focus on carefully designated group of prospects*

It is a firm mantra of marketing that one should focus on a particular range of areas where a business might score a competitive advantage. This may be the quality of the sales team and its ability to work with certain groups of prospects – or it might be to focus on a carefully-designated group of prospects – a specific range of market segments – where a dealer can gain and build reputation – against which used car stock can be built, kept up to date and interesting.

During a period of recession, inventory and inventory management is crucial in terms of holding costs and ultimately profitability. There are a number of mantras that might be claimed to apply to used vehicle inventory policy and strategy in difficult economic conditions;

- Should used car stock be focused on a range of related, product-wise, used car market segments?
- Stock turnover – may be 60-90 days in normal trading conditions; during recession and falling prices; should that be cut to 45 or even 30 days? If the unit does not sell in that time, cut the price once, transfer to another site, or send to auction.
- Only buy vehicles that closely match target market specification – if they require some remedial work, that should be undertaken fast and the units on display within 48 hours.
- Cars taken in part exchange should be evaluated immediately and either prepared/put on the lot within 48 hours – or traded immediately.

*All the more crucial in a recessionary period*

The health of the used car inventory is all the more crucial in a recessionary period when new cars and cash flows may be suffering. An aggressive, highly-proactive used car stock management strategy may be necessary, with each unit monitored closely and a decision taken on its future on a weekly basis.

A highly-focused, target market strategy can be crucial in that it will be recommended by word of mouth, and the promotional strategy can be targeted very cost-effectively rather than a scatter gun approach. There are always potential buyers who want what is a 'bargain' in their eyes – if they know where to look for such a bargain and there is a used car to interest them.

A situation that has been mooted for some months is the economy might slip into deflation. At its simplest, deflation occurs when prices for specific goods or services decline over time, not merely to be competitive, but because the industry or businesses are cutting prices below cost to achieve a positive, short-term cash flow. In industry terms, goods and services are being sold for less than their true cost of provision.

In a deflationary situation, it may be judicious to reduce stock to a minimum and to trade units even more rapidly if they have not sold and to replace with lower-priced units. A trite exposition – but it illustrates the concept.

## **7; Recession, profitability and used car finance**

Financiers' responsibility for the credit crunch and associated economic downturn is, we are told, far 'more to do with global markets than financiers' profligacy, irresponsibility and willingness to lend on almost anything as long as you have an ownership document – even if the asset is near worthless'.

Perhaps a slightly radical view, but it could be claimed to summarise the situation. The consequence is that there is a credit crunch with a singular paucity of capital to be lent or borrowed.

Within the UK, not only has the housing market collapsed because of a lack of mortgage finance but that same dearth of finance appears to be a principal cause of the fall in private new and used car sales.

*Some interesting pointers towards restructuring a profitable used car business*

While the media might resort to headlines such as ‘disaster’, ‘ruin’ and ‘the end of the road’, this is probably more to sell newspapers than an accurate reflection of the used car market. However, it does provide some interesting pointers towards restructuring a profitable used car business.

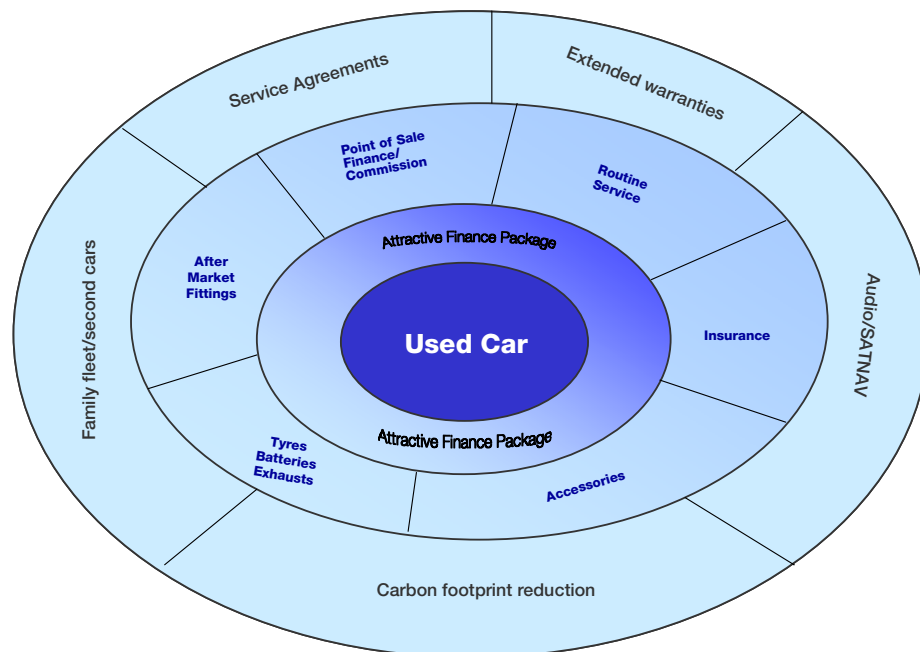
### Used car profitability

Given that used car volumes have fallen over the past year, and average selling prices are also considerably lower, it suggests profitability on individual deals has slipped too. Given lower potential margins, the immediate strategy on used cars, or new cars is to look for alternative profit opportunities in key areas.

*Used cars offer a broad range of soft profit opportunities*

Used cars offer broad a range of soft profits. The paradigm in Figure 13 outlines one view of used cars and the profit opportunities they offer. While not every one of these profit opportunities may be feasible in every transaction, they highlight some of the attractive propositions to offer prospective car buyers.

**Figure 13; Used car profit opportunities**

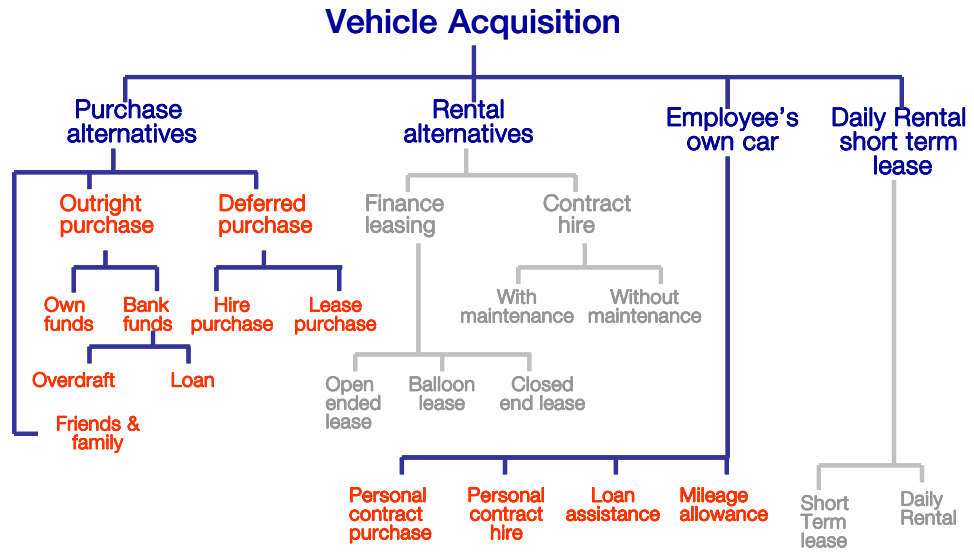


*For illustrative purposes only*

## Sources of finance

The apparent collapse of cheap bank loans closes off only one source of funds to fund a new or used car. Figure 14 summarises the alternative methods of financing a car. While the corporate methods shown under 'Rental Alternatives' and 'Daily Rental' are not applicable to used car acquisition, the alternatives shown in red may well be available to used vehicle buyers.

Figure 14; Vehicle acquisition methods

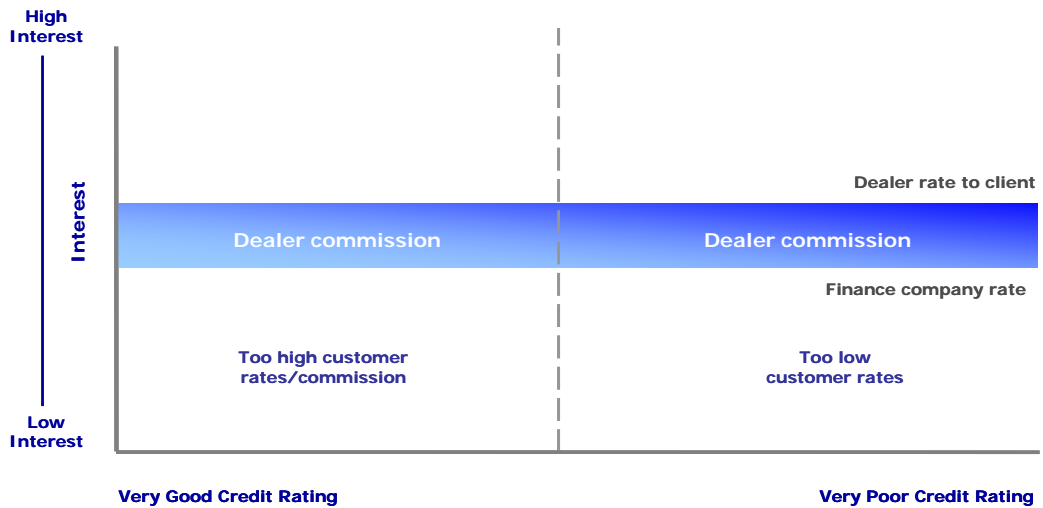


*For illustrative purposes only*

*One that is quick and easy to organise*

Currently, Point of Sale finance houses are reporting stronger growth in finance for used cars. This method of funding, hire purchase, is one that is quick and easy to organise. Providing the car salesperson gathers relevant data at the start of the sales discussion, a proposal can be proposed and approved very quickly.

Figure 15; Point of Sale finance, the uncompetitive approach



*Source; Black Horse Motor Finance*

In 2008, there has been a move by some finance houses to move away from 'flat interest rates' on Point of Sale finance deals to a 'risk for reward' approach.

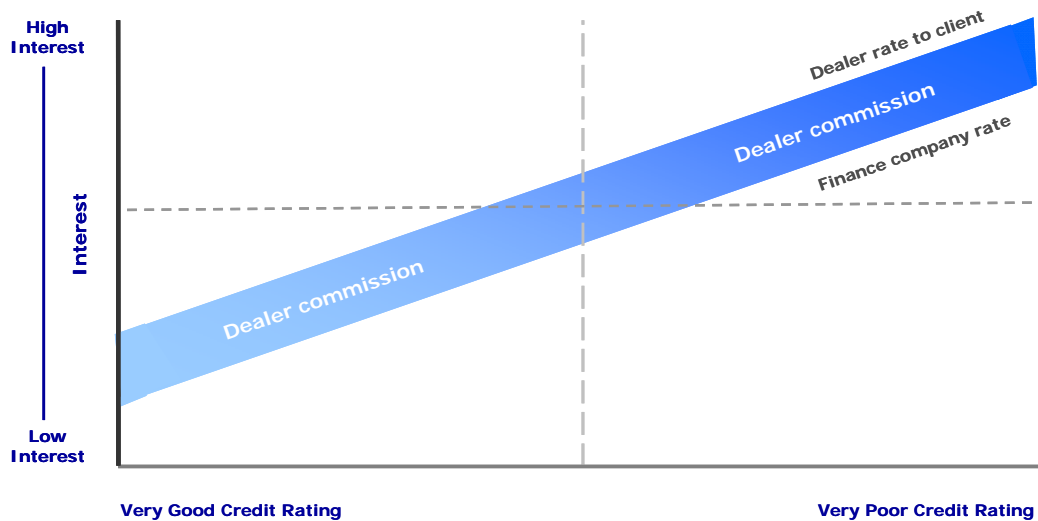
Figure 15 summarises the 'flat rate' approach whereby a prospect would be offered a standard rate, linked to the amount borrowed. However, such an approach takes no account of the quality of the credit risk.

In other words, a solid citizen who had never defaulted in their life and was backed with assets would get the same deal for a small loan on a sensible small car as someone with a much poorer credit history. In essence, this traditional method is a rate that sometimes supports a poor quality finance risk or borrowing as much as possible.

### A more innovative approach

A more innovative approach becoming wider spread in the finance industry is 'Rate for Risk' shown in Figure 16 below.

Figure 16; Point of Sale finance, rate for risk model



Source; Black Horse Motor Finance

*A suitable offer can be made very quickly*

This approach links the interest rate to a borrower's credit rating. Technology allows rapid checking of a prospect's credit rating and a suitable offer can be made very quickly.

Thus, car buyers with better credit ratings are offered the most competitive rates. When credit is more easily available, if they have already arranged a bank loan, they can be offered Point of Sale finance at a keen rate, and use their otherwise uncommitted finance for other acquisitions.

## Financing the family fleet

A spinoff from this more flexible approach to finance is funding the so-called 'family fleet', whereby parents can underwrite their children's' first car finance – normally a used car.

While children would be regarded as 'near toxic' risks by banks or finance houses, if the used car is underwritten by parents with their longer credit history, one can start to provide the 'family fleet'. Given it is 'uncool' for students to have the same used car for even a whole year, careful cultivation can lead to regular replacement even in recession, based on their parents' credit rating.

Eventually, young drivers will have their own credit rating. If you have a relationship with them through college, you should be in pole position to sell them higher-value used cars and eventually a new car at some point in time.

## 8; Car manufacturers', leasing companies' and dealers' used car strategy

A healthy used car market is critical for a successful new car market.

*Each of the principal players has an integral role*

Each of the principal players in the car supply chain leading to the used car market has an integral role. Like any chain, it is only as strong as its weakest link and it is vital that all participants strive to build and sustain a healthy used car market. In this part of the briefing, the relative roles of the three principal players are examined at high level.

### Car manufacturers' role in used car market

**Figure 17; Car manufacturers' involvement in used cars and residual values**

- Ensure manufacturer's finance house is funding used car propositions as well as new vehicles
- Protect new car price reduction programmes, so they do not run too long and impact on residual values
- Promote, as part of corporate advertising, quality used cars as well as new vehicles
- Take note of used car buyers' preferences and 'must haves' when developing new car specifications
- Manage high-volume/standard specification sales so excessive units of a single type/age will not reach used car market at same time
- Take due note of government/EU intentions with regard to emissions/ engines, VED and fuel price expectations
- Do not flood the new car market with excessive volumes of special editions that may not be desirable as used vehicles
- If higher discounts are essential, seek to offer them through finance deals rather than vehicle discounts

*For illustrative purposes only*

It will be noted that the proposed strategic thrust of car manufacturers regarding used cars and residual values, is to ensure a smooth flow of used cars rather than periods of over supply – say, with huge numbers of daily rental cars being sold over a short period. Under current market conditions, finance availability would also be beneficial.

### Leasing companies' role in used car market

*The role of leasing companies influence on residual values cannot be underestimated*

Given that fleets buy half the new cars in the United Kingdom and, in turn, around half of these units are provided by leasing and contract hire companies, leasing companies' influence on residual values cannot be underestimated.

Figure 18 summarises some of the steps leasing companies might take to help protect used car values and enhance the performance of the used car market.

**Figure 18; Lessor involvement in residual values and used cars**

- Assist clients to specify new units for the used car market – may 'free options' be necessary?
- Seek to provide cars that will be in line with EU/government expectations regarding used vehicles in 3-4 years time
- Promote popular used car colours and specifications – using pricing if necessary
- Develop and implement dispersed disposal patterns/strategies to minimise the number of similar cars offered at any auction at one time
- Establish cost/profit effective used vehicle preparation strategy to maximise residual values achieved at auction
- Analyse and develop strategy for using alternative channels to used car market – implement and monitor
- Seek to return used cars to market at or below 'strategic mileage' barriers
- During recession or slow demand for used cars, negotiate with selected clients to extend leases to control used car volumes/protect prices
- Manage seasonality either through pricing differentials or through rental delivery dates/changeover

*For illustrative purposes only*

### Lessors may have a strategic impact

*Balancing the smooth flow of cars*

As with manufacturers, lessors may have a strategic impact on the used car market and used car pricing. However, given the volumes of used units they create, their role in balancing the smooth flow of cars from first to later users can be crucial, especially in periods of recession.

Further benefit may be brought to the used car market if units being sold are of different recorded mileages that will offer used car buyers a wider price and age choice.

## Dealers' role in the used car market

The third stage in the used car supply chain, whether in an economic boom time or recession, is franchised and non-franchised used car retailers.

Dealers have a critical role in achieving the best possible used car prices at any time; particularly when the economy is in or close to recession. Consider the following steps that might be taken to enhance residual values and support sales volumes;

**Figure 19; Dealer Involvement in residual values and used car volumes**

- Consider focusing on specific used car market sectors after objective market research
- Establish a used car pricing policy that offers scope for disciplined price revision – and trading
- Ensure all vehicles are presented in best possible condition and the best display
- Target used cars at specific target market segments – follow up and monitor/act on feedback
- Establish disciplined trade-in strategy/timing and follow that strategy carefully
- Present a carefully chosen range of appropriate quality and mix of cars of interest to specific target markets
- Ensure there is Point of Sale finance for potential car buyers – have different sources so prospects can be offered the most appropriate deal
- Ensure there is an mix of model/body style and colour/fuel mix on display – and rotate regularly
- Offer used cars with range of soft-service packages – and full service history
- Ensure all customer-facing staff are well trained, motivated, remunerated – and monitored closely against used car volume and margin targets

*For illustrative purposes only*

*Essentially the same as during a period of economic boom*

The basic modus operandi of used car retailing during a period of recession is essentially the same as during a period of economic boom. The key differences are that used car buyers will need to be enticed into the showroom – and offered a proposition so attractive it will be hard to resist – and that embraces far more than merely cutting prices and margin.

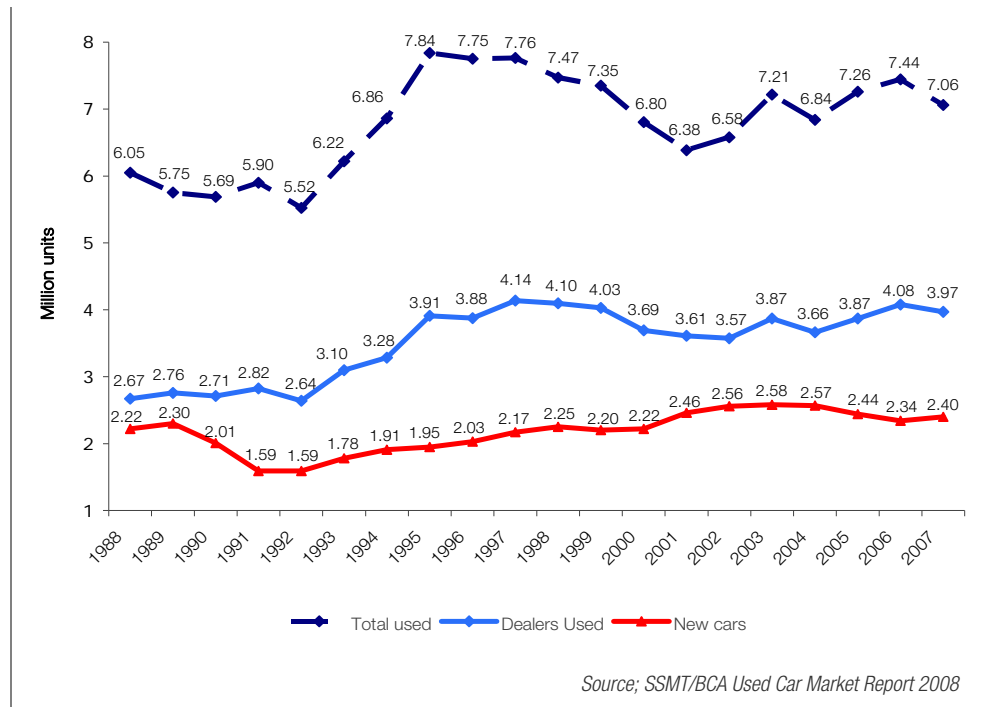
For some time, there will clearly be considerably fewer car owners able to or interested in changing their car. However, the UK car market is not about to disappear – between five and six million motorists are likely to buy a new or used car from either a franchised or non-franchised dealer in the next 12 months.

In tough market conditions, the most successful used car retailers will be those that set out their stall most effectively. Above all, they will need tight controls and a highly-professional sales team that converts the maximum number of car sales and finance opportunities into firm sales.

## Will used car volumes beat the recession?

While the new car market slumped by around 700,000 units to just 1.6 million during the recession of 1992 and 1993; not only did dealers' used car sales hold firm, but they also increased much faster than new car volumes as the economy recovered in the following three or four years. There is every reason to think a similar pattern could emerge this time.

Figure 20; New and used car volume trend



Motorists' need or desire to replace their car will not be dampened by a recession; the only thing open to question is whether they can afford to change or not. While some car owners will undoubtedly postpone replacing their car – many, many savvy motorists will recognise the high quality and the out-and-out value and affordability of used cars, and choose to go in this direction – probably at the expense of the new car sector.

## 9; Some conclusions

The foregoing has highlighted the importance of all players involved in the car supply chain 'thinking used cars' when they 'think new cars'. It is, after all, the price used car buyers are willing to pay for a used car that determines the affordability, or otherwise, of a new car.

These briefing notes have sought to highlight a number of pointers and lessons regarding recession and residual values. Perhaps the most important of these might be taken as;

- The used car market is significantly larger than the new car sector and, in periods of recession, the used car market would appear to sustain volume better than the new car market.
- The new car market is strongly linked to the used car market. In a mature industry, most new cars sold are replacement units rather than incremental, and the used car has to be sold to release its equity for further acquisition.
- Used car pricing is a complex issue and is demand driven rather than being a price set by the vendor.
- Used car buyers fall into market segments as clearly as new buyers do – and there can be real opportunities for used car retailers to specialise and target individual market segments.
- Although some car owners will postpone replacing their car, franchised or non-franchised dealers are still likely to sell between five and six million new and used cars in the next year.
- High quality and lower prices make buying a used car an affordable and very persuasive proposition.
- Faced with fewer sales opportunities, the most successful used car retailers will be those that significantly increase their car sales and finance conversion rates.

Professor Peter N C Cooke  
KPMG Professor of Automotive Management  
The University of Buckingham

January 2009