BCG

THE BOSTON CONSULTING GROUP

White Paper

August 2008

Assessment of US auto remarketing online market

Further Contact

Talley Lambert

Partner and Managing Director

BCG Atlanta

+1 404 877 5241

lambert.talley@bcg.com

Contributors

Mac Hodell

Lutao Ning

Jon Friedman

Tyler Woulfe

Valerie Gong

Contents

1. Executive summary

Many industries are experiencing shifts to the online market space, and the auto remarketing industry is no exception. Online remarketing offers efficiencies to sellers, such as time and transport savings- as well as time savings and expanded inventory access for buyers.

In order to understand the size of the online market and the key decision factors underlying buyers' and sellers' decision to transact online, The Boston Consulting Group (BCG) undertook industry research in association with NAAA, NADA, and NIADA. This research consisted of a survey of approximately 1,000 buyers and consignors (commercial and dealer sellers), as well as selected interviews with buyers and consignors.

Based on this research, the 2008 wholesale online market is estimated to be 1.7 million transactions. This represents ~18% of the 9.6 million wholesale transactions taking place in the formal auction space (with the remaining 11.4 million transactions occurring outside of auctions). We define the wholesale online market to exclude grounding dealer purchases (these are not market transactions) and to include all virtual channels, regardless of vehicle location (i.e. including in-lane broadcasts). Current online share leaders are Manheim (37% share) and GMAC Smartauction (26% share).

Looking over the next five years, the online wholesale market is poised for significant growth. Based upon BCG analysis of online adoption rates and the US car parc size and makeup, the wholesale online market is predicted to reach approximately 3 million transactions by 2013.

Summary of key findings

- **Current wholesale online market size: ~1.7M transactions**
- **Projected wholesale online market size in 2013: ~3M transactions**
- **Key decision factors to use online marketplace**
  - **Buyer: Expanded access to inventory**
  - **Seller: Access to large buyer pool**

This document presents key findings from BCG's industry research. First, we define the market and explain our rationale for its definition and segmentation. Next, the current and projected market sizes are presented. Following this are the major findings from dealer-buyer and consignor market research.

2. Current online remarketing industry

Market definition

The focus of this study is wholesale market transactions. "Wholesale" implies transactions excluding those involving the end consumer. "Market" transactions imply those occurring in a market with at least two different buyers, hence excluding grounding dealer purchases of off-lease vehicles. "Online" includes all transactions executed through a virtual platform- regardless of vehicle location.

This market is most logically segmented along two dimensions- which related directly to the nature of the marketplace and to the economics of the transaction

- *Buyer base*: closed (seller restricts buyer base) versus open
- *Location of vehicle at time of transaction*: off-site (not at auction), on-site at auction, or in-lane

Closed marketplaces must be considered distinctly- as these often serve to benefit an OEM's franchise dealer network- whereas open marketplaces attempt to allow for maximum buyer participation, thereby realizing "true" competitive pricing. Vehicle location is defined relative to physical auction sites in order to highlight the degree of time and transport cost savings. Although in-lane online can provide the same value-add services – such as inspection and reconditioning – as physical auctions, on-site online eliminates the need for cars to run through auction lanes to be sold. The on-site online marketplace maximizes the time vehicles are available for sale to prospective buyers, thereby minimizing sales cycle and vehicle depreciation. Off-site online further removes the added cost associated with transporting vehicles to auction sites.

Exhibit 1. Defining the wholesale online marketplace.

Term	Definition
Overall wholesale market	**The set of used vehicle transactions excluding those involving the end consumer** • Dealer to consumer transactions excluded • Dealer to dealer; Dealer to/from wholesalers included
Online wholesale market transaction	**A sale within the overall wholesale market executed on a virtual platform within an actual market- whether open or closed** • Excludes grounding dealer purchases of off-lease vehicles • Includes in-lane sales to non-co-located buyers
Vehicle location	
• **Off-site**	**Locations upstream of physical auctions (e.g. dealer lot, railhead, airport).**
• **On-site**	**On physical auction grounds- no further transportation (excluding repositioning) required to conduct in-lane physical sale**
• **In-lane**	**Online transactions taking place while vehicle is in-lane (e.g. Simulcast, Liveblock)**
Nature of marketplace	
• **Closed**	**Marketplace where only certain groups of buyers are allowed to attend auction, as specified by consignor**
• **Open**	**Marketplace where all buyers can purchase online**

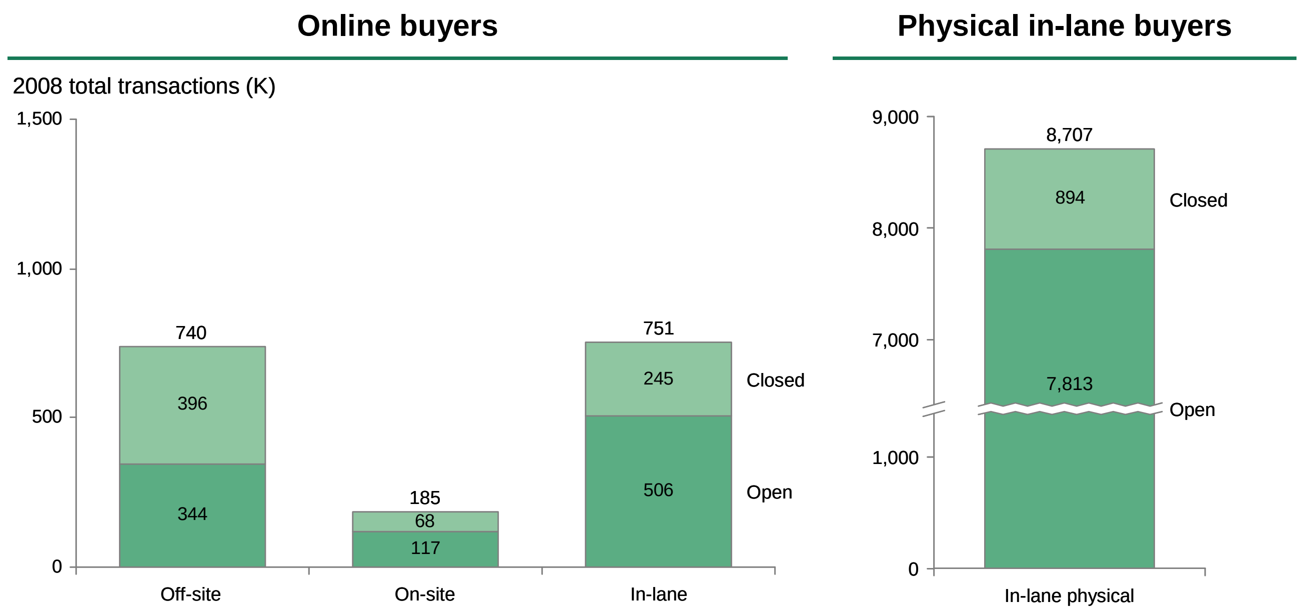
Simplified view of market place (inclusions and exclusions)

Included in online market space	**Not included in online market space**
• **B2B** • **Onsite online (open and closed)** • **Offsite online (open and closed)** • **In-lane online (open and closed)**	• **B2C** • **Grounding dealer purchases of off-lease vehicles**

- **Market size and market share by key players**

The current online auction market is 1.7 million transactions, and consists of 44% off-site, 11% on-site, and 45% in-lane transactions. Off-site serves slightly more of the closed buyers, while on-site and in-lane channels are more catered towards the open buyers.

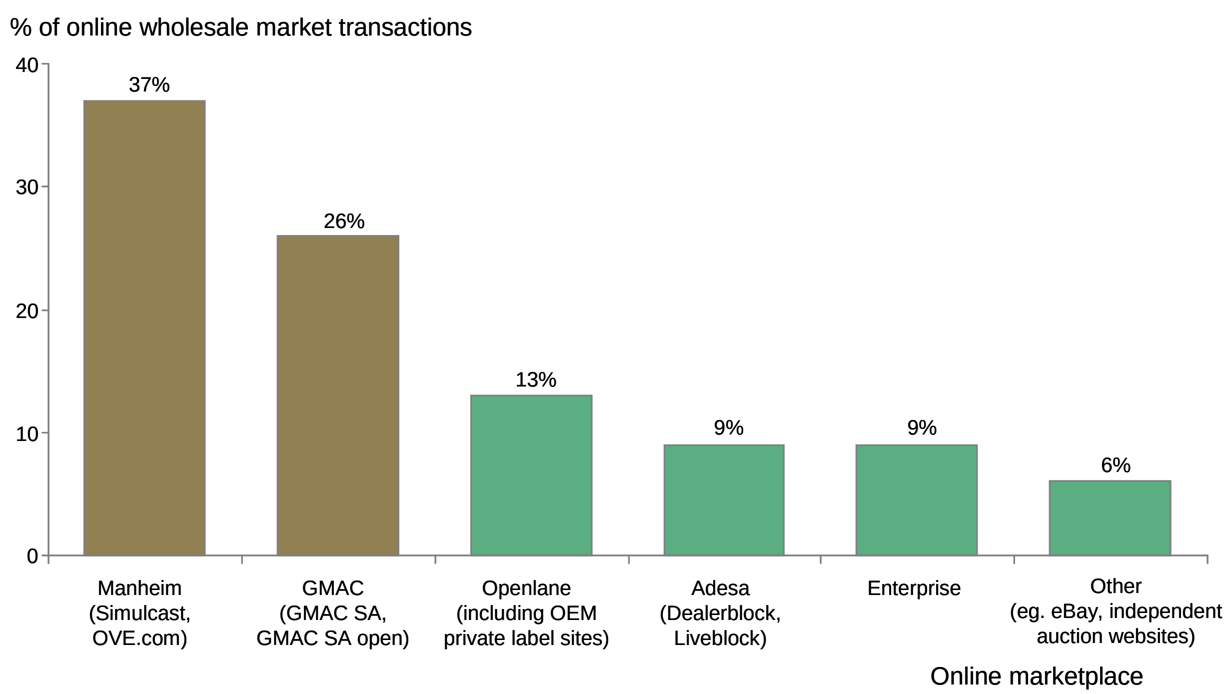
Exhibit 2. 2008 online market sized at ~1.7 M transactions by channel.



Source: BCG consignor interviews

The online market consists primarily of two main players who account for 63% of market share. Manheim is the industry leader with 37% share (including both Simulcast and OVE), while GMAC SA is the second largest player in the industry with 26% share. Other players are significantly smaller. Market shares were determined from buyer survey results and corroborated by interviews and company reports/data.

Exhibit 3. Manheim and GMAC top 2 players by total online share in 2008.

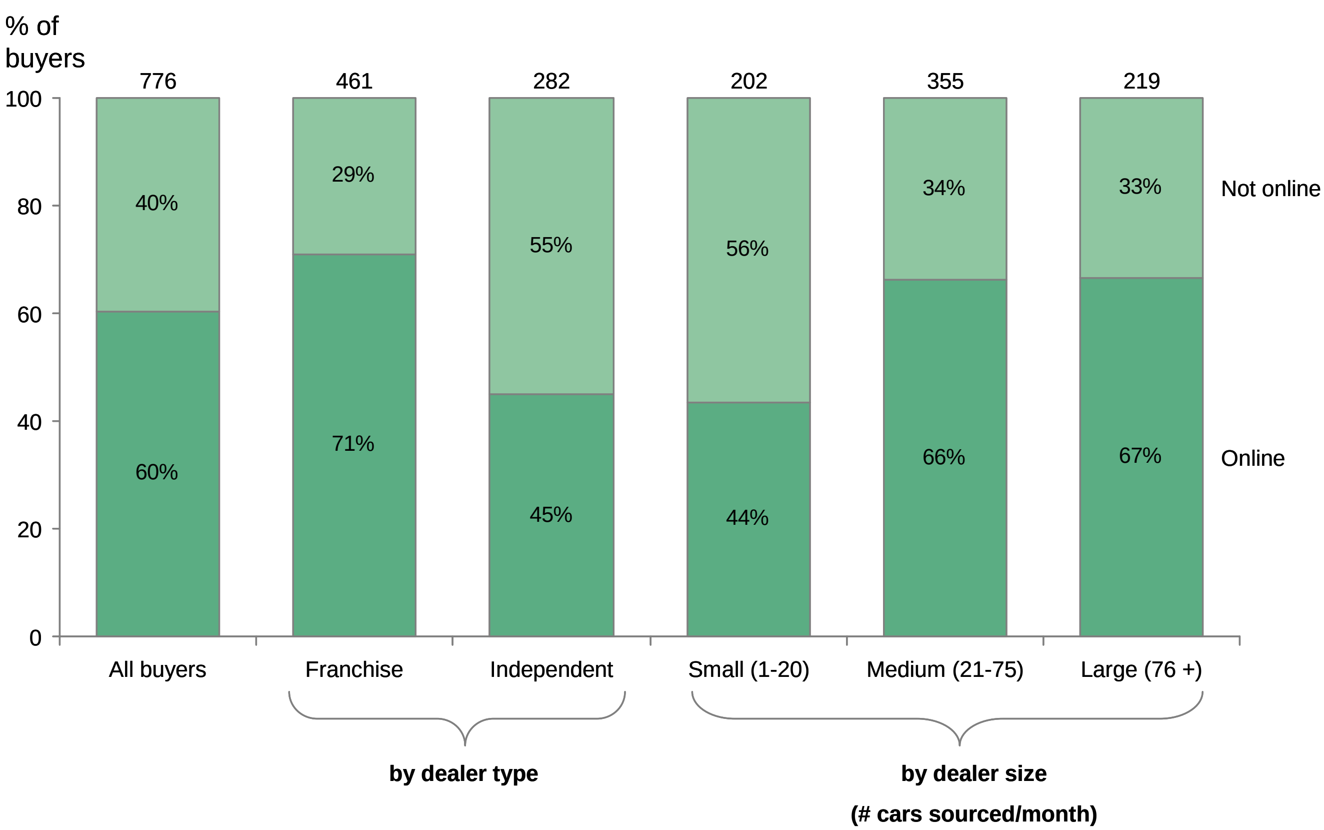


Note: survey results weighted to reflect dealer-size mix within actual market

- **Degree of buyer participation in online marketplace**

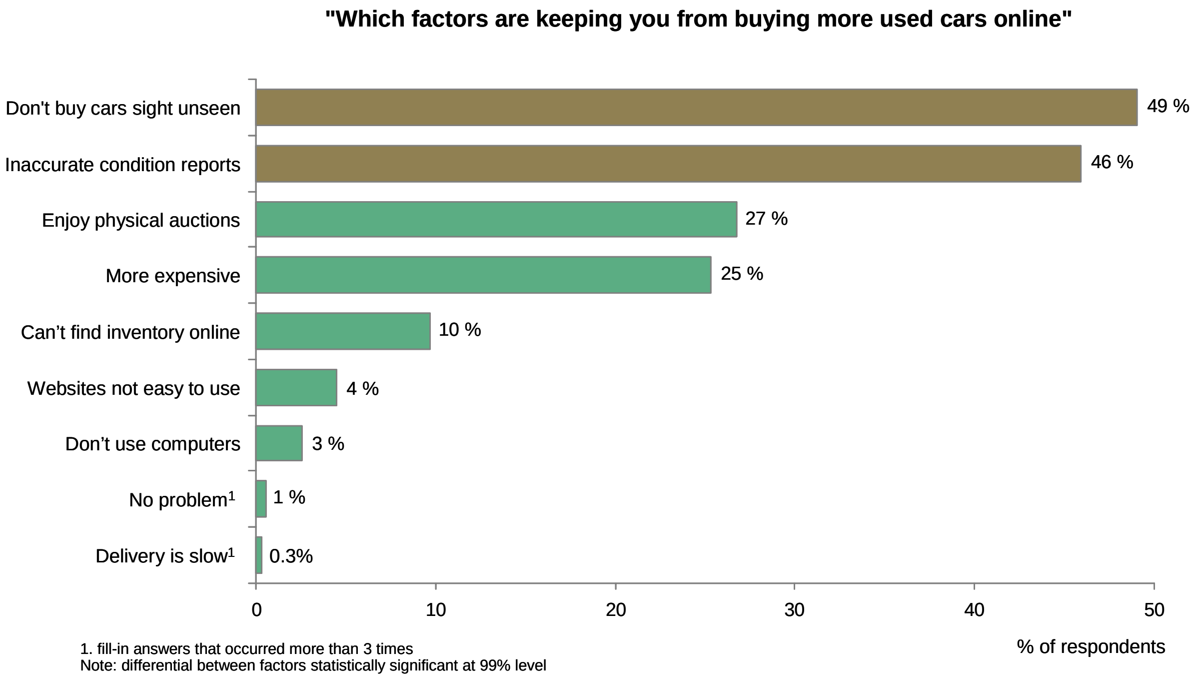
Of the buyers surveyed, 60% have used some form of online marketplace to source their vehicles. The remaining 40% have not used online marketplaces, and instead source their cars from physical auctions, trade-ins or other informal dealer networks. Online prevalence varies by dealer type and size. When broken down by dealer type, 71% of franchise dealers are online, whereas only 45% of independent dealers are online. Online presence also increases with increasing dealer size, as determined by number of cars sourced at dealership. For smaller dealers, 44% are online, but 66% of medium dealers and 67% of large dealers already transact online.

Exhibit 4. Online prevalence higher for franchise dealers and larger dealers.



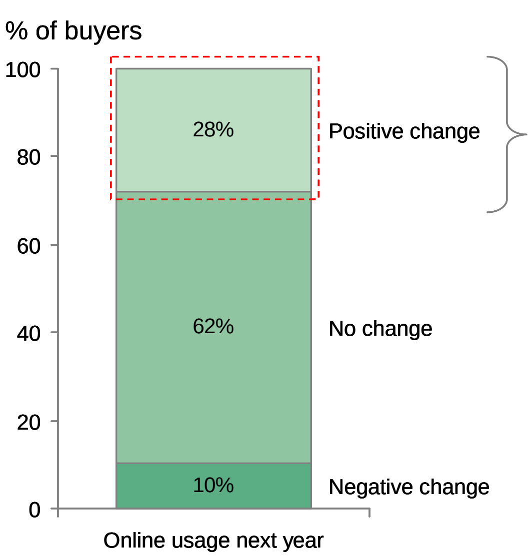
The main reason cited by dealers for not purchasing online is discomfort with buying cars online without seeing them, and the inaccurate condition reports attached to these online cars. On the other hand, website complexity and internet incapability were rarely cited for buyers in this marketplace.

Exhibit 5. Lack of ability to see product accompanied by inaccurate condition reports prevent dealers from buying online.



When asked about their online usage for purchasing cars within the next year, 28% of dealers said they will increase online marketplace usage, while 10% said they will decrease online usage, and 62% will remain at the same usage level. For dealers with significant increase in online purchasing activity within the next year, they cited overall web-based economic climate and time savings as the main drivers. Dealers cite unreliable condition reports as the main reason for decreasing online usage within the next year.

Exhibit 6. In the next year, 28% of users will increase purchasing online.

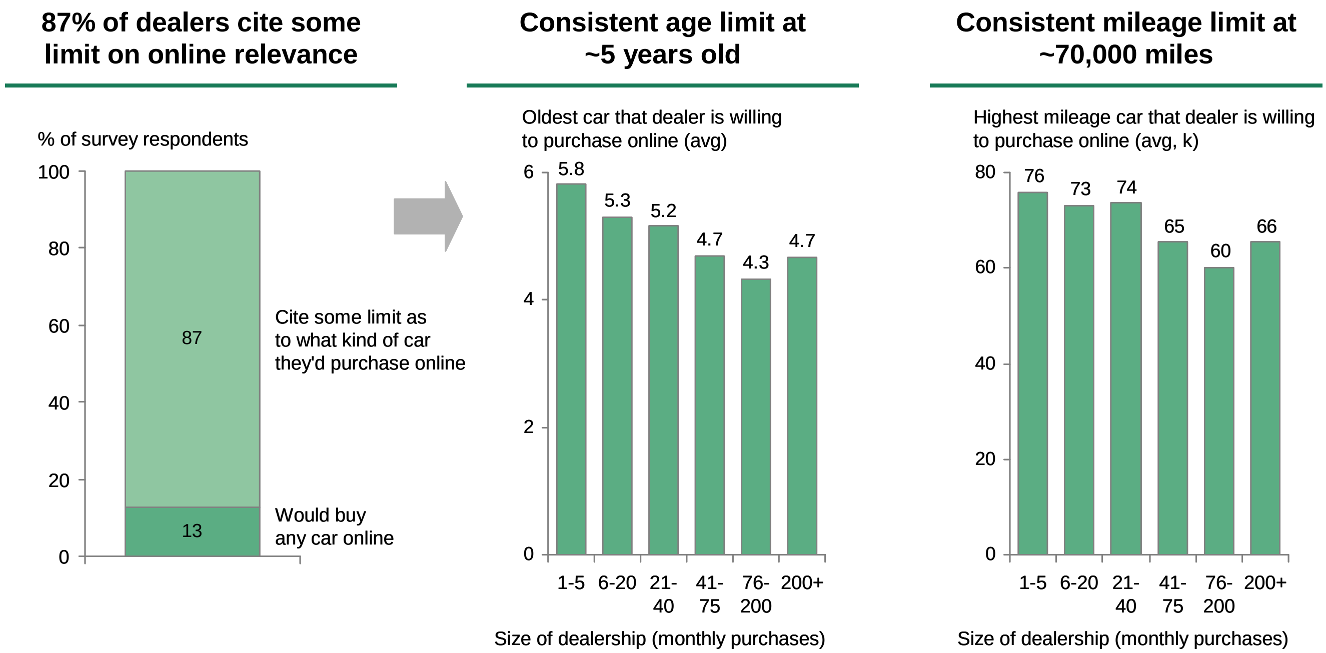


Theme	Quote
Market is moving online	New local online auction recently started, and the local physical auction is going down the drain.
Time savings online	I can go to my local auctions and look at the cars in the morning then come back to the office to bid while I am doing other things.

- **Limitations on products suitable to the online market**

Despite the significant growth in online auctions, there remains a clear limitation on the types of cars buyers are willing to purchase online. Our survey suggests that dealers are unwilling to purchase cars that are on average older than 5 years or with more than 70,000 miles, beyond which uncertainty is too great for online transactions to take place. Larger dealers are even more risk-averse than smaller dealers, indicating that this limit is unlikely to increase as dealerships consolidate and increase in size.

Exhibit 7. Limitation for online transactions seen around 5 years and 70,000 miles.



3. Future of Online Remarketing

A strong web presence in today's used car market is shifting forces in the auto remarketing industry, steering more market players online. The projected online market size in 2013 is 3 million transactions – nearly doubling what it is today.

- **Sellers: five-year growth**

We predict a distinct channel shift over the next few years, with sellers migrating to online channels more upstream. We expect approximately 19% annual growth in the open off-site channel, and ~9% in the closed off-site channel. We will also see significant growth in the on-site open channel at ~30% per year, transforming the midstream market into a valuable online exchange-place. Additionally, there will be continued growth in the in-lane online channel at ~8% per year, while the in-lane physical auctions will see decrease in activity at -2% per year. Consignors are attracted to the online channels, which provide valuable time savings and cost savings from having to transport cars to physical auction sites.

Exhibit 8. Different channels experience different rates of online growth.

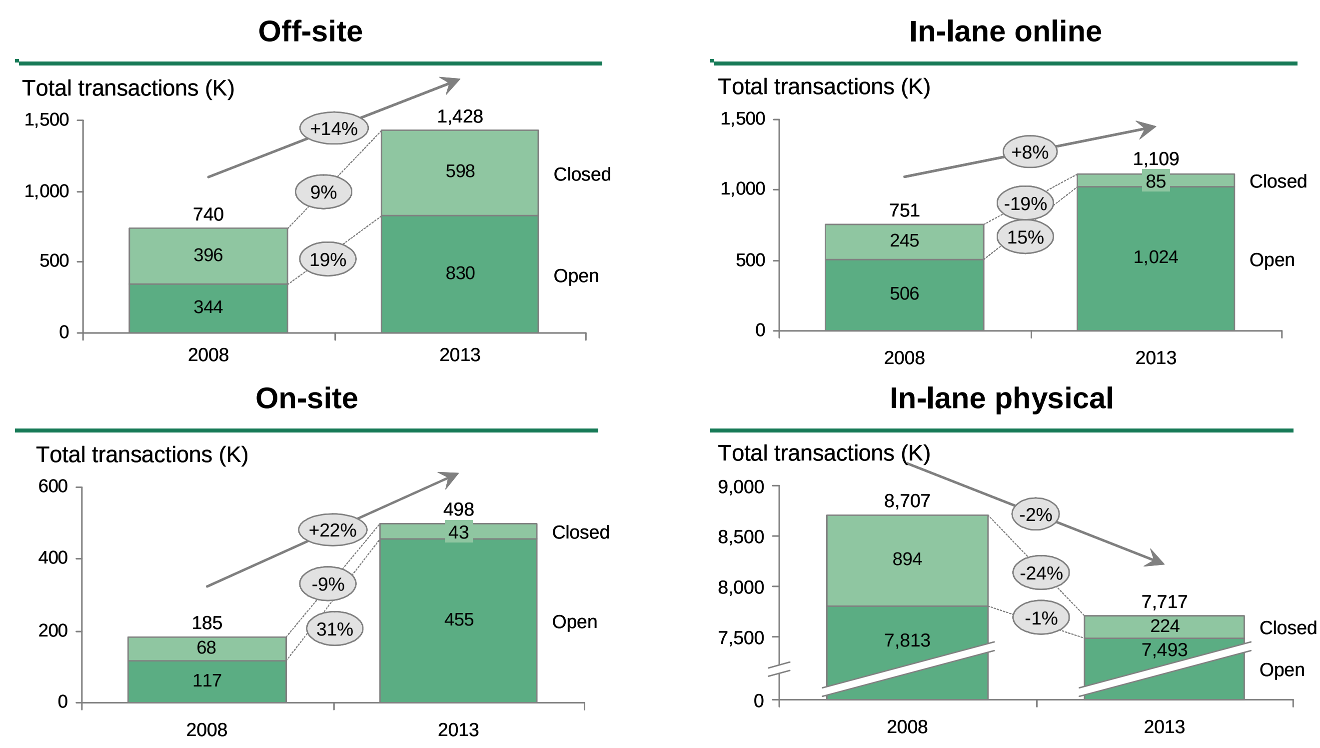


Exhibit 9 shows online growth segmented by consignor type, and **Exhibit 10** breaks it down by channel. Dealer consignors are expected to increase online volume by ~42% (CAGR 07-13), or an additional 300K transactions in offsite and onsite channels. Institutional consignors are undertaking similar remarketing initiatives to shape up their online business for 2008 and beyond. Main growth areas are commercial fleet consignors ~35% (CAGR 07-13), banks ~10% (CAGR 07-13), and rental risk ~10% (CAGR 07-13).

Exhibit 9. Areas of highest expected online growth are dealers and commercial fleets.

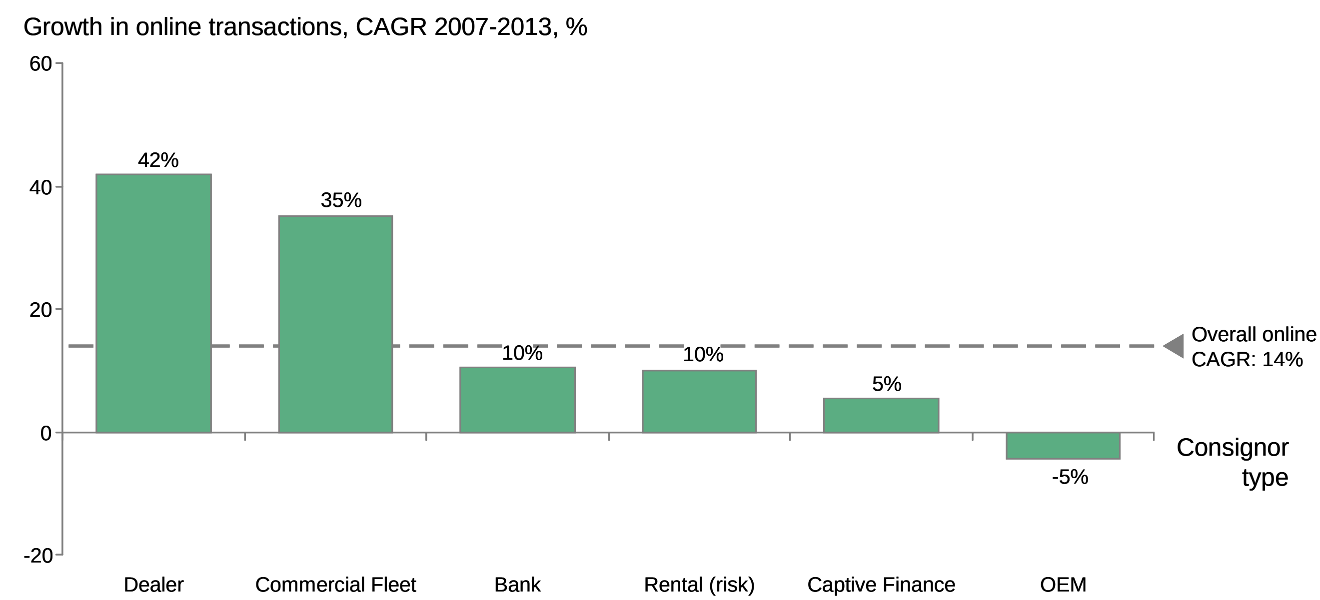


Exhibit 10. Areas of online growth of dealer and commercial consignors by channel.

	Off-site			On-site			In-lane			Total online			Online penetration[1]
Consignor	2007	2013	CAGR	2007	2013	CAGR	2007	2013	CAGR	2007	2013	CAGR	2013
Dealer	60	358	35 %	26	323	52 %	66	557	43 %	152	1,239	42 %	9%
Bank	14	43	21 %	2	7	23 %	44	58	5 %	60	107	10 %	11%
Captive Finance	290	501	10 %	50	52	1 %	188	180	(1) %	527	733	6 %	39%
Commercial Fleet	20	110	33 %	3	52	61 %	22	110	31 %	45	272	35 %	16%
OEM	112	134	3 %	22	13	(8) %	217	73	(17) %	350	265	(5) %	51%
Rental (risk)	172	236	5 %	24	50	13 %	41	114	19 %	237	418	10 %	33%
Other	0	0	-	0	0	-	3	4	5 %	3	4	5 %	2%
Total	667	1,428	14 %	126	497	26 %	581	1,114	11 %	1,374	3,040	14 %	15%

1. online volume as a % of total wholesale transactions
Note: 2007 and 2013 figures are total transactions in thousands.

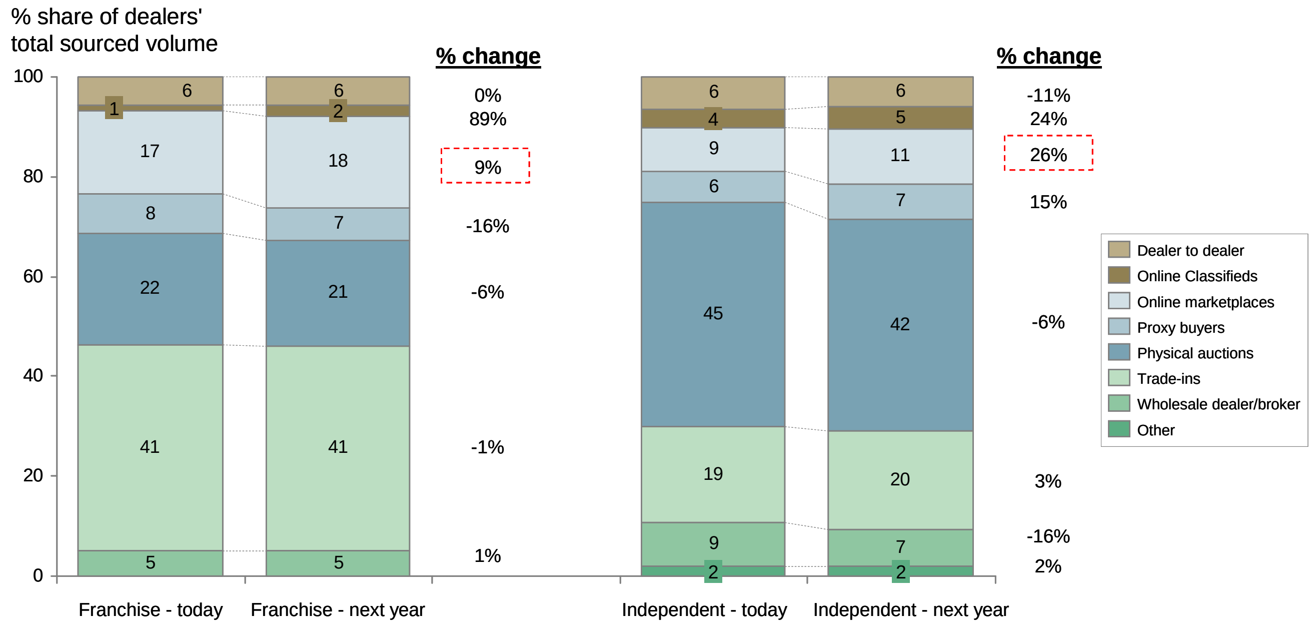
The largest growth is expected from dealer consignors, who seek the benefit of wholesaling vehicles directly from their retail lots to increase conversion and turnover rate. Growing off a small base, large commercial fleet management companies will also expect significant growth online. Banks should show growth both off-site and on-site, fueled primarily by repossession vehicles moving online. Rental will grow steadily as risk units increase, while captive finance will shift to off-site, but decline overall in the online space due to reduced off-lease volume. OEMs will expect sharp decline in program rental units, reducing flow to off-site and on-site channels.

- **Buyers: next-year adoption**

Although currently not a major sourcing channel by volume for dealer-buyers, the online marketplace is expected to undergo the largest growth within the next year. On the other hand, current major sourcing channels, such as trade-ins and physical auctions are expected to decline in volume within the next year. Our survey responses show that franchise dealers are expecting to grow their online purchases by ~9% over the next year, expanding off of a larger proportion that is already online, compared to the 26% growth expected from independent dealers, growing from a much smaller base that is primarily online in the in-lane channel. This represents an overall online growth of 17% per annual over the next 5 years (**Exhibit 11**).

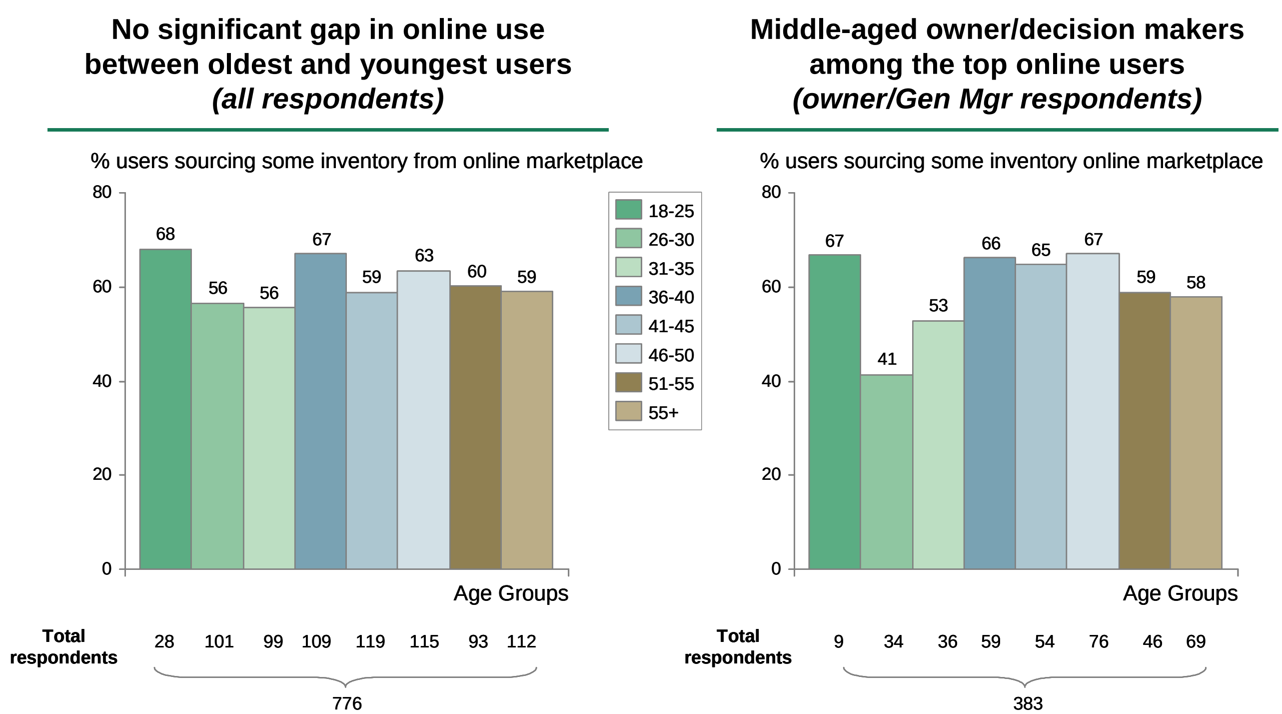
Although independent dealers seem to be later in the adoption stage than their franchise counterparts, they are recognizing the benefits of online's ability to remotely access a broader inventory pool without the time and travel cost of physical attendance. Furthermore, in online sourcing, proximity to the inventory becomes less of a factor, allowing smaller dealers in more rural areas access to the same pool of inventory that was once only accessible by the largest national dealers.

Exhibit 11. Dealers cite growth in online sourcing volume, and decline in physical auction volume within the next year.



One common hypothesis in the industry is that dealer buyers are moving online partly due to the rise of a younger generation of dealers more comfortable with technology. However, our survey results suggest that to the contrary, there is no significant gap in online usage between the older and younger users. In fact, the average user age is highest for the heavy online users, defined as conducting >50% of transactions online. More specifically, our results show that the average age for heavy users is 45.3, while the average age for none users is only 42.7 and for light users is 42.5. When looking only at respondents whose role is the owner or general manager in the dealership, similar online prevalence is observed across all age groups.

Exhibit 12. Similar online prevalence across age groups for all roles as well as for owners/GMs

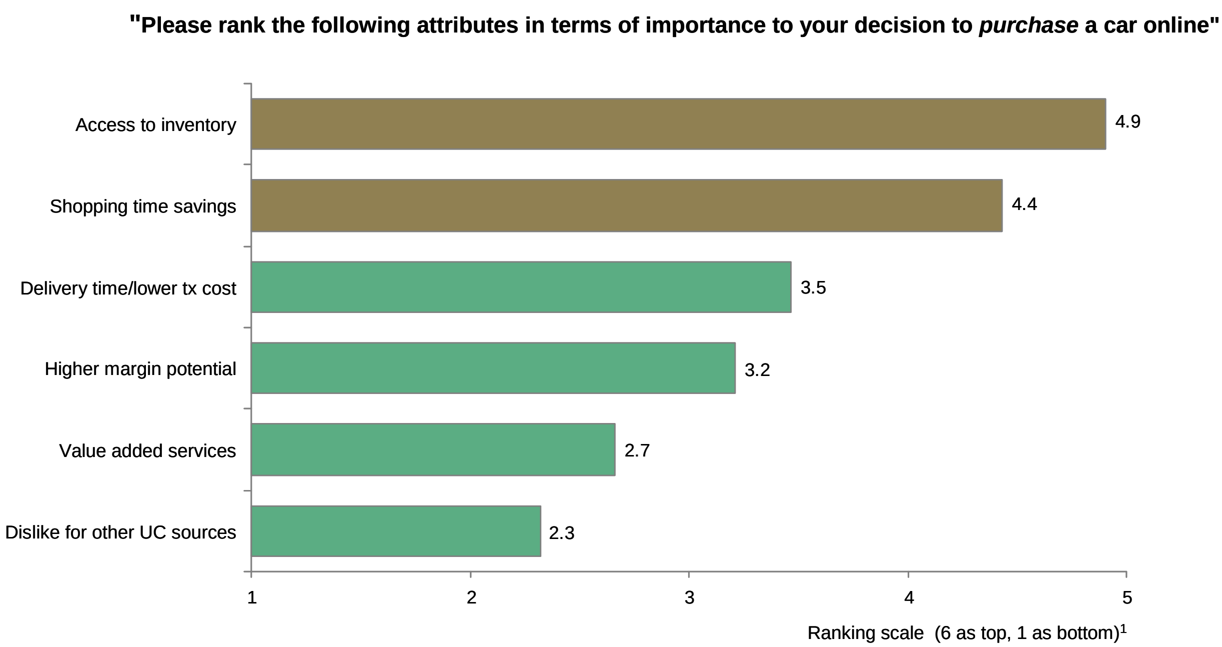


Note: The 5-year growth projections for the online market are based on the predicted evolution of buyer and seller behavior. The projections do not account for possible changes in the structure of the online marketplace itself. Major structural changes in the current online and physical markets may alter growth rates and/or shift volume from one channel to another.

4. Key decision factors from buyer's perspective

The most successful marketplaces will be those best able to cater to the needs of the online buyers and sellers. When dealers ranked several factors in terms of importance to their decision to purchase a car online, **access to inventory** and **shopping time savings** were rated as the two most important decision factors.

Exhibit 13. Dealers ranked access to inventory and shopping time savings as most important decision factors to purchase online.

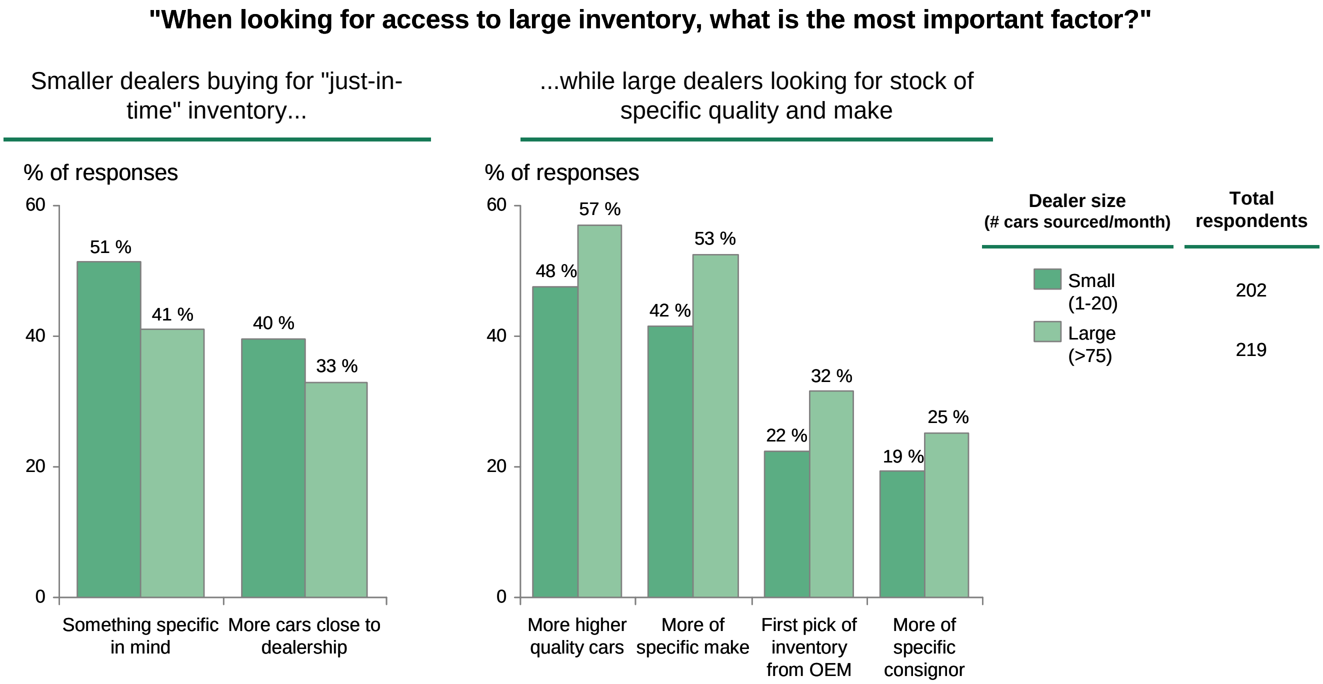


1. dealers force ranked decision making factors from 1-6
Note: differential between access to inventory and shopping time savings is statistically significant at 99% level;

- **Access to inventory**

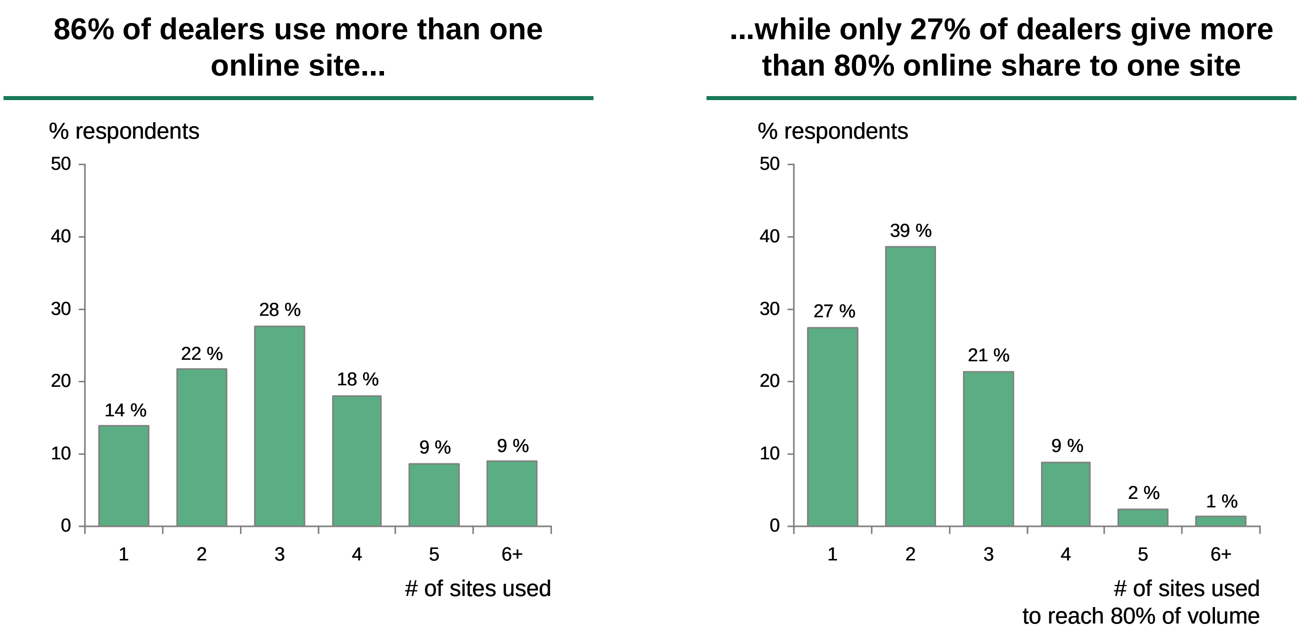
In making the decision to purchase online, the most important factor is access to relevant inventory from a fluid marketplace. Access to inventory becomes increasingly important as dealer size increases. Additionally, the type of inventory sought after, whether it is a specific make, age, or type of car, depends on the size of dealership. Small dealers buy for "just-in-time" inventory – a specific car they have in mind in a close-by location, while large dealers look for stock vehicles of specific quality and make.

Exhibit 14. Smaller dealers buy for "just-in-time" inventory, while large dealers look for stock of specific quality and make.



Overall, dealers look for an online platform that has the right mix of vehicles to offer, allowing both in-stock purchase and just-in-time finds. Driven by access to distinct inventory pools offered on different sites, 86% of dealers use more than one online platform for their purchasing needs. Along the same lines, only 27% of dealers give more than 80% of their online share to one single site.

Exhibit 15. High degree of multi-site sourcing in the online market space.



Majority of online users spread share over 2 or 3 sites

- **Time savings and convenience**

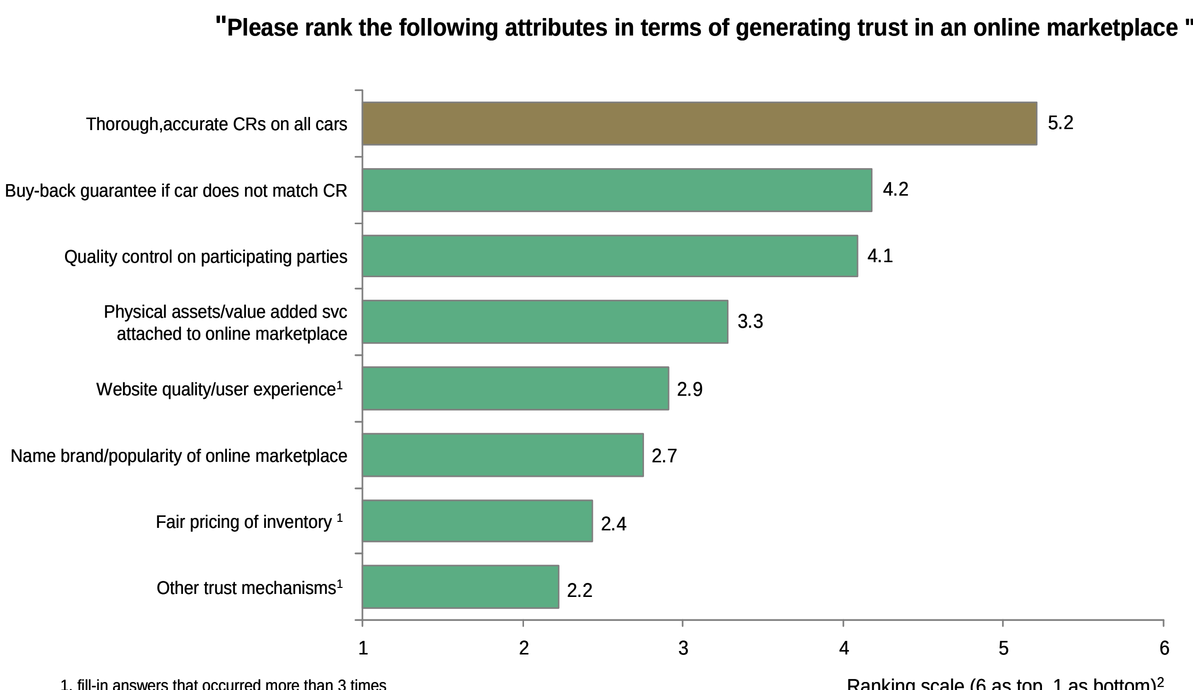
Online websites eliminate the need for buyers to travel to the physical auction site, where there is no guarantee of finding the right car. The ability to shop online without leaving the dealer lot is a critical benefit especially for small dealers, who represent a greater portion of the independent dealerships. These dealerships cannot afford the extra person and time to attend physical auctions.

- **Condition reports**

Dealers are in the early stage of online auction adoption, driven by distrust of condition reports and inherent discomfort with buying cars without seeing them or "kicking the tires". The auto remarketing industry has several initiatives underway to rebuild trust in these platforms, and the prevailing view is that an improved condition report process can address latent dissatisfaction with the online market. Our survey of buyers agrees that condition report is the main trust engendering product, establishing a standardized metric when evaluating used vehicles.

> "I only buy from auctions I've been to, though, because I don't trust just the CR. I might shop at more sites if they provided better CRs." – Independent dealer

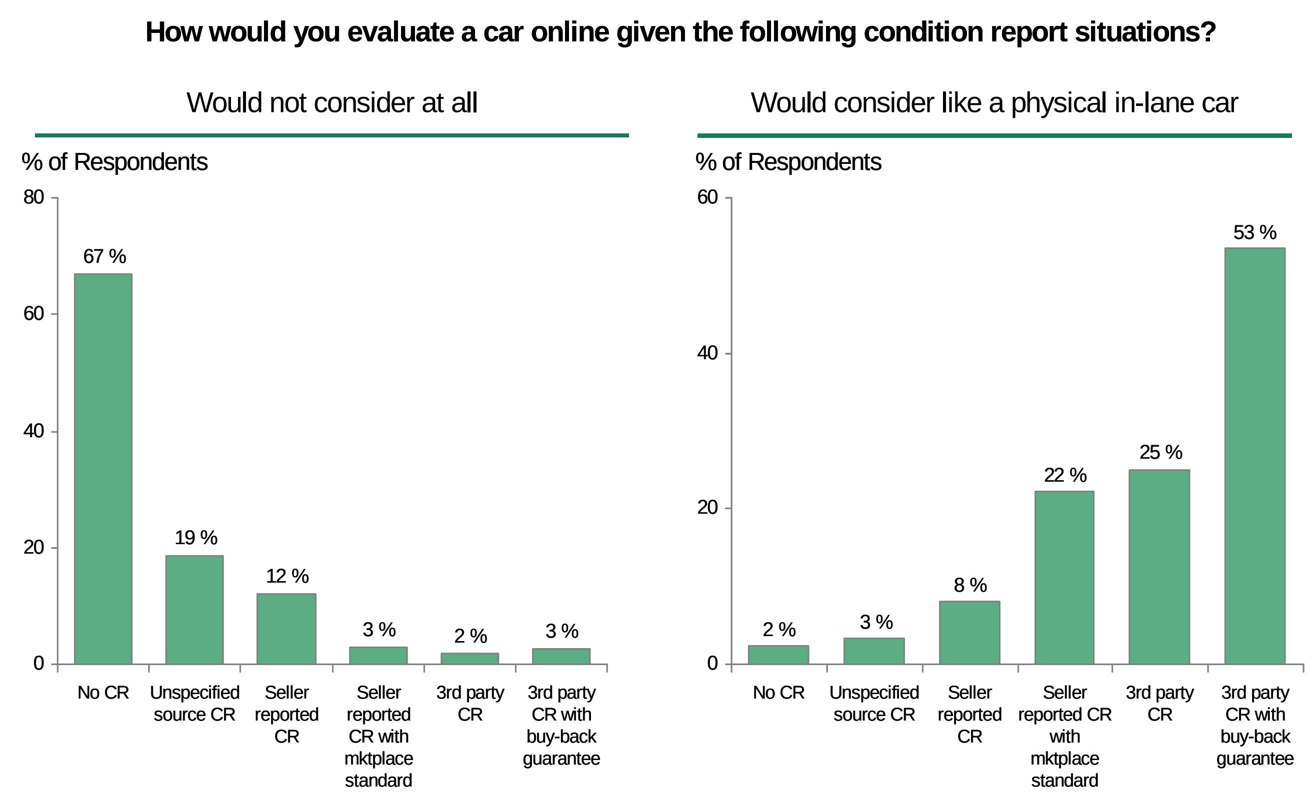
Exhibit 16. Dealers ranked condition reports by far the most important trust-engendering mechanism.



1. fill-in answers that occurred more than 3 times
2. dealers force ranked decision making factors from 1-6
Note: differential between thorough, accurate CRs on all cars and the other factors is statistically significant at 99% level

Condition reports with an industry standard greatly increase dealer chance to buy online, but seller reported condition reports are also worth considering. Our survey response shows that for an online car without a condition report, 67% of respondents would not consider it at all, while only 2% would consider it as if it were a physical in-lane purchase. The reverse is seen for online cars with 3rd party condition reports with buy-back guarantees. While only 3% would not consider it online, 53% would consider the car as if it were in a physical lane. Therefore, clear and accurate condition reports can enable more transactions online and help buyers become more comfortable with online wholesale auctions as a trusted option for purchasing used cars.

Exhibit 17. Majority of respondents would not consider a car online without condition report.

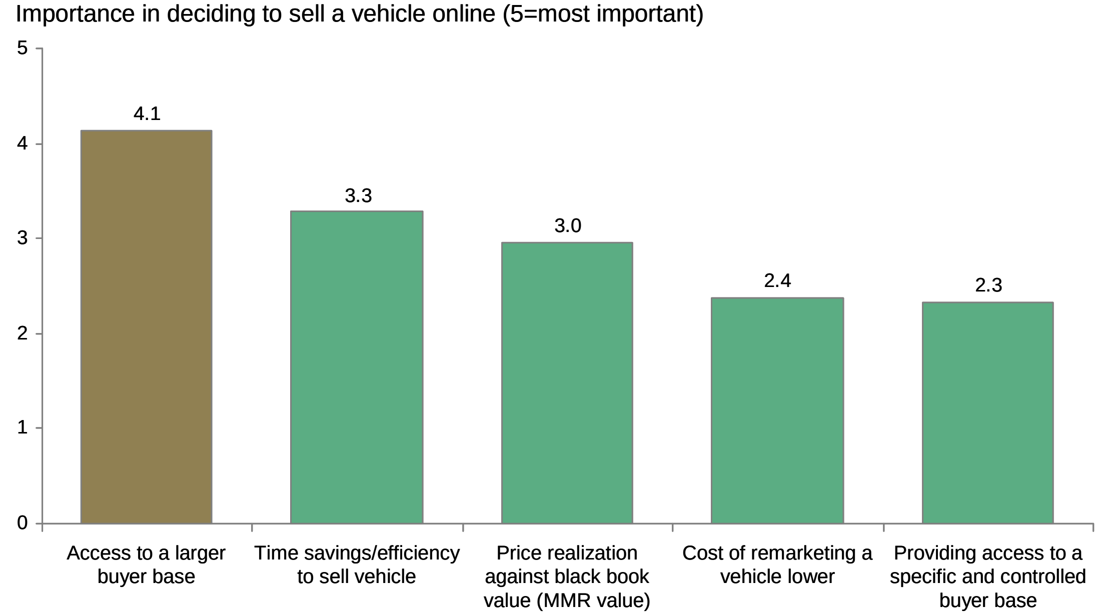


5. Key decision factors from seller's perspective

- **Critical mass of buyers**

Access to a large pool of buyers is often cited as the most important selection criterion for consignors when deciding where to list their used cars. Survey results support that both dealer and commercial consignors select their choice of online platform based on the largest buyer base.

Exhibit 18. Access to large buyer base is the most important factor for consignors when choosing an online platform.

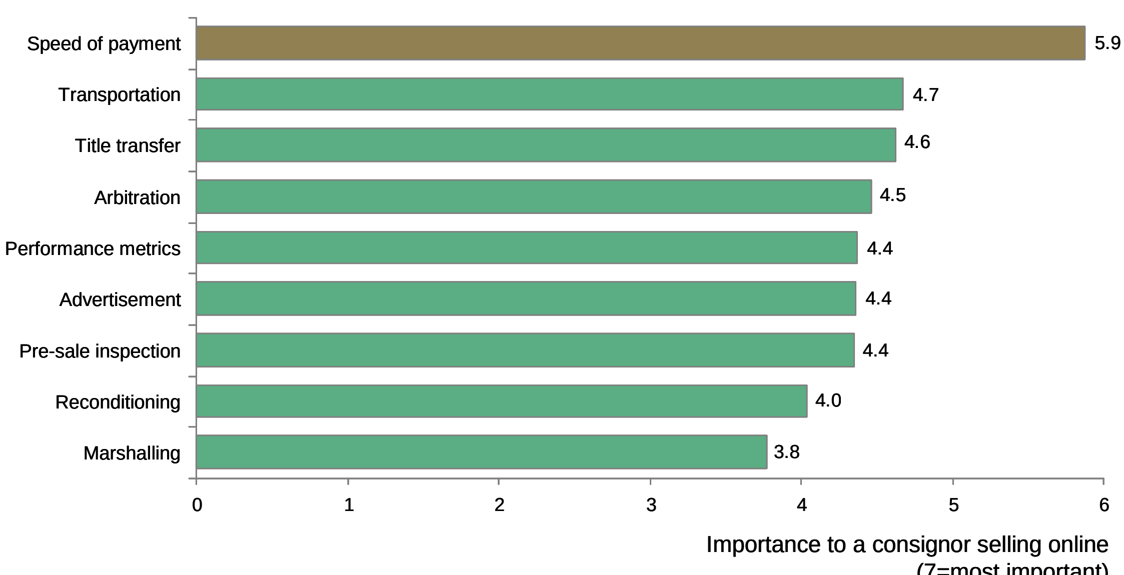


Note: differential between access to large buyer base and other factors is statistically significant at 99% level

- **Top service provided - speed of payment**

In terms of services provided by online sites, both commercial and dealer consignors believe that speed of payment is the most important value-added service. This expedient payment method is more important for dealer consignors. There are currently two prevailing methods of payment to consignors in the industry. Common practice is to pay the consignors upon receiving payment from the buyers. However, some online sites, e.g. Manheim, pay consignors as soon as the listings are sold, often before the payment is actually received from the buyer.

Exhibit 19. Speed of payment is most important service for all consignors.



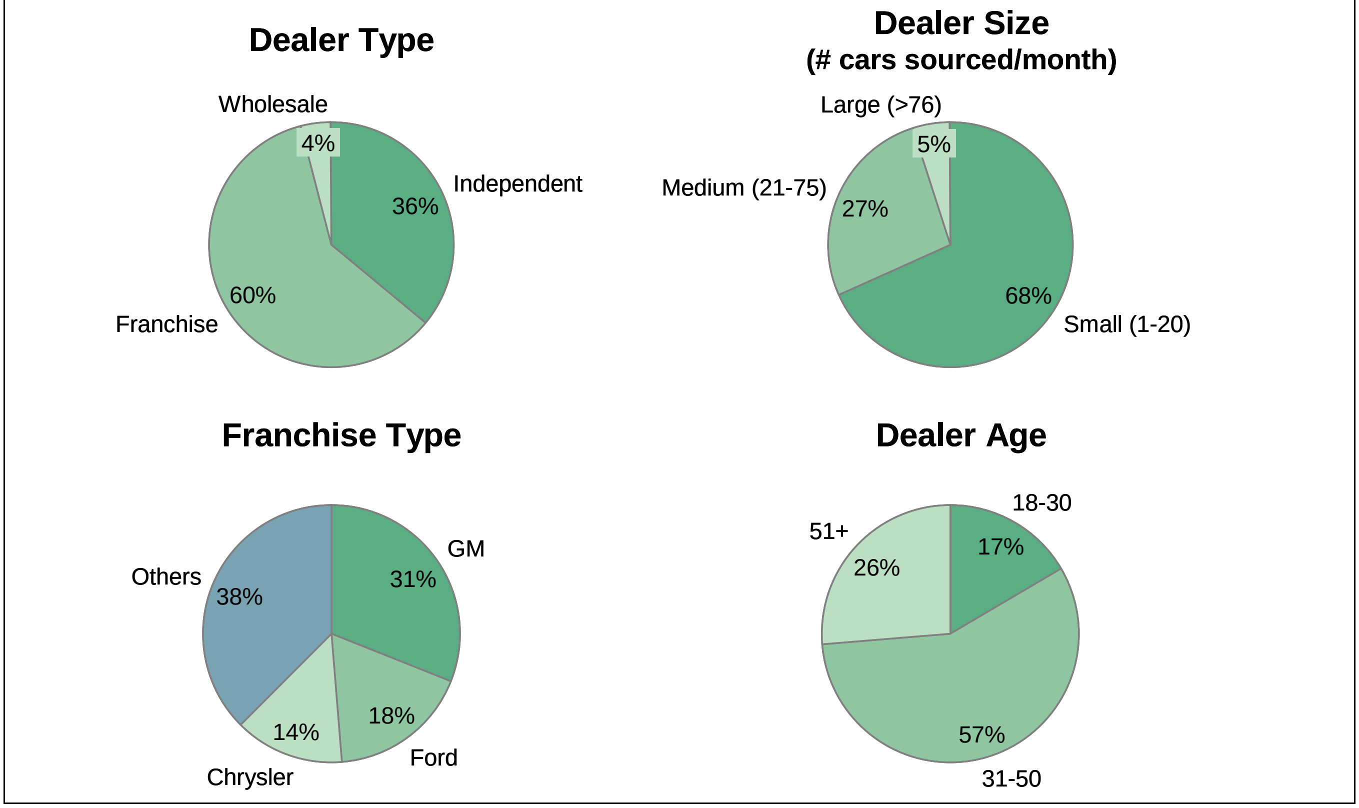
Note: differential between speed of payment and other factors is statistically significant at 99% level

6. Survey methodology

To quantify the current and future online wholesale market, and to gain a better understanding of the online market with views from both a buyer and seller perspective, an independent and franchise dealer perspective, across dealer sizes and across consignor types, we conducted a large-scale survey complemented by qualitative interviews.

For our survey, we obtained a robust sample of 776 buyers, 150 commercial consignors, and 307 dealer consignors. Of the 776 dealer buyers, 36% were independent dealers while 60% were franchise dealers, and the remaining 4% were wholesale dealers. Of the franchise dealers, 31% were GM-dealers, while the rest were non-GM dealers. See **Exhibit 20** for a more detailed breakdown of survey respondents.

Exhibit 20. Breakdown of survey respondents by demographics.



Since the mix of respondents was different from the overall market, our survey results were weighted to reflect to actual market. The survey responses were de-averaged by dealer size, and then weighted by actual market share in terms of retail sales per dealer. This calibration was used to estimate market size and share, market growth, and dealer opinion questions.