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*The future of
the U.K. used
car market*

&

**Trends and
opportunities**



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Executive summary



With an estimated 7 million cars sold in 2014, the U.K. used car market is the largest in Europe. Despite its seeming maturity, however, it is undergoing considerable change as buyers and sellers alike move online and as greater information and pricing transparency make it increasingly efficient.

The market is made up of competitors with three distinct business models. The transaction parties, including franchised and independent dealers and online buying platforms, take on the financial risk of buying and selling cars. The transaction facilitators — online sales platforms, online matchmakers, and auction houses — depend on fees from enabling sales transactions. The information providers offer insights into pricing trends and details of the condition of specific cars.

Over the next several years, the aging of the used car supply, the increase in online transactions, greater price transparency, and the growing value of convenience will disrupt the market's current supply-demand balance. Increased transparency will put pressure on the margins of traditional dealers, forcing them to move online, while providing a convenient end-to-end buying experience. The transaction facilitators will likely see their market share grow, but competition among them will increase, as will the pressure to consolidate. Better access to all kinds of information will ease the process of finding and buying used cars, making it more difficult for channel participants who have long depended on lack of transparency to prosper.

Supply constraints loom

Despite the used car business's somewhat seamy reputation, the market for "pre-owned" cars in the U.K. is among the most mature and efficient in Europe — as well as the largest. The ratio of used-car to new-car transactions is growing, and information about individual cars and prices has become more widely available, thanks to the wealth of data now online. Moreover, turnover is high, suggesting an increasing level of trust in a business traditionally characterized by asymmetric access to information and mistrust on the part of buyers.

Yet the U.K. used car business is by no means entirely stable. The supply of used cars is changing: There is a lack of younger used cars in the market, because the market for new cars is still struggling to recover from the 2008–2009 recession and its aftermath. Furthermore, competition is intensifying as digitization continues to boost price transparency and squeeze margins.

The changes overtaking the U.K. market will have consequences not just for private individuals who make up the majority of buyers and sellers of used cars, but also for the large operators — the franchised and independent dealers, the auction houses, and the many online intermediaries that are playing an increasingly important role. In this report, we examine the makeup of the U.K. used car market, how it will evolve over the next several years, and the opportunities and challenges these trends will create.

The ratio of used-car to new-car transactions is growing.

The state of the market

A look at the current state of the U.K.'s used car market suggests just how strong and well developed it is. With approximately 7 million cars sold in 2014, up from 6.8 million in 2013, the market is the largest in Europe, outpacing even Germany, though Germany has almost 40 percent more cars on the road overall. While that total is still below the number of used cars sold in 2007, before the recession, the ratio of used-car to new-car transactions has increased by more than 15 percent over the past six years, and it is expected to continue rising.

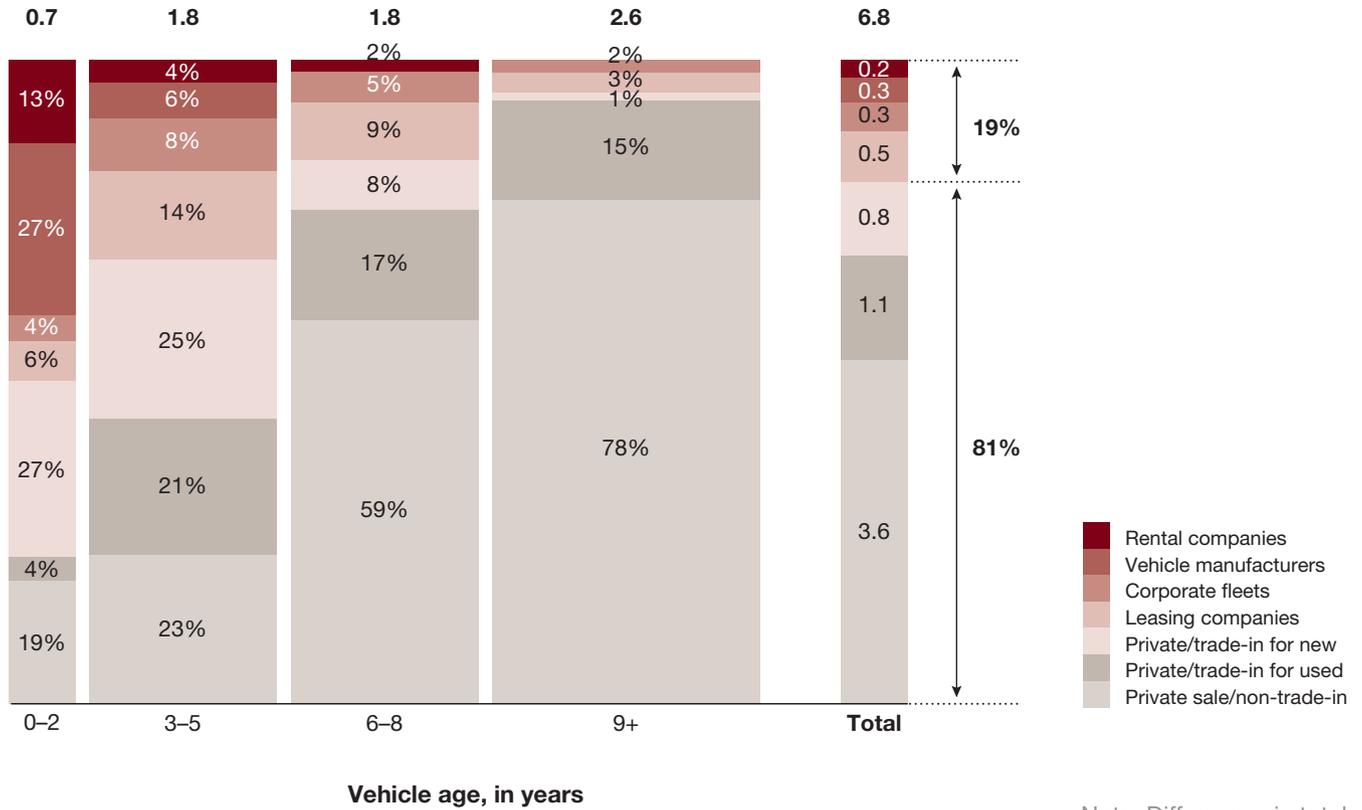
The supply of used cars comes from a variety of sources. Private owners account for more than 80 percent of the total, and an even larger percentage of the supply of older used cars. A third of those older cars are traded in to dealers for a new or used car, while the rest are sold to private buyers or directly to dealers, online buying platforms, and other channels. Newer used cars are much more likely to be sold into the market by business owners such as rental companies, corporate fleets, leasing companies, and vehicle manufacturers themselves, although these cars represent just 19 percent of the total supply (*see Exhibit 1, next page*).

Used cars are sold to end customers through three primary channels: private owners, franchised dealers, and independent dealers (*see Exhibit 2, page 8*). Half of the private sellers manage their own transactions, marketing their cars and finding prospective ultimate buyers through online and offline service providers. These sales make up 39 percent of total sales, and fully 70 percent of sales of cars nine years or older. Franchised dealers account for a third of all used cars sold, but they are by far the largest channel for sales of cars less than nine years old, while independent dealers sell less than a quarter of all used cars. Other sales channels — such as auction houses, which make up less than 5 percent of total sales to end customers — focus almost entirely on cars less than nine years old.

The U.K.'s used car market is the largest in Europe, outpacing even Germany.

Exhibit 1

U.K. used car supply by source and age, 2013 (in millions)

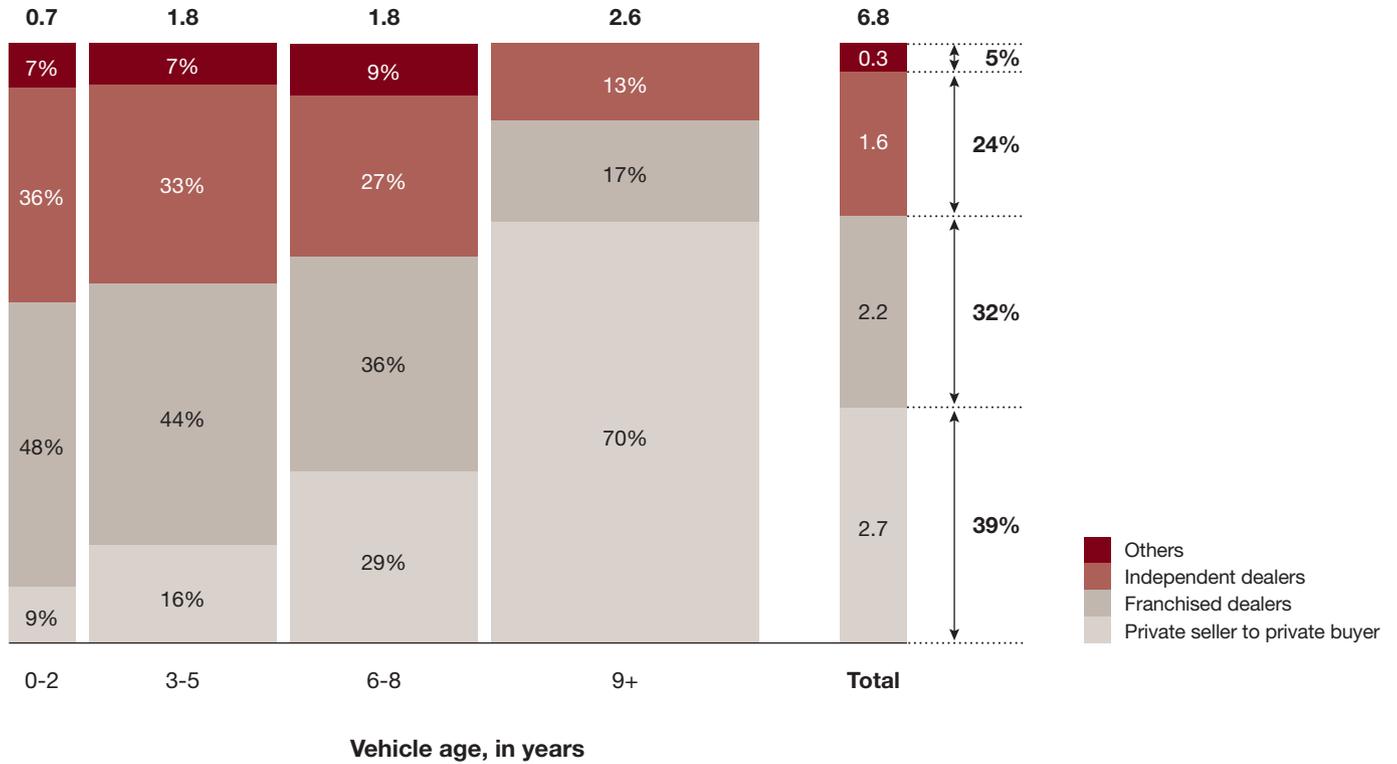


Note: Differences in totals are due to rounding.

Source: Society of Motor Manufacturers and Traders, Data Monitor, British Car Auctions, Strategy& analysis

Exhibit 2

U.K. used car sales volume by channel and age of car, 2013 (in millions)

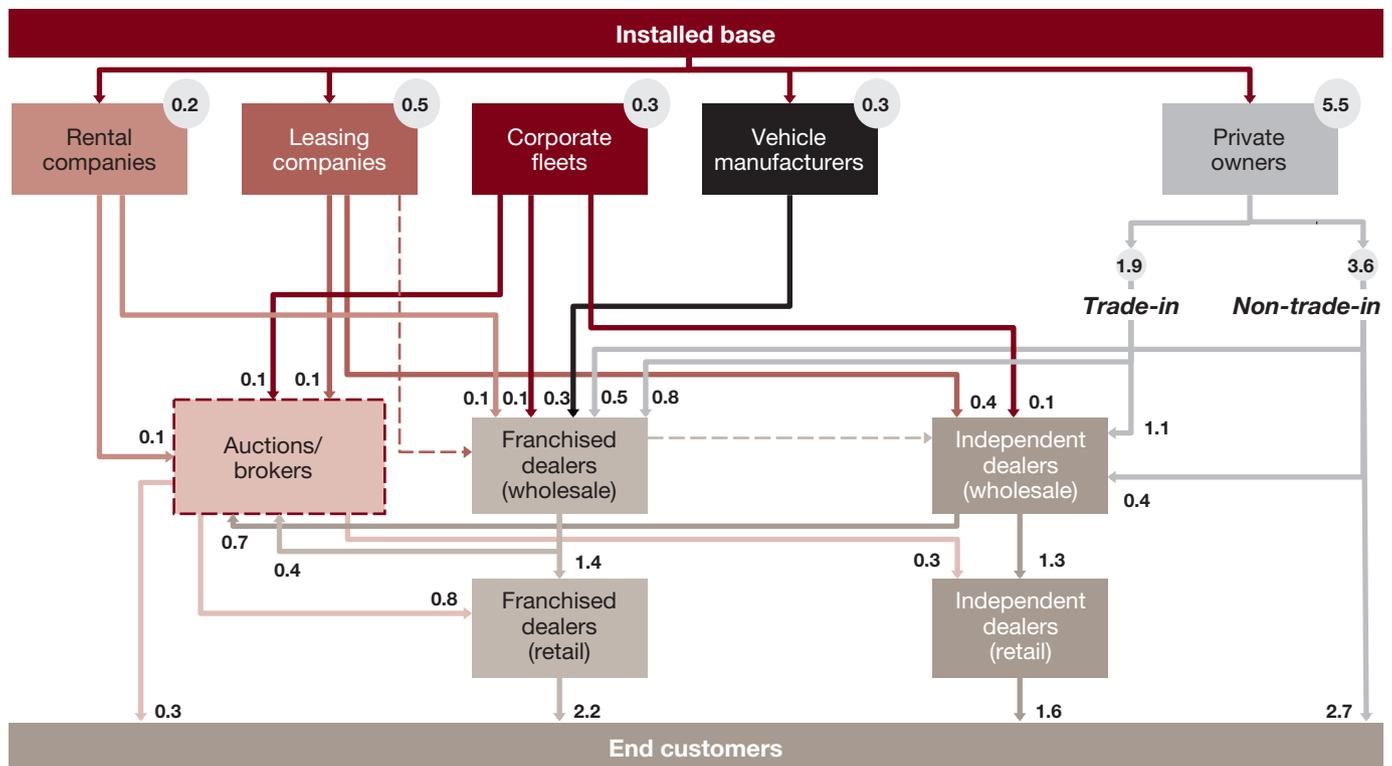


Note: Differences in totals are due to rounding.

Source: Society of Motor Manufacturers and Traders, Data Monitor, British Car Auctions, Strategy& analysis

In addition to sales of cars to private owners, there is also a well-developed wholesale market for used cars — primarily newer ones — in the United Kingdom. Virtually all of the used cars sold by corporate owners — original equipment manufacturers (OEMs), fleet owners, and rental and leasing companies — as well as a large portion of cars traded in by private owners, are then sold among dealers, either directly or through auction houses, which play an important role in the wholesale market (see Exhibit 3).

Exhibit 3
Used car sales flow in the U.K. (2013, in millions)



---> Flow below 100,000 units

Source: Strategy& analysis

Three distinct business models

As the U.K. used car market has matured and been transformed by online technologies, the movement of used cars from various kinds of sellers to the ultimate buyer has come to depend on three business models: transaction parties, transaction facilitators, and information providers (see *Exhibit 4, next page*).

Transaction parties

Transaction parties include the franchised dealers, independent dealers, and online buying platforms that take ownership of used cars and sell them to the next customer:

- *Franchised dealers* sell both new and used cars, typically the brands made by the vehicle manufacturers they represent. These dealers purchase privately owned vehicles on which they expect a good return — usually as trade-ins linked to the sale of a new car or newer used cars they buy from OEMs or fleet owners — and they offer buyers a variety of additional repair and financing services, which adds to their reputation for convenience. While their link to OEMs signals to buyers a relatively high level of trustworthiness, there is little or no transparency into how much their cars actually sell for, or the condition of the cars they sell.
- *Independent dealers*, which are typically smaller than the franchised dealers, focus exclusively on used cars, and usually buy and sell any age, make, and model of car. They often repair and recondition the cars they buy to boost their value before selling them. Independent dealers lack the financial strength of franchised dealers, however, as well as their reputation for trustworthiness, especially since potential buyers know even less about the condition of the cars on offer.
- *Online buying platforms*, such as webuyanycar.com and wewillbuyyourcar.com, buy used cars from private owners and sell them immediately, “as is,” to the next buyer. Their value proposition lies in providing a fast, easy way to sell cars for people who either value the

Exhibit 4

Roles of market participants in the value chain

Business model	Purchase vehicles from owner	Transfer and prepare for next owner	Sell vehicles to end customer	Offer post-sales services
Franchised dealers				
Independent dealers				
Online buying platforms				
Online sales platforms				
Auction houses				
Online matchmakers				
Vehicle history reports				
Online research				
Offline research				
Classified ads (offline)				
Reconditioning/transportation				
Post-sale (financing, insurance, parts, etc.)				

- Transaction party
- Transaction facilitator
- Information provider
- Operates in section of value chain

Source: Company websites; Strategy& analysis

simple, “hassle-free” buying process or just need cash fast. Prices, however, are usually less than other buyers are likely to offer, and are sometimes lowered further when the car is inspected, limiting the reputation of these firms for trust and value. Still, the growing importance of convenience will likely enable these platforms to play an increasingly important role in the market.

These three types of transaction parties are sufficiently distinct in terms of the segments served and value proposition that they could continue to coexist as the principal sales channels.

Transaction facilitators

Transaction facilitators include the various online sales platforms, online matchmakers, and auction houses that buy and sell used cars, earning fees for providing a platform for transactions without taking ownership of the cars or the associated asset risk.

- *Online sales platforms* offer both private and commercial sellers a relatively easy way to put their cars on the market, usually for a finite amount of time. Buyers can bid for the used cars in auctions or, if the seller allows, buy the car instantly. The platform earns fees for services that may include listing the car, successfully selling it, and facilitating payment. They offer transparent pricing and guaranteed sales, although it can be time-consuming for sellers to advertise, manage potential buyers, and complete the transaction. Sellers also run the risk of payment fraud on the part of buyers, while buyers may find that cars are not accurately described.
- *Online matchmakers* publish classified listings of vehicles from private sellers and dealerships on the Internet. They do not hold online auctions or facilitate payment; otherwise, buyers and sellers run the same risks they face when using online sales platforms.
- *Auction houses* are used primarily by dealers and wholesalers to trade cars and manage stock. While their high fees have deterred most private buyers from participating, this is beginning to change. Because cars are sold quickly to the highest bidder, their convenience is leading more private individuals to turn to them to buy and sell cars.

Information providers

Information providers include the various firms offering specific information for used cars (such as vehicle history reports, technical advice, market overviews, as well as online and offline research) and the various platforms for advertising used cars (including newspaper classified ads and online boards). By providing a wealth of independent, objective information, these companies — particularly those offering information online — play an increasingly important role in improving market transparency. As they do not participate directly in the buying and selling of used cars, the information providers, and the many after-sales providers such as financing and insurance firms and reconditioning shops, while important, lie outside the purview of this report.

Market trends

As mature as it currently is, the U.K. used car market will undergo a number of significant changes in the next several years.

Changing supply

While the overall number of cars on the road in the U.K. will remain essentially stable, the mix of cars is changing. Sales of new cars declined sharply during the 2008–2009 recession, and despite the recent market recovery, with 2.48 million new cars sold in 2014, they have only now moved about 3 percent above prerecession levels. As a result, in 2015, there will be 2.5 million fewer cars in the 3- to 8-year age range than there were in 2007, and it will take several years of strong new car sales to build up the supply of prime cars.

Meanwhile, however, owners are holding on to their cars longer: The average age of cars on the road increased from 6.8 years in 2007 to 8.0 years today (see *Exhibit 5, next page*). The improved quality of cars and declining interest in driving among younger, urban dwellers, however, may put a further damper on new car sales. As a result, the average price of older used cars will likely decrease, while prices will tend to rise for the undersupplied segment of middle-aged cars.

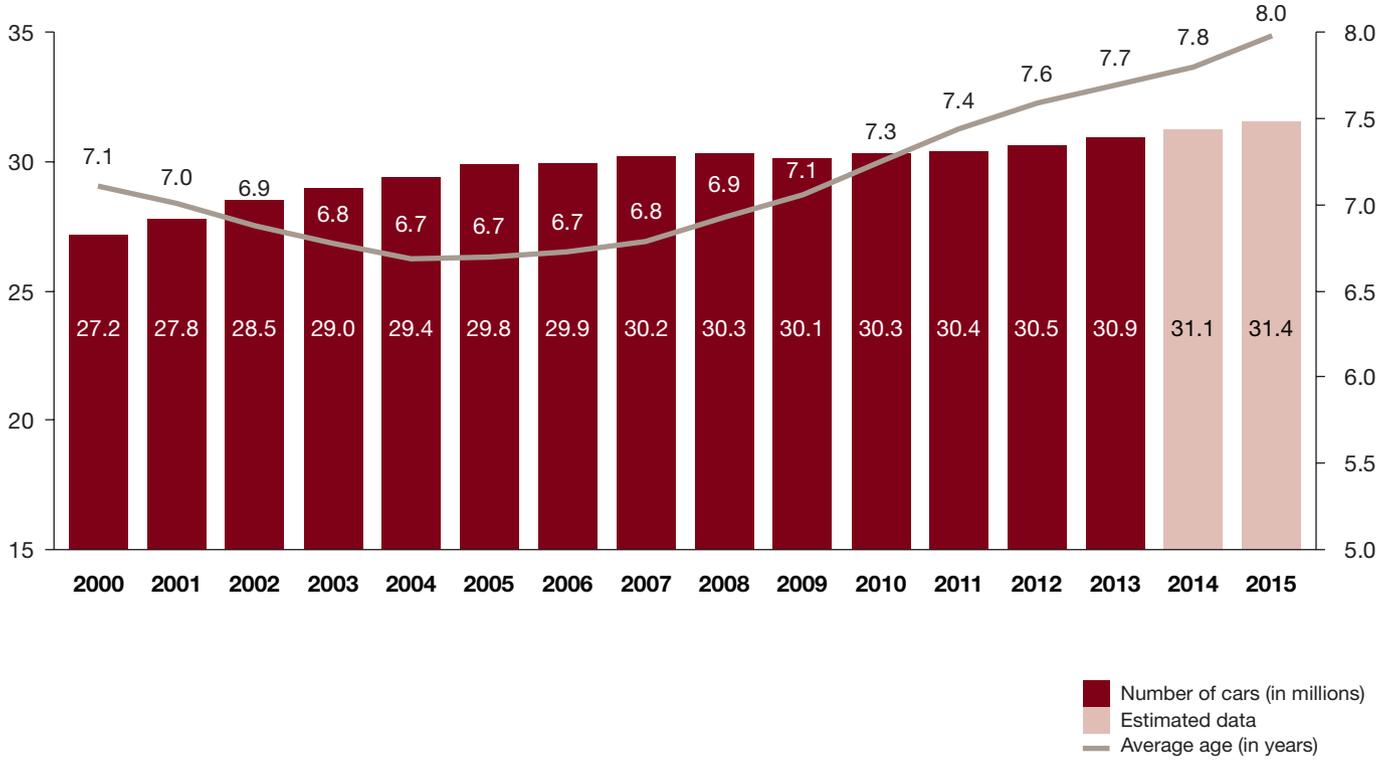
More online transactions

Buyers of used cars are slowly but surely turning to the Internet to research and buy cars. Consumers are arriving at dealerships armed with more information about specific cars and a better understanding of market prices, and they are visiting fewer dealers before buying their chosen car. The rapidly increasing use of mobile devices is boosting this trend: More than 20 percent of all Web searches related to “used cars” are now conducted on these devices.

Further encouraging the trend is the aging of the average used car sold: As the share of used cars nine years or older increases, buyers

Consumers are visiting fewer dealers before buying their chosen car.

Exhibit 5
Average car age in the U.K., 2000–2015



Source: Society of Motor Manufacturers and Traders

and sellers alike will be looking for the quickest, cheapest way to buy and sell those cars. Traditional brick-and-mortar dealers will be forced to follow this audience online, perhaps offering used cars through online marketplaces that provide referrals to dealers with binding offers — a model already available in the United States.

Increased transparency

The availability of information on the Internet has already increased the efficiency of the used car market significantly, providing greater transparency into prices and even the condition of specific used cars. Growing use of online transaction platforms will only boost market efficiency further; indeed, digital intermediaries have the opportunity to shape the structure of the industry as their influence grows, accentuating competitive pressures and revealing the disparity between the most efficient buyers and sellers and the laggards.

Growing importance of convenience

For private owners, selling used cars isn't easy. First, they may decide to spend some money fixing up their used cars and promoting them online or through classified ads. Then they must spend time actually selling the car, negotiating with multiple potential buyers, and completing the transaction. That's why more and more private sellers are looking for fast and hassle-free ways to sell their used cars. In a recent survey, a quarter of all private used car sellers said they would be willing to lower the price of their cars by more than 10 percent in exchange for a more convenient sales process. Private sellers of newer used cars value convenience the most, most likely because the opportunity cost of their time is greater, given their higher incomes.

This trend will have a real impact on the used car market in the U.K. as private owners turn to newer online business models to sell their cars. Offering fast, guaranteed transactions, online buying platforms are particularly likely to benefit.

Market effects

These trends will play out differently for different providers. Franchised and independent dealers will likely be the hardest hit. The supply of cars in their prime market — those less than nine years old — is dwindling, and unlikely to revive soon. Moreover, the market's increasing price transparency and greater availability of information will place downward pressure on their margins. In order to stay relevant, both types of dealers will need to invest in new capabilities to increase their online presence and streamline their processes, differentiating themselves by providing a satisfying, convenient, end-to-end car-buying experience to an increasing number of customer segments. Even older buyers are turning to the Internet for information on the cars they're interested in.

The online buying platforms are also likely to see margins come under pressure. While they will benefit from the increasing share of people looking for fast, hassle-free ways to sell their cars, the current gross margin levels for “flipping” vehicles are likely not sustainable. That's because growing competition from new entrants will force prices to rise, while the increasing number of online transactions will lead to greater price transparency and make it easier to compare prices across different platforms.

As for the transaction facilitators, their financial risk is considerably less than companies that buy and sell cars, since their primary investment lies in building and promoting their platforms, not financing and carrying inventory. They may suffer some fee erosion as used car prices decline as buyers gain access to more information on pricing. At the same time, their share of transactions will likely grow as the available supply of cars gets older and private owners look for easy, low-cost, or free ways to sell their used cars.

Exhibit 6, next page, summarizes the degree to which each of the trends discussed above will affect the market's primary business models.

Even older buyers are turning to the Internet for information on the cars they're interested in.

Exhibit 6
Relevance of trends on specific business models

Business model	Changing supply	Online transactions	Increased transparency	Value of convenience
Franchised dealers				
Independent dealers				
Online buying platforms				
Online sales platforms				
Auction houses				
Online matchmakers				

Transaction contracting party
 Transaction facilitator
 = high relevance
 = low relevance

Source: Strategy& analysis

Conclusion

The U.K. used car market is undergoing important changes, and participants must respond if they are to thrive. A common link among the trends discussed here is an overall reduction of information asymmetry, which has different impacts based on scale and the importance of that asymmetry for the participant in question.

- Customers are increasingly using the online channel and looking to be better informed before making a decision. This increasing use of the Web generates more and more available data on the condition of a car. Consequently, players who will be able to find economies of scale in information acquisition and effectively leverage big data will be best positioned in the future.
- Increasingly available data, coupled with the increased quality of cars and overall less unobserved variance, will reduce the “market for lemons” effect. As such, business models that rely on information asymmetry — such as auction platforms — will see their margins getting squeezed over the coming years.
- Finally, customers are willing to pay more for convenience in buying or selling used cars. This will favor the development of online facilitating platforms, particularly if they manage to increase their level of trust among consumers.

In summary, these shifts will impact all participants in the used car value chain. However, by understanding the trends and adapting their business accordingly, companies can ensure they are positioned even in a more dynamic used car market.

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