

# Resilient dealer model endures despite industry's disruptive forces



Glenn Mercer has long been at the forefront of predicting dealership viability and vitality.

An independent automotive researcher and industry futurist, Mercer authors an annual report forecasting the future of the dealership and assessing risks to the traditional franchised model. He has more

than 35 years of automotive experience, participating in hundreds of client studies. In addition to project work for investment firms, he has advised the National Automobile Dealers Association and other industry entities such as the National Auto Auction Association. He has been an expert witness in auto-related legal cases and has lectured on automotive economics at universities.

Prior to beginning his automotive career at McKinsey, Mercer worked at the Central Intelligence Agency and then at BP. He has been president of the Society of Automotive Analysts and director of the International Motor Vehicle Program, a research consortium founded to analyze the global auto industry.

Mercer recently spoke with Jason Stein, Presidio managing director, on Presidio's Full Throttle podcast about industry disruption, the direct-to-consumer model and the future of auto retailing.

Here are edited excerpts of their conversation:

## **What are the disruptive factors you see for the dealership model?**

Time after time various knights on horseback have charged the castle gates of the dealership system in the United States. And the castle seems to be fairly well intact. We've seen at least six runs at the castle as people circling it say, "How do we get a share of this revenue and profit?"

We had attempts by both Ford and General Motors. Ford

went further than GM did. GM pulled back before they really launched. The lesson learned there is that company-owned stores by the OEMs are very difficult to make very profitable for a bunch of reasons.

Then we had Wayne Huizenga and the public chains. AutoNation and the publicly owned chains would have the scale and the skills to wipe out private dealerships. And while the six of them have survived and thrived, [they represent] 10% of the industry. So that wave receded.

Then we had Tesla and direct to customer and others who have followed. They work in certain situations. Mostly for higher-priced vehicles where demand exceeds supply. And frankly when demand exceeds supply, you can sell any way you want. So it's not impossible, but it's an exception as opposed to a role model.

Then the most recent run at things has been agency, which is the halfway house between direct to customer and franchise dealership. And if one's cynical about it, one would say during the chip shortage and the pandemic OEMs were trying to figure out a way to grab some of that margin, understandably. But again, the appetite for it cools as demand shrinks below supply.

This just comes back to the incredible resiliency of the dealership model. First, it's the right model. You want distributed inventories owned by people who are highly motivated to get them sold. That's why we have dealerships in a nutshell. And then secondly, it is a system that is extremely adaptable and flexible.

## **You've talked about what the future dealership would look like and once gave a prognosis for that for 2025. What did you get right? What did you get wrong?**

I think I was right that autonomous vehicles were a long way off and we would not be all in robotaxis by 2020. I think I got right that ride hail would not be a threat to personal ownership. Electric vehicles were not really on the map at that point in time. So I'm not sure I had a huge prediction,

but if I did, it was probably wrong and didn't see just how big the regulatory push would be in that direction.

I think I underestimated just how much more [finance and insurance income] per new unit retail we could get to by professionalizing F&I, by cleaning it up with better products, menu selling.

**Dealers responding to Presidio's surveys have consistently said direct sales and the agency model present some of the biggest risks to the traditional franchise dealer model in the long term. What do you see as the real risks for dealers presented by direct sales and agency models in America?**

I'm more neutral on agency. That is, I can see the deal. You don't get margin, you get a commission, but we take off your balance sheet all the inventory and you're no longer responsible for setting the price. Direct to customer, I don't see as having much of a future in the mass market because I think it's the wrong system. The trouble with direct to customer is that once supply gets to be greater than demand, direct to customer backs up with unsold product. And the only way to get rid of it is to cut price. So if Tesla's got 100 cars they need to sell and they've got demand for 90, just [to] move the last 10, they cut price, but it's on all 100. And we've seen that it has devastated their margins. Whereas with a dealership network, the dealer essentially

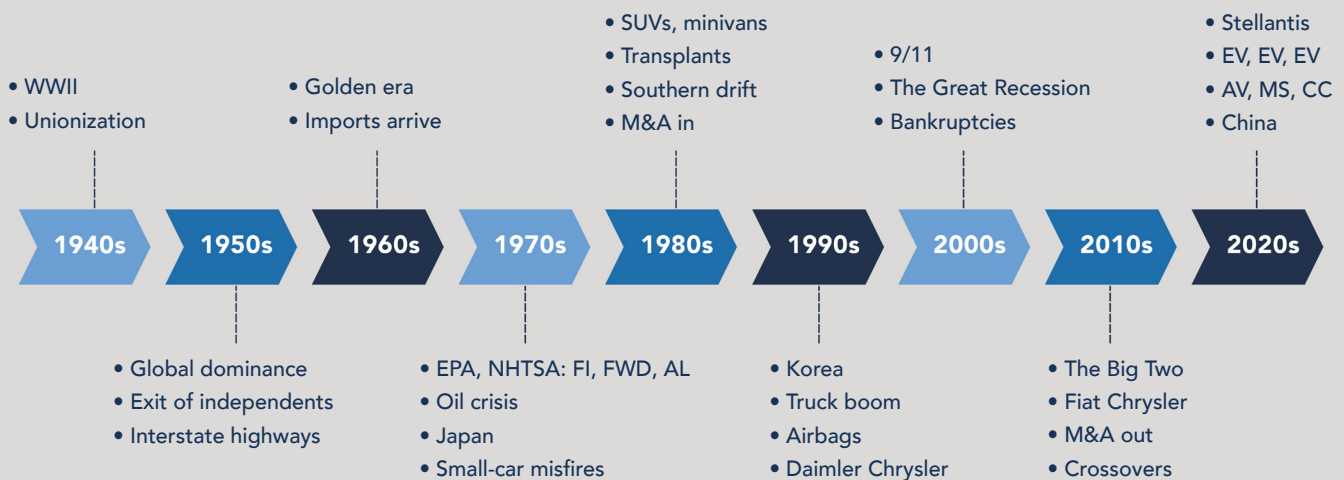
is like that sorting hat in Harry Potter: This customer needs an over allowance on the trade-in; this customer needs to switch to a different trim level; this customer will buy if we throw in the floor mats; and this customer needs a different financing source. Dealers get the deal done. It's in their name. And because it's an expensive thing to buy and it's almost always a complex purchase, I think the dealer system is just superior to direct in an environment where there's supply piling up at the factory and we've got to move it.

**So what are the existential threats then as you see it?**

At the risk of being the person who says I don't think this is an existential threat just before the asteroid hits his house, I am not sure I can see an existential threat to the dealership system. I can see it being less profitable in the future, but if we just talk about America, we're mobile. We're not stopping driving. We're still inching upward in cars per household, even though we've got more cars than we've got driver's licenses.

We're not all going to just move into urban high-rises and not move around anymore. So we've got a demand for mobility, and over and over again, it's been shown when people have the ability, that have the money, they don't want to share. They don't want to carpool. They do not want to ride on mass transit. They want their own car. So we've still got our own car. Demand goes up and down,

**Glenn Mercer's bias regarding change: It's *always* been like this**



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— Auto industry analyst and consultant Glenn Mercer

but the dealership system buffers it.

I’ll say the one thing that no dealer and no OEM will ever say: The dealership system is good at selling cars that people don’t really want. Every once in a while, a car company will make a car that is not exactly desirable and somebody has got to move it, and in a direct-to-customer environment, it doesn’t move unless you just slash price into disastrous levels. So I think the system stays intact, at least for the rest of my lifetime.

**As you consider other existential threats, what’s your view of Chinese EV makers? Could they change the industry and the dealer model in America?**

Yes, they could change the industry, and yes, they could change the dealer model. Impact, of course, is they’re the people to accelerate the EV transition, which right now is sort of bumping along in a kind of a plateau in America. But cheap cars that go 600 miles or whatever and are pretty high quality — that changes the game.

That being said, nothing unites Democrats and Republicans more. They don’t like China, and so we have this tariff wall. [To] people who say, “Yeah, well, tariff walls are permeable,” I point them to the chicken tax of 1964, which is still on the books and still protecting our pickup trucks. But where do we go past the politics? I wrote a letter to Automotive News recently, [which] they published, saying when the Japanese showed up, we had this existential

crisis, and we did some quotas and things. And then we figured out a new level of coexistence.

Did the Big Three lose market share? Yes. But we survived. The Koreans showed up. Same thing. BYD might sign up with somebody who provides them diplomatic cover. And then they eventually built a plant here. Will the domestics like this? No, they won’t, but we’ll get by and survive. Will they use dealers? Well, if I were a money-losing EV maker in China desperate to sell in the United States, and I was facing a \$100 million, \$200 million homologation bill and legislative pushback, wouldn’t I want to use a ready-made distribution system that already exists? Or do I want to spend another \$100 million and develop my own? I think if they’re rational, they will mostly use dealers.

#### **Presidio’s take**

As Glenn Mercer articulates, disruptive factors are nothing new to the franchise dealership model. The castle gates, to use his analogy, are still very much intact. The model is resilient, adaptable and invariably finds a way to win. But with more headwinds and change in the works than ever before, dealers must continue to evolve, implementing new technologies and processes to improve efficiency and the customer experience and making sure their store portfolios are sized and aligned by brand and geography for success.



## **The Automotive Industry is Evolving More Rapidly than Any Time In Its History**

The professionals at Presidio are here to help our clients navigate through these times.