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ZEV Mandate – Impacts for Dealers, Leasing Companies and Consumers

On Wednesday 24th May the latest and final consultation into the ZEV Mandate closed and we now await the final version of what will presumably become UK law in the next months. We now assess what impact that may have for dealers, leasing companies and consumers.

Given the experience post the first consultation phase it's unlikely we will see any material changes to the direction of travel indicated in report issued on 30th March.

We covered the key points of this in some detail in the April edition therefore our focus now turns to the potential impact of the mandate on franchise dealers and fleet and leasing sectors. By way of reminder the ZEV Mandate has set a cadence for the industry to move towards a ban on the sale of petrol and diesel passenger cars by 2035.

Annual targets

2024: 22%	2025: 28%	2026: 33%	2027: 38%	2028: 52%	2029: 66%
2030: 80%	2031: 84%*	2032: 88%*	2033: 92%*	2034: 96%*	2035: 100%*

Department for Transport *Target will be legally adopted in a future policy

Annual targets for the percentage of a manufacturer sales that must be ZEV are shown above with the introduction of the regime planned for next year.

With BEV penetration currently at 15.4% (April YTD), the sector has a lot to do and in a challenging economic climate where affordability of new cars is being challenged.

Some OEMs are better paced than others in terms of ZEV Mandate "readiness" with Tesla and MG already compliant with 2024s target level. Other's look like they are on track BMW, Mercedes-Benz, Peugeot and Renault within 3% if we assess BEV share of sales in 2022.

For a few this remains a steep challenge. Notably Ford, Toyota, Land Rover and Dacia are starting from an extremely low base, and they will have some difficult choices to make as we progress.

OEMs do have options though and they can be summarised as follows.

1. Comply by managing the ratio of ZEV vs ICE.
2. Borrow ZEV credits over the next three years but pay back with interest.
3. Purchase ZEV credits from an OEM who has banked excess credits.
4. Pay the fine for non-compliance.

In our opinion, Option 1 will receive the most effort and will see the greatest impact on the market.

OEMs can comply by selling more ZEV qualifying units. However, that relies on taking BEV share from competitors which is normally a very expensive exercise unless you have a unique product offering or segment leading pricing. Ultimately, it requires marketing expense, sales allowances and adequate supply.

Alternatively, OEMS can reduce the number of ICE vehicles sold into the market. That will result in a lower volume of sales and a reduction in share which are never popular strategies to pitch in the board room. Lower volumes are also never popular with dealers as they impact today's gross profits but also chip away at an already shrinking aftersales parc opportunity.

Predictions

- More tactical registrations of ZEV – which may mean more volume for fleet channels where supply has been starved but the UK tax regime is favourable.
- A big push in Q4 2023 to register ICE stock
- Contingent bonuses/penalties for dealers who manage a favourable ICE/ZEV mix
- Bigger discounts on ZEV

SMMT is predicting a market of 1.96m units in 2024. That's an increase of 130,000 units on this year's forecast. Given the above predictions that may be an ambitious number and we may see product allocations for the UK market reduced as the OEM head offices look to maximise GPUs in a production environment which still has some supply restrictions.

Planned

Retail looks a difficult channel to rapidly grow ZEV share. There are few products in the sub £30k price range, there are no government incentives as in the US and the retail consumer is squeezed by stickily high inflation and higher interest rates.

That's why we would expect more ZEV volume to be diverted into the fleet channels and even the lower profit rental channel. The low BIK tax regime will persist, making a big incentive for company car drivers who lease their cars.

OEMs of course will not neglect retail and although it's typically more profitable it is also harder to move volume quickly into. That's why we would expect to see incentivisation for dealer to sell an appropriate ratio of ZEV/ICE. Normally this will be bonus or margin at risk which have a material impact on the retailer P&L. Retailers are used to this type of arrangement, but it is seldom popular as it adds complexity and risk

Push

As with the recent emissions related CAFE regulations we would also see an opportunity for some OEMs to push ICE product into market in 2023 before the ZEV mandate comes into effect. That may mean tactical registrations in all channels in the Q4 this year. Of course, this is subject to supply and at this stage we do not appear to be in an oversupply situation.

Panic

With the penalties for non-compliance so severe we may even see an element of discounting re-appear in the market. The problem with this is the long-term impact on residual values and the market needs stability in Used BEV values.

With margin on BEV product not equal to ICE it's hard to see too many OEMs going down this route when they have other option – notably borrowing allowances.

Impact

So, what does all this mean for dealers, fleet companies and the leasing market?

- Brands who are behind the curve on ZEV penetration may opt to starve their dealers and customers of ICE products. Lost market share is hard to take back and is the scourge of dealer networks who are scaled for ambitious volumes. It hurts viability in the short and mid-term as the volumes reduce aftersales revenue potential.
- Fleet and Leasing look set to be allocated more product which will be the first time in several years that those channels get more favourable allocations.
- Dealers will have more complex sales processes to manage in order to maximise profitability.
- Brands on or ahead of the 22% target will have a much simpler time – their dealers will have a volume opportunity and less P&L risk, but the fleet and leasing channels may not enjoy access to product in the same way as they will with the OEMs with a bigger gap to close.

CAFÉ regulations introduced a third dimension to the profit/volume equation. With the ZEV Mandate we can now expect that OEMs sales planning departments have developed a more sophisticated excel spreadsheet to help model multiple scenarios. By the end of next year, we may look fondly back on the simpler life afforded by the COVID era.

If you would like to know more about how we can help, then please contact us at the details below:

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