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Automotive loyalty in the wake of the COVID-19 recession

IHS Markit looks back on registration and loyalty trends following the 2008 recession to prepare for a post-COVID-19 reality

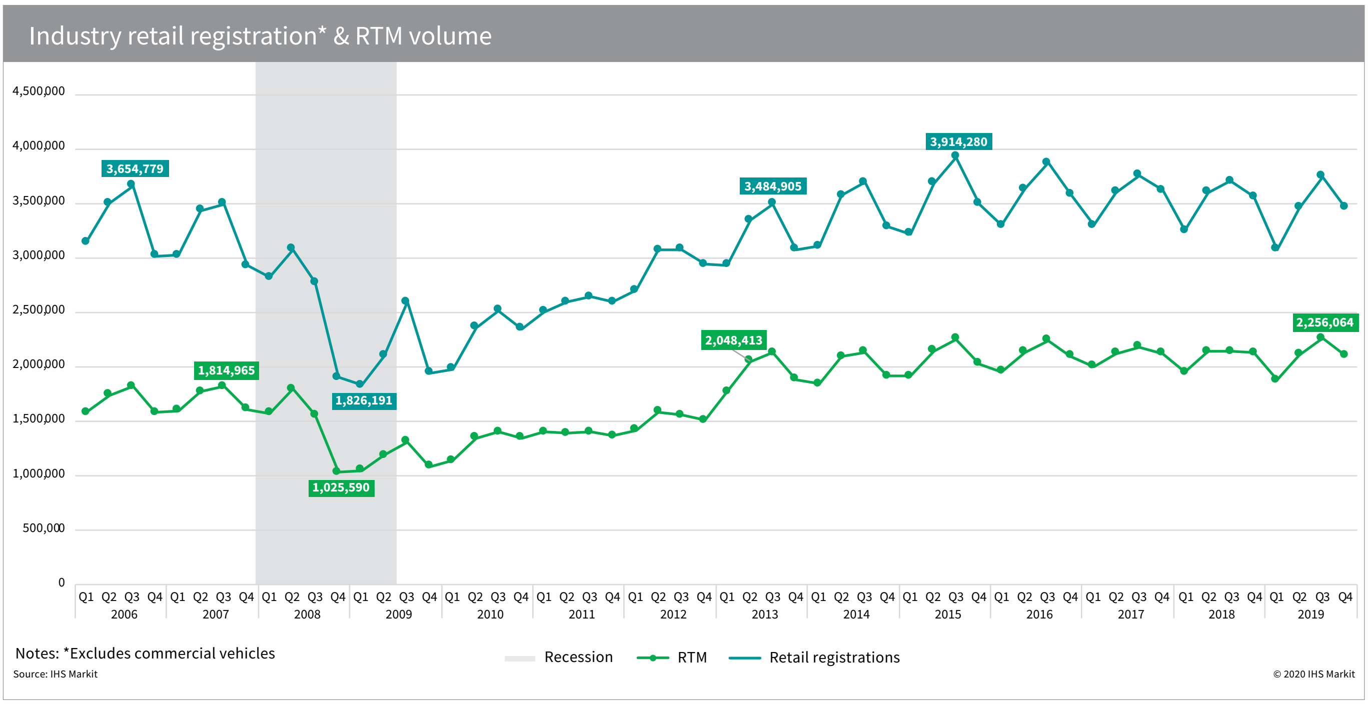
May 2020

Introduction

With auto sales forecast to decline as a result of the nationwide shutdown due to the coronavirus disease 2019 (COVID-19) outbreak, the automotive industry is set to be substantially impacted on levels unseen since the 2008 recession. Nationwide retail closures have already led to an unprecedented drop in sales volume while future production has come to a near standstill. In addition, unemployment claims have reached record highs, crippling consumer confidence and further limiting forecasts for a quick recovery.

With the chance of another economic recession rapidly growing, it is important to investigate the past to help understand what is in store for the future. For this, monitoring the events surrounding the 2008 recession could provide the closest example of how this upcoming downturn may play out. By identifying the length and essential factors of the recovery, we can better determine what awaits the automotive industry and why this recovery could face more challenges than in 2008.

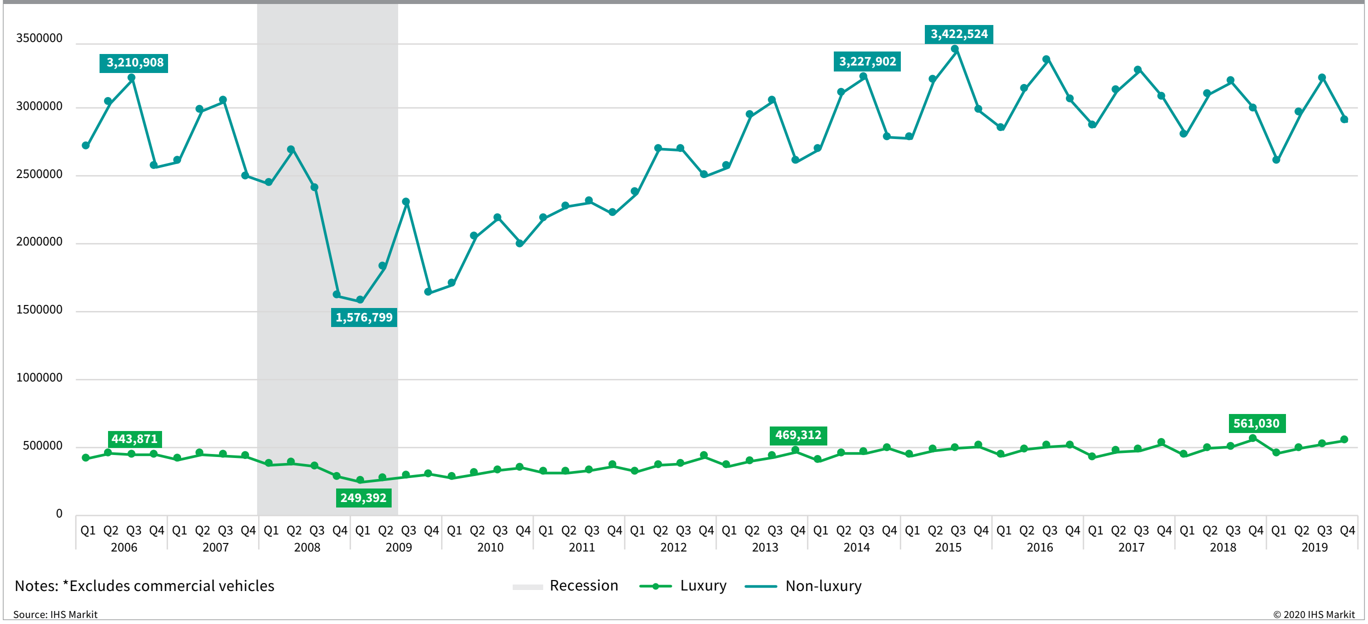
Registration trends and return to market activity: From peak to trough



Registration

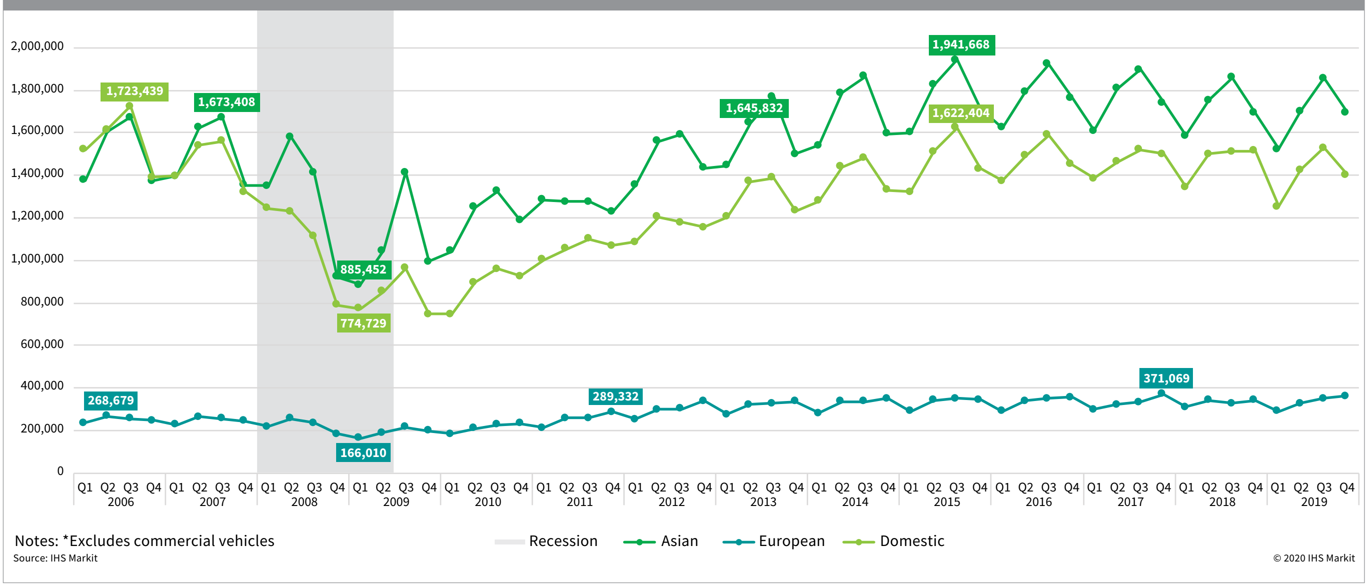
When tracking registrations at a quarterly level, in the two years leading up to the 2008 financial crisis, new vehicle retail registrations peaked at 3.6 million in the third quarter of 2006. Following that peak, a rapid decline emerged as the industry entered the early stages of the recession in the first quarter of 2008, eventually falling about 50% to its lowest point in the first quarter of 2009.

Retail registrations by luxury status



The impact to registrations was felt among both sectors of the automotive industry with the decline of the non-luxury sector (down 51%) outpacing the luxury sector (down 44%). However, luxury accounted for only 13% of total registrations during that period, yielding the bulk of the contribution to the non-luxury sector.

Total industry retail registrations by manufacturer origin*



This trend, when broken down by origin, shows that domestic manufacturers were the hardest hit, experiencing a 57% decline in retail registration volume from their prerecession peak of 1.7 million in the third quarter of 2006 to a low of ~775,000 in the first quarter of 2009. Asian and European manufacturers saw 47% and 38% declines during the same time period, respectively.

Return to market

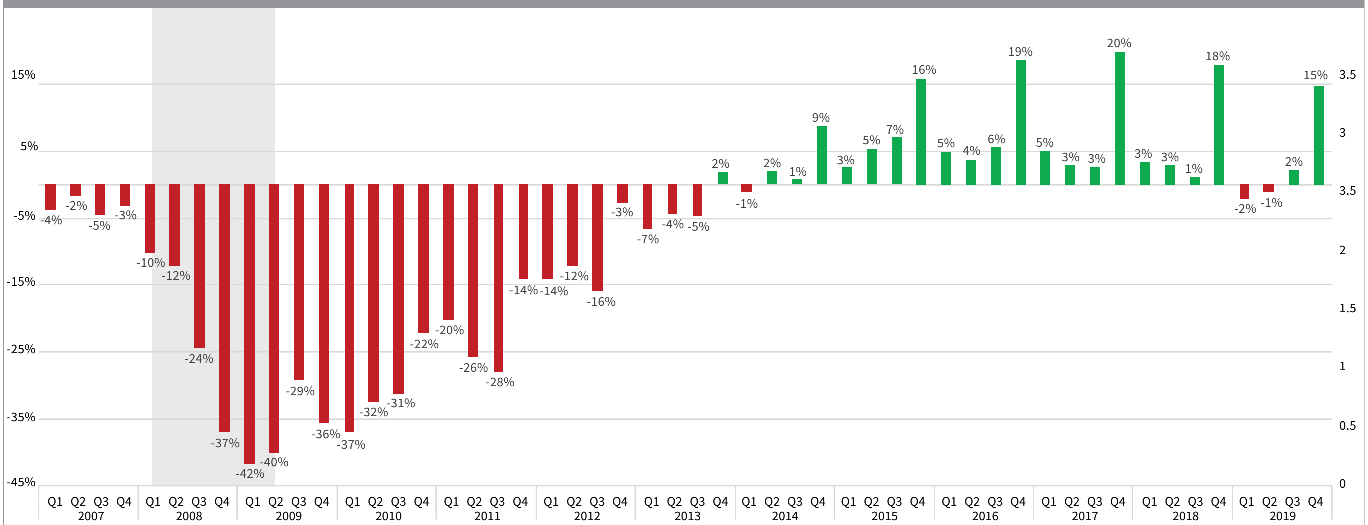
As registrations declined, so too did customer return-to-market (RTM) activity, a key indicator of economic health and an important metric in tracking loyalty and conquest behavior. Similar to registration trends, RTM volume followed a comparable, yet rapid pattern, reaching its peak of 1.8 million in the third quarter of 2007 before falling to its low of 1 million in the fourth quarter of 2008, one quarter prior to the registration low point. Although the peaks and troughs of registration and RTM activity vary, the movement between the two showed a high positive correlation with a coefficient of 0.95, signaling a strong relationship between the two. This relationship showed a similar pattern as the industry eventually began to recover.

The road to recovery

Once the lowest point of the recession was reached in late 2008/early 2009, the next question would be, how long would it take for the industry to recover and what steps were needed to assist in recovery. Looking at the difference in trends between registration and RTM activity, it would take a few years before the automotive industry would return to prerecession levels.

Retail registration recovery

Percent change in retail registration* volume vs. same quarter 2006

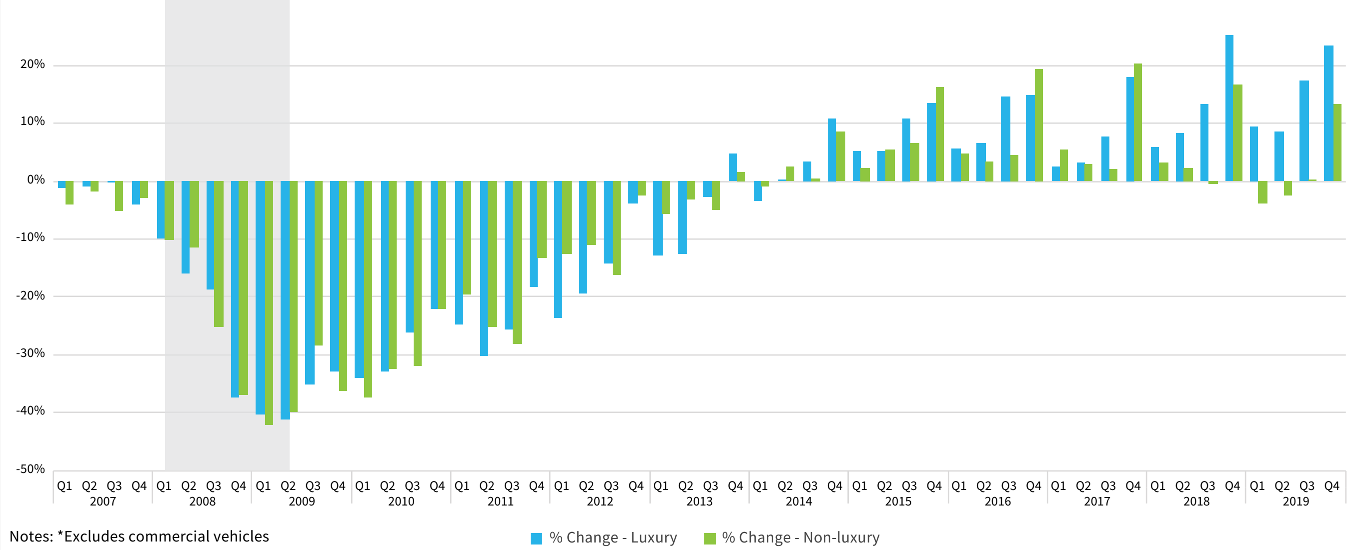


Notes: *Excludes commercial vehicles

Source: IHS Markit

In order to gauge where the initial signs of recovery came to light, we need to look at the last period of healthy sustainability in the industry. Using each quarter of 2006 as a base period to compare retail registration volume, there were 27 consecutive quarters where registration volume was lower than the corresponding quarter of 2006. From the first quarter of 2009, where registration volume bottomed out, it took 19 quarters (until the fourth quarter of 2013) to see the first period when registration volume outpaced 2006 levels.

Percent change in retail registration* volume vs. same quarter 2006

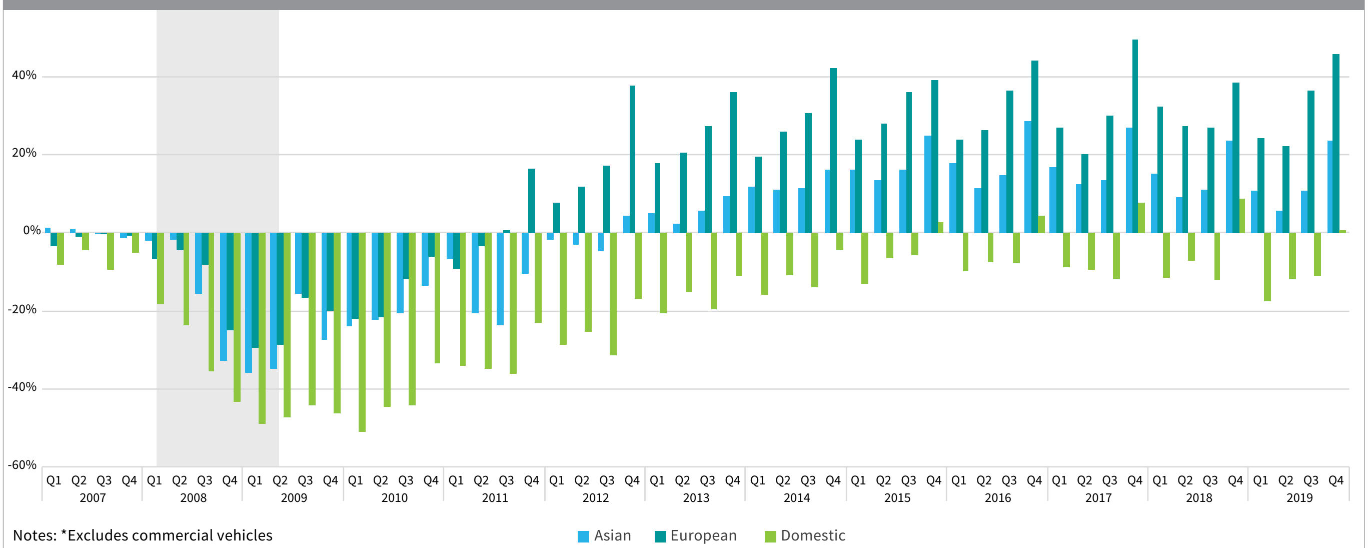


Notes: *Excludes commercial vehicles

Source: IHS Markit

Breaking this trend down by sector reveals that the luxury sector was quicker to recover from its low point (19 quarters) compared with the non-luxury sector (21 quarters).

Percent change in retail registration* volume vs. same quarter 2006

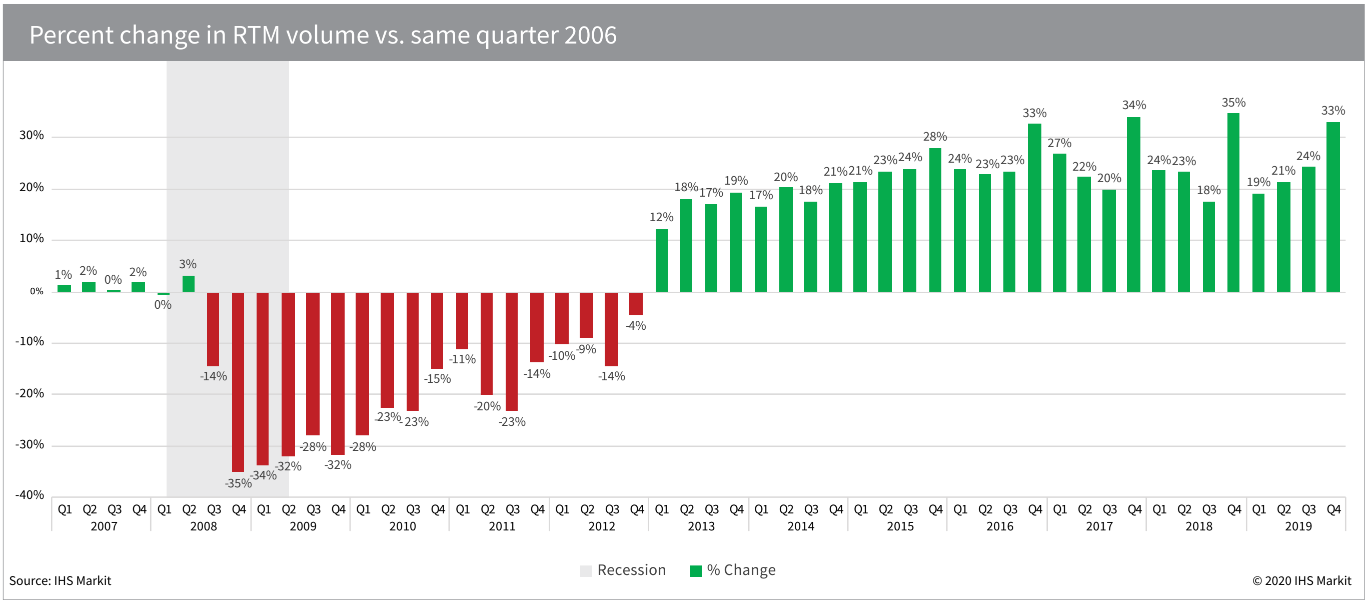


Notes: *Excludes commercial vehicles

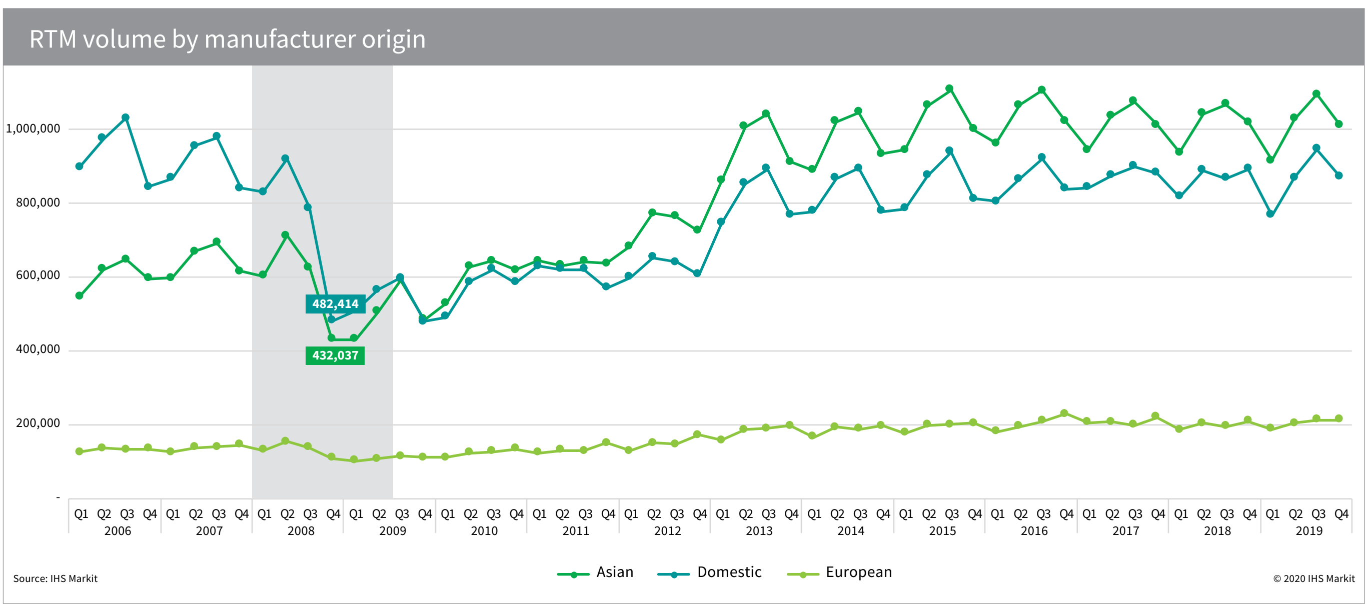
Source: IHS Markit

Based on closer observation, European manufacturers were the first to see a consistent pattern of growth versus 2006, starting in fourth quarter 2011, while Asian manufacturers took one year longer to start showing growth in the fourth quarter of 2012. Conversely, domestic manufacturers never fully recovered post-recession, taking 26 quarters to reach a new peak of 1.6 million in the third quarter of 2015. However, that peak was still 6% lower than their prerecession peak.

Return to market recovery

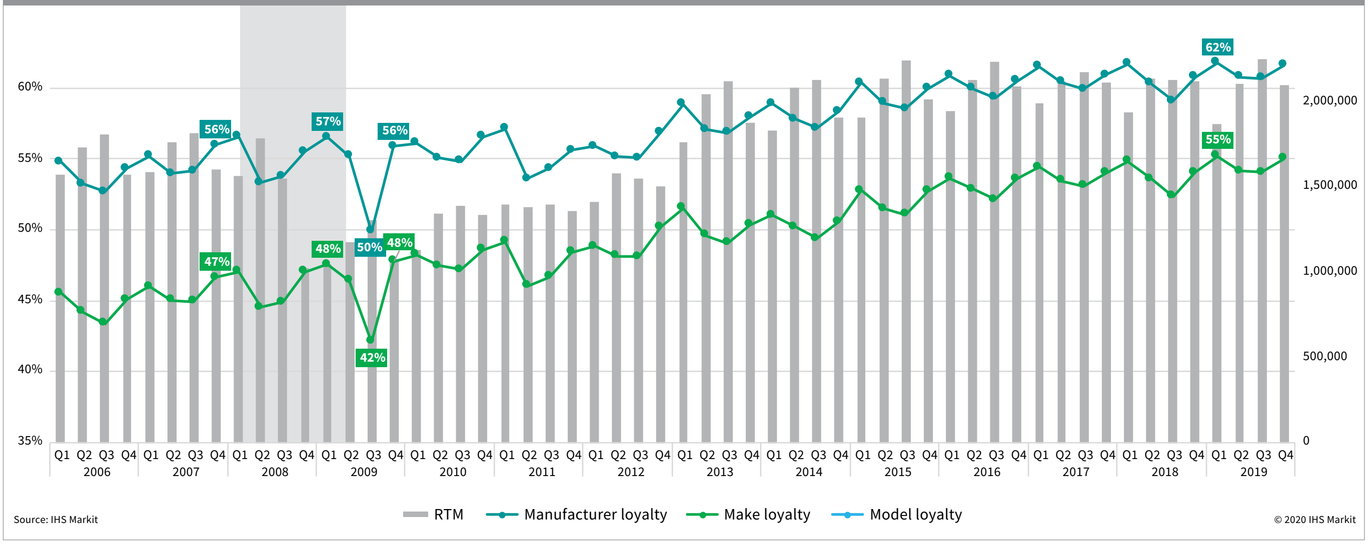


Tracking RTM volume to the corresponding quarter in 2006 reveals the first two quarters of the recession showed moderate gains versus 2006, signaling a slight variance with registration movement. This positive year-on-year (y/y) change in RTM volume, compared with a decline in registration volume during the same time period, could potentially be attributed to a loss of first-time buyers, which the RTM metric does not account for. Starting in the third quarter of 2008, it took 18 consecutive quarters before RTM volume approached 2006 levels. The most significant drops in RTM volume correspond with the quarters where retail registrations showed the sharpest decline in volume, again highlighting the strong correlation between the two.



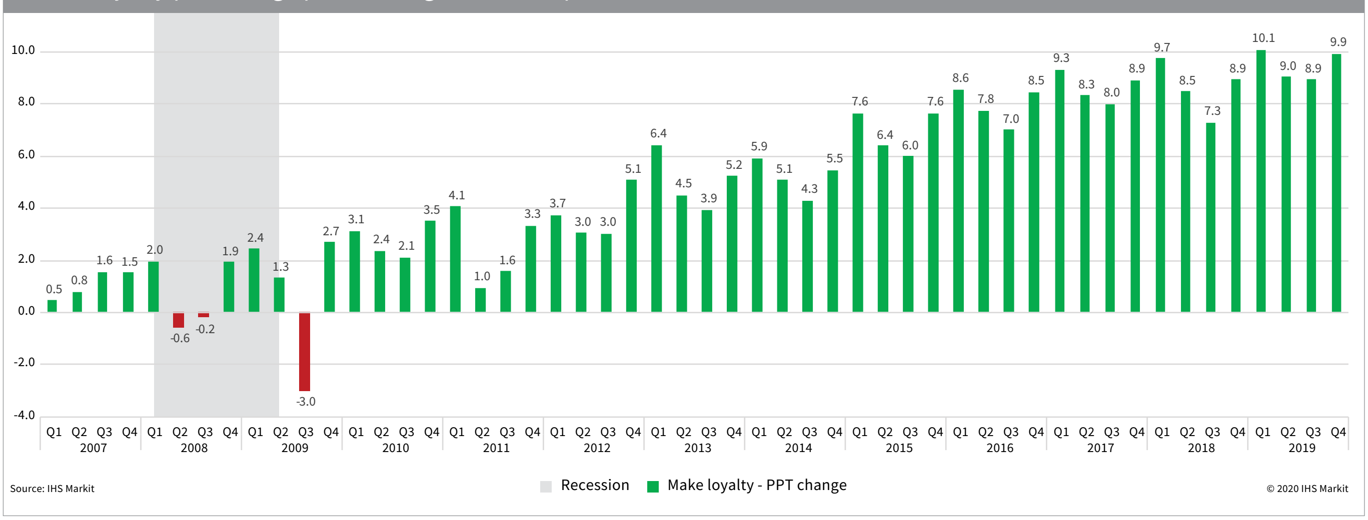
Separating RTM activity by manufacturer origin gives further clarity regarding brands that may have been responsible for the automotive industry's recovery from the recession. While Asian and domestic brands reached their lowest levels in the fourth quarter of 2008, Asian manufacturer's RTM volume grew 47% through the fourth quarter of 2011 while domestic volume grew by only 19% in the same period (European manufacturers also saw growth of 36%). However, from the first quarter of 2012 to the fourth quarter of 2019, Asian and domestic RTM volume grew at a rate of 48% and 45%, respectively, while European manufacturers' RTM volume grew 65%. Although registration and RTM activity saw similar parallels in downward and upward movement, the resulting trend among loyal buyers was much different.

Total industry – Make and manufacturer loyalty



Overall, industry make and manufacturer loyalty levels were unaffected by the recession and loyalty rates continued to grow. While the first quarter of 2009 was the worst quarter for retail registrations, make and manufacturer loyalties peaked above prerecession levels. The notable drop in loyalty during the third quarter of 2009 can be attributed to the government "Car Allowance Rebate System" often referred to as 'Cash for Clunkers.' This lack of decline can be attributed to the nature of consumer purchasing habits and their reluctance to move away from the familiar when given little flexibility to do so. In times of economic slowdown and industry stagnation, returning customers are more than likely to remain with their previous brand than defect to something new. The 'Cash for Clunkers' program stands out as a true outlier because of the high incentive tied to it, allowing the buyer more flexibility to venture away from what they were familiar with.

Make loyalty percentage point change vs. same quarter 2006

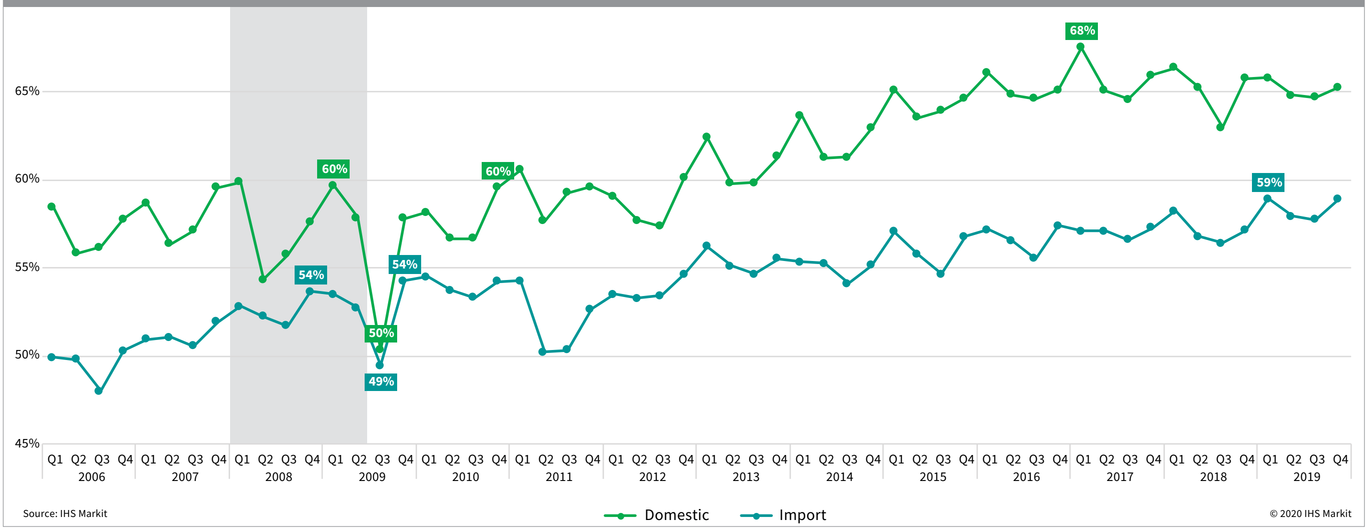


In comparing each quarter with the corresponding timeframe in 2006, there were only three quarters when make loyalty declined compared with the base periods. The first two quarters showing decline were in the second quarter and third quarter of 2008, which led to the worst periods of registration and RTM volume. With loyalty movement contrasting with RTM and registration trends, it is important to understand the factors that contributed to the recovery from the recession and how they influenced each metric.

Factors that contributed to recovery

'Cash for Clunkers'

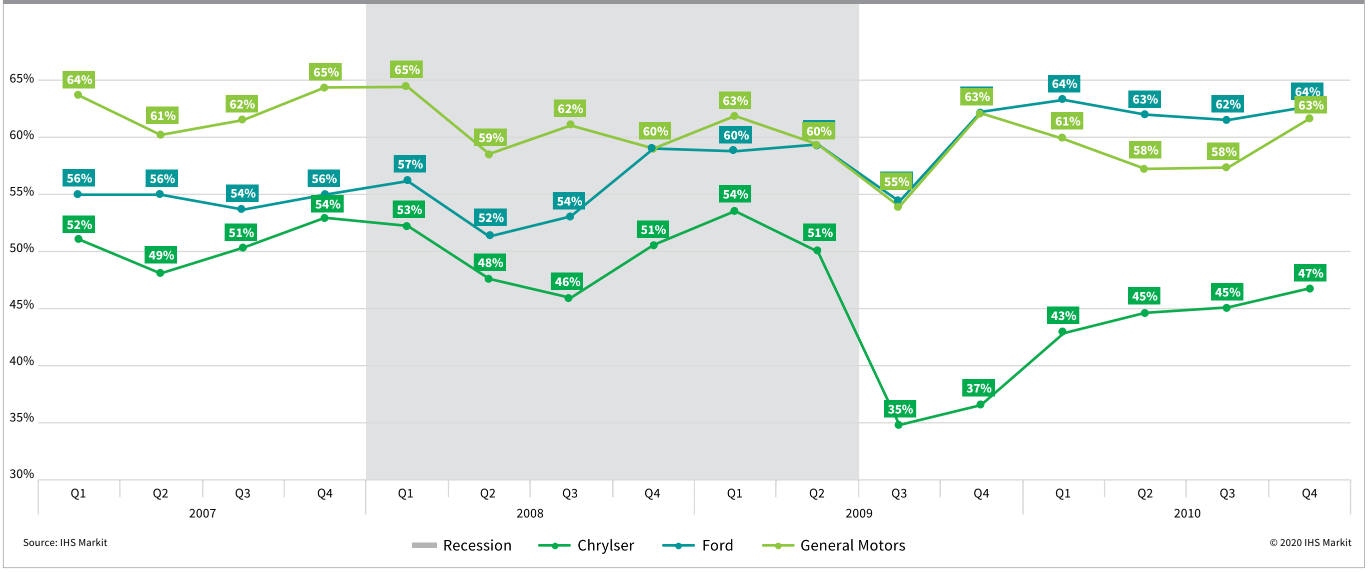
Domestic and import manufacturer loyalty



As fuel prices were reaching all-time highs and the effects of the economic downturn were limiting buyer activity, the Car Allowance Rebate System ('Cash for Clunkers') program was instituted to incentivize consumers back into the market. By trading in gas-guzzling vehicles, consumers were rewarded with a high cash incentive to purchase a new, more fuel-efficient vehicle. The program was an immediate success, spurring a surge in sales activity through the mid-to-latter part of 2009. While the industry saw an overall positive boost to retail activity, the results were diverse among various brands, with loyalty showing the true winners and losers.

Domestic manufacturer loyalty was hit hardest by the 'Cash for Clunkers' incentive. From the second quarter to third quarter of 2009, loyalty dropped 8 percentage points while import manufacturer loyalty dropped only 3 percentage points. When looking at the recovery time of manufacturer loyalty throughout the recession, domestic manufacturers took much longer—nearly five quarters—compared with import manufacturers who rebounded in just one quarter. This difference in recovery time is likely due to the respective lineups (both used and new) between domestic and import brands. Loaded with lineups of vehicles with high fuel consumption, the domestic brands faced an uphill battle trying to retain customers from defecting to the more fuel-conscious offerings from import brands. It becomes more evident when looking at the vehicle movement. According to the US Department of Transportation, the most common model traded-in was the Ford Explorer AWD while the most acquired was the Toyota Corolla.

Domestic manufacturers – Manufacturer loyalty rates



Although all three major US automakers were impacted by ‘Cash for Clunkers’, Chrysler was by far the worst hit. From the second to the third quarter of 2009, Chrysler’s manufacturer loyalty dropped 16 percentage points while General Motors and Ford’s loyalty rate only fell by 5 percentage points. Chrysler’s lineup leaned heavily on gas-guzzlers which might have limited their appeal to consumers searching for more fuel-efficient options, resulting in a longer recovery time to prerecession levels (15 quarters) compared with other domestic brands (one quarter for Ford and General Motors).

Product portfolio and brand perception

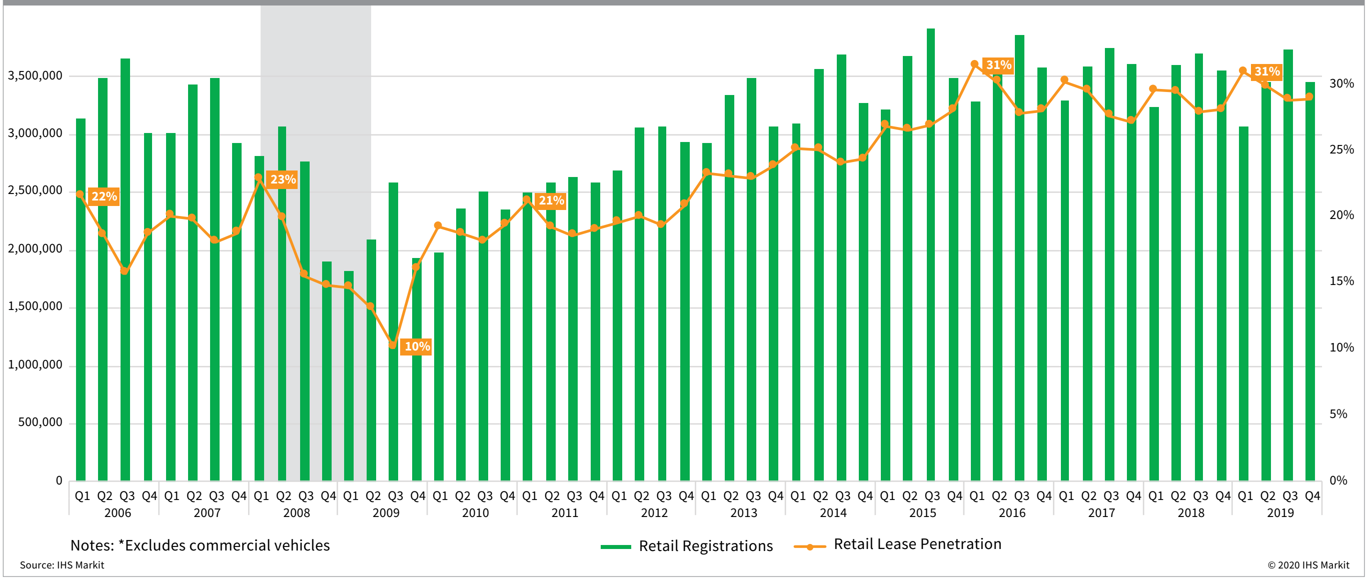
Although ‘Cash for Clunkers’ helped stimulate buyer activity, the industry as a whole was undergoing a major shift as many OEMs placed a greater emphasis on improving quality, performance, and overall brand perception. Imports, especially Asian manufacturers at the time, had much broader portfolios that appealed to price- and fuel-conscious consumers with many sedans and compact cars, along with an emerging fuel-efficient crossover utility vehicle (CUV) portfolio, during a time when gas prices were high.

Among the domestics, the bankruptcies of General Motors and Chrysler and their subsequent government-bailout funds led to a negative consumer sentiment surrounding most domestic vehicles, hurting their sales performance for years to come and hindering their portfolio overhaul. Ford was the only domestic brand to see any positive buzz surrounding its brand, betting the future on rebuilding the brand on its own in lieu of a government bailout.

Previously considered a wide chasm among the industry, the improvement of quality, product, and perception was quickly shrinking as more OEMs adapted to the changing environment of the industry.

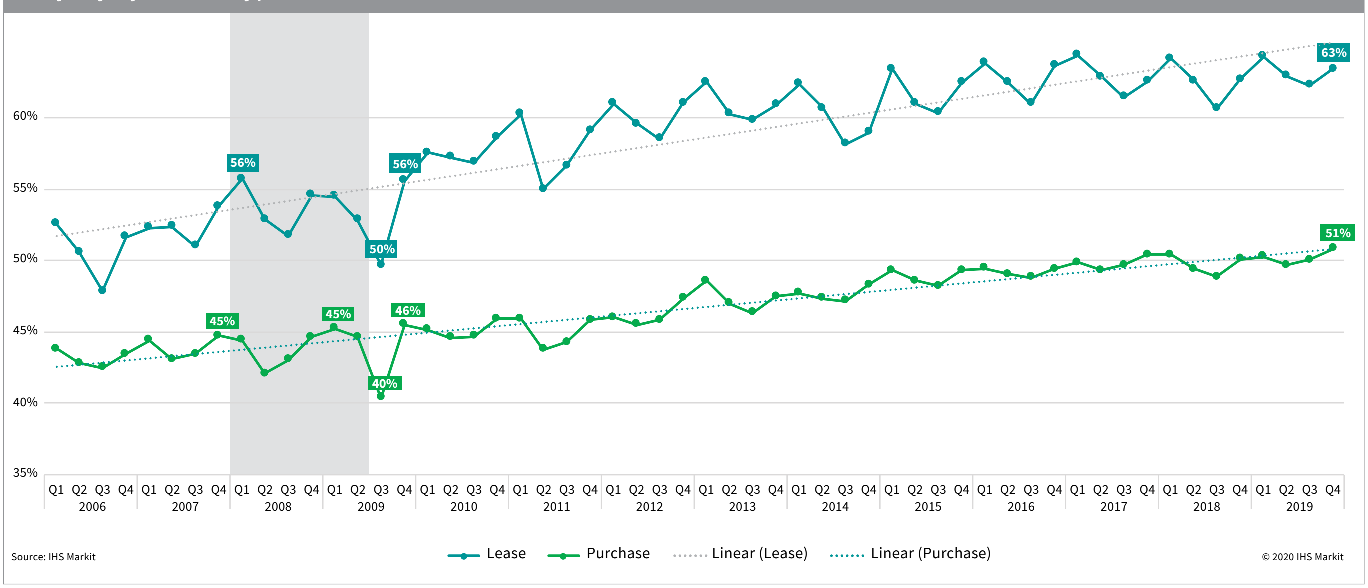
Leasing

Total industry retail lease penetration*



The drop in sales during the recession, in addition to the institution of ‘Cash for Clunkers’, revealed untapped potential by way of leasing. A combination of a rapidly dwindling used vehicle supply due to ‘Cash for Clunkers’ and the recession, along with more disciplined go-to-market strategies among all OEMs, yielded a surge in resale values, strengthening residual values and making leasing less expensive for OEMs and their lenders. At the start of the recession, industry retail lease penetration was 23%, eventually dropping 13 percentage points to a low of 10% in the third quarter of 2009. It took six quarters for lease rates to recover to prerecession levels; however, lease rates continued to grow along with registration volumes. By the second quarter of 2016, industry lease penetration was three times what it was at its lowest in the third quarter of 2009.

Loyalty by finance type



The rapidly growing popularity in leasing is clearly reflected when looking at its impact on loyalty. While leasing has consistently shown higher loyalty levels than purchase, the loyalty lift from leasing has grown steadily since the end of the financial crisis. In a 10-year period from the fourth quarter of 2009 to the fourth quarter of 2019, lease loyalty increased by 7 percentage points while purchase loyalty improved by 5 percentage points.

Conclusion

By observing the length of the 2008 recession, it can be assumed that the expected fallout as a result of the COVID-19 shutdown could potentially be as damaging. The many factors that played into the automotive industry's recovery phase in 2008 have undergone drastic changes in the last few years, thus the path to recovery in 2020 may be entirely different.

- **'Cash for Clunkers':** As Corporate Average Fuel Economy (CAFE) standards continued to rise, fuel-economy levels among the industry improved, resulting in a market that has clearly adapted to current trends. Unless the government is willing to institute a used-to-new trade-in incentive program, regardless of mpg and age limits, the automotive industry will be missing a key stimulus program to boost vehicle sales as it heads into the economic downturn.
- **Room for growth:** Auto sales were already forecast to decline during a time when the economy was stable. Now with production slowing down due to shutdowns, and the economy headed toward a recession, the retail sales potential will only diminish. Automakers will need aggressive sales and incentive strategies to maintain market share, which could lead to a trickle-down effect that could result in further weakening of the market.
- **Demand for crossovers:** As a primary driver for sales growth during the last few years, the industry has placed a heavy emphasis on producing more crossovers, overtaking sedans as the majority body type in the market. This rapid growth rate has not slowed down despite an expected stagnation in industry growth prior to COVID-19. With industry sales expected to decline even further than the previously forecast level of under 17 million units, it may be difficult to rely on this pipeline in the future owing to their high MSRPs and a consumer base that is more price-sensitive entering a period of financial uncertainty.
- **Leasing and the growing used supply:** As lease penetration continues to remain at an all-time high, the used supply will continue to grow, hurting resale values and lowering residual values, making it difficult to offer a competitive lease payment. In addition to the challenges facing lease payments, the rise in used supply, and subsequent decline in resale values, could shift demand away from the new market as consumers become more price conscious. As production of crossovers has rapidly grown since the last recession, the number of available offerings in the used market will further increase, eventually overtaking sedans as the majority body type available and splintering demand. A rise in incentive spending and lease subvention will be needed to keep lease payments competitive. However, this will place additional downward pressure on resale values, widening the gap between the used and new market and creating a vicious cycle that will be difficult to break.

Given the current climate of the automotive industry and its expected decline due to the COVID-19 crisis, it will be important to understand and maximize the current pipelines available to adapt to an expected change in consumer behavior:

- **Utilizing incentive and fleet channels:** In the past, a quick way to see an immediate boost to sales has been to utilize incentives to bring transaction prices down and boost demand. Fleet sales were another channel with which to funnel inventory and lower elevated days' supply counts. While these are effective strategies, they carry with them long-term damaging ramifications that will hurt brand perception, residual values, and profit per vehicle.
- **New product/redesigns/refreshes:** In some cases, all it takes is a successful launch of well-received redesigned/new products to spike interest in a brand and attract

customers during a downturn. Examples of this would be the rise of Hyundai and Kia with the launches of the Elantra, Sonata, and Optima in 2010 or Volvo's resurgence with the XC90 launch in 2015.

- **Disciplined price and volume strategies:** A more long-term strategy to weather the storm of the recession, and the expected rise in used supply, will be to focus on balanced price and volume strategies to limit the need for incentives, stabilize resale values, and control future used supply. By sacrificing either price or volume, an OEM could conceivably continue to utilize leasing channels to keep its customer base without the need for incentives or lease subvention in order to keep payments down.
- **Maximizing the used market opportunity through certified pre-owned (CPO):** A way to help take advantage of the growing used supply could be to place more emphasis on utilizing CPO as an additional channel for sales. By pushing more off-lease vehicles into CPO programs, OEMs could limit the number of vehicles sold through car auctions, potentially mitigating the expected impact on used prices, while also increasing potential for a spike in used-to-new loyalty opportunity.

Understanding the past and recognizing the limitations of the present and the future will play a significant role in whether an OEM can minimize loss during a time of economic uncertainty. While a large portion of their consumer base will potentially remain loyal when returning to market, the ability to limit defections and capture as much of the returning consumer base as possible will be integral to maintaining market share and accelerating recovery.

Disclaimers and glossary of terms

All registration data presented in this paper are based on retail registrations only and exclude commercial vehicle registrations.

All return-to-market and loyalty metrics are based on the IHS Markit new-to-new household methodology.

The 2006 base period is used when measuring recovery because it was the last calendar year leading up to the 2008 recession where registration and return-to-market volumes were unaffected. The comparison is made at the quarterly level to account for seasonality.

Household new-to-new methodology – This methodology analyzes all vehicles in the garage that were acquired new within the last 10 years, and that are still owned by a household, to determine loyalty. The benchmark vehicle is the vehicle most closely associated with the newly acquired vehicle (same model, same make, same manufacturer, or same segment). If no match exists, the benchmark vehicle defaults to the most recently acquired vehicle in the garage. Household methodology does not assume any vehicle disposal when a new vehicle is acquired and considers additions to the garage.

Return-To-Market (RTM) – The count of households that acquired a new vehicle within the last 10 years and returned to acquire another new vehicle. The RTM universe contains households that remained loyal and those households which defected to a competitive vehicle.

Make loyal – Households that return-to-market and acquire a new vehicle of the same make as a vehicle that is currently in the garage are said to be make loyal.

Manufacturer loyal – Households that return-to-market and acquire a new vehicle of the same manufacturer as a vehicle that is currently in the garage are said to be manufacturer loyal.

Luxury – Luxury is defined by aggregating all IHS Markit luxury segmentation (Luxury Exotic, Luxury Full Size SUV, Luxury Sport, Luxury Mid Size SUV, Luxury Traditional Sub Compact, Luxury Traditional Compact, Luxury Traditional Mid Size, Luxury Traditional Full Size, Luxury Prestige Full Size, Luxury Compact CUV, Luxury Mid Size CUV)

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