

# THE FUTURE OF CAR DEALERSHIPS

Philip Wade, Managing Partner

## BEYOND REGULATION

---

Block Exemption (BER) features heavily in most people's thinking in Europe about the future shape of franchised dealer networks. This is particularly true for new car sales networks. The prospect of the new 'location clause'<sup>1</sup>, which comes in to effect in October 2005, has concentrated minds wonderfully.

Now the European Commission's Competition Directorate is inviting tenders for an impact assessment of the current Block Exemption, including forecast indicators of the effects of the new clause. The study is scheduled to be completed by end year, though I suspect it will take longer, and it will have a major impact on what happens after the current BER expires in 2010.

This preoccupation in Europe with regulations and their effects is understandable, but we should not ignore some important global trends that are already changing the shape of new car retailing, whether in Europe, the USA or elsewhere.

It would be too much to say that there is an impending financial crisis in the dealer industry. Somehow, dealers always seem to manage to adapt and survive. However, on both sides of the Atlantic there is a worrying longer-term trend concerning dealers' profitability and return on investment.

European dealers may have to start looking closer at the solutions adopted by their US counterparts if they are to find their place among the survivors. US dealers have boosted income from financial products and used car sales, but their real advantage is in their scale of operations. Is Europe set to follow the US multi-franchising trend?

## EXCLUSIVE NEW CAR SALES CHANNELS

---

For HWB's annual study of Europe's franchised dealers, the "GMAP European Car Distribution Handbook", we study 38 car brands that account for over 98% of new car sales. These are, in effect, 38 separate sales channels. There is an ebb and flow among the 15 car manufacturer companies that own these brands, in terms of how much corporate dualling they allow. Overall the shifts towards separation (Audi from VW, Lexus from Toyota) outweigh the shifts towards dualling (Alfa Romeo with Fiat, smart with Mercedes).



Across the EU approximately 70% of dealer showrooms are brand exclusive and around 80% are corporate exclusive. By comparison, in the US 57% of dealerships are brand exclusive<sup>2</sup>.

Manufacturers prefer exclusive showrooms because they focus staff attention on the brand and can project an undiluted brand image to the customer. The latter reason is even more important for multi-brand carmakers. If Toyota Motor Corporation invests millions in product development and advertising to make the Lexus customer experience feel distinct and separate from Toyota, why not support that effort by making the dealers look and feel different too? The same is true for Ford's Jaguar and Volvo brands.



BER is designed to remove barriers to multi-franchising in Europe. US franchise laws have long given dealers great freedom to take on additional franchises. Those US franchises that have held on to higher rates of exclusivity have done so though economic persuasion. This will be increasingly the case in Europe too.

## THE COST OF EXCLUSIVITY

---

Building a new exclusive dealership is expensive, typically costing in the region of £3 million to £5million. Such investment by a dealer requires an adequate return. This can only be generated by profits which in turn depend heavily on dealer sales volumes.

The minimum volume thresholds for viable exclusive dealerships continue to move upwards as costs rise. Some of these cost increases are the result of the manufacturers raising their own franchise standards in the escalating war of the brands. Some are from external forces, especially the rising property values and related cost factors in key metro markets.

The dealer's income is also being hit. Gross dealer margins on new cars continue to shrink and more and more of that margin is tied to achieving standards. Some new cars have a guaranteed gross margin of only 6%. This compares with typical levels of 16% or more in the recent past. In other sectors we can still find gross margins of 80% to 150% on some items of office equipment and even on some supermarket products.

After-sales income is declining too. We, along with many other experts, have long predicted that the amount of service work (and parts sales) at franchised dealer workshops would fall. Key factors affecting the dealer's main 1 to 3 year service market, are longer service intervals and diminishing work. Now there is research



evidence of the actual decline in service work at UK dealers<sup>3</sup>. No wonder many dealers struggle to beat 1.5% net return on sales.

Across the EU, the average franchised dealer sales outlet sold 208<sup>4</sup> new cars in 2003. This is the number when we count every sales point within each franchise (including sub-dealers) as a separate outlet. If we could accurately derive a net figure for physical outlets when multi-franchising is taken into account, the total per outlet would rise slightly (multi-franchised outlets are more common among smaller brands and smaller markets, so the increase would not be large). On the other hand, the average sales calculation uses the total sales for the brand in the market. Subtract the fleet, employee and other sales that usually bypass the dealer and the average goes down.

<b>Average Sales per Dealer* 2003</b>	
<b>EU</b>	<b>208</b>
<b>USA</b>	<b>393</b>
* per franchise point – net totals for multi-franchised dealerships would nudge the EU total slightly higher (USA = 753).	

Sticking with our simple total, the average sales per outlet has been going up, partly due to market recovery since the dip in the early 1990s, partly because some makes have been scaling back their sales networks. However, the EU average is only 53% of the equivalent US average of 393<sup>5</sup>.

All Makes	Average Dealer Sales per Contract 2003	Ratio: sales outlets per sales contract 2003	All Makes	Average Dealer Sales per Contract 2003	Ratio: sales outlets per sales contract 2003
Italy	600	1.75	Czech Republic	194	1.28
UK	556	1.19	Finland	189	1.26
Spain	498	2.14	Slovenia	172	1.16
France	416	2.64	Sweden	167	1.27
Turkey	355	1.47	Romania	129	1.34
Poland	352	1.31	Latvia	126	1.06
Germany	289	1.78	Denmark	125	1.20
Hungary	280	1.23	Estonia	121	1.17
Belgium Luxembourg	271	1.69	Switzerland	109	1.99
Netherlands	268	1.52	Serbia Montenegro	90	1.17
Portugal	252	2.06	Norway	79	1.10
Croatia	222	1.43	Lithuania	74	0.77
Greece	214	1.23	Bulgaria	49	1.18
Slovakia	200	1.13	Bosnia Herzegovina	46	1.20
Austria	196	1.63	Macedonia	45	1.28
Ireland	194	0.96	Albania	12	1.00

Across the EU dealer densities vary, whether measured against the population or against geographic area size. Unsurprisingly, average dealer throughputs also vary by enormously market. Italy, for example, has twice the average throughput of Germany and nearly six times that of Switzerland.



Multi-franchising is more common in the smaller markets, where it is harder to sustain a national network on the basis of the volumes available to a single franchise. This means that the variances between markets in actual throughput per physical dealership are narrower than the table suggests.

The higher levels of multi-franchising in the US boost the average total of new light vehicle sales per dealership. In 2003, the US market totalled 16.65 million units, sold through 22,119 dealerships, giving an average dealership throughput of 753 units<sup>6</sup>. There is no directly comparable figure for Europe, but the average sales per main dealer contract<sup>7</sup> in 2003 was only 341.

## FUTURE MANUFACTURER STRATEGIES

---

Some manufacturers may come to reflect that they over-egged the pudding in the last round of standards definitions, to the point that they have added unnecessary cost to many dealer operations. Manufacturers are under intense competitive pressure to cut their own distribution costs, so they are unlikely to raise margins, though they may give dealers financial support in other ways.

The minimum sales volume for a viable solus dealership is likely to continue to rise, for the reasons mentioned earlier. If a franchise does not deliver the appropriate volume potential, then dealers will either leave the franchise or look to go the multi-franchise route.

Few franchises can expect to significantly increase average dealer volumes through sales growth in Europe's mature markets. Brand exclusivity may therefore require even further consolidation of sales networks into fewer, larger dealer operations. The new regulation forced the split of sales and service contracts. In 2004, there were already 1.53 service contracts for every sales contract in Western Europe (71% of dealers have both sales and service contracts, down from 76% in 2002). So we could expect that more consolidation of sales networks would not necessarily impact on service coverage.

If the major manufacturers are successful in their strategy, we will have a European landscape consisting mostly of fewer, larger brand-exclusive showrooms. There will be some multi-franchising - smaller brands have already generally accepted multi-franchising as a necessity, though they prefer to co-habit with other smaller brands.

This scenario may fit well with trends in consumer behaviour. New car buyers are now doing much more pre-shopping research on the internet and many will be prepared to travel further to buy at a dealer.

However, there is a risk that dealer costs are rising faster than profits. Manufacturers, for their part, will have to pay more attention to the impact of their franchise policies on dealers.



## THE RISE OF DEALER GROUPS

---

The new freedoms allowed under Block Exemption favour the expansion of dealer groups at the expense of smaller dealers. So far, UK-style 'financial groups' have hardly impacted continental Europe. This may change. Groups want to be good corporate citizens and they generally do not want multi-franchise showrooms. Manufacturers increasingly tolerate groups as franchise partners, since financial stability, the capability to run larger operations and availability of funds are valued above past loyalties and dedication.

Do existing dealer groups want to expand their investment in franchised dealerships? Dealer groups look at return on investment rather than just profitability. They want to 'work the assets'. Increasingly, this means looking at those parts of the business beyond the influence of the manufacturer. It is noticeable that the share prices of publicly quoted groups get a boost whenever the financial press reports on regulations that weaken manufacturer control over the franchise.

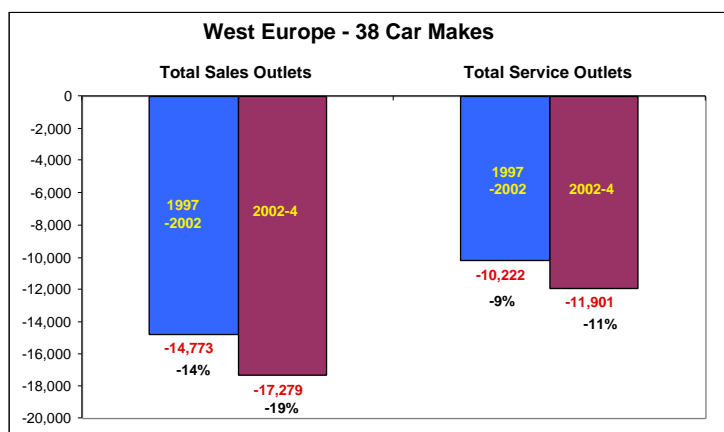
The bottom line is that European groups will lead the charge to multi-franchising if they are not getting the returns they want.

## BEYOND RATIONALISATION

---

Western Europe lost more sales outlets in the two years around Block Exemption than over the five preceding years as a result of network consolidations (see chart). Further rationalisation is likely, as the major brands try to maintain their dealers' showroom exclusivity by boosting throughput.

Nevertheless the winning brands likely will be those that give much broader consideration to the financial health of their dealers and show a willingness to critique how their own actions impact on dealer businesses.



## Notes

---

<sup>1</sup> Dealers within a network will be permitted to build additional customer delivery points, in addition to their contracted sales location, anywhere in the EU. These must conform to the relevant franchise standards.

<sup>2</sup> US data from Automotive News. Brand exclusive dealers sell only one make of new car; dualled dealers sell two or more makes. Corporate exclusives sell only makes belonging to one car company.

<sup>3</sup> Trend Tracker MFBI "Car Service and Mechanical repair 2005"

<sup>4</sup> Some makes have consolidated dealer market areas, with the result that several main dealer outlets are covered by one dealer contract. Hence the average sales per dealer contract is higher at 353.

<sup>5</sup> Passenger vehicles only

<sup>6</sup> In the US Lexus dealers are now second only to Toyota in average new vehicle sales per dealer. For 2004, Toyota averaged 1,464 per dealer (66% exclusive), Lexus 1384 per dealer (80% exclusive). By comparison, Chevrolet averaged 664 per dealer (52% exclusive), Cadillac 157 per dealer (15% exclusive), Mercedes 676 per dealer (47% exclusive). Source: Automotive News, new car & light truck sales.

<sup>7</sup>16 markets

