

Dealership of the Future

Revolution or Evolution?

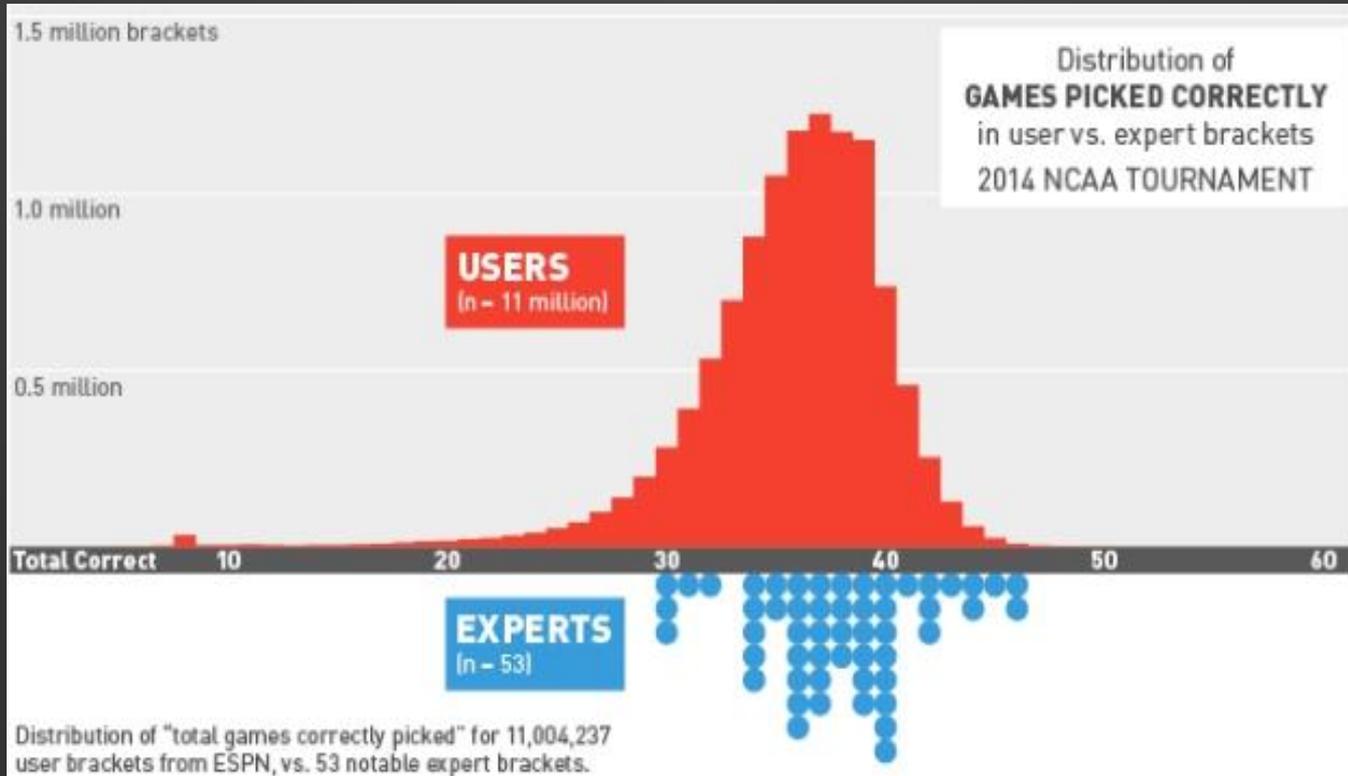
Glenn Mercer for NAMVBC
San Diego, September 19, 2014



Contents

- Beware of experts (including me)
- What does the past say about the future?
- Inputs to my forecast
- The dealership of the future

Beware of experts making forecasts! (1)



Beware of experts making forecasts! (2)

Past forecasts have not been very accurate (3): Automotive News, 1993

A look 20 years ahead, from a survey of experts, dealers, and customers:

1. Retail chains will sell more automobiles, squeezing out solo operators.
2. Consumers will be able to order cars by mail, via catalogs, 24/7 800-numbers, and via their TV sets, like HSN but with interactive technology.
3. Instead of car lots and test drives, dealers will use high-tech sales tools like virtual reality to simulate seeing, touching and driving specific cars.
4. Dealerships will get smaller – and bigger. Off-site service centers will open in locations convenient to customers. And big retail centers will combine many competing dealerships in the same place, with restaurants, stores, and playgrounds.
5. There will be fewer dealers in the future, as new ways of marketing evolve.
6. Surviving dealerships will carry more brands of vehicles – but there will be few on hand to look at. Instead of carrying large inventories ready for instant sale, dealers will custom-order what customers want, to be built and delivered directly to the buyer within a week.
7. Service departments will be always open, to repair vehicles whenever customers want.

Contents



Beware of experts: **use your own judgment**



What does the past say about the future?



Inputs to my forecast



The dealership of the future

What does the past say about the future?

WHAT DID NOT HAPPEN

1. **Arrival of the publics...** AutoNation found scale economies elusive, “end to end” integration synergies (e.g. by ownership of Alamo, National, and other rental car firms) non-existent, and under CEO Mike Jackson reverted to a traditional type of strategy. Market share flat.
2. **Rise of the internet disintermediators...** Each realizes this is impossible (e.g. allocation issues) and that in fact they are only adding a layer of cost. Both fall back into simple lead generation. AutoByTel stock is at \$12.
3. **Invasion of the OEMs...** FRN is gone by 2001 and GMRH is cancelled before it can launch. Plans to own and run dealerships run up against reality as OEMs find they do not have adequate skills, the incentives are wrong, split systems don't work ... and as dealers revolt *en masse*. In hindsight, this might have been a good thing, as it persuaded OEMs to steer clear of selling cars themselves.

What does the past say about the future?

WHAT DID HAPPEN

1. **SERVICE:** Warranty work fell as car quality rose
2. **CONSOLIDATION:** Dealer counts fell but then stabilized, at ~18,000
3. **SALES:** Shopping (*not* transactions) moved online, narrowing transaction price bands (“no more dumb customers”) – but note Mike Jackson’s comment: *stairsteps* widen them again
4. **F&I:** carried more of the profit of the store (but now being capped?)
5. **BODY SHOP:** More dealers abandoned, moved off-site, or subcontracted collision repair
6. **FINANCES:** OEMs moved profits from up-front *margin* to back-end *payments*
7. **FACILITIES:** Programs begin converting low-cost, personalized *dealerships* to high-cost, standardized retail *stores*

Contents



Beware of experts



What the past says: **don't over-predict change**



Inputs to my forecast



The dealership of the future

Additional inputs to my forecast

- From general **retail trends**: automotive retailing may be different, but that doesn't mean we can't learn from other sectors
- From **Apple and Tesla and other innovators**: if auto retailing is “ten years behind,” then we can find the future just by looking around
- From **demographic shifts**: it is pretty easy to forecast population changes, so find the store formats that are responsive to these changes (see Bill Ford in the *Wall Street Journal* this summer re urban stores)
- From **inertial forces** (regulation, complexity, risk adversity, dealer adaptation): not all forces favor change
- From **industry participants**: the “dealer of the future” is probably already here today... if we can find her; extensive dealer interviews



Inertial forces slowing change

REGULATION: Massively important to customers (size of purchase), governments (source of tax revenue), and local politicians (employers, business people) thus dealerships are regulated more than most businesses, which in turn limits their ability to rapidly evolve. Further, there is no *organized* constituency interested in change.

COMPLEXITY: As a dealership is several businesses integrated in one location, the complexity of its operations make it hard to experiment: it is a system, not a single function (cf. Tesla handing trades to AutoNation).

RISK AVERSITY: Car purchase is so important, there is little *actual* customer demand for change (versus *stated* demand). In particular, customer may want dealer-as-owner to assure good treatment over time.

DEALER RESPONSE: In reality dealerships *have* been steadily evolving, which reduces pressure for radical change (e.g. dealer ability to manage own internet leads has reduced the power of third-party lead generators)

Contents



Beware of experts



What does the past say about the future?



Inputs to my forecast: **cast the net wide**



The dealership of the future

One view of the future!

Demolition Man, 1993



Characteristic	Past (1955)	Present	Future (2025)
Number of dealers	41,0000	19,000	about the same
Size (NVR/days inv)	150/40	650/60	1,000 or more/30
Consolidation	None	Nat'l low, local medium	Region mid, local high
Brands	From many to one	Store one, group more	Store one, group many
Service % of profit	1/3	1/2	3/4?
Location	Main street	Suburban auto mile	Diverse locations
Physical integration	High	Medium (body shop out)	Low (BS, BD, FO gone)
Balance of power	OEM	Dealer	Customer?
Life of format (yrs.)	25 (change the sign)	10-15 (raze & rebuild)	?? (change the graphics)
Role of dealer:	Vital	Major	Modest
Transact (many parts)	High	High	High?
Promote	High	Medium	Low
Inform	High	Low	Low
Price	High	Medium	Low
Stock (+deliver, own risk)	High	High	Medium
Service (+recall)	High	High	Medium
Function of store	Dealer (earn margin)	Retailer (get incentives)	Company store?
Regulatory focus	Minimal	Protect the dealer	Enable the dealer?

Description of a typical dealership, 2025

Store has 3 branches: 2 satellite service, 1 demo point

Part of 5-store privately-held local group

Retail units are 1,500 new + 1,500 used
40%, inventory is down

Service absorption >120%

Store has “express delivery”

Showroom (finally) has full home

Highline service is mostly pickup/dropoff; mass service is upgraded

Facility restyled at low cost every few years, rebuilt every 10-15 or so

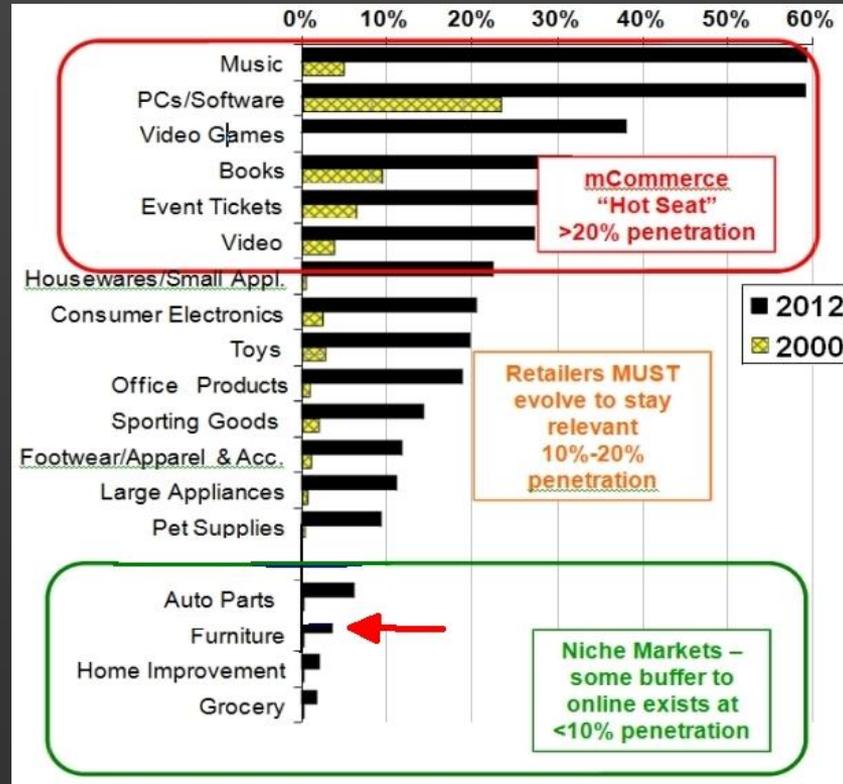
What about “the digital revolution?”

Less a *revolution* than just more *evolution*
in the way we reach customers:
newspapers, billboards, radio, TV, direct
mail, phone, email, social media ...

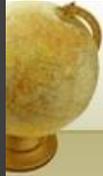
“Cars are more like furniture than books”

Cars: more like couches than movies?

PERCENTAGE OF ONLINE SALES, 2012



The China question: will they “go direct?”



Contents

Challenges facing a new entrant to the US market

- Value proposition: why buy a Chinese car?
- Homologation: costs of getting ready for the US
- Image: how to overcome established brands?
- Used cars: the “hidden competitor”
- Distribution: the cost of building out the network

Tesla: Disruption or Distraction?

- The two camps: pro-dealer and anti-dealer:
 - Pro-dealer: dealers, ATAEs (focus on fairness), even some OEMs
 - Anti-dealer: fragmented (libertarians focus on free market, techies on innovation, populists on Evil Dealers, Tesla fanboys on Anything Elon Says)
- Sides are talking past each other, by confusing two issues:
 - Pro-dealer side is worried about OWNERSHIP of channel
 - Anti-dealer side is concerned with FORMAT issues
- Format: most of what Tesla does dealers working with OEMs and regulators could do also:
 - industry has experimented before: Saturn, public dealer chains, CarMax, Scion online customization, Hyundai Equus home service, Lexus luxury stores, etc. etc.
- Ownership: economic evidence shows dealer-as-owner superior globally (see also Keller report), and customers can't tell the difference anyway (see McDonald's (80/20 independent-corporate split)
 - the real issue is fairness to existing dealers *today*, and exposure to future (foolish) large-volume OEM-direct experiments *tomorrow*
- Recommendation: allow regulations to change to permit dealers more FORMAT flexibility ("horses for courses"), while defending OWNERSHIP issues aggressively

Contents



Beware of experts



What does the future hold?



Inputs to my model



The dealership of the future

Thank you!

On to the Q&A and
the discussion...