CARS 21
Submission by the International Car Distribution Programme (ICDP)

CARS 21 has the laudable objectives of strengthening competitiveness, promoting road safety and improving the environmental impacts of the sector. It rightly aims for an integrated strategy to optimise the role played by regulation, and thereby to foster an improvement in innovation.

However, it will not be possible to achieve these objectives without taking account of the critical role of vehicle distribution, in the broad sense of the word, encompassing new and used vehicle supply and selling, service, repair and parts, as well as the whole range of ancillary services such as finance. Distribution makes a major contribution to the overall value added in the industry, accounting for 20% of the value of a new car[1] (and a much larger proportion of lifetime value). Being at the interface with the consumer, the distribution function is the visible front end of the industry, and is what the consumer experiences whether buying a vehicle or having it serviced or repaired. It therefore has a prime role in determining whether the outcome of the experience is satisfactory for the customer. Distribution is also a significant economic activity in its own right, encompassing 350,000 businesses and 2.5 million employees across the EU.

The vehicle distribution sector has been the target of successive and specific regulatory interventions by DG Competition, with the aim of improving competition to the benefit of consumers. So far, these regulations have generated significant compliance costs for all players, particularly for those within the franchised parts of the sector, without clear evidence of equivalent benefits for consumers having resulted.

It is, of course, at least as important to be competitive in services as in the production of goods. Vehicle manufacturing has already been subject to dramatic efforts to improve quality and to cut costs, and the equivalent breakthrough has yet to occur for distribution.

[1] For more information, see "*How to cut the cost of distribution?*", ICDP Management Briefing No.24, by John Whiteman, October 2004

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The ingredients of improved effectiveness and competitiveness have been identified by ICDP's research over the last decade[2]:

- Measurement is the starting point, moving from a narrow focus on financial indicators plus reliance upon the subjective sampling of 'customer satisfaction' to a more rigorous assessment of quality, delivery and cost, as now occurs as a matter of course in manufacturing, as well as in more advanced retail sectors
- Supply chain reform is a necessary enabler of improved service performance
    - New vehicle ordering and supply, including the removal of finished vehicle stocks from the dealership and their replacement with an open order pipeline fed from distribution centres or directly by the factory
    - Parts stocking and logistics, including centralised stock control, shorter order to delivery lead-times and a revised physical distribution structure based on the use of Local Distribution Centres
- Process effectiveness through the chain then underpins all these reforms, developing ground-up methodologies which cut costs at the same time as improving the value delivered to customers.

The vehicle distribution sector should form a module of study for CARS 21 if it is to fulfil its brief in a meaningful and complete manner.

John Whiteman and Andrew Tongue

The International Car Distribution Programme is a collaborative research programme into all aspects of car distribution, including the supply and retailing of new and used cars, after sales, network structures and operations. It has been conducting independent investigations since 1992.[3] It is funded by participants from car makers, dealers, car industry suppliers, representative bodies and governments. ICDP does not represent any of its members or their individual policy views.

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2 For details of ICDP's research findings, see "*Fulfilling the promise: what future for franchised car distribution*", The ICDP Review, edited by John Whiteman, Dr Andrew Tongue and Professor Dan Jones, January 2001 and "*Progress on the road to Customer Fulfilment*", ICDP Research 2000-2003, edited by Dr Andrew Tongue, John Whiteman and Professor Dan Jones, September 2003

3 For details of ICDP's research over the past decade, see "*Car distribution: answering the big questions*", ICDP Management Briefing No.22, by Dr Andrew Tongue and John Whiteman, May 2004

MANAGEMENT BRIEFING NO. 22

Car Distribution: Answering the Big Questions

By Andrew Tongue and John Whiteman

EXECUTIVE SUMMARY

ICDP recently celebrated its 10th anniversary; a decade has passed since the inaugural pan-European research programme set out to assess the performance of and future prospects for the car distribution sector, and to show where and how improvements could be made to the structure and operation of franchised networks.

Over this time, a great deal has changed in the competitive environment for selling and servicing cars, but many of the major strategic issues and challenges that could be identified in 1994 still face the industry today.

This Briefing reviews some of the major lessons that have emerged over the course of the programme and considers how the area of distribution chain structures will become a key strategic challenge, and research focus, over the next decade.

At our recent Spring Meeting, held in the delightful surroundings of the Hotel Bauer in Venice[1], the theme for our presentations and discussions was "*Creating a More Effective System: Visions of Car Distribution in 2015*". Much of the agenda was given over to an exploration of the likely evolution of car distribution and of franchised dealer networks in particular, over the course of the decade ahead. Alongside this, we spent some time reviewing the key lessons which have emerged over the first decade of ICDP's operation, and were fortunate be able to welcome back Founder Director Malcolm Harbour MEP, taking some time out from his Brussels schedule to reflect on the early days of the programme, and on the questions which inspired the initial phases of research. Many of these questions remain valid today, and some of them remain unanswered.

[1] ICDP Spring Meeting 2004, Wednesday 24th to Thursday 25th March, Hotel Bauer, Venice – presentations and a meeting record are available from the Members' section of www.icdp.net.

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SUPPLY CHAIN IMPROVEMENT

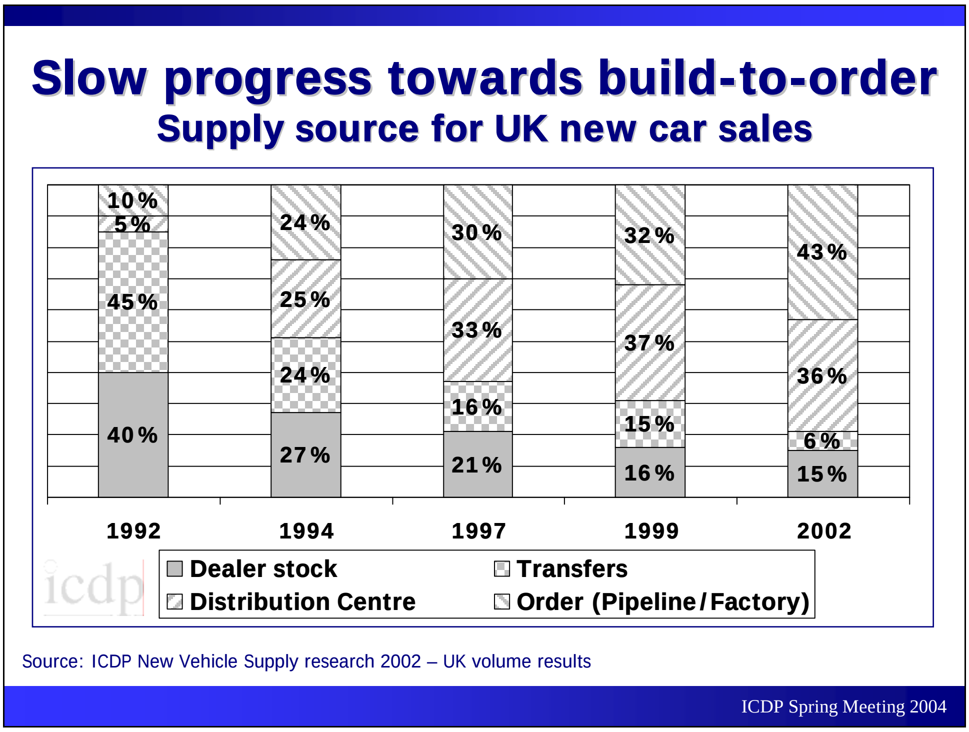
Reform of the whole supply chain, whether in new or used vehicles, or spare parts distribution, has been the central focus of ICDP since the start of the initial pilot programme in 1992 and then the full pan-European programme in 1994. In the production environment in the early 1990s, for cars as for many other sectors, the emerging understanding and codification of the 'Lean Production' paradigm as embodied in the Toyota Production System[2] caused a radical rethink of factory processes and organisational structures, and allowed its adopters to realise significant efficiency, productivity and quality gains that are being enjoyed and built on to this day. Wherever possible, both surplus inventory amassed and products assembled according to long-term forecasts were replaced by 'just-in-time' supply and build-to-order production triggered by actual demand, and processes were adapted along 'kaizen' or continuous improvement principles to deliver the product or service right first time, every time, to the next stage in the chain.

Improvements in production served to throw the critical spotlight onto the whole post-factory area of retailing and distribution; what was the point in improving the efficiency of assembly if the finished product then piled up outside in a sub-optimised distribution chain? Surely the same 'lean' principles could be applied downstream of the factory gate, replacing the 'push' of stocks of vehicles from factory to storage compound to dealer lot with the 'pull' of actual customer demand? This was very much the starting point for ICDP, picking up on the body of knowledge acquired by the Massachusetts Institute of Technology-led International Motor Vehicle Program[3] and seeking to transfer it to the distribution environment.

10 years on, achieving supply chain reform remains the fundamental challenge facing the sector in Europe. Partly as a result of the work conducted by ICDP and its sister 3DayCar programme in identifying the steps towards a 'leaner' and ultimately a build-to-order approach to selling and distributing cars, all brands across Europe have embarked upon numerous programmes of reform to improve the efficiency of their physical distribution operations, with the result that over 50% of manufacturers now have the basic capability to supply a car to a customer order within 14 days.

The issues surrounding how new vehicle supply should be reformed, including the removal of finished vehicle stock from the dealership and its replacement with an open order pipeline fed from distribution centres or directly by the factory, are now well-known and accepted by the industry. The negative effects on the whole sales and service chain of the 'stock push' distribution mode, in terms of culture, customer relations and profitability are also increasingly appreciated. However, in practice, the harsh realities of the marketplace mean that, for many brands, the supply chain is not operated to its full capability in terms of efficiency and effectiveness; when times are tough, the tactic of pushing finished vehicles into the market is a familiar, easy fall-back. ICDP's regular benchmarking activities over the past 10 years show the gradual overall progress the industry has made, in the UK in the following example, towards the goal of increased build-to-order. In the other major markets, progress has been slower.

[2] See *The Machine that Changed the World* by Womack, Jones and Roos, Rawson Associates, 1990.
[3] For more details about IMVP, see http://web.mit.edu/org/c/ctpid/www/imvp/



In the area of after-sales and spare parts supply, similar challenges in reforming system operation are still facing the industry 10 years after ICDP first started. Uncertainties over the size and shape of future after-sales demand remain, as continued improvements in overall vehicle quality, reliability and durability are offset by the introduction of new technologies, particularly electronics-based componentry, plus an increasing producer responsibility towards end-of-life vehicles. In spare parts, efforts to improve system performance have struggled against a rapid proliferation of model ranges bringing with it an increase in the number of parts lines that need to be handled.

ICDP's work in after-sales has concentrated on applying the principles of 'lean distribution' on two fronts, reforming parts supply and improving workshop processes. In the former, the benefits of centralised stock control, shorter order to delivery lead-times and a revised physical distribution structure based on the use of Local Distribution Centres (LDCs) have been demonstrated through a number of benchmarking and simulation exercises; current research is exploring the growing implementation of these ideas across the industry. In the latter, the pilot application of a number of process improvement tools and techniques has highlighted how dealerships and independent garages can initiate programmes of change that will cut costs at the same time as improving the value delivered to customers, critically by increasing the pre-diagnosis of incoming service and repair jobs. Industry adoption of these ideas has been slow so far, although isolated examples are progressing strongly. It is a disappointment that our efforts in selling this concept to the industry have not had more effect.

In the used car field, the dynamics of the marketplace, and particularly the increasing phenomenon of the stock-driven 'nearly-new' used car in a number of European markets, have precluded the emergence of a true end-to-end model of a 'lean distribution' approach. ICDP has continued to explore and benchmark a number of areas of best practice in used cars, including the growth of more sophisticated, process-driven used car 'superstores' in the UK market, and the development of auction houses and web-based selling and trading operations in continental Europe. For much of the industry across Europe, the scope to improve the operation of the current stock-based system remains very large.

Overall, a great deal has been achieved by the car industry in the area of supply chain reform over the past decade, much of it strongly linked to the ideas exposed and researched by ICDP. Nevertheless, the true extent of progress towards the goal of a fully 'lean' approach to vehicle and parts supply varies significantly by brand and by market, for a variety of reasons. And, as we have mentioned, in many cases supply chains whose capabilities have been improved are not always operated to their full potential. Sometimes this is due to the short-term pressures of the marketplace; more often it appears to be attributable to the lack of an appropriate culture for implementing and sustaining the necessary changes to systems and processes. The whole area of the cultural challenge of moving from a stock-push to a demand-pull mode of distribution is one that has been underestimated by the industry at large, including by ICDP. More work needs to be done on applying 'lean' strategies in an ever more complicated market environment, and the prize that can be gained through supply chain reform is still out there for the industry to play for. We will continue to explore ways to help the industry tackle problems surrounding the implementation of a truly lean approach to distribution.

REFORMING DISTRIBUTION CHAIN STRUCTURES

If the steps that need to be taken in supply chain reform are now relatively well-known and accepted across the industry, there is little consensus surrounding how the structure of distribution networks should best be improved in the future. ICDP has looked at aspects of this problem from a variety of angles, without ever successfully having answered the big question itself head-on. Similarly, players within the industry regularly embark on major programmes of structural reform of their networks, but without any common, consistent track record of success to show for their efforts. To illustrate what we mean, it is worth reviewing a past piece of ICDP work.

Reviewing the *Evolved Dealer*

Using the grounding of our research into the current-day operation of car distribution to develop scenarios for the future of the industry has been a regular activity for the programme. Towards the end of ICDP's second phase of research, we produced a brief report summarising the programme's recent activities and looking ahead to 2010[4]. The report drew out two possible paths the sector might follow; the evolutionary response and revolutionary change, and then four potential channel scenarios; the *Evolved Retailer*, the *Dominant Retailer*, the *Dominant*

4 "*Future Directions for European Car Distribution: Evolution or Revolution?*", ICDP Research Report 11/98 by Malcolm Harbour with Professor Jonathan Brown, Philip Wade and the ICDP Research Team, available from the Members' section of www.icdp.net.

Manufacturer, and *Multiple Specialists*. Of these, the *Evolved Retailer* was positioned as being the likely preferred outcome for the industry, an assessment supported by the voting of our Members at the Spring Meeting in Annecy in 1998, and also the embodiment of the best practice lessons learnt during the programme so far. 6 years on from the report's publication, how well have the implicit predictions it contained stood the test of time?

"*New cars, used cars and after-sales are delivered through exclusive, independent dealers operating a marketing network over large sales territories. For new car sales, most dealers will have a major central showroom, but will have facilities for test drives and demonstrations at a prospect's home or workplace. Small local showrooms (positioned alongside service and used car sales) will be used to generate consumer interest. Late model used cars will be marketed at a 'super-site' and at dispersed locations. Financial services are strongly marketed at all new and used car sales points. After-sales facilities are dispersed throughout the territory in small, user-friendly locations with the character of a fast-fit operation. Any cars needing major repairs (which are rare) are moved to a central workshop and diagnostic facility."*

- This prediction strongly reflected the full implementation of the 'Market Area' concept that was widely discussed at the time the report was written. Several brands moved to restructure their networks to have fewer franchise holders each covering a number of amalgamated previous dealer territories. The new dealer would then deploy a main 'hub' facility offering the full range of sales and service facilities, supported by a number of 'satellite' locations providing only certain facilities as appropriate on a local basis. Whilst considerable progress was made with the concept, it has never reached its full expression as detailed in our scenario. In some cases, dealerships have been hamstrung by having to operate with existing facilities and locations unsuitable for the 'hub and spoke' format or for the enlarged territory. In others, increased franchise standards have effectively turned every outlet into a main dealer facility, limiting the scope for savings through reduced duplication of expenditure or activities. Finally, the removal of the sales-service tie in the new Block Exemption 1400/02 has ended the manufacturer's ability to stipulate that the holder of a sales franchise in one location should also operate a workshop in another location; in theory at least, the concept can no longer be mandated, it can only be implemented unilaterally by a dealer if they think it appropriate.

"Each retailer acts as a Local Distribution Centre for parts and is directly supplied from the maker's central warehouse or by suppliers based in the local market. The parts warehouse is located on a low cost industrial location within the territory and delivers parts directly to work stations in service shops."

- The scenario of Local Distribution Centre-based parts supply is, as already discussed, one that our research continues to highlight as potentially delivering major efficiency benefits to the industry. Many brands have moved strongly in this direction over the past few years, although much progress remains to be made. Again, the changes introduced in 1400/02 mean that this scenario cannot be implemented in the top-down fashion we originally predicted; manufacturers can no longer tie new vehicle and parts selling franchises together, meaning that they cannot oblige a vehicle-selling dealer to establish a parts warehouse in a specified location. The dealer can freely choose to do so, but also in a location of his own choosing. The alternative is for the manufacturer to own and operate the parts warehouse himself, or allow a third party contractor to do so.

"Distributed computer networks are used to provide management and customer information. There is a minimum of 'back office' activities at subsidiary operations. Centralised customer record and follow-up systems ensure that prospects making contact at any point of the marketing network can be captured and their transaction history recorded."

- The rapid advance of Information Technology, and particularly of web-based systems, has outstripped any predictions we or others were making 6 years ago. Customer Relationship Management (CRM) has become the label for ever more complex systems which attempt to link customer transaction data through to fulfilment mechanisms. However, beyond the hype, there are relatively few examples in the car industry of such techniques and technologies being used to their full potential, and dealer groups have been slow to centralise the 'back office' handling of customer data along the lines suggested above. In many cases, this is a result of the divergent requirements of each different franchise held, and of the continued tendency for a lot of dealer groups, particularly multi-brand groups, to be run as a collective of individual outlets rather than as an integrated business. Furthermore, tougher data protection laws are now limiting the extent to which customer data can be passed from organisation to organisation.

"The evolved dealer firms have been able to significantly increase profitability - reducing costs, lowering their asset base and improving margins. Major improvement has come from better selling processes, by car makers moving to customer pull supply systems (in parts and vehicles), and by better customer tracking through their information networks."

- 6 years on from this prediction, there is little evidence thus far of a general improvement in dealer profitability across Europe having resulted from better selling processes, pull supply systems and I.T. What gains have been achieved appear to have been offset by increases in franchise standards and changes to margin and reward structures, notably a decline in fixed payments and an increase in variable payments conditional on performing functions or meeting enhanced standards.

"The potential return on assets has attracted significant interest from external investors. Many of the new dealers have evolved from amalgamations or co-operation between long established smaller dealerships. These have, in turn, merged together to form large-scale companies, many of them floated into public ownership. Car makers have encouraged this development, realising that profitable, growing businesses can provide them with high quality, long term representation."

- Fierce competition, relatively low returns and specialised activities have all meant that the car distribution sector has not proved as attractive to outside investors as might have been expected. In some markets, an increased presence by banks and other financial institutions has occurred in recent years, although this appears to be driven by a desire to access a known customer base for financial products and also to secure a channel to market for ex-lease and other managed vehicles, rather than out of any specific attraction to running dealerships.

Small dealers have indeed continued to be swallowed up into groups over the past few years, and this phenomenon is still progressing rapidly in the continental European markets, although the attractiveness of moving into public ownership has declined in many markets alongside falling stock market confidence. Manufacturers have, however, increasingly come to terms with working with dealer groups which might hold a portfolio of different brands.

"While their contracts permit dealers to take on other franchises, most dealers have no interest in doing so, since their strongly focused businesses are easier to manage and profitable. Some car makers have moved, with dealer support, towards a much more prescriptive franchise format providing uniformity of presentation and process throughout their networks."

- An increase in franchise standards relating to presentation and process has been a major trend in the sector since 1998, and arguably has accelerated still further since the introduction of the new Block Exemption 1400/02, and not always with full dealer support. Nevertheless, the jury remains out on the ultimate effectiveness of the preoccupation with standards of all shapes and sizes currently being displayed by a number of brands, and on the extent to which standardised processes can be deployed throughout a whole network. Multi-franchising has proved a major preoccupation for regulators seeking an opening up of franchise networks, but has proved a less attractive format for dealers on the ground, partly because of the standards requirements imposed by each franchise held, and partly because of the inherent complications of running a multi-franchise site effectively. Nevertheless, the format does have its place in the right circumstances, notably in the more rural markets.

"With a much smaller number of high quality dealers, manufacturers have drastically reduced operating costs by streamlining their field force and brand promotion. The dealers handle most customer promotional activity. There are no dealer volume bonus or intrabrand competitive incentives. Many car makers have no import companies but supply dealers directly from a central European facility."

- Whilst a number of manufacturers have streamlined their field force and brand promotion activities over the past few years, there is little evidence of a drastic reduction in operating costs having resulted as new tasks have expanded to fill up the gaps. Nor is there any real sign of dealers having assumed a greater responsibility for customer promotional activity. Volume discounts, a regular topic of debate at ICDP meetings, have still not become a regular feature of the sector, although one-off deals for the disposal of surplus stock are common for a number of brands, and the new Block Exemption has removed much of the scope for discriminating between dealers within the same network in terms of rewards or incentives. Finally, as discussed in the opening section, a number of brands have taken big steps forward in the organisation of their physical distribution, including the central coordination of supply and direct delivery from the factory or distribution centre. In some cases, this has removed some of the responsibility from the national sales company or importer, although the latter still remain fulfilling their other usual functions, including brand promotion and network management. Indeed, the future role of the national-level organisation, and the opportunities for streamlining its functions to remove waste and promote efficiency are two of the major challenges facing the European industry over the years ahead.

As can be seen from this brief review, some elements of what was considered likely future best practice in 1998 have developed strongly in the meantime. Others have not, and for a variety of reasons. Many things have changed over the past 6 years, although there is no consistent pattern of improvement, and the overall picture remains remarkably similar. All this points to the need to explore and to understand more deeply the key ingredients of distribution chain reform, and to piece together those that will deliver lasting improvements in system efficiency and effectiveness.

As the traditional franchised dealer format, and the 'bundle' of activities and services that it usually encompasses comes under ever greater pressure from new competition of all shapes and sizes, from rising customer requirements and expectations, and also from the greater demands of the manufacturers themselves, the need to explore and codify the ingredients of an efficient and effective approach to network provision will become more and more critical in the years ahead. As such, it will need to form a major focus of the industry's, and ICDP's attention.

ICDP's contribution to this area so far has been the development of the Customer Fulfilment measure of system effectiveness, and the package of self-improvement tools and techniques under the heading of the 'Lean Dealer'. Customer Fulfilment, which measures the extent to which the distribution system performs a vehicle sale or a service or repair job 'right first time on time', provides an objective assessment of the value being delivered by the system from the point of view of the customer in a way not usually possible under traditional Customer Satisfaction measurement schemes. The results of this research have revealed not only a worrying lack of basic performance across the board in the UK, German and Italian markets surveyed, but also a raft of reasons for the lack of 'right first time on time', which themselves can be targets for improvement activity.

LOOKING TOWARDS 2015

As ICDP completes one decade of operation and looks ahead to the next, it is clear that many of the issues the programme has been researching since its inception are still very much unfinished business for the industry. Supply chain improvement has been considerable, especially in new vehicles, and increasingly so in spare parts and used vehicles, but no brand has yet reached the goal of a fully 'lean', customer-pull system. For many, the current 'hybrid' phase of operation looks set to persist for a while yet, although the scope for pushing further ahead remains as strong as ever. The challenge of reforming distribution chain structures in the face of the increasing fragmentation of products, customer types and channels is possibly the most important one facing the sector over the coming decade.

Hard questions will need to be asked about the future of the traditional 'bundled' franchise dealer format, the role of the national sales company, the merits of standards and process improvement programmes, the use of performance measurement and reward schemes, and there are unlikely to be easy, 'one size fits all' answers. In our research, we are exploring distribution in a number of ways:

- We are starting from the concept of how performance and effectiveness should be approached
- We have charted the development of dealer groups, and will monitor their progress and strategies
- We are exploring the impact of changing regulation on the structure of the industry, and the response of players to that regulation
- We continue to identify progress and pitfalls in the reform of supply chains for new cars, parts and used cars.

We would welcome other ideas for future research topics.

ICDP AND THE CAR DISTRIBUTION INDUSTRY

The International Car Distribution Programme (ICDP) is a collaborative research programme into all aspects of the car distribution system – new and used car supply and retailing and ancillaries as well as parts, service and repair. It is an independent project run by industry experts and academics, funded by participants from carmakers, dealers, car industry suppliers, representative bodies and governments.

ICDP is a research body. It does not represent any of its members or their individual policy views.

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MANAGEMENT BRIEFING NO. 24

How to Cut the Cost of Distribution?

By John Whiteman

EXECUTIVE SUMMARY

The overall cost of car distribution is widely regarded as being too high. It is generally estimated at 30% of the retail list price of a car. This figure is often wrongly compared just with the margin added at the retail level for other products – for cars this cost is only around 5% of the total car price, which is low compared with virtually all other sectors.

This briefing assembles an approximate breakdown of the total cost of new car distribution. It splits this cost by stage of distribution, from manufacturer's head office, through the national importer or sales company, to the dealer. It also analyses the major ingredients of the 30%, one of the largest being discounts and incentives to customers; these should more accurately be deducted from the price rather than regarded as a cost of distribution. The other main elements are what is termed here the cost of customer capture, i.e. everything that is involved in persuading the customer to decide to purchase a new car, and the cost of customer fulfilment, i.e. what follows all the way from the order being placed to it being delivered to the customer.

As this briefing shows, for each of these elements there is proven scope both to reduce the cost and to increase the value or quality of service delivered to the customer. Reform of the vehicle supply chain is the primary ingredient – albeit one that many manufacturers are addressing, with varying degrees of enthusiasm and effectiveness.

There remain areas for further investigation, particularly as regards the value created by ever increasing dealer standards, and the effectiveness of the system's selling efforts. These will be addressed in future ICDP research work with its member companies.

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INTRODUCTION

“The cost of car distribution is too high” - this seems to be a widely held view among observers of, and even players in, the car distribution sector. This perception is usually based on an estimate that the total cost of car distribution, from production line to final customer, is around 30% of the retail list price of a typical car. As with all estimates, it is only a representative average, and certainly varies by brand, by market, and over time. The estimate also reflects in part the allocation of shared costs between different activities in the manufacturer and the distribution chain

In most other sectors, the cost of distribution is taken as the mark up applied to products at the retail level, with the overall cost from factory to consumer seldom being available in the public domain; for many consumer items the retail price will in fact be several times the factory cost, implying a cost of distribution of up to 75% of the retail price. For the sale of new cars at the retail level, retained gross margins (i.e. after allowing for any discounts given to the customer) are quite modest, mostly in the range 5-10% in the major EU markets (and generally closer to the lower end of this range). As a result, new car selling is not viable as a stand-alone activity in most mature markets, and is subsidised by other elements of the dealership mix, primarily service and parts. Cross subsidy of this kind is typical in retailing for all kinds of products. However, the overall gross margin for a dealership, at between 10 and 15%, is still quite modest compared with most other kinds of retailer across different product and service categories.

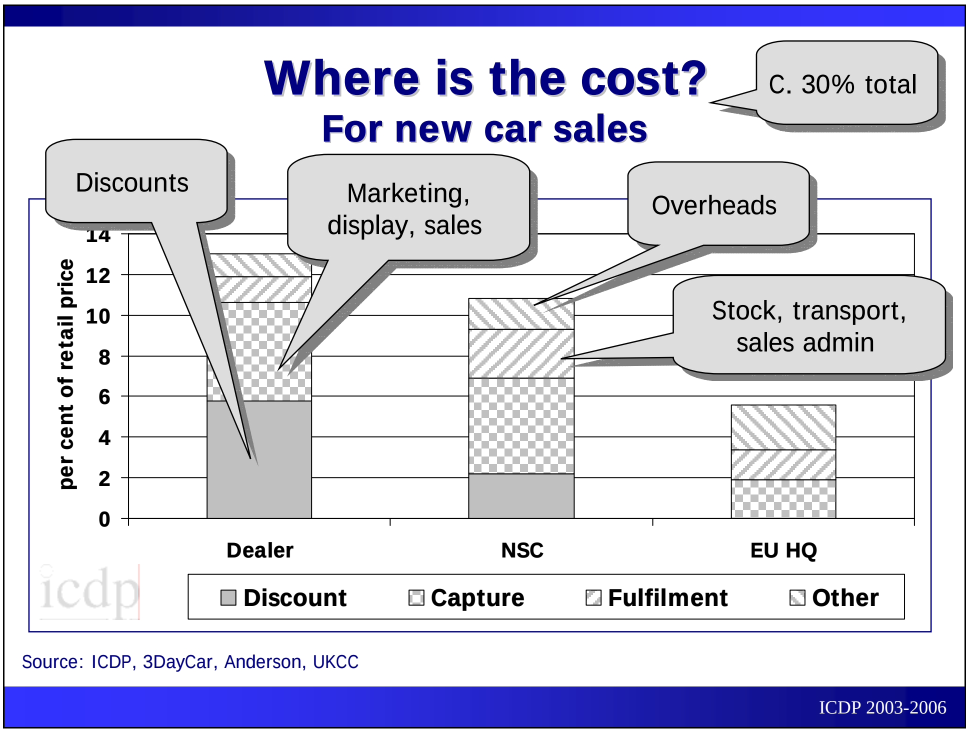
This briefing focuses on the overall cost of distribution for new cars, and examines the available evidence on ways to cut costs or improve profit in the sector. It also identifies areas for possible future research.

The estimates for the composition of the cost of distribution are taken from a wide range of sources including Andersen, the UK Competition Commission, past ICDP research, and the author’s own personal experience of car retailing and importing.

The briefing reports on one part of a wide-ranging stream of research currently being undertaken by ICDP examining the potential for improvement of efficiency and effectives of car distribution channels. The research has been discussed with individual ICDP members and in closed workshops.

THE COST OF DISTRIBUTION FOR NEW CARS

Looking at the total cost of distribution for new cars, the chart below shows the estimated make up of this cost.



It is split in two ways.

First by the three layers of distribution:

- The dealer, the normal focus for retail comparisons.
- The manufacturer's importer or national sales company (NSC).
- The (European) headquarters of the vehicle manufacturer (EU HQ).

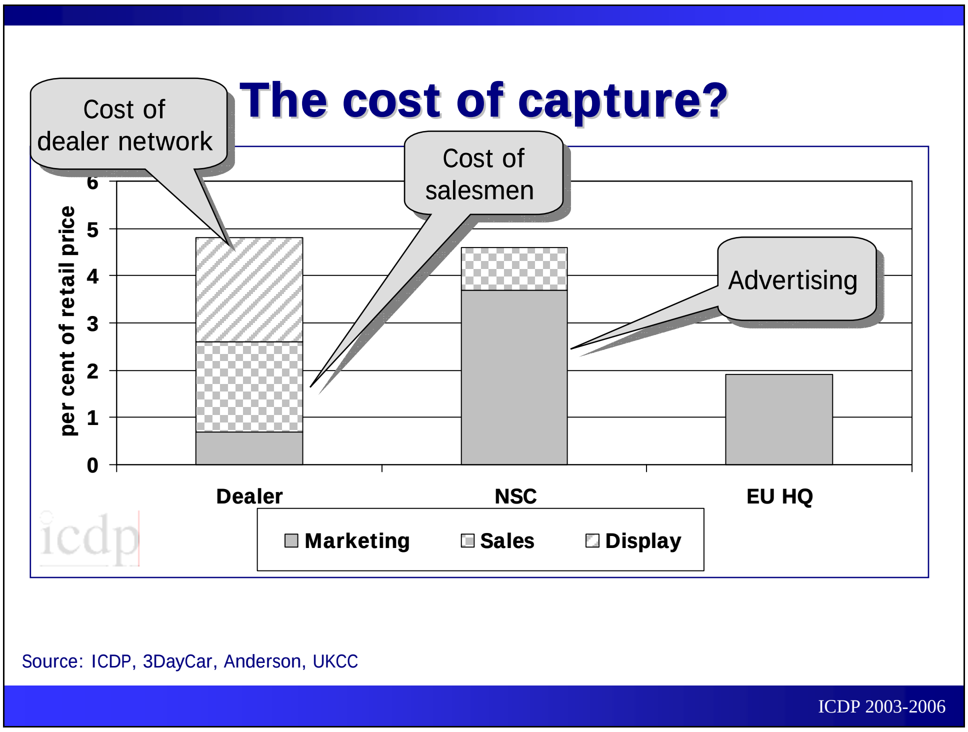
This kind of analysis is rarely undertaken for other products or services, and the retail margin is usually taken as the overall cost of distribution.

And second, by the kind of cost:

- Discount – this is the largest single element and in most product sectors would not normally be regarded as a cost, as it is the reduction against list price given to the customer, whether an individual or a fleet customer and whether in the form of part of the dealer's margin, or additional incentives funded by the manufacturer.

- Customer capture - this is everything that is involved in persuading the customer to decide to purchase a new car, including advertising and promotion, display and selling activities.
- Fulfilment services – this is what follows all the way from the order being placed to it being delivered to the customer, including sales administration, stocking and delivery costs, and physical preparation of the car for sale.
- Other – this is overheads, or costs of management of the system, including dealer network managers, accounting, and personnel management as well as the overheads of the dealership itself. These are costs not directly attributable to either customer capture or customer fulfilment.

Taking discounts as a price reduction rather than a cost of distribution, the largest ingredient of cost is what is termed in this briefing customer capture, which can be further split as in the chart below.

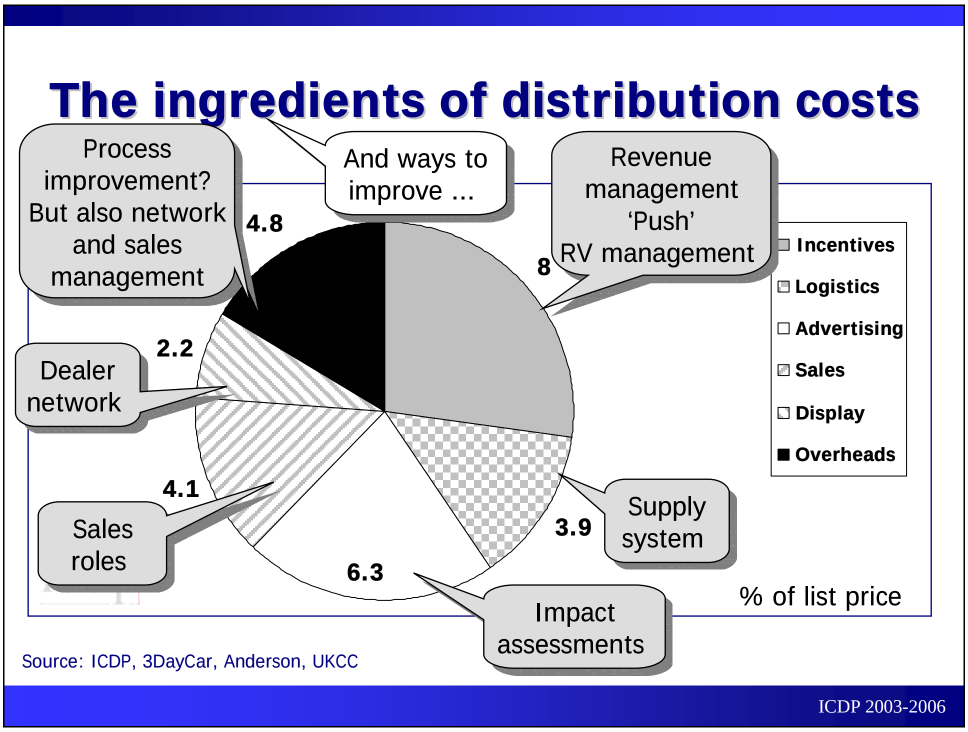


The ingredients of customer capture are:

- Advertising and promotional activities, carried out primarily by the national sales company.
- The sales force, whether employed in the dealer, and primarily focusing on sales to private customers and small businesses, or in the NSC and selling to fleets and leasing companies.
- The cost of display, principally the physical cost of creating and sustaining the dealer network; however, this is not the total cost of the network as some is attributable to after-sales activities (service and repair as well as parts distribution).

WHERE CAN SAVINGS BE MADE? AND HOW?

The next chart shows all the elements of distribution cost for new cars, regardless of where in the manufacturer to dealer chain they are incurred.



For a number of them there is quite a body of research as to how they might be reduced.

In order of size:

- Discounts and incentives, along with the cost of the stocking and supply system (together some 12% of the price of a car); extensive research by ICDP, 3DayCar, and other programmes over the last decade has shown how this cost (or opportunity for profit in the case of discounts) is strongly influenced by the character of the new car supply system that is being operated. ICDP's 2002 benchmarking has shown that the supply systems that are closest to a build-to-order approach incur lower stocking costs and suffer less from discounting[1]. There is, of course, still a need to promote total sales volume, but this is not hampered by attempts to sell customers the wrong car. ICDP research suggests that this element of cost (or loss of profit in the case of discounts) could be halved, even without moving to the utopia of a full build to order system.

[1] See ICDP Report 02/03 'Linking Supply to the Customer' by Geoff Williams and Louise Harbour, May 2003

- Advertising (6% of the price); this is not an area of expertise for ICDP, but there is a variety of techniques for monitoring the impact of advertising on awareness and purchase.
- Selling activities (4% of the price); a lot of effort is put into sales training, mainly by the NSC but also by bigger dealer groups, but to date there is little research on the strategic role of the sales force in car distribution. There has been extensive investigation of it in other sectors, and particularly as regards business-to-business activities[2].
- The Dealer network (2% of the price); reform and enhancement of the network is a constant preoccupation of manufacturers, whether through improving the structure, changing the ownership arrangements, or raising standards. Network planning is very well-developed, in the sense of determining the best locations for the different elements of a dealership. There is however no clear operating formula for a dealership or understanding of how far standards, e.g. of facilities, actually matter to customers.
- Management costs (c 5% of the price); some of these are linked to other elements, such as management of the dealer network, but it is all susceptible to the process improvement techniques, such as 'lean,'[3] which are migrating from manufacturing to service activities and are already being applied to office activities in some companies within the automotive sector.

So, while there is no single blueprint for cost measurement or reduction, and almost certainly no single right way to run a dealership, for each element of cost there are options for improving performance.

WHAT TO INVESTIGATE NEXT?

It is clear from this summary that much remains to be done to implement known concepts and practices for lowering the cost of distribution, or improving the value which the system creates for its customers.

Two main areas for further research can perhaps also be identified:

- The organisation and operation of the dealer network, particularly in the light of the new EU Block Exemption.
- Selling activities, and specifically the role of the sales force.

Linking these is the broad question of the whole interaction between dealers and NSCs in achieving effective distribution, and the role of IT systems in facilitating this joint action.

[2] See for example 'The New Challenge – Managing the Sales Organisation in a Completely New Era' by Professor Nigel Piercy, originally published in 'Market-Led Strategic Change' ed Piercy Oxford Butterworth-Neinemann 1997. An updated version of the chapter is available at www.sams.org.uk.

[3] For more information on the Lean approach to reform, refer to *"Lean Thinking: Banish Waste and Create Wealth in your Corporation"* by James Womack and Daniel Jones, Free Press Business, Simon and Shuster Ltd., 2003, or visit www.leanuk.org

The Dealer Network

As regards the operation of the dealer network, the starting point should be to consider the most basic question – why does the manufacturer have a dealer network at all? What roles is it designed to carry out? How well adapted is it to those roles? These can be distinguished into two categories of activity:

1. What has been be described in this briefing as 'customer capture', persuading the customer to commit to a purchase.
2. Provision of a whole range of fulfilment services, generally delivering what the customer has committed to buy.

Each of these is examined in turn below.

1. Customer Capture

There are a number of related functions for the dealer network in customer capture:

- Brand representation, supplementing advertising with a visible physical presence for the brand and its associated corporate identities. The awareness of potential customers is raised and reinforced as they visit or at least drive past the outlets.
- What might be described as a controlled channel to market, a way of ensuring that the product is available to customers across geographic markets. In other forms of retailing this would perhaps be described as ensuring shelf space for the brand, i.e. that the models are on display and available for potential customers to inspect.
- Post purchase reinforcement, making customers feel comfortable with their purchase because of the visible symbols of the brand. The hope is that they feel their choice is confirmed by seeing the outlets and other symbols of the brand.

These elements related to customer capture are probably the primary driver of standard setting for networks, including the style and quality of dealerships and in particular of showrooms as well as the myriad standards for customer care. Increasing competition accounts for the tendency of these standards and their cost to rise gradually. But is this aspect critical? And is it progressive, with ever higher standards leading to ever higher satisfaction? Experience and research across sectors suggests that it is more an issue of a threshold of acceptable standards (which may differ sharply by brand) beyond which the benefits of additional enhancements are not proportionate.

2. Fulfilment Services

The dealer network's role in fulfilment includes:

- Stocking, making available a physical selection of vehicles for customers to purchase, whether locally or in a regional or national stocking point; this activity is reduced in a sales system with a high level of build-to-order for new cars.
- Delivery of the car from factory to the point of sale, and carrying out the inspection and preparation of the car prior to sale.
- Provision of warranty services, as well as recall campaigns when necessary.

- Undertaking regular maintenance and repair services.
- The provision of replacement parts in support of maintenance and repair.

These fulfilment activities are probably the primary role of the network as far as the customer is concerned. In these activities avoiding dissatisfaction is likely to be the prime measure of success, by achieving consistent 'right first time on time' delivery of the activity. Once the customer's needs have been met there is again little gain from higher levels of 'service' provision. The evidence suggests however that the car selling and servicing system has plenty of scope to improve its level and consistency of basic service delivery. It is also important to remember the divergent needs and expectations of the different market segments, both as regards the range of car brand and cost, and the differing routes to use of a car, such as leasing, business cars, etc. The cost of distribution, and the role of the network in both capture and fulfilment, will differ widely between a private individual and a fleet purchase. In some markets the private retail purchaser using a dealership is no longer the largest segment, yet the primary basis for design of the network is this kind of sale.

There are a number of obvious issues in relation to design of any dealer network, including:

- How many selling/service points should there be?
- Where should they be?
- What size?
- What mix of activities should they carry out?

These are all traditional network planning issues, with a well-developed set of approaches and skills to address them, either within the manufacturer or in specialist consultancies. Applying these techniques has been made more complicated by the regulatory regime now established under 1400/02, with the weakening of territories and of the compulsory link between sales, service and parts . The intention of the regulators is that the NSC has less power to implement what their analysis shows as the ideal network configuration. In principle the initiative for network design could pass to dealer groups, especially those with a regional concentration; they may also be closest to the market and best placed to devise a viable pattern of representation. It still remains to be seen how far this intended shift of initiative will occur and over what time frame.

The appropriate ownership structure for the dealer network is much less clear cut:

- There are some traditional patterns, such as the ownership in France and Germany of major outlets by domestic manufacturers, e.g. the Niederlassungen, or Succursales.
- Otherwise there is a variety of experiments, all involving a greater degree of vertical integration, with manufacturer participation in car dealerships, including:
    - Ownership by the NSC of outlets in major cities.
    - Joint ventures or minority shareholdings in conjunction with franchise dealers and groups, or options to purchase key outlets if the dealer decides to relinquish them.

There is however no clear 'winning' formula so far, and it is quite likely that there is not a single formula applying across brands and markets.

Selling Activities

As regards questions about selling activities, and in particular the strategic role of the sales force, there are unresolved issues at a number of levels for the car industry:

- Effectiveness at the basic transaction level:
    - The sales force is a significant element of distribution costs, and many sales executives are well paid, but it is not clear whether the effort and effectiveness is proportionate to the rewards. 'Many car salesmen are paid quite a lot for doing remarkably little' according to a specialist dealer group CEO with previous experience in non-automotive retailing.
- How to re-orientate the sales force towards a (customer) life-time management role?
    - It would seem to be the avowed aim of every commercial organisation to move away from a series of unconnected transactions towards developing a relationship with each customer. However the organisation and reward structure for the sales force is largely if not entirely based on each individual transaction. Research in other sectors shows that this re-orientation is as much about the type and style of sales management as about measures and rewards as well as systems[4].
- How to adapt to a multi-channel customer access?
    - It is now not unusual for a customer to use several different means of access to the selling system while considering a purchase – the internet and help-lines being obvious first points of contact. But again the means of reward for the salesman assumes that the person completing the transaction has sole responsibility for making it happen.

CONCLUSIONS – SCOPE TO IMPROVE

The conclusion from this brief overview of the work by ICDP and others on the cost and value of car distribution is that, by any relative or absolute standard, the cost of car distribution is not high, even when allowance is made for the cross-subsidy usually received from after sales.

Paradoxically, this does not mean that it does not warrant critical attention. There is proven scope both to reduce the cost and to increase the value or quality of service delivered to the customer. Reform of the vehicle supply chain is the primary ingredient – albeit one that many manufacturers are addressing, with varying degrees of enthusiasm and effectiveness.

There remain areas for further investigation, particularly as regards the value created by ever increasing dealer standards, and the effectiveness of the system's selling efforts. These will be addressed in future ICDP research work with its member companies.

[4] See footnote 2 above

ICDP AND THE CAR DISTRIBUTION INDUSTRY

The International Car Distribution Programme (ICDP) is a collaborative research programme into all aspects of the car distribution system – new and used car supply and retailing and ancillaries as well as parts, service and repair. It is an independent project run by industry experts and academics, funded by participants from carmakers, dealers, car industry suppliers, representative bodies and governments.

ICDP is a research body. It does not represent any of its members or their individual policy views.

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