Driving growth through roadblocks:  
A look at Russia's automotive finance market 
October 2014
After exhibiting strong economic growth over the last decade, the Russian market has been impacted in the last two years due to the cooling down of global oil demand, high domestic inflation, currency depreciation compounded by ongoing political disputes with the EU and the US. These roadblocks have raised concerns in the investor community, and stakeholders across industries are looking keenly at the latest market developments to formulate their future market strategies.

The automotive industry remains a critical component of the overall Russian economy, and the Government has focused on developing the domestic supply chain, skill set and R&D base to attract international automotive original equipment manufacturers (OEMs) and suppliers. While these players continue to focus on Russia as a growth driver, recent economic and political issues have impacted vehicle sales and consumer sentiment. Financing is expected to play a crucial role in driving future growth in the Russian automotive market. Traditionally, Russian consumers preferred to buy vehicles with personal available cash/savings. Gradually, automotive financing has gained momentum with rising vehicle ownership costs, higher credit availability and government-interest subsidy programs. Captive banks are starting to grow and will provide tough competition for larger banks.

We remain positive about the long-term prospects of the Russian automotive industry and believe that realized and declared investments will help to change the current situation in the industry and make it more competitive in the next few years. We would be glad to share with you our market experience and assist you in your business activity, helping you identify investment opportunities, as well as providing risk, operational and cost management advisory services.
The Russian economy is going through a downturn, with a decline in GDP growth, high inflation and currency depreciation. Long-term growth potential still remain intact, driven by a growing middle class.

The economic situation in Russia has been further aggravated by the political dispute with Ukraine and resulting economic sanctions from the EU and the US. Furthermore, the depreciation of the ruble against the dollar and the euro has hampered import-export trade and fiscal deficit targets.

Key triggers for potential economic recovery in Russia:
- Resolution of Ukraine dispute and withdrawal of sanctions
- Expected decline in inflation to 4% by 2016, which is expected to lead to interest rate stabilization
- Shifting focus toward Asian economies to sign trade and investment agreements
- Growing the exports of oil and gas products and diversification to non-energy commodities
- Stabilization of currency

Russian economy trendicators:
- **8.5% to 0.5%**
  - Decline in real GDP growth rate from 2007 to 2014 (expected to grow at 3.3% by 2017)
- **RUB70b**
  - Cumulative investments in Russia during 2007–13 (further RUB60b expected during 2014–17)
- **29.8%**
  - Devaluation of Russian ruble against US dollar during 2008-13

Source: Ministry of Economic Development of the Russian Federation
Russia is still a dynamic and high-potential market for the global automotive industry

The market has a promising long-term outlook despite short-term decline

After recording significant growth during 2009–12, the Russian automotive market started reporting a decline in sales from 2013 due to economic concerns, political crisis, currency deprecation, high interest rates and negative consumer confidence and affordability.

However, the long-term prospects of the Russian automotive market remain intact with significant room to expand vehicle penetration, replacement of the aging vehicle park and government incentives to drive demand.

“The extent and timing of the economic recovery, movement of the ruble, government policies and political scenario will govern the performance of the Russian auto Industry.”

William Andrew King
Russia Automotive Leader, EY

**Russia automotive market trendicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Value</th>
</tr>
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<tbody>
<tr>
<td>Expected CAGR in PV sales over 2015-20 (to reach 3 million units)</td>
<td>4.5%</td>
</tr>
<tr>
<td>Expected rise in car density by 2019 (from around 300 vehicles/1000 adults to over 400)</td>
<td>30%</td>
</tr>
<tr>
<td>Average age of current car park in Russia (significant replacement demand potential)</td>
<td>11.5 years</td>
</tr>
</tbody>
</table>

Source: LMC Automotive
Driving growth through roadblocks: A look at Russia’s automotive finance market

The automotive finance market in Russia has followed a typical emerging market evolution path over the last two decades.

Finance penetration increased even in an overall declining market during 2013.

**Evolution of the Russian automotive finance market**

1998-2003
- Banks started following Western lending policies, such as high interest rates on auto loans

2003-08
- Competition led to a decline in interest rates
- 50% of car sales were through credit in 2008

2008-10
- Financial crisis led to expensive loans and tight credit terms
- Government subsidy on auto loans to stimulate demand

2010-13
- Strong recovery in both total sales and credit sales
- Preferential car loan program played a major role

**Future growth drivers**

- Interest rate stabilization
- Increased penetration in used cars and leasing
- Proactive credit risk management
- Focus on flexible and customized financing solutions

**Russia auto finance market trendicators**

46%
- Finance penetration in new car sales in 2013 (up from 24% in 2009)

38%
- CAGR for new cars sold on credit during 2009-13 (compared to 18% CAGR for total sales)

15%
- Average new car loan rate in Russia; average loan amount is 510K rubles

“The Russian automotive finance market is young, dynamic and has a high potential for development. Captive banks are starting to grow and will provide tough competition for larger banks.”

Jens Diehlmann
Global Automotive Finance Leader, EY

Source: The Association of European Businesses (AEB), AUTOSTAT Analytic Agency, National Bureau of Credit Histories
State-sponsored car loan subsidy programs have driven automotive sales in Russia
Focus on promoting domestic automotive manufacturing/assembly

Automotive loan subsidy programs introduced by the Government in the last four to five years have managed to partially offset declining number of vehicle sales in Russia

**State car loan subsidy program 2009**

Launched in 2009 to stimulate the sales demand after 2008 sub-prime crisis
First major subsidy program to support the Russian car industry; continued until 2011

- **Conditions to participate:**
  - Car to be assembled in Russia
  - Price not to exceed RUB350,000

- **More than 100 credit institutions were involved in the program**

- **Focus on promoting local automotive assembly/manufacturing**

**Preferential car loan program 2013**

An updated program launched in July 2013, which ended on 31 Dec 2013

- **Conditions to participate:**
  - Price should not exceed RUB750,000
  - Initial contribution should be at least 15%

- **134 banks took part in the program**

- **Focus on reviving automotive sales**

- **Nearly 277,000 new cars were sold in 2013 leveraging this subsidy program**

**Russia state car loan program trendicators**

- **~1 million**
  - Vehicles sold under state-sponsored credit subsidy program in last five years

- **23%**
  - Share of vehicles sold under state-sponsored program in total vehicle sales on credit (2013)

- **2/3**
  - Extent of subsidy provided (compared to refinancing rate of the Central Bank of Russia)

Sources: AUTOSTAT Analytic Agency, Russian Ministry of Industry
High growth in the auto finance market expected to drive competition between established universal banks as well as captive and small banks.

<table>
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<tr>
<th>Large universal banks</th>
<th>Small banks</th>
<th>Captive banks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of players</strong></td>
<td>All 812 banks active in Russia</td>
<td>7 (3 more planned)</td>
</tr>
<tr>
<td><strong>Key advantages</strong></td>
<td>Access to cheap source of funding and a large customer base</td>
<td>Ties with local dealers and customer base</td>
</tr>
<tr>
<td><strong>Challenges</strong></td>
<td>Smaller players taking away market share</td>
<td>Access to financing and national scale</td>
</tr>
<tr>
<td><strong>Strategies for growth</strong></td>
<td>Special schemes and programs: interest-free loans, quick loans, factoring, buy-back, trade-in, car loans without the first payment</td>
<td>Entry into full-fledged banking products: deposits, lending (non-car), investing</td>
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- OEMs also choose to tie up with different domestic banks, which bring in an already existing client base and can save high investment costs of setting up their own business.
- However, captive units are best placed in the eco-system to drive OEMs’ sales growth agenda and also play a critical role in customer life cycle management.
Used car financing is gaining popularity in Russia, with increasing presence of banks in secondary market purchases.

Automotive dealers are set to drive the shift toward organized used car sales channels.

- Financing penetration in used cars is one-third compared to new cars; structured products by banks, dealers/captives to drive growth.
- Increase in used cars sold through dealerships (The still well below the European average of 50% in some countries).
- Used car prices are not expected to rise as fast as new car prices.
- 10% expected growth in used car sales in 2014.
- Used cars sold on credit in Russia in 2013 at 15% penetration (expected to rise to 18% in 2014).
- Share of dealers in used car sales in metros like Moscow (compared to only 5% in other cities).

Sources: AUTOSTAT Analytic Agency, Newspaper Izvestia, Autonews.ru
Vehicle leasing for commercial use has grown exponentially over the last few years. Leasing has now started to become an essential element of sustainable development for small and medium enterprises.

“Originally, leasing in Russia was popular for large companies, but today it has become an essential element of sustainable development for small and medium-sized businesses. Individual entrepreneurs are increasingly resorting to this instrument being more profitable and convenient compared with credit financing.”

Jens Diehlmann
Global Automotive Finance Leader, EY

- Car leasing for individual/SME use is expected to grow and compete with car loan products. This segment has the potential to garner a significant portion of the car financing/leasing market.
- Captive leasing companies, with current low penetration, have significant room to grow by providing flexible and customized leasing products.

Russia leasing market trendicators

- **25%** Share of cars + trucks in overall leasing market in 2013 (up from 16% in 2011)
- **29%** Growth in value of new automotive leasing contracts in 2013 (50% growth in truck leasing)
- **RUB112.6b** Value of new car leasing contracts in 2013 (40% of total market)

Sources: Expert RA Rating Agency
Key considerations for stakeholders to drive Russian automotive finance market growth and contribute to a customer-conducive marketplace

- Implement driver-based insight, data analytics and scenario modelling to minimize default risk
- Identify programs to attract and retain talent to drive innovation
- Form need-based and strategic alliances, JVs and acquisitions to gain access to resources, operation network and re-financing
- Adopt customer life cycle approach to identify touch-points to cross- and up-sell
- Penetrate used car and leasing businesses
- Standardize and centralize processes — logistics, supply chain, IT and finance
- Improve ties with Europe to prevent any further impact on the economy, currency, inflation
- Simplify banking license and leasing regulations
- Integrate captives’ and OEMs’ IT and finance standards
- Converge digital and physical experience of brand and financing touch-points
- Set up cross-border shared service centers for functional units, such as customer relationship, contract management, collections and remarketing

**Large universal banks**

**Small banks**

**Captive banks**

**Government**

**Dealers**

**OEMs**
Want more?

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