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Manager's Journal: Car Retailing Needs a Tune-Up

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Abstract:

Traditional car dealers shouldn't take too much comfort from AutoNation's decision last week to close 23 of its used-car superstores. AutoNation still profitably operates 409 dealerships selling new and used cars, making it the largest auto retailer in the country. Despite its high costs, the company has enormous growth potential; AutoNation may not be efficient, but it is effective, thanks to cutting-edge technology and unaggressive salespeople. AutoNation and others -- including manufacturers -- must radically reinvent the retailing model in this industry, making it both efficient and effective.

Auto retailing is a marketing dinosaur. It is the last refuge of the old-fashioned hard sell, a "push oriented" model devised under the theory that a loaded dealer is a motivated dealer. While most manufacturers have moved to just-in-time production, the car industry still practices what we call just-in-case marketing. The average dealer has a huge 60- to 70-day inventory. Manufacturers have lost control of the relationship with the customer. Buyers must endure the least pleasant purchase experience of any industry; their loyalty to dealers is less than 20%.

Full Text:

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There are too many new-car dealers -- nearly 20,000 of them nationwide. Yet there are too few to provide convenient service. Thus about 85% of highly profitable nonwarranty service revenues bypass dealers. All told, manufacturers and their franchised dealers capture only about half of the auto industry's $1 trillion a year in revenues ($350 billion in new-car sales, $650 billion in after-market products and services) and less than one-fourth of the profits. Little wonder that the average market capitalization of the Big Three auto makers is barely 50% of annual revenues, compared with General Electric's 400%.

Why does such an inefficient and ineffective system stay in place? Part of the reason is political. With more than $530 billion a year flowing through franchised dealers in 1998, and an average of 52 such dealers in each congressional district, dealers enjoy enormous clout in state capitals and in Washington. Archaic laws prevent manufacturers from reforming their distribution system. Twenty-eight states have statutes restricting manufacturers from owning dealerships; seven ban any form of manufacturer ownership. In Texas, auto makers can own a dealership only for a year, and only as part of a dealer-development program to help women or minority owners. In North Carolina, manufacturers can own up to 34% of a dealership -- provided it is at least 65 miles from the nearest independent dealer.

Auto makers have gone to great lengths to optimize their supply chains and improve their design, development and production processes. They must do the same for their distribution system. But they can't without legal reform. State laws governing car distribution should be scrapped in favor of uniform federal legislation. If Congress refuses to act, auto makers should go to court and challenge these laws as unconstitutional restraints on interstate trade.

If this happens, the industry is likely to move to a two-tier distribution system, with a handful of huge national one-stop chains like AutoNation and many smaller, focused specialists. Most of today's dealers fall in the no man's land between these two models. They will either get folded into larger chains, shrink into specialist status or simply vanish. A hybrid distribution system will evolve, with many new-car purchases made direct from the manufacturer, with dealers serving as order and pickup points.

The Internet has armed customers with so much information that distribution must move to a customer-initiated pull-oriented model. More cars will be customized. Dealers will have access to third-party or manufacturer-owned distribution centers with shared inventory pools to serve regional markets.

Customer incentives like rebates, which now average more than $2,000 per car, will shrink. Fixed pricing will become the norm. Inventory levels will decrease by as much as 90%. This will save huge amounts of money -- smaller lots, less money tied up in rapidly depreciating inventory. After some initial pain, dealers may find they like the new system as much as manufacturers and customers do.

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