



2022 MARKET OUTLOOK

Trends and Predictions for Automotive Dealerships

INTRODUCTION

Who predicted that 2021 would be such a profitable year for automotive dealerships? Halfway through the year, when inventory shortages began to impact sales volume, dealers quickly pivoted to a short-term profit model that works: high margins on new and used vehicles, as well as increased F&I per vehicle retail (PVR) and product penetration rates. Additionally, many dealers reduced operational expenses.

Looking ahead to 2022, what lies in store for automotive dealerships?

This ebook shares insights into current trends that are expected to impact dealership profitability.

9.5-11 MILLION VEHICLES

taken out of production in 2021 as a result of the chip shortage.



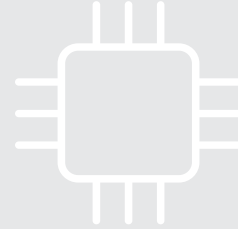
Source: IHS Markit

When will inventory levels normalize?

This is the biggest question on everyone's mind.

Auto industry analysts predict that supply chain issues may not resolve until late 2022 or 2023. If supply chain issues continue until 2023, dealers will feel the pain from lack of new inventory. However, as long as consumer demand for vehicles remains greater than supply, the current profitability model is sustainable, if not ideal.

One positive takeaway from the supply chain issue is that it has spotlighted how inflexible the supply chain for auto manufacturers has become. With so much money at stake, auto manufacturers will be pressured to find a solution to the chip shortage. In addition, expect to see changes to manufacturers' "just in time" lean inventory management models, along with improved risk monitoring and management.



**Chip shortage
expected to cost
the auto industry
\$210 billion
in revenue in 2021**

Source: AlixPartners

COMPETITION FOR PRE-OWNED VEHICLES

As long as there is a limited supply of new inventory, competition for pre-owned inventory in 2022 will be fierce.

Many independent dealerships don't have the cash flow and large floor plans to compete at auction with franchise auto dealers and online retailers. When the effects of inventory shortages first became apparent in 2021, independent dealerships were faced with two choices: pay more and sell the car for more or be more prudent about the type of inventory stocked. As a result, independent dealerships developed ideal inventory models and became more selective about the vehicles they acquired.

In 2022, this trend will continue. Both franchise and independent dealerships will focus on refining their ideal inventory models. Dealers must know which core makes and models they can sell at higher prices and which vehicles don't sell well in their market.

Dealers will also cast a wider net to look for inventory. With the growth of online auction sites, dealers can purchase cars anywhere in the U.S. Even with the added transportation costs, it's still possible to make a profit.

What happens when inventory levels normalize?

As supply chain issues resolve and vehicle inventory is replenished to levels that exceed consumer demand, dealers will once again be making “normal” profit margins, which in recent years have been slim.

There may be other long-term repercussions from the current inventory shortages. The following trends threaten to impact dealership profitability in 2022 and beyond.

VEHICLE AFFORDABILITY

For many years, consumers have been used to factory incentives that improve vehicle affordability, such as no money down, rebates, cash back, and special APRs. With demand for vehicles now outpacing supply, auto manufacturers will no longer discount new vehicle prices in 2022. Additionally, vehicles are getting more expensive to build, which will continue the upward pressure on pricing.

This will lead to affordability issues for many consumers, as average monthly payment estimates increase hundreds of dollars per month.



In October 2021,
average transaction
prices for new vehicles
in the U.S. hit a record
\$46,036

Source: Kelly Blue Book

SERVICE HEADWINDS

With fewer new cars to sell, dealerships are losing an automatic pipeline of service revenue from new vehicle customers. In the next several years, this will have a negative impact on service revenue.

Additionally, a rise in EV sales and the production of higher quality vehicles needing less frequent maintenance will lead to longer service intervals. These trends will make it challenging for dealers to achieve service revenue projections.

To address this challenge, dealers need to focus on:

- Service recovery
- Customer retention
- F&I products for service and maintenance

INDUSTRY CONSOLIDATION

In 2021, there was a record number of buy/sells among auto dealerships. This is expected to continue in 2022 but with a shift in the type of buy/sell activity. In the last several years, most industry consolidation was due to mid-size dealership groups acquiring additional brands to round out portfolios of five to fifteen stores. Now large dealer groups are acquiring again, and many individual stores and smaller groups are exiting the business altogether.

With scale comes economy and an improved ability to build long-term relationships with customers that are traditionally lost to brand defection. If dealerships can learn to sell effectively and service entire households over multiple transactions, the fundamental economic unit of automotive retailing will shift from store profitability to customer profitability and a larger focus on customer lifetime value.

In 2021, auto dealerships increased F&I product penetration rates and per vehicle retail (PVR) profits. As a result, F&I profits rose at the same time front end profits spiked due to high demand and low availability. Dealers were able to focus on maximizing overall total profit per deal sold, even with less inventory. (Source: APCO Holdings)

How will dealers continue to pull higher profit margins as vehicle pricing moves back to a more competitive model once availability of inventories stabilizes? How will F&I departments fare in 2022? Can dealerships continue to increase penetration rates? Here are a few predictions.

F&I PROCESS WILL EVOLVE

During the pandemic, dealerships adapted their F&I processes for consumers who purchased remotely. Now dealers are finding that these same processes can be used in other situations, such as customers who have ordered and are waiting for a vehicle. The use of digital technology will continue to grow and play a role in how these F&I processes evolve.

An old adage in dealerships was that the longer the transaction was dragged out, the higher the gross. In 2022, the opposite is true. By managing customers' time more efficiently and conducting the F&I process "outside of the box," consumers may be more receptive to hearing about F&I products that fit their needs. Technology will make it possible for dealers to adjust their F&I processes to offer more convenient and faster processes when purchasing a vehicle.

90% of car buyers who purchased their vehicle entirely online purchased F&I products, while only 61 percent of car buyers who purchased their vehicle in the showroom added F&I products.

Source: Roadster Dealer Impact Study

F&I PROFITS WILL RISE

Due to inventory shortages, F&I product penetration rates and per vehicle retail (PVR) profits will continue to rise in 2022.

Savvy dealers realize that the greatest contribution from F&I product sales is not the profitability of each transaction but how these products become the glue that links customers to their store throughout the ownership lifecycle.

As a result, in 2022, we'll see an increased focus on the sale of vehicle service contracts (VSCs), GAP, and other products that create lasting value for the consumer and help to build long-term service loyalty.

74% of car buyers who had their car serviced by the dealership of purchase were likely to return there for their next vehicle purchase.

Source: Cox Automotive Survey Industry Study

3 Trends Contributing to Higher F&I Profits

- 1 **Uncertainty.** In uncertain times, consumers are more willing to purchase insurance and similar types of products that provide them with a sense of financial security.
- 2 **Consumer Acceptance.** Today's consumers are accustomed to purchasing warranties that protect their purchases and guard against future high costs of repair. This has translated to higher acceptance rates for F&I products in the auto industry.
- 3 **Digital Retail.** A virtual F&I presentation removes the pressure that many consumers feel while "in the box" at a dealership, especially at the end of a long sales process. As a result, they are purchasing more products.

CPO PROGRAMS ON THE RISE

According to IHS Markit, sales of certified pre-owned (CPO) vehicles grew 11 percent year-over-year from July 2020 to July 2021. Growth in the CPO market has been driven primarily by new vehicle inventory shortages and new-vehicle affordability.

Participation in CPO Programs

Used Car Sales

2020 < 12%

2021 > 17%

**40%
Increase**

Source: APCO



Used-to-new brand loyalty is
> 7 points higher
for households with a CPO
vehicle versus a non-CPO.

Source: IHS Markit

In 2022, more dealers will participate in CPO programs.

Participation is a great way for auto dealerships to differentiate from competitors, establish a brand promise and build loyalty with customers.

Benefits of CPO Programs

- Helps dealers offset the high cost of inventory acquisition, as car buyers will pay 10% to 30% more for certified vehicles
- Yields higher profit margins vs. non-CPO sales
- Customers receive the "new car coverage and assurance" at the used-car price, delivering higher levels of satisfaction
- Inventory has faster turn times
- Helps add value to the book for certain banks

The increase in F&I product sales has had a net positive impact on auto dealerships' reinsurance positions. For many dealers, additional F&I revenue has resulted in large surpluses.

However, several changes on the horizon may impact this source of profits for dealers.

NEW TAX LAWS

In 2022, new tax laws will likely be implemented before the mid-term elections. Proposed changes to the tax law include increases to the long-term capital gains tax, dividend rates, and ordinary income tax.

To avoid paying higher taxes, many dealers have taken larger than normal distributions from their reinsurance programs in 2021.

It is important for dealers to consult with their reinsurance vendors so they know the impact that new tax laws will have on their reinsurance positions.

INFLATION AND INTEREST RATES

The impact of inflation and potentially higher interest rates will also affect reinsurance investment decisions. Dealers should meet with their reinsurance vendor to get a forecast of the year ahead and to hear recommendations on what the response should be to changing market conditions. Long-term expectations and allocations may need to be adjusted.

Reinsurance vendors should be able to react quickly to market conditions, selling out of existing assets and getting into new and different asset classes that are more favorable to the current environment.

DEALERS WILL BE MORE STRATEGIC ABOUT THE LINK BETWEEN F&I AND REINSURANCE

Every dealer sets an annual budget, goals, and performance expectations for their F&I departments. However, few dealers strategically align their F&I strategy around how it affects their reinsurance performance. This should change in 2022 as more dealers realize the tremendous impact that F&I product strategy has on reinsurance profitability and future cash flow.

Dealers need to understand the direct link between F&I product sales and reinsurance profitability; e.g., how will a 10 percent higher service contract volume in 2022 impact future reinsurance profitability?

Dealers should know which F&I products give them the best opportunity for profits and which products should not be reinsured. For example, reinsuring Tire and Wheel in an area where that product nets a loss rather than a gain may not be the best strategy. Understanding which products contribute to reinsurance profitability versus losses allows dealers to make decisions that increase their overall reinsurance profitability.

What is driving the demand for digital retail, and how will it evolve in 2022?

Most dealers tend to view digital retail as a technology solution, but from the customer perspective, digital retail is simply a demand for more transparency, information, and convenience. Dealerships that can satisfy this demand will be successful in 2022, whether they adopt an in-store, wholly online, or hybrid solution for purchasing vehicles.

MORE DEALERS WILL ADOPT ECOMMERCE PLATFORMS

The adoption of digital retailing tools by auto dealers was rapidly accelerated during the pandemic and today is nearly ubiquitous. However, the majority of dealerships still do not offer a full ecommerce experience that allows consumers to purchase 100% online. Based on current consumer behavior, buying vehicles on site is still the preferred method. More customers could seek the convenience of completing some if not all of the process online if dealers focus on ways to grow this channel of business, but there's still some time before they have enough confidence to buy sight unseen.

In 2022 we'll see increased implementation of full ecommerce platforms, but not just for online car shoppers. In most dealerships, a disparity still exists between the in-store sales process and online sales process. As more dealerships adopt full ecommerce platforms, we'll see a convergence of the online and in-store sales processes.

Consider saying the on-site process will continue to evolve as more of the car buying experience happens online, and those same online tools will be adopted to make showroom sales more efficient. Digital tools will see higher adoption across the board. This will offer customers a more streamlined, connected, and transparent shopping experience, whether they are buying online or onsite.



76%

of shoppers are open to the idea of buying completely online, but only 1 in 3 dealers offer all the purchase steps online.

Source: Cox Automotive Digitization of End to End Retailing Study

As more of the buying process happens online, it will be important for dealers to adopt a well-defined value proposition that works to create that same improved customer experience when buyers are onsite.

EXPANSION BEYOND PRIMARY MARKET AREAS (PMA'S)

Auto dealerships typically sell the bulk of their vehicles within their primary market area (PMA). This has changed in the last six months, as consumers are willing to drive and even fly long distances for vehicles due to inventory shortages.

This trend will normalize somewhat as supply chain issues resolve. However, dealers recognize that they have opened up sales to areas they normally don't penetrate. This provides them with the opportunity to figure out how to sell efficiently to consumers who live further away. If dealers can establish a streamlined process to sell to customers outside of their PMA, there is no reason why they cannot continue to expand their reach in the future.

ONLINE BUYING WON'T BECOME UNIVERSAL

Most dealerships don't want to become online retailers. While they recognize the importance of offering customers a digital retail option, the vast majority of dealers want to operate in their brick-and-mortar place of business. Being like Carvana is not in their business model.

Dealers will want to offer services as well as vehicles, and as this new digital channel is defined there must still be a focus on featuring everything they have to offer on site.

In 2022, dealerships will be more willing to take a multi-channel sales approach. That means they will sell to the customer in the way that the customer wants to buy, rather than forcing the customer to buy via the traditional onsite process. The majority of customers still want to see and test drive a vehicle before purchasing, so a hybrid sales process will most likely become the "new normal."

IMPROVED TECH WORKFLOWS

The workflow involved with selling a vehicle is difficult to digitize. Salespeople and F&I managers must access several systems during the purchase process, including the DMS, CRM, and menu technology. In addition, F&I managers must visit the manufacturer website to access incentives and state websites to complete vehicle registration.

This can make it difficult for dealers to offer a seamless process around forms and signature requirements. Dealing with a customer who is not at the point of sale can also complicate managing compliance.

The next step for digital retail is a consolidation of technologies designed to improve workflow and make it possible to deliver a true ecommerce experience. This includes technology that will enable F&I platforms and credit submittal tools to be integrated into Inventory and CRM systems, as well as integrated access to manufacturer and state websites.

CONCLUSION

Overall, the market outlook for 2022 is positive for auto dealerships.

A profitability model that relies on high sales margins and increased F&I profits will sustain dealerships through the short term, but inventory levels must be replenished sooner rather than later so that dealerships can meet rising consumer demand for new vehicles.

In the meantime, dealerships can take the following steps that leverage current market trends in order to maximize profitability:

- Develop an ideal inventory model and be selective when acquiring inventory
- Focus on F&I product sales that provide the customer with long-term value and link them back to the dealership's service department
- Align F&I strategy with reinsurance program goals
- Focus on service marketing and service customer retention
- Prepare to help consumers with vehicle affordability issues
- Consider participating in a CPO program
- Deliver a full ecommerce shopping experience to consumers who wish to purchase 100% online



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