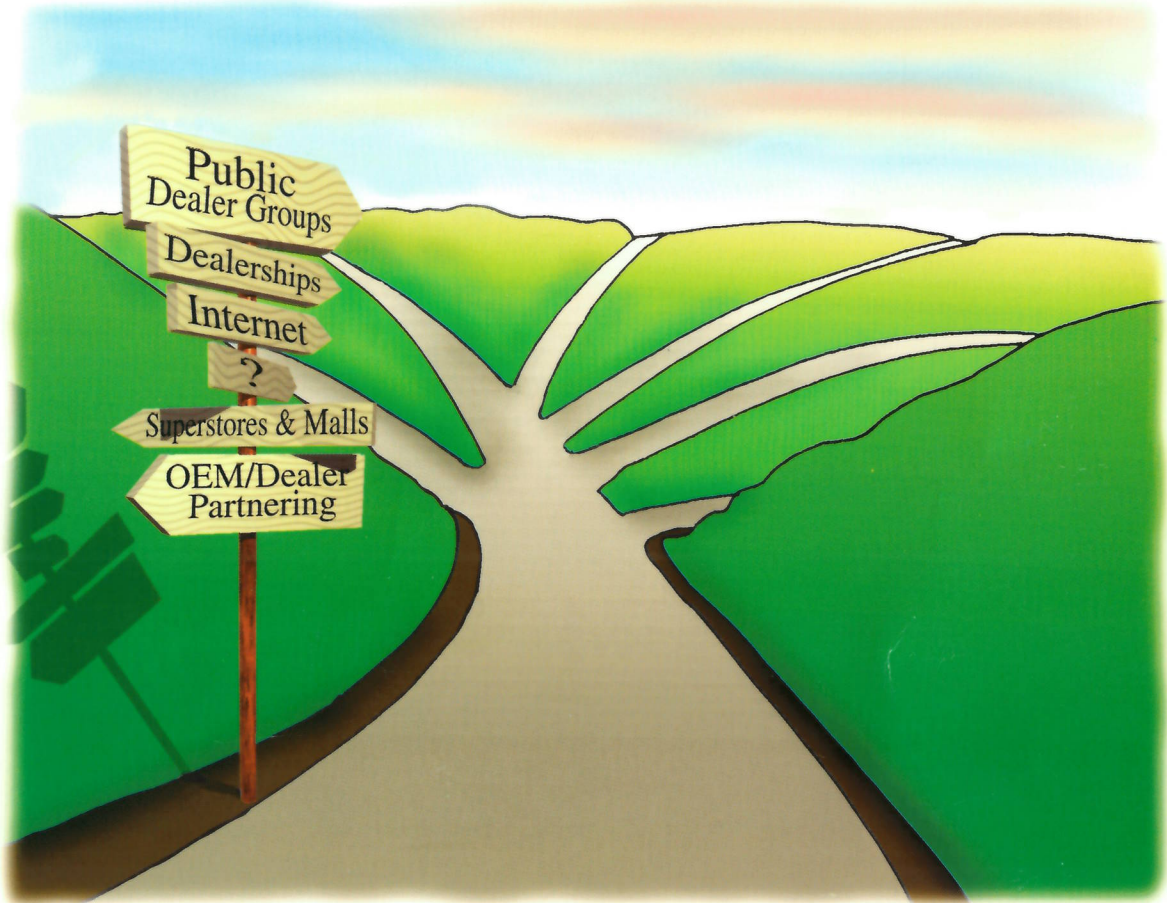


Divergent Views on the Future of Automotive Retailing



University of Michigan
Transportation Research Institute

A Joint Study by:



Michael S. Flynn
Bruce M. Belzowski
Kara F. Alkire
Jack C. Cragen



James A. Mateyka
Jay C. Houghton
James G. O'Brien, Jr.

Divergent Views on the Future of Automotive Retailing

Michael S. Flynn, Bruce M. Belzowski, Kara F. Alkire, and Jack C. Cragen
Office for the Study of Automotive Transportation

James A. Mateyka, Jay C. Houghton, and James G. O'Brien, Jr.
A. T. Kearney

March, 1999

**Respondent Report
University of Michigan Transportation Research Institute
Office for the Study of Automotive Transportation
UMTRI 99-4**

Background

During the fall of 1997, the University of Michigan's Office for the Study of Automotive Transportation (OSAT) and A.T. Kearney conducted in-depth interviews with forty-five automotive industry retailing thought leaders. The objective of this effort was to capture their insights and to identify key future issues in automotive retailing. The interviewees, carefully selected to represent a broad spectrum of views, included the following:

- Vehicle manufacturers (or OEMs, original equipment manufacturers) — The interviewees were senior sales and marketing executives or the executive directly responsible for building and maintaining the strength of the U.S. dealer network. In total, sixteen interviewees from thirteen different vehicle manufacturers participated. They represented manufacturers based in the United States, Europe, Japan and Korea, all selling vehicles in the U.S. market.

- Dealers — Twenty dealer principals or general managers were interviewed. Leading-edge and award-winning dealerships were identified through industry news sources, manufacturer zone representatives, and the National Automobile Dealers Association (NADA). In all cases, the interviewees were identified as thought leaders in the industry. This group includes representatives from new and used dealerships; single-, dual-, and multibrand dealerships; and both independent dealerships and public dealer groups. The dealers were chosen from four major metropolitan areas—Atlanta, Detroit, Los Angeles, and New York. The selection process did not attempt to assure a representative mix by size, geography or vehicle brands, since our focus was on opinions about future trends rather than a reflection of current realities.

- Analysts/others — To complement the views of dealers and manufacturer representatives, we interviewed a total of nine analysts and other industry thought leaders. The analysts include financial analysts who follow the automotive retailing industry and executives from market research firms that focus on the U.S. market. Other thought leaders include executives from companies providing logistics and auction services. Due to the smaller number of interviewees in this category, data representing their views are not presented in the sections of the report unless there is an unusually clear consensus.

All interviews utilized the same core set of essentially open-ended questions. In addition, a few questions were included that were tailored to each executive's specific role in the industry. The interviews were conducted face-to-face and typically lasted an hour or more. Anonymity was promised to all interviewees and the companies they represent. In all cases two interviewers conducted the interview. We carefully examined and coded the answers to the open-ended questions, establishing reliability and resolving any discrepancies by using two coders. The coders quantified the responses with numerical codes, which

were entered into a database to allow statistical analysis and comparisons between the thought leader groups. The results presented in this report are based on the percentage of total mentions (up to four mentions per respondent) or on the percentage of respondents (one answer per respondent). Also, note that reported percentages may not total one hundred because answers were often quite idiosyncratic and varied as a result of the open-ended interview process.

We thank these thought leaders for expressing candid and honest views about the automotive “retail revolution.”

Introduction

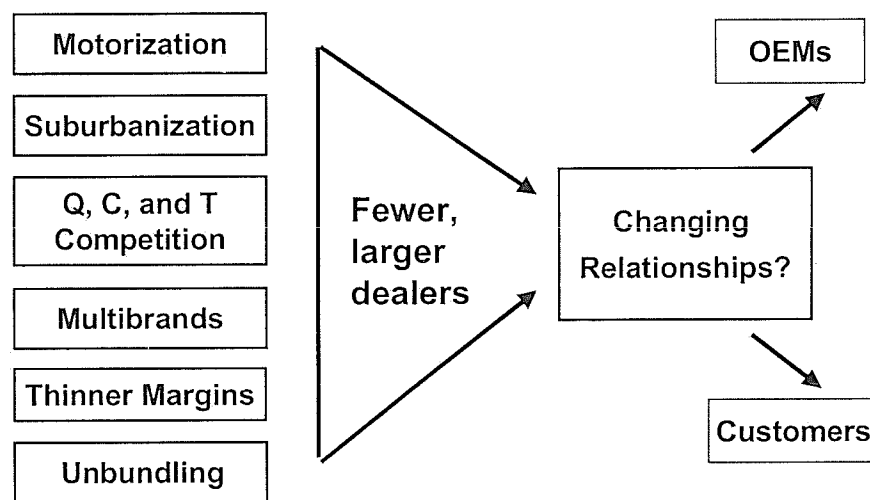
The automotive retail system is generally thought to be relatively high in cost and low in customer satisfaction. Costs attributed to the existing retail system are often reported to be as high as 35 percent of the total retail cost of the vehicle. While other industries have implemented more customer-oriented formats or operations, automotive retailing in general has been slower to introduce similar initiatives. A recent Gallup Poll reports that only 42 percent of consumers feel positive about a new-vehicle buying-or-leasing experience, but that this figure is considerably higher than what the industry media perceives it to be.¹ Automotive retailing is clearly an area facing intense pressure to change. In fact, 91 percent of the interviewees agreed that the retail/distribution system will change more in the next decade than it has in the past decade.

This report is based upon the analyses and insights derived from forty-five manufacturer, dealer and analyst interviews. The sometimes divergent views of these interviewees about the future of automotive retailing, the dealer environment, distribution chain, basis of competition, and changes and threats to the existing retail system provide useful and insightful material as the industry continues to evolve.

¹ Interestingly, dealers think that 34 percent of consumers feel positive about a new-vehicle buying-or-leasing experience, while the media thinks that only 2 percent of consumers feel positive about this experience. The Gallup Organization, “Survey of Attitudes and Perceptions Among Three Major Groups,” *Automotive Retailing Today*, Fall 1998.

Dealer Environment

Several developments in the last fifty years have led to fundamental changes in the automotive retailing infrastructure. Following World War II, the United States became more motorized as industrial advances led to a more affordable and available supply of vehicles. Motorization led to suburbanization, as more and more people left the confines of the cities for the wide-open, surrounding spaces. People could now commute from their homes in the suburbs to their jobs in the cities in their new cars.



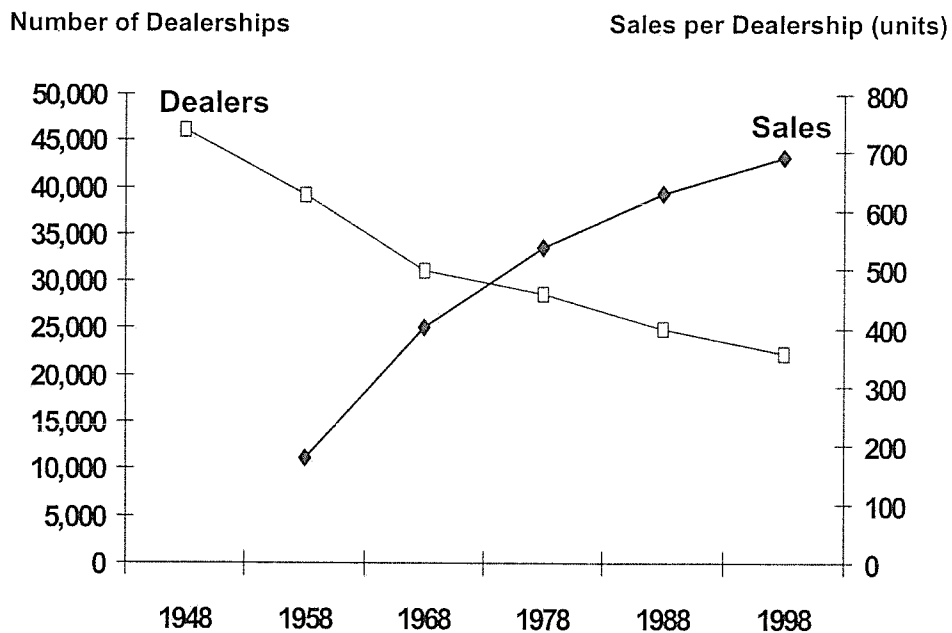
Source: ATK/OSAT Project, 1997-1998

Figure 1: The Retail Infrastructure Changes

Figure 1 details the changes that have influenced and altered the retail and infrastructure relationships. The growth of motorization over the past fifty years has turned the U.S. market into a replacement market, rather than primarily a market of first-time car buyers. Suburbanization and an increased tolerance for local travel have continued as well, allowing a smaller number of larger dealerships to serve a more dispersed populace. Other factors have also contributed to the alterations of the retail system. The quality, cost, and timing of products (Q, C, and T Competition) in the market have proven to be essential as competition has increased among more and more automotive manufacturers. This has increased customer choice and directly pressured retailing.

Dealers have secured franchises for multiple brands over the years in an effort to meet the needs of their customers across market segments. They are continuing to experience thinner margins as competition intensifies, particularly on new-car sales. Dealerships are also involved in businesses other than new vehicle sales, including used-vehicle sales, service and parts, and financing and insurance. In each of these areas of the dealer’s portfolio of business, there are outside competing suppliers that focus only on one area. These “unbundled” services can be provided independent of the dealership and function as a substitute for dealer services. Examples are the repair services provided by chains like Midas or Sears, as well as the various services of finance and insurance providers. This competition for unbundled services has almost certainly restricted profit levels of dealerships.

The independent franchised dealer has been the traditional representative of the industry over the years. Nevertheless, changes occurring in the past few years in automotive retailing, in other segments of the automotive industry, and in retailing in general have put pressure on dealerships and the existing retail structure to change. The factors diagrammed in figure 1 are contributing to consolidation of dealerships. As dealerships continue to change, they will alter their relationships with the vehicle manufacturers and customers, changing the way that business is conducted. The interview analysis identified many specific areas of change, such as the distribution chain, modes of competition, the selling process, Internet marketing, the emergence of large public retailers, and the future structure of automotive retailing.



Source: Automotive News Market Data Book & Ward's Automotive Yearbook

Figure 2: Automotive Retail Concentration—Shifting Structure of Retail

There is little doubt that the structure of automotive retailing is shifting. Figure 2 illustrates the decrease in the number of new-car dealerships and the corresponding increase in sales per dealership that is occurring in the industry. Consolidation is progressing through this segment of the industry, just as it is taking place in the supplier and manufacturer segments. Many small, independent dealerships are disappearing or consolidating to form larger dealerships or dealer groups with higher average sales. New entrants—large publicly traded retail groups—have accelerated the consolidation of the automotive retail industry. Large dealer groups have existed for years in retailing, but lacked the scale, scope, and access to capital of today's groups. The cost pressures on vehicle manufacturers resulting from globalized competition are in turn passed on to dealers, squeezing their margins. Dealer returns have decreased from a net profit of 2.2 percent of sales in 1985 to 1.4 percent in 1997.² In fact, some estimates indicate that the share of total sales concentrated in the top 5 percent of dealer principals grew from 25 percent in 1988 to 33 percent in 1998 and might reach 50 percent by 2008.³

The structure of other segments of the automotive industry has also been in flux. Cost reduction and consolidation are proceeding in the automotive supplier industry, and a parallel can be drawn between the manufacturers' relationship with suppliers and their evolving relationship with dealers. Some manufacturers succeeded in improving supplier performance through squeezing supplier prices and demanding higher quality and performance. On the other hand, some companies—notably Chrysler⁴ and Toyota—have earned a reputation for guiding, supporting, and rewarding a job well done by suppliers. Can the manufacturers use this model to improve relations with dealers? Indeed, manufacturers are already squeezing dealer profit and demanding change. Will some OEMs provide support and direction to dealers to help them in the transition where manufacturers have a vested interest?

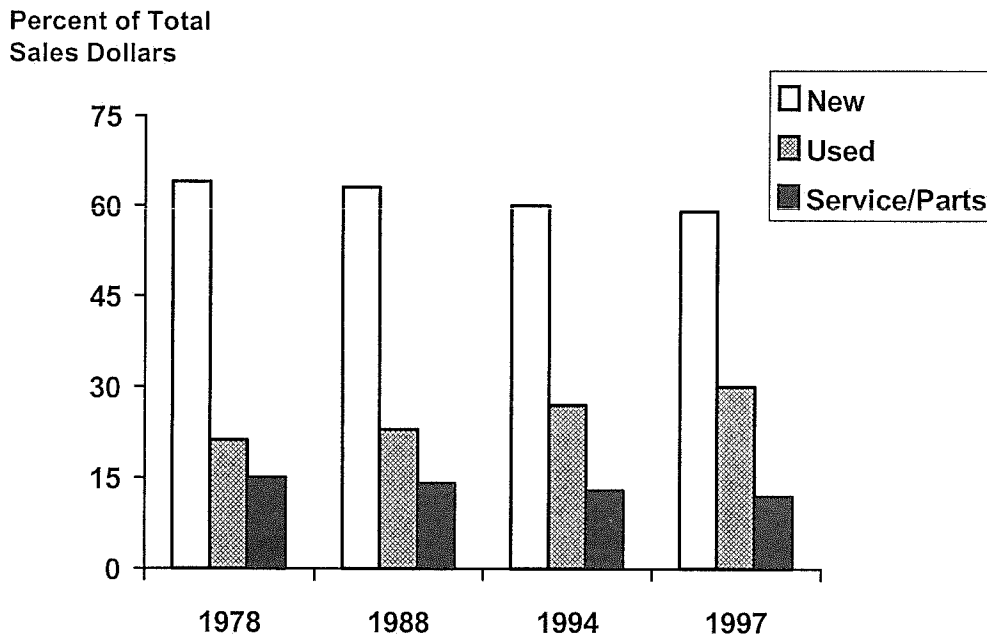
Dealers often face a challenge managing relationships because of the conflicting demands of their manufacturers and customers. The inconsistent or even competing demands of these relationships will certainly affect the shape and performance of the changing retail infrastructure.

Evidence of change in the distribution system and internal dealership structure is apparent in the distribution of total dealership sales shown in figure 3. Service and parts sales have decreased slightly as a percentage of total sales, but have increased in total dollar value and in relative contribution to dealer revenue. Dealerships have been investing in their service and parts operations to attract customers and to compete better with service providers for postwarranty vehicle maintenance, repair services, and parts sales.

² NADA Industry Analysis Division

³ Tom Libby, "Quick Facts," *The Power Report*, January 1999: 4 (Source: *J.D. Power and Associates 1998 Dealer Attitude Study*).

⁴ Now DaimlerChrysler



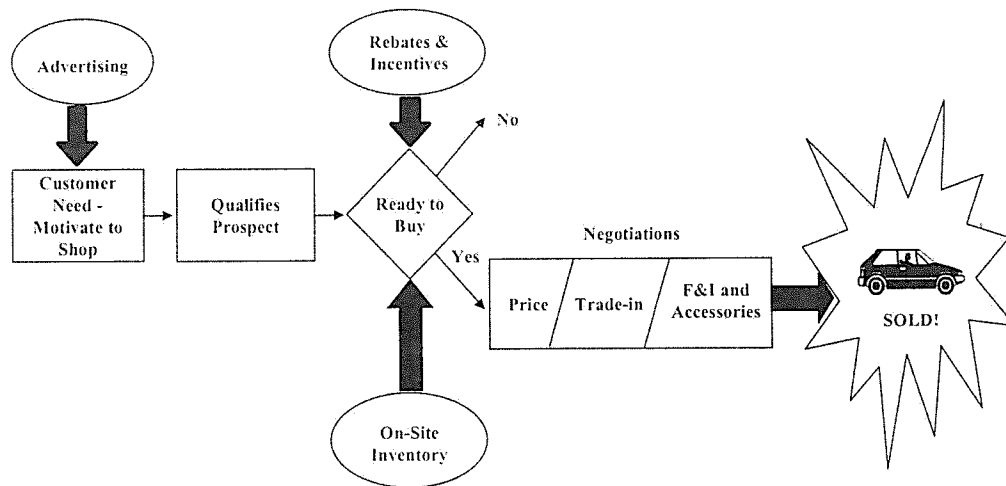
Source: NADA Industry Analysis Division

Figure 3: Automotive Retail Concentration—Shifting Sources of Revenue

In addition, figure 3 shows that the percentage of total sales attributable to new-vehicle sales has eroded, while the percentage due to used-vehicle department sales has increased. This shift from new-vehicle to used-vehicle sales is an important change in how dealerships operate. The percentage of customers (retail and fleet) leasing vehicles has also grown dramatically since 1990, returning a bountiful supply of “nearly new” vehicles to the market that is only expected to increase in the next few years. These nearly new vehicles constitute an emerging and important third category to add to the familiar new- and used-vehicle sales categories, though they are included in the used-vehicle segment and thus are partially accountable for the dealer revenue shift displayed in figure 3. Many consumers view nearly new cars and trucks as viable alternatives or close substitutes for a new vehicle. Consumers may feel that they garner a better value with a nearly new vehicle due to the improved quality, durability, and reliability of recently manufactured vehicles. Nearly new vehicles also typically offer higher margins to the retailer. The influx of nearly new, off-lease vehicles has helped to transform the used-vehicle market into a more important revenue maker for the dealer and to pressure the new-vehicle market. Nearly new vehicles also provide an entry opportunity for new retailers, such as Circuit City, whose CarMax superstores concentrate on nearly new vehicles offered in an environment meant to be customer-friendly and haggle-free.

Distribution Chain

The traditional retailing or distribution system is high in cost because the supply chain from manufacturer-to-dealer-to-customer is not optimized. It still operates as a push system in which manufacturers too often build more units of a particular model than the market can absorb and then push the vehicles out to individual dealers to sell to customers. Slow-selling models are moved via manufacturer direct-to-customer rebates, dealer and customer incentives, subsidized financing, and pressure sales techniques. Even for more popular models, large amounts of cash in the form of direct-to-customer rebates and incentives from the manufacturer are now common to convince the customer to buy. Therefore, it is not surprising that buying and selling is a price-based process or transaction, rather than a critical event in an ongoing relationship between the customer and the brand or the dealer. The typical sales process is diagrammed in figure 4. Dealers realize the value of customer retention and are increasingly using follow-up phone calls and other incentives to generate a relationship with the customer that extends beyond the sale event and warranty service.



Source: ATK/OSAT Project, 1997-1998

F&I=finance and insurance

Figure 4: Vehicle Sales Process

The traditional event selling process depends heavily on the generation of showroom traffic. Also reflecting the importance of a customer visit, a few dealer interviewees identified on-site inventory as important for attracting customers and motivating them to buy.

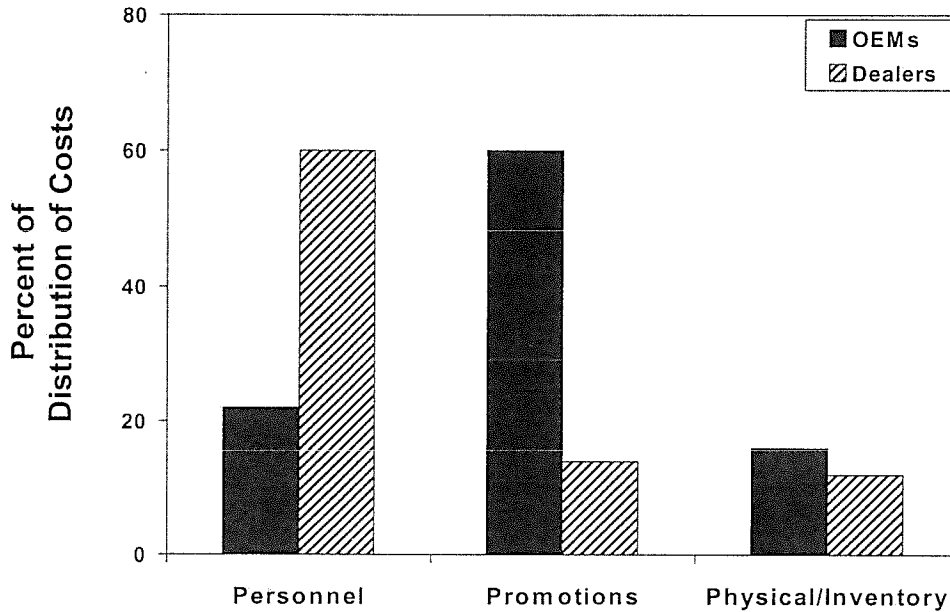
Historically this process has translated into large advertising expenditures by manufacturers and dealers aimed at inducing a customer to visit a dealership. Advertising, or “one-voice marketing,” is centralized and controlled by the manufacturer. This type of advertising is effective for building vehicle brand image. Several dealer respondents indicated that marketing is an important tool for dealers as well. Dealer-sponsored marketing, including Internet marketing, enables the individual dealership to differentiate itself from its competitors, particularly in saturated markets. Indeed, many dealer respondents believe that they can judge the needs of the vehicle customers better than the manufacturers can. A number of dealers believe that the manufacturers should look upon them as the customer and allow the dealer to use marketing monies to sell within their local market. This disconnect between the manufacturers and the dealers exemplifies one of the challenges facing their relationship: who should play what role.

Negotiating the vehicle sale is even changing under the current system. Saturn outlets and a few large dealerships (e.g., CarMax) offer haggle-free, one-price shopping. These dealers believe that by offering a set price, they can attract customers who are tired of the current system of back-and-forth negotiations. Will one-price shopping create more satisfied customers? Recently more dealerships have begun experimenting with one-price selling, but we are hearing resistance from many others. Some dealers believe that one-price selling is a welcomed time-saving tactic for both the dealer and the customer. Other dealers argue that a more efficient and well-managed selling process could save the same amount of time as one-price selling. Even with no-haggle prices, negotiations continue beyond the sale price of the vehicle to include trade-in value and financing terms, which are perhaps more emotional negotiations for the customer. These negotiations may still leave the negotiation-averse customer with an unsatisfactory experience at the dealership. Also, some dealerships have retreated from their “no-haggle” policies, possibly because Internet proliferation offers customers previously undisclosed information, such as factory invoice costs, informed consumers may prefer negotiating, and dealerships in competitive markets are being undercut by only a few dollars by dealerships who are not selling at one-price.

Currently, the manufacturer’s brand dominates, and dealers execute the selling process and support the vehicle by providing after-sales service, especially during the warranty period. However, dealers are much more sensitive to customer satisfaction than they were a decade ago. This is partly due to pressures and incentives from the manufacturers linked to the dealer’s customer satisfaction rating, as measured in customer surveys. It is also due to the recognition that more and more of the dealer’s profits will have to come from “downstream” activities such as service, parts, and body-shop operations, which require the customer to return to the dealer after the sale. Understanding the shift in dealer profit from new cars to used cars and now to service is critical to understanding the transformation that is occurring in the automotive retail industry today.

Dealers estimate the overall “cost of distribution” at 20 percent of MSRP (manufacturer’s suggested retail price) and manufacturers estimate the figure at 28 percent, but both groups caution that these are rough estimates. Both dealers and OEMs acknowledge the inefficiencies in the current distribution system and see the lack of common processes as a major cost driver. Dealers’ costs are heavily biased toward personnel (including sales department, training, and overhead), which constitute 60 percent of the costs

for this group as shown in figure 5.⁵ For OEMs, the analogous personnel costs total about 22 percent of total costs. Both dealers and OEMs expect training and development costs to increase, while dealers expect sales department costs to decrease.



Source: ATKOSAT Project, 1997-1998

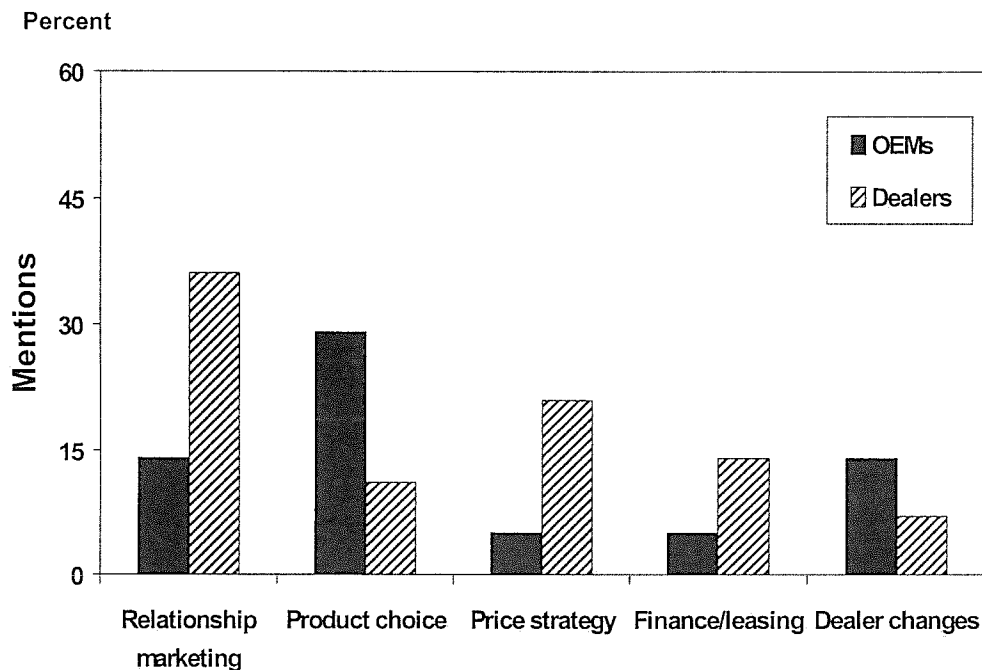
Figure 5: Distribution—OEM-Dealer Costs

Manufacturer distribution costs are concentrated in advertising, promotions, rebates and incentives (60 percent). The analogous number for dealers is 14 percent. The cost of physical distribution and inventory totals 16 percent for OEMs, and inventory carrying costs are 12 percent for dealers. Both manufacturers and dealers expect inventory costs to reduce in the next ten years.

⁵ Answers and mentions reported in percentages do not usually total 100 percent, since answers to these open-ended questions were often varied and unique.

Basis of Competition

Nearly 90 percent of the dealers and manufacturers believe competition has changed in the past decade, although they see these changes somewhat differently, as shown in figure 6. Dealers think competition has primarily changed in terms of relationship marketing/customer satisfaction (36 percent) and price/profitability strategy/financing (21 percent).⁶ Manufacturers view the change as more focused on product quality/choice (29 percent), followed to a lesser extent by relationship marketing/customer satisfaction and dealer change (each 14 percent).



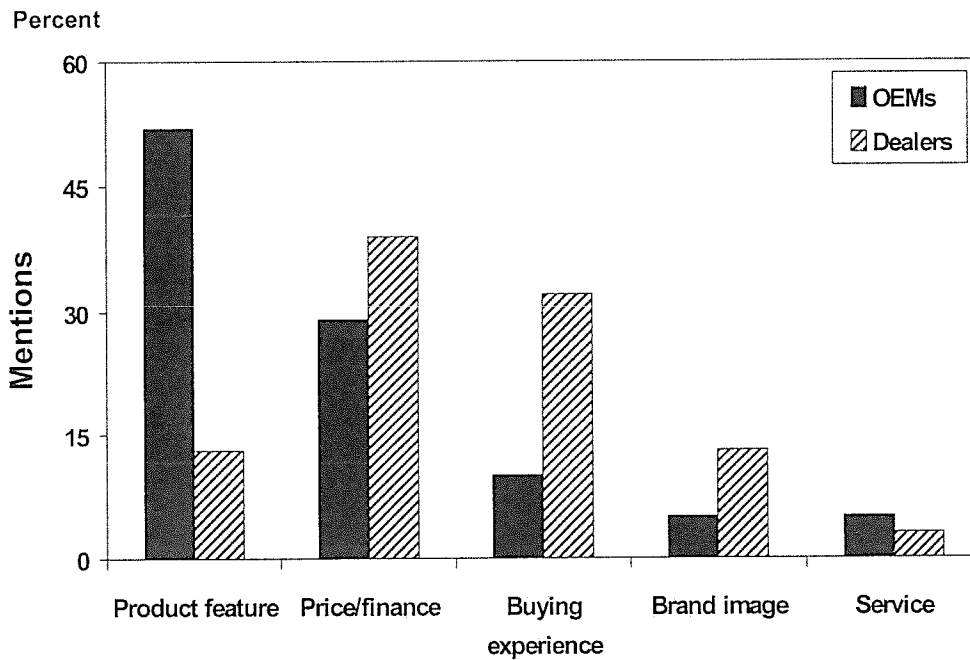
Source: ATK/OSAT Project, 1997-1998

Figure 6: OEM-Dealer Disconnects—Change in Competition Over the Past Decade

The dealers and manufacturers have similar views on the changing level of competitiveness of today's market, but show less agreement on the focus of the competition. Both dealers and manufacturers think the automotive retailing business in the United States is very competitive. However, as figure 7 shows, dealers view competition as focused primarily on price or financing (39 percent), followed by the customer buying or selling experience (32 percent). The manufacturers, on the other hand, see product or product features (52 percent) as the focus of competition, followed by price or financing issues (29

⁶ Note that the percentages reported here are a percentage of total mentions. Respondents were allowed up to four mentions. In other cases (e.g., figure 8), the percentages reported are a percentage of respondents (one answer only).

percent). These responses reflect the traditional differences between the two groups and closely resemble the beliefs discussed above on how competition has changed in the past decade. The dealers place more importance on the buying experience and the manufacturers place more importance on the product. Their agreement on the price and financing issues reveals a level of shared views. A few analysts responded to this question and, in this case, most agreed with the dealers that the buying or selling experience is the focus of competition. Because customers are mobile and most brands have many dealerships in a metropolitan area, competition for the sale is often among dealers of the same brand. In situations between same brand dealers, it is understandable that price, financing, and customer buying experience are the focus of competition for dealerships.



Source: ATK/OSAT Project, 1997-1998

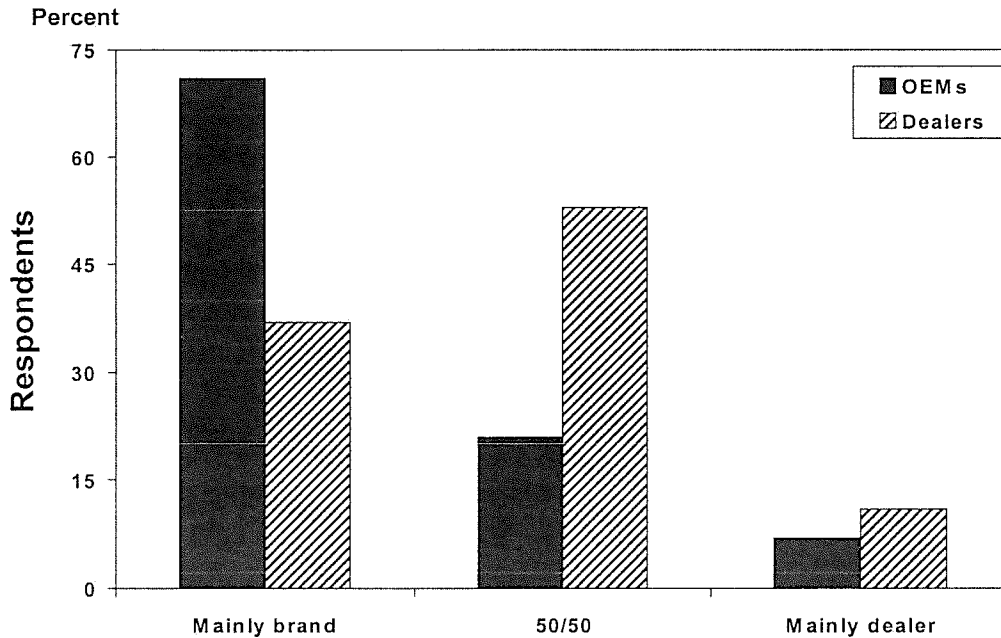
Figure 7: OEM-Dealer Disconnects—Focus of Competition

There is also a disconnect between the dealer and manufacturer reports of key dealership performance measures. A plurality of both dealers (33 percent) and manufacturers (42 percent) think that dollar sales or units sold are the best immediate measure of performance for dealerships. Dealers selected profit/gross profit (27 percent) as the second best indicator. Yet manufacturers (23 percent) listed customer satisfaction more often than dealers (7 percent) as a key performance measure. The selection of customer satisfaction by manufacturers rather than dealers is an interesting reversal of thinking relative to the views of the two groups on the focus of competition.

While having excellent products is viewed as essential, this is no longer adequate to differentiate in a crowded marketplace, according to some of our dealer interviewees. As manufacturers improve the speed of new-product development and stretch vehicle platforms to create many models that compete in many segments, it is becoming very difficult to create unique brand positions and strong brands.

Some of our questions asked the respondents to identify what they perceived as the primary needs and desires of the consumers. They identified factors or vehicle attributes for which they thought consumers would be willing to pay more. The comparison of results for the manufacturer and dealer groups is quite interesting. The most frequently mentioned factor by manufacturers was distinctive product features (47 percent), while this was ranked second among the dealers (21 percent). The most often mentioned attribute by dealers was sales and service convenience (29 percent), with manufacturers rating this second (24 percent). Analysts mentioned sales and service convenience as being important, but discussed durability, quality, and reliability of the vehicle as being the most important attribute to consumers. On the other hand, dealers and manufacturers mentioned vehicle safety as a factor that buyers would be willing to pay more for, while analysts did not. We followed this question with a similar one to capture respondents' views on the attributes for which customers feel they already pay too much. The responses of dealers and manufacturers revealed similar patterns with one exception: Manufacturers (38 percent) more often than dealers (11 percent) mentioned service and parts as being a feature for which consumers feel they already overpay.

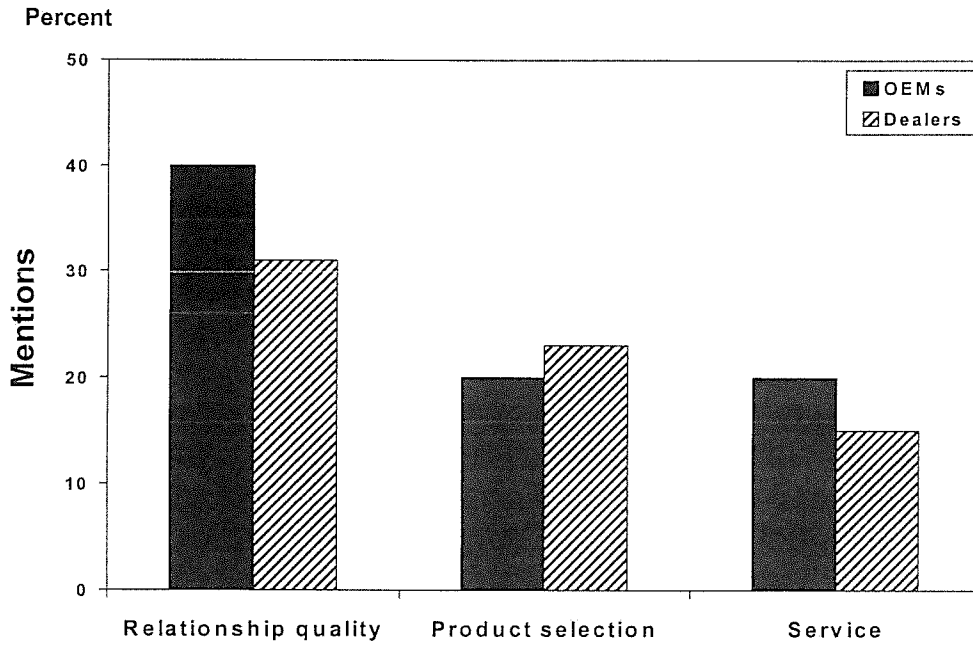
Dealers and manufacturers disagree about the focus of competition partially because they have different views of whether a customer buys a vehicle more on the basis of the maker/brand or the dealership, as shown in figure 8. Over half of the dealers think that the brand and the dealership have equal weight in the buying decision, while about one-third think that customers buy more because of the brand than the dealer. In contrast, almost three-fourths of the manufacturers think the brand is more important to the buyer than is the dealer, and less than one-quarter think the brand and the dealer are equally important in the buying decision. Dealers think that both positive dealer attributes, like a good buying experience or loyalty to a specific dealership, and positive brand attributes, like loyalty to a certain brand, affect the dealer-brand comparison. Manufacturer responses to influences of maker/brand or dealer are more differentiated, ranging from strong brand and product attributes, like brand loyalty and strong brand qualities, to both positive and negative dealer attributes associated with the buying experience. Lower-volume importers often cannot offer sufficient dealer profit potential to demand exclusive dealer outlets, so many niche vehicles are sold at multibrand outlets. For these niche products, the dealer's reputation and capability may be more important than the manufacturer's brand for winning sales.



Source: ATK/OSAT Project, 1997-1998

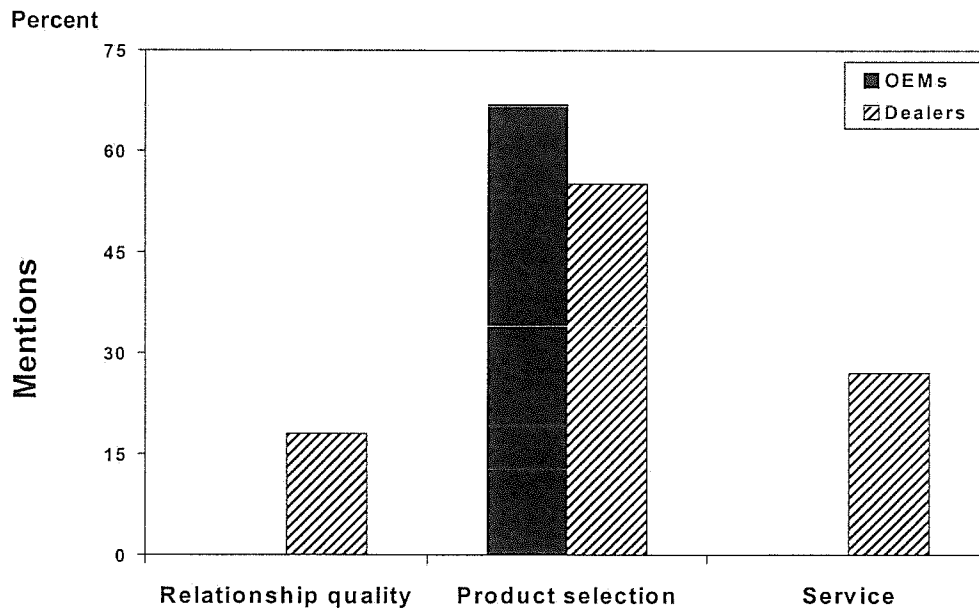
Figure 8: OEM-Dealer Disconnects—Why Does the Customer Buy?

In these interviews, dealers and manufacturers do agree, though, on the advantages of the different retail formats in market competition, as displayed in figures 9 and 10. Both selected quality of relationship as the largest advantage of single-brand outlets and product selection as the greatest advantage of multibrand outlets. Notice that the dealer respondents see service and relationship quality as possible advantages of multibrand outlets, while the manufacturer respondents do not.



Source: ATK/OSAT Project, 1997-1998

Figure 9: OEM-Dealer Views—Advantage of Single-brand Outlets



Source: ATK/OSAT Project, 1997-1998

Figure 10: OEM-Dealer Views—Advantage of Multibrand Outlets

Saturn and Ford offer other models of competition for automotive retailing. Saturn has been a leader in experimenting with customer-oriented formats, such as no-haggle pricing, Internet selling, and renovating dealerships to make customers feel at home by adding fireplaces, aquariums, cappuccino bars, and Internet access.⁷ Saturn gives dealers large territories, thus dampening intrabrand dealer competition. By the Saturn benchmark, about 380 dealers, most volume brand franchises have too many dealerships. General Motors, Ford, and Chrysler⁸ have about 2,000 to 3,000 dealers per sales division and the Japan-based companies have about 1,000.

Both OEMs and dealers recognize that the market has too many dealers. General Motors, Ford, and Chrysler have implemented strategies to decrease the number of dealerships. Ford has been the most active in this pursuit, creating the Ford Retail Network, which consists of regional groups of company/dealer equity joint-ventures. Ford is the minority partner with dealers or dealer groups in select regions (e.g., with Republic Industries, Inc. in Rochester, New York).⁹ The Ford Retail Network is an attempt to consolidate over-dealered markets as well as to gain more control over the sale and distribution of vehicles. The consolidated retail outlets are experimenting with different formats, including one-price selling and neighborhood service centers. Ford is hoping that its retail groups will benefit from the same economies of scale as publicly owned retail groups—reduced costs in advertising, inventory, purchasing, parts distribution, insurance, and information technology. It merits mention that vertical integration is the model the manufacturers are moving away from in their supplier relations. Nevertheless, could this joint ownership be reflective of a new, more vertically integrated model for dealer-manufacturer relations?

The sales process is another dimension of competition among dealerships. According to one insightful dealer respondent, dealerships in the past competed with one another through product knowledge. With the abundant information available to the public through various publications and the Internet, it is possible for the consumer to be more prepared than the salesperson with information on a specific vehicle. A few dealer respondents suggested that training the sales staff on product knowledge and computer competency will increase at many individual dealers and dealer groups. Both dealers and manufacturers (39 percent of each group) agree that the sales agent's role will change in the future to acting more as a purchase advisor in the sales process and as a consultant for the customer. Both groups also see the future salesperson as a product expert (dealer mentions, 23 percent; OEM mentions, 19 percent) and relationship manager (dealer mentions, 19 percent; OEM mentions, 23 percent).

⁷ Lindsay Chappell, "Saturn Renovation: Dealers to Add Cozy Study, Cappuccino," *Automotive News*, October 26, 1998: 1, 53.

⁸ Now DaimlerChrysler but at present dealerships are still known as Chrysler.

⁹ Bradford Wernle, "Ford's Dealership Plan may Include United Kingdom," *Automotive News*, October 19, 1998: 16.

Sources of Change

According to the dealer and manufacturer executives we interviewed, two developments are accelerating the changes in automotive retailing: the impact of the Internet, and the emergence of large, publicly traded companies in new- and used-car retailing. While the thought leaders are in agreement on these drivers of change, there is less agreement on their exact implications.

The Internet

According to the respondents, the Internet and electronic commerce are important sources of how competition has changed and will continue to change in the future. The Internet is already used substantially in gathering shopping information for some brands. For example, in 1997 16 percent of new-vehicle buyers collected vehicle information or performed some portion of their shopping or buying process on the Internet.¹⁰ This figure is expected to grow dramatically in the next ten years. Our dealer interviewees view the introduction of the Internet into automotive retailing as a positive step for both dealers and consumers. For the dealer, it offers the opportunity to attract customers to their dealership and to learn about specific consumers and their vehicle needs before they walk into the showroom, perhaps improving their customer relations. Through the Internet, the customer has the opportunity to develop a more focused visit to the dealership.

The Internet is seen as a positive step in improving dealer-customer relations. Dealer Internet sites are increasing in number each year, though their sites tend to be limited in the number of functions that can be performed directly from the site. These sites generally provide the consumer with introductory information about the dealer, such as contact information, hours of operation, services provided, and inventory. Some dealer sites provide contact with a salesperson through electronic mail, encouraging communication and relationship building with the customer.

Other industry Internet sites offer even more conveniences to the consumer than do many dealer sites. The manufacturers are increasingly designing Internet sites as marketing tools to strengthen brand identification and promote new features and models. Manufacturers are advancing their Internet sites to function as more than mere advertising campaigns to address the competition coming from independent Internet car-buying services such as Auto-by-Tel and Microsoft's CarPoint. For example, through GM BuyPower, customers can search all dealership inventories in an area for a specific vehicle. Consumers can research models and features, select a vehicle, access financing and insurance options as well as other services directly on-line. Independent Internet services may offer more detailed information on specific vehicles than some manufacturer Internet sites, as well as the ability to compare different makes and models. Auto-by-Tel, an Internet brokerage, attempts to offer another advantage to the customer by guaranteeing a price on the vehicle of their choice without negotiating with a dealer. All transactions are

¹⁰ Tom Libby, "Auto Buyers Get Connected!" *The Power Report*, March 1998: 4.

performed on the Internet with Auto-by-Tel up to delivery of the vehicle. It seems the automotive retailing industry is only beginning to explore the potential of the Internet.

Many respondents agree that the Internet is one of the most valuable resources for car buyers. It provides the potential for consumers to be better informed when they enter a dealership. Consumers have the opportunity to perform an increasing range of activities including comparing different vehicle makes, models and features, searching inventory for a specific vehicle, applying for electronic loan approval services, and performing much of the actual purchasing process before going to the dealership. The Internet also allows consumers to bargain more confidently and to make better-informed decisions at the dealership.

This explosion of available information means that it will be difficult or impossible to communicate consistent information about vehicles to consumers, since OEM's no longer "control" information dissemination and may have some difficulty addressing erroneous or inaccurate information. Sensitive information (such as dealer price and vehicle invoice) is available to the customer on the Internet. Intermediaries, like Auto-by-Tel and Microsoft's CarPoint, and OEM- and dealer-sponsored Internet services will be growing, but according to the respondents, ten years from now most people will probably still have their vehicle delivered through a franchised dealer.

Publicly Traded Companies

Large retail groups have long existed in automotive retailing. Until recently they have not been publicly traded and have not existed on the scale and scope of today's emerging public retail groups. Revenues, vehicle sales, and the number of dealerships owned by today's groups are exponentially larger than the groups of just a few years ago. Two notable groups in today's market, Republic Industries (retail outlets include AutoNation USA retail chain) and Circuit City (CarMax superstores), have entered the automotive industry drawing on experiences from other industries, introducing new ideas, formats, and a pace of change unusual to the automotive retail industry. They also have brought with them new ideas about the consumer and customer relations. Large public groups seek an advantage through economies of scale in inventory, advertising, purchasing, parts distribution, and insurance that support a lower price to consumers. They also expect cost savings through updated financing methods and centralized information technology and management. Some of these players (e.g., John Elway AutoNation USA and CarMax) are attempting one-price selling of vehicles. They believe that this option will attract customers. Despite the similarities, the large public groups have different market strategies. For example, both CarMax and Republic Industries operate new and used vehicle retail outlets, but the CarMax retail outlets are focused on the used vehicle market, while the Republic outlets are concentrated in the new-vehicle market.

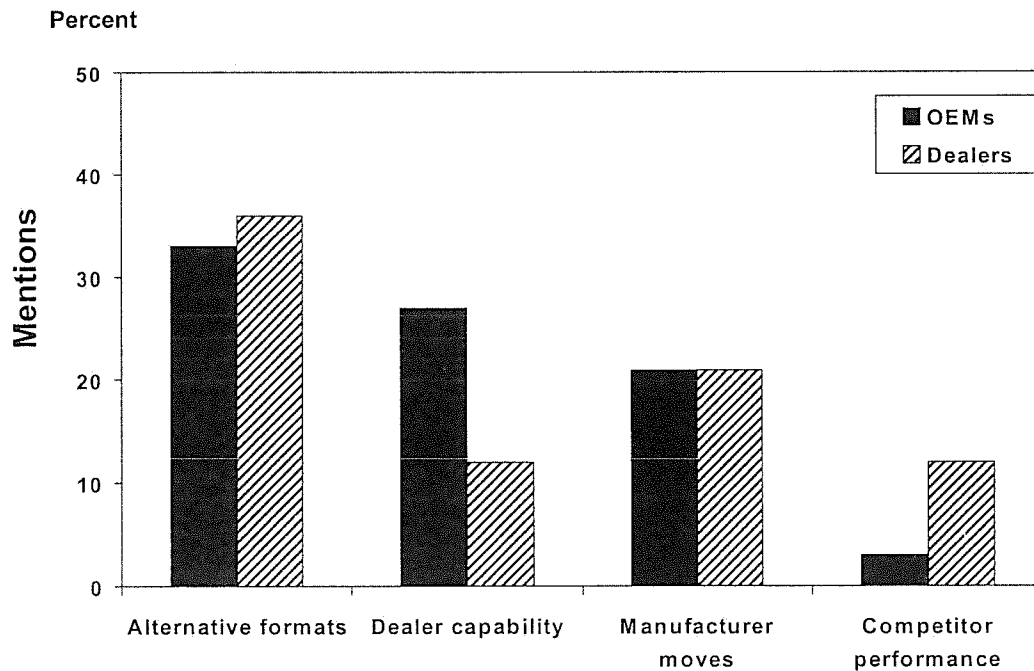
The emergence of large publicly traded companies in new- and used-car retailing has sparked a reaction among existing dealers and manufacturers. The entry of these groups into automotive retail may alter the power balance between dealers and vehicle manufacturers. These large retail groups are less dependent

on any one manufacturer than is the traditional dealer and often have immense resources, such as access to capital at the same cost as the manufacturers. Are these groups giving a wake-up call to the industry? The introduction of new- and used-car superstores certainly has the potential to transform the traditional dealership.

The thought leaders had very different views about the new entrants to automotive retailing, and their views to a certain extent depended upon their position in the business. Established volume automakers based in the United States see new retailers as a potentially positive development. They do not expect them to become powerful enough to threaten manufacturer control of the system, and perhaps they will introduce new ways to increase profit and customer satisfaction in automotive retailing. Foreign-based manufacturers, particularly the more successful ones from Japan, are worried that large, public dealerships will disrupt their established dealer networks. Another concern is that if these new entrants fail, the manufacturers will have to buy and rebuild those dealer points.

Most dealers remain very skeptical that new entrants will succeed. They mention the high purchase prices for dealerships and question whether these new entrants can truly improve operations or secure scale economies sufficient to justify the dealership-acquisition premiums. They also emphasize how thin the talent base is at a dealership: If a few key people leave the administrative or sales department, the dealership is in trouble. However, the dealers' reluctance to recognize the potential threat of this new and powerful type of competitor is perhaps similar to the manufacturers' slow recognition of the seriousness of Japanese competition in the late 1970s and early 1980s. On the other hand, financial analysts seem to be adopting a wait-and-see attitude, evaluating the strategies and performance of the retail groups individually rather than as a whole.

As shown in figure 11, both dealers (36 percent) and manufacturers (33 percent) rated large publicly traded retail chains, superstores, and alternative formats as the top threat to existing dealers. Dealers and OEMs (both 21 percent) also rated actions by the manufacturer as an important threat. In fact, dealers rated this as their second biggest threat. They gave examples of OEMs seeking to control sales and marketing, entering the retailing side of the business, or just making poor products. OEMs saw the second biggest threat to dealers as being the dealer's inability to manage change (27 percent), but they also acknowledge the fact that excessive OEM control or poor products are a threat to their existing dealers (21 percent). Dealers acknowledged that their own inability to change rapidly and profitably to meet the challenge of the future (12 percent) and competition from other dealers (12 percent) are also threats. It is interesting that dealers do not see the Internet as a threat, but rather as a positive development, consistent with the discussion above.



Source: ATK/OSAT Project, 1997-1998

Figure 11: OEM-Dealer Views—Most Important Threats to Traditional Dealers

Future of Automotive Retailing

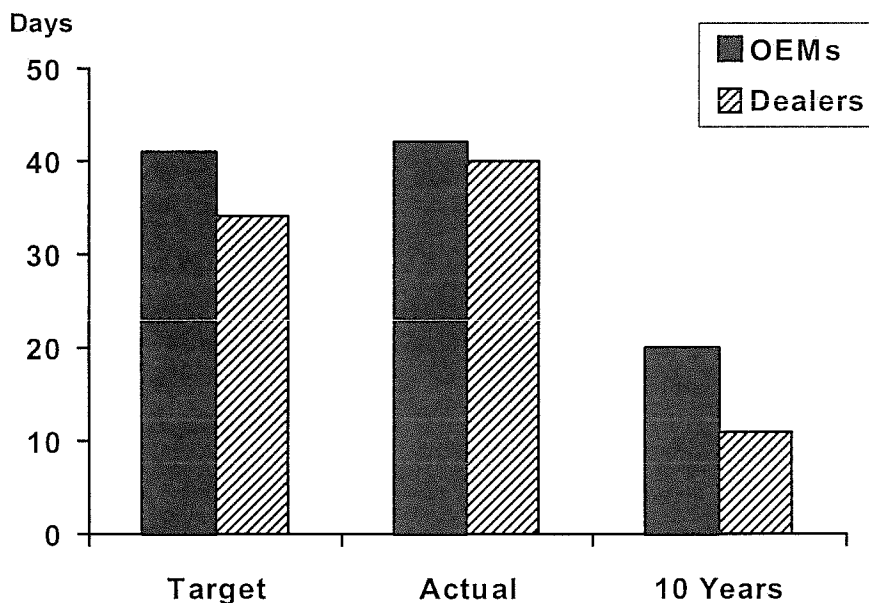
There is little consensus among industry thought leaders on where the future of automotive distribution lies, except that the traditional approach of the full-service franchised dealer will not be the only way cars will be sold and warranties serviced in the future. It is clear that the traditional dealer is not dead, and notices to that effect are premature. However, major changes in the industry's distribution chain for dealers and customers are only beginning.

The manufacturers and dealers both believe that the distribution system must move more toward a customer-pull rather than a manufacturer-push system in order to reduce dealer inventory. Our dealer and OEM respondents have different ideas about inventory levels, perhaps reflecting their different views on the push-versus-pull system. If vehicles can be delivered on the promise of a short waiting period, then there will be less need for the dealer to carry a large inventory. The mean dealer estimate for ideal inventory levels is 38 days, while OEMs respond with a mean of 55 days. The actual inventory level according to dealers is 59 days, and 74 days according to OEMs. Both groups believe that ten years from now, dealer inventory levels will be much lower than today. But this conflicts with the responses of

many dealers who continue to believe that inventory and showroom traffic are necessary prerequisites to sales, at least in today's retail environment.

The respondents expressed varied opinions on how fast and flexible manufacturers will become in the order fulfillment process. Today, the vast majority of vehicles are bought from dealer inventory: Dealers report that 75 percent of their customers order out of stock, while OEMs estimate the level at 86 percent. Since dealers frequently cannot obtain the exact vehicle the customer wants quickly, they must often persuade the customer to compromise or risk losing the sale. Dealers believe that with the proliferation of product types, the order-to-delivery process from the manufacturers is less able to meet true customer demand than it was ten years ago. Nevertheless, industry participants often point to the high percent of vehicles bought off-lot as proof that the current method meets customer needs. Still, a special-order vehicle typically arrives in about forty days today, as illustrated in figure 12, and probably few customers are willing to wait that long.

OEMs think that ten years from now they can reduce order lead time to twenty days, but dealers believe it will be reduced to eleven days. Perhaps a decrease in inventory costs will be facilitated by this reduced factory-order-to-customer-delivery time for new vehicles. Faster order-to-delivery time implies that a smaller inventory can satisfy customer demands. OEMs and some dealers believe that inventories are excessive and the distribution chain must be improved and will be. It is just a question of how much and how soon.

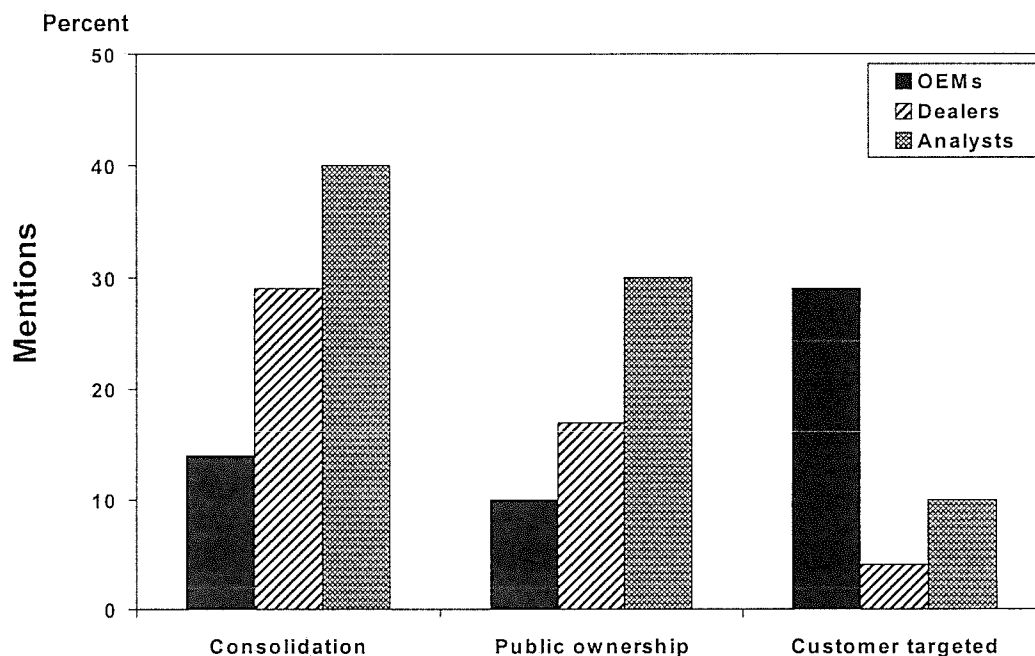


Source: ATK/OSAT Project, 1997-1998

Note: Based on 1998 estimates

Figure 12: OEM-Dealer Reports—Time to Fill Customer Orders

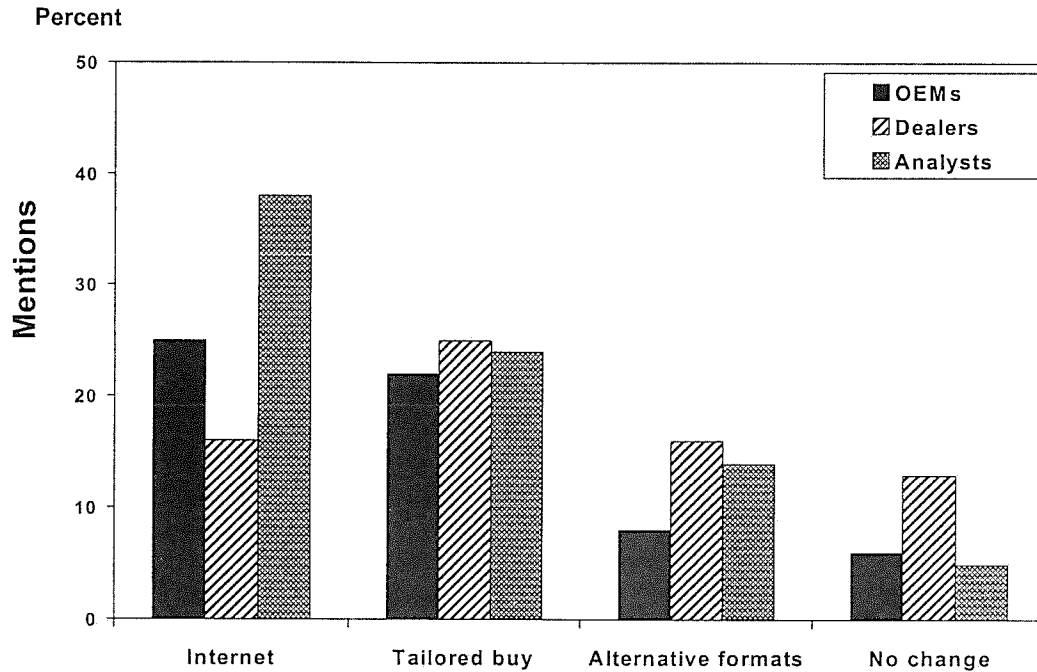
Figure 13 displays some of the divergent views held by the interviewees on exactly what shape the retail system will take in the future. Dealers most often mention consolidation of dealerships as impacting the future of retail, followed by public ownership and customer targeting. Analysts' views on future changes in the retail system also reflect this pattern. Manufacturers, on the other hand, think that the greater change in the retail system of the future will be through better customer targeting, increased responsiveness to customer demands, and improved marketing.



Source: ATK/OSAT Project, 1997-1998

**Figure 13: OEM-Dealer-Analyst Disconnects—
How the Retail System Will Change in Ten Years**

Looking forward to how people will be buying vehicles in ten years, OEMs, dealers, and analysts express a range of opinions, as shown in figure 14. Analysts and manufacturers see the Internet, electronic interfaces, and the resulting information-rich customers as the most powerful force. In particular, 38 percent of the analysts' mentions suggest that the Internet will be the main way customers will purchase vehicles in ten years. Dealers, manufacturers, and analysts all believe that providing a "tailored" buying experience will be one of the most important options. Alternative formats, such as chains, superstores, malls, and one-price selling are methods that consumers will use to shop in the future, according to the dealer and analyst respondents. Thirteen percent of dealers feel the consumer will buy the "same as today," while a smaller percentage of manufacturers and analysts agree. A few OEMs think sales and service will become unbundled, and the dealer will deliver the vehicle directly to the customer. A few dealers suggested that leasing might grow and evolve such that customers would buy "total transportation" through one monthly payment covering all their transportation needs. This might include the option to switch types of vehicles as desired, perhaps using a sports utility vehicle in winter and a convertible in summer.



Source: ATK/OSAT Project, 1997-1998

**Figure 14: OEM-Dealer-Analyst Disconnects—
How Customers Will Buy in Ten Years**

There is a consensus among the thought leaders that consumers will be the big winners in the retail revolution because they will have more choices of products to buy and ways to buy them, as well as the information to secure the best terms and the lowest price. Different groups of consumers will probably prefer different sales processes, just as they prefer different types of products today. The challenge for both dealers and manufacturers will be to satisfy these different groups while also being able to maintain or increase profit margins. Two important questions remain unanswered: Will retailing power shift to new entrants or remain with traditional dealers? Will a new model emerge that substantially and effectively challenges the current system?

Moving Forward

The OSAT team has tabulated the detailed findings from the thought-leader interviews. The results were shared first with those who participated in the interview process. Anonymity of individual respondents is, of course, being maintained.

The results are powerful. They allowed OSAT to take the next step, which was to conduct a large mail survey of dealer and manufacturer stakeholders in the automotive retailing environment that addresses the key issues identified by the thought leaders. A.T. Kearney and NADA supported this survey of dealers and manufacturers, which began in the fall of 1998. The results will help to quantify the likely trends and degree of harmony on key issues between the two groups.

This mail survey includes nearly 800 responses from a representative sample of dealers, and responses from executives of twenty-two vehicle sales companies or divisions. These results will be tabulated and analyzed in early 1999.

Ultimately, OSAT and A.T. Kearney will share findings with the public as a whole, while protecting the anonymity of the survey respondents. The automotive retailing revolution has begun. This research will shed light on where it is going, and the readiness of various stakeholders in automotive retailing to make the changes necessary to survive and thrive.

List of Sources

Automotive News Market Data Book. Crain Communications, Inc., 1998-1979.

Chappell, Lindsay. "Saturn Renovation: Dealers to Add Cozy Study, Cappuccino." *Automotive News*, October 26, 1998: 1, 53.

The Gallup Organization. "Survey of Attitudes and Perceptions Among Three Major Groups." *Automotive Retailing Today*, Fall 1998.

Libby, Tom. "Auto Buyers Get Connected!" *The Power Report, J.D. Power and Associates Automotive Journal*, March 1998: 4.

Libby, Tom. "Quick Facts." *The Power Report, J.D. Power and Associates Automotive Journal*, January 1999: 4.

NADA Data, National Automobile Dealers Association (NADA) Industry Analysis Division.

Ward's Automotive Yearbook. Ward's Communications, 1998-1979.

Wernle, Bradford. "Ford's Dealership Plan May Include United Kingdom." *Automotive News*, October 19, 1998: 16.

Acknowledgments

The members of the A.T. Kearney and OSAT teams would like to thank the industry thought leaders who participated in our study. We are especially grateful for the time and insight they volunteered in support of our efforts. We hope this report justifies their contributions.

A.T. Kearney team members

James A. Mateyka of A.T. Kearney's Alexandria, Virginia office managed the project. Significant contributions came from James G. O'Brien, Jr., also of the Alexandria office, Jay C. Houghton and Marty Taylor of A.T. Kearney's Southfield, Michigan office, and Larry Stout of Electronic Data Systems in Troy, Michigan.

OSAT team members

Michael S. Flynn directed the project, while Bruce M. Belzowski, Kara F. Alkire, Eric Budnik, M. Lee Burge, David E. Cole, Jack C. Cragen, Jeffrey Davis, David Graham, Kim Hill, Jeremy Meyer, Barbara Richardson, and Richard Senter all made significant contributions.