

THE IMPACT OF THE CRISIS IN THE CAR LEASING INDUSTRY

The car leasing industry is suffering this crisis in a specially tough way, as it is affected by its double belonging to the financial and the automotive industries. But, in general, it seems that the measures taken by leasing companies are the correct ones.

In this paper, many of the data presented belong to the Spanish market, which has been hit specially hard, but most of the comments are valid and referred to most Western European markets.

If we begin by seeing the crude data, 2009 will be the first year, since car leasing began in the 70's that the total fleet will not grow on a European level. In Spain, it will be reduced by some 10%, which is specially hard for a market used to two digit growth rates throughout its 24 years of existence, including the 1993 crisis.

The real measure of this crisis becomes obvious in the purchases of new cars. In Spain, during the first nine months of this year, purchases have been less than half compared to last year's. It is estimated that by the end of the year the number of new cars purchased will not reach the 97,500 bought during 2001!! Probably, not all present players will be active by the end of next year.

However, the highest cost of the crisis was the falling prices of second hand cars. Prices began falling at the end of 2007 and kept falling throughout 2008, stabilizing themselves this year. Suddenly, leasing companies found themselves selling cars coming out of contracts with an average loss of over €2,000. The speed of reaction to this new market environment varied a lot between companies and the ones that reacted first suffered less. But all companies had to face unforeseen losses in the sale of every car. In Spain, the number of cars terminating contracts during 2008 was 165.000 and this meant a loss for the industry of € 350 million.

The stock of used cars reached unknown levels and finding parking lots become a serious issue. Some companies reached stocks of six months, including hundreds of cars with more than one year in stock.

An old saying in the industry is "Never think tomorrow you'll sell a car better than what you can get today". Many companies new this, others took a little longer learning it.



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Companies that took longer to react found themselves not just with higher losses per car, but also with an increase in their operating costs and a deteriorating treasury, as a consequence of growing stocks.

However, the lesson was learnt. In a few months many companies found new channels of sale for the used cars. Exports and sales through the internet grew significantly, both through their own websites and/or specialized third parties. As a result, stocks were significantly reduced.

Another formula used to diminish these losses was the extension of contract terms. This was commented in a previous paper (see CAR News 05/09). During 2008 and 2009 almost a third of the contracts due to expire, were extended between 6 and 24 months. This helped not just the leasing companies, but also the clients.

The sale of used cars, was not the only problem that the car leasing industry had to face. Bad debts and delay on payments, which were problems almost unknown for the industry, became important.

The increase in bad debts hit harder to companies which were more into retail leasing. Individuals, professionals and small companies where the first groups to increase their bad debts ratios. Some clients with larger fleets also contributed to the growth of accounts receivables, but what has been more common has been delays in payments.

Car leasing is a very capital intensive business and it requires the leasing company to have access to sufficient funds at a competitive cost. The reduction of profits, plus the big increase of stocks of used cars, plus the need for specific provisions, plus a big increase in the accounts receivables, were all elements that hit the treasury of leasing companies.

Leasing companies have not been immune to the generalized credit shortages and companies that do not belong to a banking group were hit the hardest. Presently, the difference in cost of funds between a company belonging to a banking group and companies belonging to car manufacturing groups is at best, slightly over 1%. In some cases reaching even 2%. This difference in cost of funds is unsustainable in the long term. Proof of this, is that several captive leasing companies from car manufacturers, have either stopped operations, or are restructuring themselves to lean on operators belonging to banking groups.



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And not all that is happening is an increase of costs. This crisis has also brought a decrease in revenues.

The acquisition of new customers has been reduced to the minimum and the renewal of existing contracts have in many cases been denied by companies credit committees. Good clients, as they have also been affected by the crisis, have in many cases, reduced the number of cars in their fleets and/or reduced the category of the cars. Hence the reduction in the numbers of total fleet and the sharp reduction in the purchases of new cars. And we should not underestimate the financial impact of the reduction in the average investment per car, which has been of at least of €1,000. In Spain today, the average investment per car has decreased to € 17,500,-

For the major leasing operators, an important contributor to their income have been the volume bonuses paid by the car manufacturers. As purchases of new cars have decreased, these bonuses have been significantly reduced and for some companies have simply disappeared.

Up to now, we have commented on the negative aspects and consequences of the crisis. Not that there are positive ones.... But as mentioned here above, in my opinion, leasing companies are, in general, doing their homework and taking the right corrective actions.

For companies with fleets, the leasing operators are service suppliers. And even though clients always say they are looking for quality of service, this is not entirely true. Companies look for price, and at times like now, even more so. Clients demand savings, and leasing companies being aware of this reality, have had to act accordingly and have searched for ways of reducing their operating costs.

From the operating point of view, leasing companies have streamlined their processes and procedures in order to reduce costs. Staff reductions have been made in practically all areas and functions have been outsourced that only recently would have not been even contemplated. Some companies looking ahead at the "after the crisis" are using this period of low activity to improve or implement new systems and review their products and services.



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Also conditions and prices of service suppliers to leasing companies have been reviewed and in many cases reduced. From registering cars out of bigger cities in order to reduce the road tax, using second brands in tyres and minimizing the usage of premium brands, to servicing cars out of the manufacturers dealer network. Every aspect of the product has been, or is being reviewed in search of cost reductions.

This crisis caught almost everybody by surprise. We should not forget that the day before of the bankruptcy of Lehman Brothers its rating was still "A". We don't know how much more this crisis will last, even though, we do know that in Spain it will last longer. As crisis are a part of the economic cycles, so are recoveries, even though politicians like to take the credit for them. And we also know that when times of growth come back, we shall find a market with probably less operators, but much more efficient and specialized.

In my opinion, the companies that manage to avoid their services becoming a "commodity" like most financial services, will be the ones in a position to better benefit from the economical recovery period.

I hope this information can be of use.

Jose Luis Criado

