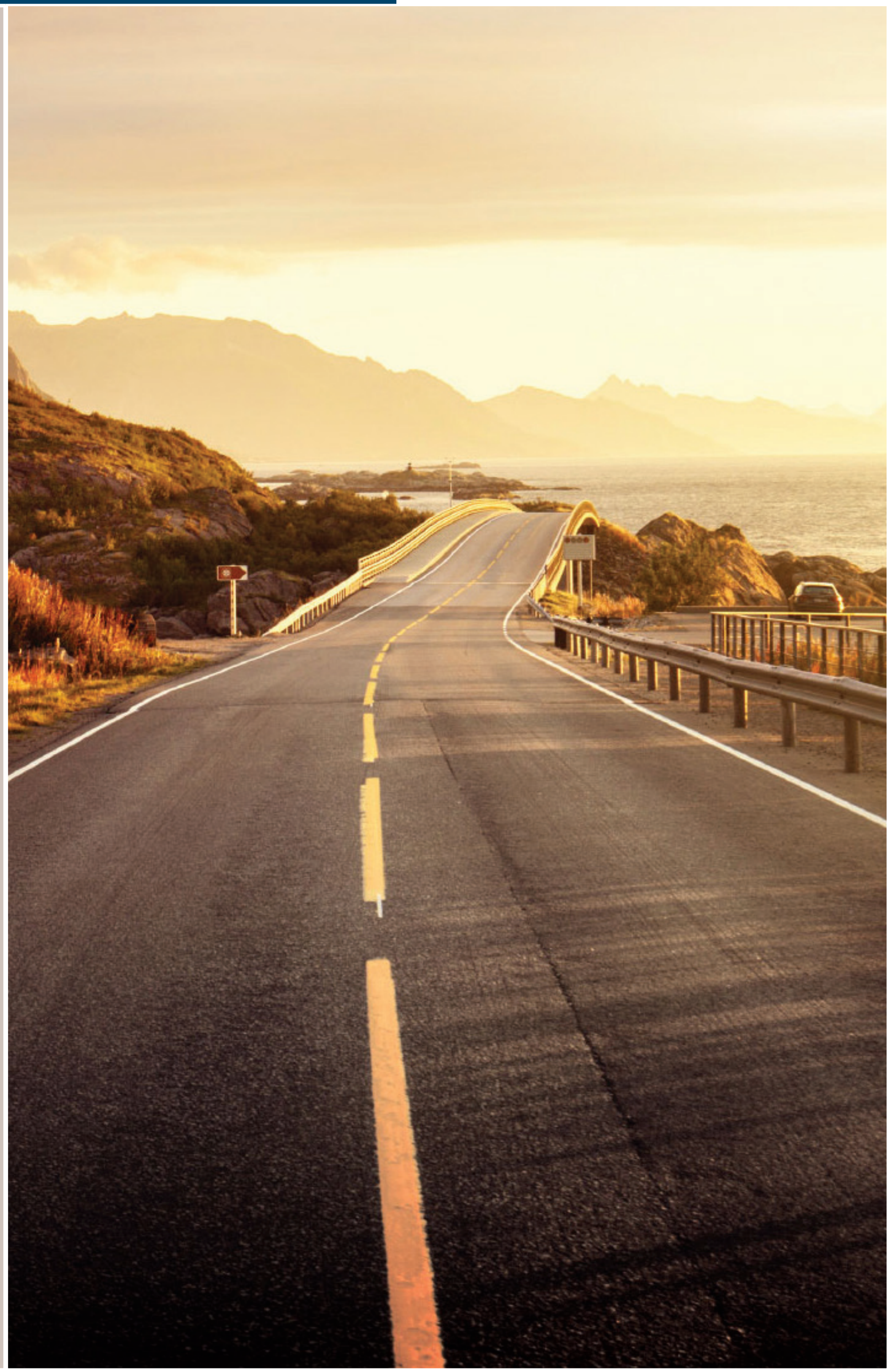
2030 Dealership Vision: The Road Forward!

AutoTeamAmerica



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Introduction

In 2011, Auto Team America member firms first sat down to look at the trends, developments and key ideas that might shape retail automotive in the next decade and beyond. The intention was to examine how fluctuations in our business would give rise to challenges, shifts and opportunities that dealer owners and managers should consider to better plan for their long-term goals. However, in 2011, Tesla had only sold a few thousand vehicles, Uber had a few hundred drivers in five cities, and autonomous vehicles were more the activity of DARPA than Google.

How these influences, along with other trends, will impact the future of the retail automotive industry remain to be seen. There are champions and detractors for every possible development that will impact retail automotive. For some, evolution is inevitable but for others change is more imaginary than realistic. To address both camps, this white paper will explore the impact on dealerships if every transformation becomes fully realized, followed by a prediction of likely outcomes.

Once we move past the big ideas, we will then direct our attention to a discussion of the forces that may change the model dealership in 2030. What might they look like, how will they make money, and what could be the challenges they need to overcome?

A brief note before we begin about the limitations of this paper. While outside influences of the general economy, interest rates, unemployment and related macro-economic issues will certainly impact dealership operations, those items are beyond the scope of this paper. Instead, we wanted to concentrate on retail dealership operations as they continue to evolve and to address the opportunities and challenges that lie ahead.

THE BIG DISRUPTORS

Three notions of the future that if they occur would dramatically alter the face of automotive retailing.

FRANCHISE LAWS WILL BE REPEALED

To dealers, Tesla Motors has never been about an innovative electric vehicle; it has been about the end of the franchise system. While an uneasy state has existed for the past two years, it is clear that the final battle has not been fought. If one were to follow the Tesla sales model to its conclusion, it appears clear that the future of independent automotive retailers is in peril. Calls to allow manufacturers to sell directly to the public as a consumer benefit have been touted by research papers claiming that the franchise system adds five to ten percent to the price of a vehicle. Opening the door, even the crack that has been granted in some states, may allow Tesla to demonstrate that factory-direct sales models can work and that it is something that consumers desire.

The entirety of the franchise system also rests with the responsibilities of the 50 state legislative bodies that have written and passed stronger franchise laws in recent years. This legislative strength has been possible for dealerships as they consisted mostly of local hometown employers with a strong presence in the community, collecting billions of dollars in sales tax, and employing thousands of state residents. If consolidation continues, where there are fewer dealership owners (owning more locations) or large private equity, family offices and public corporations acquiring more of the dealership population, state legislative support could fade with the diminishing number of business owners.

It does not take much research to find someone, somewhere claiming that the franchise system is a dinosaur that had its purpose and day in the sun, but the sun has set. If that were to occur, some believe the manufacturers will decide in each individual situation what would best suit their needs for a distribution system. Most, it is argued, would opt for a combination of factory-owned and independent retailers, leaving some room for the local business owner to continue as in the past.

Auto Team America understands the varied perceptions of the franchise system, but fails to find an economic argument for ending the current distribution system. The demise of the franchise system would occur if there was a wide ranging Federal Court action to strike down certain aspects of state franchise laws, but that seems unlikely.

Tesla's needs aside, most legislatures recognize that Tesla is not representative of the luxury vehicle market, let alone

the entire retail automotive industry. Tesla's argument that it needs specialized trained employees to sell its vehicles flies in the face of simple evidence such as the Chevrolet Volt, which began outselling the Model S in the last quarter of 2016. In fact, of the approximate 160,000 electric vehicles sold in 2016, only about 47,000 were Teslas.

The idea that every vehicle requires a "gallery" sales experience does not make sense for the vast portion of our population that is not in metropolitan areas. Yes, there is a big difference in the consumer experience between an Apple store and Best Buy store, this does not, however, equate to a conclusion that the best consumer deals can be found inside the stark white and glass walls of an Apple store.

More factory involvement and control might play to a mixture of distribution channels, but what manufacturers have learned about every ten or fifteen years when they try, is that factory stores cannot compete against independent dealerships. Barring a monopoly, like Tesla, it is impossible to fix prices in the long-term. Further, the manufacturer can fall victim to their own manufacturing decisions. When a factory makes vehicles that fail to excite, it is local, independent dealerships that are able sell them. Manufacturers have a perfect storage system for over production – it is called "dealership parking lots."

The retail automotive marketplace moves slowly. One of the prime reasons is that change is adopted, free of corporate edicts on how to respond to local market disruptions. The road is littered with people, companies and institutions that believed a new idea would put an end to the franchise system as we know it. And like Tesla, these issues might have worried the dealer body for a period of time, but in the end when the dust settles the strength of the franchise system and laws have only gotten stronger. There is no foreseeable reason to believe this will not continue.

RIDE-SHARING/VEHICLE-SHARING WILL REPLACE VEHICLE OWNERSHIP

While ride-sharing brings to mind the idea of Uber and Lyft, the combination of ride or vehicle sharing actually has a much broader base. For vehicle-sharing, Zipcar is the largest with 730,000 members sharing 11,000 cars by the hour. The potential size of this market in the future is projected to be large enough for manufacturers to invest heavily in this emerging segment of the automotive industry. Volkswagen launched MOIA last year following in the footsteps of General Motor's Maven, Mercedes-Benz's Car2Go, BMW's ReachNow and others.

Ride-sharing has been an uncommon success in many areas of the country. The firms and drivers involved have taken the aggravation of public and for-hire transportation away and made it as easy as some clicks on an app. The services have proven a disruptive force in nearly every market they have entered and consumer response to the services have been well received.

Car sharing has a presence in large urban areas across the world. The expense of ownership including the costs of garaging, insuring and maintaining one's vehicle for only a few hours of use a week has made vehicle-sharing services attractive to consumers. Sharing has grown in suburban areas as well and the cost of an Uber or Lyft on a per mile basis is very close to the cost of vehicle ownership. With the increasing numbers of services and their membership, fleet size has grown exponentially with no signs of slowing. The manufacturers are now investing in the ride-sharing business and, it could be that they challenge automotive retailers not by selling directly to consumers, but by renting them a vehicle, one hour at a time.

Auto Team America sees that there are two distinct models; ride-sharing and vehicle-sharing. Ride-sharing competes against public transportation, taxis, livery vehicles and traditional rental vehicles, not franchise new vehicle dealerships for consumers. Even if the factory begins to sell fleet vehicles to those services directly, those ride-share vehicles will need to be repaired and serviced much like today's rental vehicle fleets. The added body and detail work required of a shared fleet, in addition to more maintenance due to a faster accumulation of miles, could be a positive for dealerships.

Likewise, sharing vehicles will have about as much impact on the retail automotive industry as Airbnb has had on the hotel industry. It applies and works for a segment of the market, but not much more than was previously available through vacation rentals and other services. Similarly, vehicle-sharing will cut into the vehicle rental market more than the vehicle purchase market. We expect the vehicle rental industry to adjust to these market changes.

Current vehicle-sharing services are typically used for one-off, distinct purposes; a trip out-of-town, shopping for home goods and things that make using public transportation or even an Uber cumbersome. The average vehicle-sharing user drives well below 5,000 miles a year. This has allowed most vehicle-sharing services to maintain a rough ratio of one vehicle for every 30 members. It is also important to keep in mind that membership to a vehicle sharing service does not directly correlate to full-time active use. It is hard to imagine how the model would sustain itself under typical consumer driving use (over 12,000 miles per year).

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Let us carry the vehicle-sharing model forward and suppose a future where a portion of the population, not just in urban centers but in metro and suburban areas, actively uses sharing. Imagine that service pops-up like cell phone carriers, where you contract with a company for either a pay-as-you-go plan or a more generous subscription that may even include luxury vehicles. The choice of having a sedan during the weekdays and a van or pick-up on the weekend could also be part of the menu.

Now consider the logistics that this would entail. What portion of that population needs to arrive at and depart from work at roughly the same time? What portion eats lunch and dinner at the same time? When do they go to church? When do they go to the mall? It does not take much analysis to realize there are going to have to be a whole lot of cars parked in a lot somewhere to meet peak demand. These vehicles would have to be placed in areas that are readily convenient for its members, which in many metro and even urban areas may not be possible.

Some research shows the acceptance of millennials in the sharing economy and their acceptance of such services. This may be true, but every study buries the idea that this has more to do with the financial position of the population being surveyed. The underlying force is that for many vehicle sharing members, vehicle ownership is beyond their means – not their willingness to purchase.

AUTONOMOUS VEHICLES WILL RULE THE ROADS BY 2030

The progression of safer vehicles via autonomous or self-driving systems is the game changer everyone seems to be waiting for and will be the most likely to impact retail automotive. We already have vehicles that will stop in an emergency, warn you of lane departures, parallel park themselves, and adapt the cruise control. High-end vehicles have traction control on steroids that will correct spin-out conditions. You have likely seen videos that show Tesla, Uber or Google vehicles navigating the road in a fully autonomous way. There are two categories of autonomous vehicles – those with a driver and those that are truly driverless vehicles. While it may seem like driverless (often termed as Level 5) will be the last development of the technology, it has the most economic pressure to be the first.

There are several driving forces for autonomous vehicles, which include safety, and freeing up unproductive time, but the most economical would be to eliminate drivers in commercial and public transit. Some studies done by the American Transportation Research Institute show the cost of the driver is one-third of all transportation costs. Additionally, most transportation fleet operators are self-insured, which gives them more of an incentive to make vehicles as safe and error free as possible.

Driverless public transit also makes sense because the vehicles normally follow a clearly defined route that would simplify the technology. Mapping out a city grid or highway system is easy compared to every possible scenario that might happen on local roads. This simplicity is critical to autonomous development. The technology required will likely not be an evolution of adaptive cruise control to self-driving vehicles. Autonomous vehicles (Level 5 vs. Level 4) will only be allowed on the road when the public is guaranteed that they can account for and react to the thousands of possibilities encountered on the road. Currently, tests of Level 4 vehicles are occurring in metro areas, but by definition Level 4 does not cover every driving scenario and requires a driver ready to take over to keep the public and regulators happy. This is important to help placate public safety concerns but these vehicles will have to run fully autonomous (Level 5) to make sure the systems work properly. There cannot be a learning curve – they have to make the right decision 100% of the time on the first day they hit the road. Having a more clearly defined route as is being tested now will help minimize the variabilities.

Auto Team America can see technology will continue to advance rapidly and that autonomous vehicles (level 4) will someday impact retail automotive, but it will not be by 2030. Further, the rush for driverless transit will likely occur first but it will impact professional drivers, not retail automotive customers. The inevitable consumer driverless autonomous vehicle (Level 5) still feels like it is decades away. Absolutely, vehicles will be smarter and able to perform more tasks, safer and in a variety of conditions – but there still will be a human behind the wheel to assume control for the times when the vehicle will be unable to calculate the right course.

The real impact on the retail vehicle market will only occur if autonomous vehicles are matched to vehicle-sharing. We see a future where removing the driver would allow a vehicle do things like find you or drive itself to be serviced. This is unlikely to occur by 2030.

THE DEALERSHIP OF THE FUTURE

As in prior reports, Auto Team America began its task by performing a survey on the dealership body and what we have found supports the primary changes in the dealership business model. The result of these surveys, analysis by industry experts, past research and interviews conducted for this paper have all been synthesized into our conclusions below.

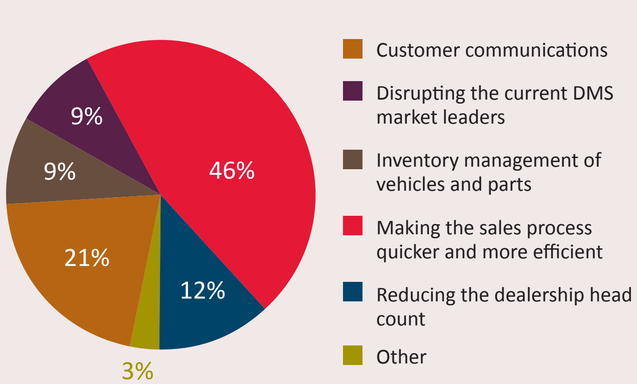
DEALERSHIP SALES ENVIRONMENT

In the past decade, dealerships have honed their lead development process to a science. Most dealerships can pinpoint their most profitable lead providers and can map out a process from initial email to handing over a set of keys.

Part of the growth of this expertise has allowed dealers to look even further into the future as the lead and sales process more clearly defines itself. Compared to a decade ago, customers come into the showroom further down the sales funnel due to internet research, lead generation communications, and the ability to shop inventory and price vehicles electronically. With increasing availability of various research tools, consumers continue to be closer to a purchase decision before they walk into the dealership showroom.

For example, manufacturers are now trying to offer virtual test drives in stores and, when virtual reality use becomes more common, these demonstrations should eventually occur outside the showroom. Imagine such technology placed in the local mall or other heavily trafficked retail space or even available at home. We expect this trend to continue and consumers will have much of the shopping experience outside of the dealership. This makes the sales process in the store much shorter, allowing sales people to see more customers and close a higher percentage of customers due to the greater transparency and speed of the process.

What area of technology do you think will have the greatest impact by 2030?



Surveys show that dealerships expect technology will enhance future customer communications and improve the sales transaction process. With improved communication comes more transparency of the process which will increase consumer satisfaction with the overall purchase experience.

That does not mean everything will be handled via email and text. Human beings still matter in 2030. It is tempting to project that technology will make the sales process perfect but it will be the stores with the best people who can connect with customers, in whatever manner the customer chooses, that will win. For some customers, the opposite might also be true. They will be drawn to a process that has the least human interaction and treat shopping for a vehicle no different than buying a new vacuum cleaner.

The goal of any successful business is to profitably provide the consumer with what they want when they want it. Current lead management systems are designed to get consumers to the dealership lot so they can interact with a salesperson. This has resulted in hesitancy in quoting prices, having extended dialogue with the customers from initial lead, or allowing off-site demonstrations. Many lead follow-ups employed today are scripted, formulaic and often automatic – and they appear that way. To move shoppers down the sales funnel and get them on the lot is going to require skilled employees in the dealership's Business Development Center (BDC) or Internet department. The skill levels between the BDC and sales floor will be reversed or the two will be merged into a single sales process. Highly skilled people will need to interact with the customers early and effectively.

These skills will be needed as there will be four distinct generational/shopping preferences in the marketplace. We are also beginning to see the creation of customer relationship specialists that are better able to handle and direct the consumer. Segregation of duties from product introduction, research gathering and inventory assistance will be performed either through technology or via "product specialists" in the store.

By 2030, surveys show a belief that obtaining a financing source will be conducted during the pre-purchase decision process. Consumers will continue to be able to leverage the wide array of bank choices that the dealership can provide at a single point. The credit application will be handled on the dealership's website or through lending institution websites. Again, consumers will have a choice to either go through the entire buying decision, right up to delivery, with limited dealership sales personnel interaction or opt to use traditional methods.

When the consumer reaches the point of purchase and is signing on the dotted line or box on a tablet, the actual sales transaction, at its core, will be the same in 2030 as it is today. While that signature might be a finger print, retinal scan, some government issued ID chip, or many things we cannot imagine today, at the end of the day, someone still has to close the sale. Regardless of how willing a consumer is, the purchase is still a major one and it takes a skillful salesperson to guide the customer to make them comfortable with the purchase. Additionally, due to regulatory and manufacturer requirements, the actual closing process will likely still take place at the dealership, with all the requisite forms being completed electronically and vehicle delivery occurring at the showroom location for a majority of sales. (Some state franchise laws allow delivery outside the showroom but most states restrict sales to the dealership location. This would have to change to allow a more varied delivery process.) If there is a possibility that identity protection and regulatory compliance significantly improve, there could be a softening of the exact nature of signing all those required forms.

Therefore, technology will serve to assist in customer communications, but may have little influence on the average sales rate or the number of humans working in the dealership's sales force. Human connections still take time and effort, regardless of the channel of communication. More effort on demonstrating vehicles, getting in front of customers where they want to do business and working the various leads will always be a time-consuming process.

The salesperson will have to heavily utilize technology to guide their work and the consumer through the purchase process. There will be a continual build-up of regulations and policies aimed at fair and secure transactions. The only efficient way to address compliance on every transaction will be by leveraging technology. Since technology will ease some of the burden on the dealership, and due to consumer-oriented legislation and regulation, surveys point to the Finance & Insurance department once again being absorbed into the salesperson position. Items currently determined as "aftersale" will migrate to be part of the overall buying process.

DEALERSHIP FIXED OPERATIONS

The transformation continues through fixed operations as vehicles and customer habits change. The easiest changes to see are in the parts department. The past several years leading up to 2017 have seen the manufacturers work on perfecting stocking guides and improving automatic replenishment of dealership inventories. Better logistics, improved demand analysis, careful selection of strategic warehouse locations and more common vehicle systems in 2030 will allow even more efficient control of inventory. Dealer-to-dealer transactions through the manufacturer parts locators will also improve inventory movement between dealerships. Overall, manufacturers will control 90% of dealership parts inventory with guaranteed buybacks, eliminating much of the past obsolescence issues.

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Even with the timely delivery of parts improving, the average turn of dealership inventory will not improve above twelve times a year. It could climb as high as twenty depending on the dealership's wholesale business, but manufacturer demands to keep more breadth in their managed part numbers will hold the average lower. Other options will come about from improved transportation. Mentioning again driverless transport options, or even drone delivery, might make the cost of same-day or even same-hour delivery possible.

Parts gross profit will remain highest on most non-maintenance parts. The lack of aftermarket competition on many specialty parts, the relative high cost of shipping with OEM/dealership internet sellers, and a decreasing Do-It-Yourself market will help maintain gross profit percentages. The complexity of the automotive systems involved will also keep out aftermarket manufacturers.

Moving to the service department, it will continue to be the most profitable area for dealerships according to respondents to our surveys. This is despite a reduction in the maintenance requirements, extended maintenance intervals, and more manufacturers covering maintenance items under the new vehicle warranty.

There could also be increased profits if the dealership is allowed to perform a "refurbishing" of pre-owned vehicles which would be a large step up from "certification." Under "refurbishing" major systems including battery, engine and transmission would be replaced with factory refurbished module components. However, if such work became too profitable for dealerships it would tempt the factory to include it as part of their own re-marketing program.

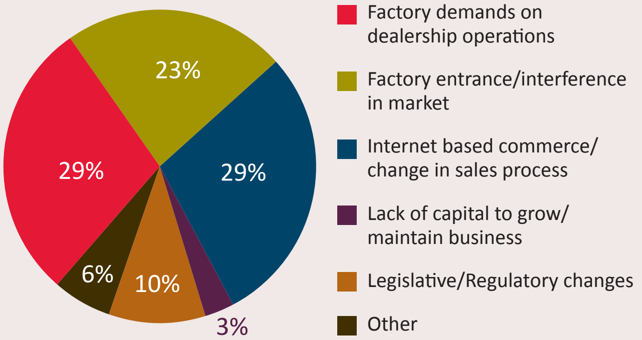
Profitability will be further hindered by the manufacturer's recommended maintenance. If vehicles begin to know when they are operating in normal or extreme conditions and can report directly to the consumer which services are required, it would effectively end "factory recommended" services. If the manufacturer ends up covering the maintenance, it would further limit the suggested services. There will be more transparency in the service transaction just as we expect on the vehicle sales side. The upside to transparency is that it will reinforce the trust that the consumer places in the service advisor and shop as a whole.

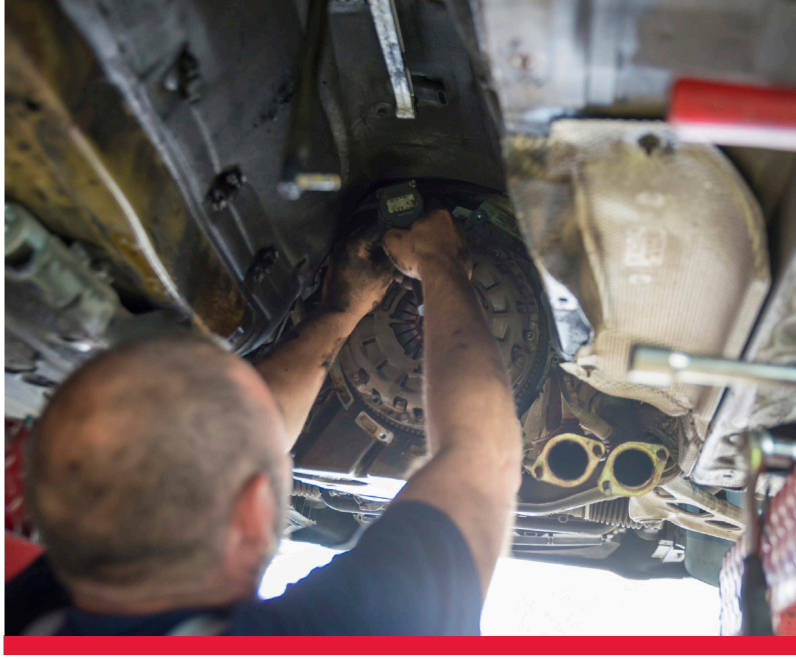
The growth over the next decade will be in customer repair work due to an increase in the average vehicle's age, the complexity of design, and several new propulsion systems that will have limited repair expertise in the marketplace.

Also, assisting the service department will be increased reliance on remote diagnostics, where vehicle monitoring systems will alert the driver of an error and automatically upload data files to the manufacturer and dealership. Such systems will not only directly encourage the use of the dealership service facilities, but it will also passively encourage it as the diagnostic information will already be there for the customer, making for a more efficient service visit. It may also open up more competition between local dealerships using the diagnostics to provide competitive estimates and timely appointments.

Such systems will also develop to a point that under warranty repairs, the required parts will be automatically sent to the dealership. While it makes sense with the reduced costs of distribution and automatic buyback guarantees to ship lower value cost parts to the dealership in preparation of the repair, this will also be true of complete assemblies. As systems grow in complexity, the easier and more economical repair will be for complete systems to be swapped out as whole "modules." These modules will then be returned to the manufacturer for rebuilding. If a major fault is detected with a large assembly, the most efficient and cost effective repair will be to swap out the easily replaceable and rebuilt module.

What is the greatest threat to the current automotive franchise system and your way of conducting business?





Having a stream of information being fed to the service department directly from the vehicle will also aid the write-up process. This will allow the dealership to not only have electronic communication with the vehicle, but also the customer. Much of the repair order will be pre-populated upon arrival at the dealership, which will free up service advisor time allowing them the opportunity to build a better relationship with the customer.

OTHER INFLUENCES ON FUTURE DEALERSHIP OPERATIONS

The sales and service process is a myopic view of the overall retail automotive environment. Dealerships do not operate in a vacuum of only selling products and services to customers. There are pressures from government regulators, consumer organizations and the manufacturer. These pressures cannot be discounted as they shape the way the dealership conducts its business in the future.

Regulation Of The F&I Profit Center

Surveys have shown that dealers believe increased regulation will erode dealership profitability and make sales transactions even more complex than they are today. However, the complexity will be reduced through technology that will provide some relief to dealership staff and consumers. Since much of the customization of after-sale products and finance qualifications will happen prior to the close of the retail sale, the function of F&I will be reduced to compliance. New technical innovations will make compliance easier, so the final steps of the sales process will be performed with a delivery specialist or salesperson at lower cost to the dealership.

In some regards, such a vision paints a challenging outlook of the potential for profits on new vehicle sales in the Year 2030. In the sale process, F&I profits will continue to evolve from variable gross based on what the transaction will bear to a fixed "per-unit" basis with flat fees or commissions on the various products offered.

Greater Factory Influence

The manufacturers' appetite to meddle in dealership operations will not subside. As the long trend of weakened front-end gross continues, the demand will remain for back-end payments to the dealer, in order for them to maintain profitability on new vehicle sales. With greater incentives from the manufacturers comes greater influence and control on how the dealership conducts its business.

Since the factory incentives represent a key difference between being profitable or not – facility imaging, business practices, advertising requirements, and stocking guides will continue to encroach on dealers being able to react to local market conditions. The only hold against the tide of manufacturers looking to micromanage the dealership, without taking any of the responsibility or capital risk will be increasingly specific state franchise laws protecting the dealership's investment.

Used Vehicles Hinge On Dealership Throughput

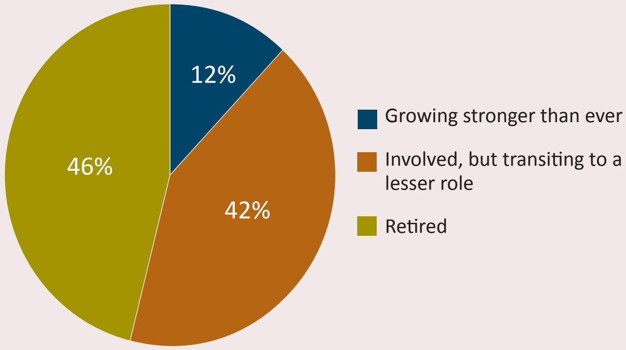
Moving to the pre-owned vehicle department, we also see changes in the sales process and inventory. With stabilized lease penetration, some brands will rely heavily on 2-3 year vehicle turnaround. By 2030, the best strategy will be for dealerships to sell the same vehicle twice – once on the lease transaction and the second time as a certified pre-owned. Those dealerships that increase their capacity to recondition will get the pre-owned vehicle on the lot as quickly and economically as possible and will have the advantage.

This will also be true in regard to the previously mentioned refurbished vehicles that are a step above certification. As models become more complex, it might be difficult for dealerships to take competitive vehicles in trade. Same make stores will likely offer the best trade-in value for consumers. This will be a unique opportunity for dealerships that are part of a larger group that represent several brands.

In the non-certified and vehicle acquisition markets, technology has made the department much more efficient. Physical auction visits are rare, as program/remarketed vehicles are sold via online bidding. Outside wholesale buyers, likewise bid on vehicles in an online marketplace, allowing the dealership to maximize wholesale profits.

Auctions, the manufacturers, and other large remarketers of vehicles will be able to acquire more inventories for specific market demands. Market pressures will continue to push manufacturers to maintain high residual/pre-owned wholesale values – forcing more vehicles into their branded certification process.

In 2030, will the current dealer/majority owner at your dealership be:



Dealership Consolidation

While there were differing opinions regarding the nature of those changes in our paper three years ago, we did find a near unanimous agreement that dealership ownership was going to contract. For well over two decades, the narrative of dealerships has been one of consolidation. From the early days of growing regional groups, to the publics, the factory and now large private groups, there appeared nothing that would slow a progression of group consolidation.

Currently, it is a seller's market of certain brands as there are many new willing buyers entering the marketplace, but a lack of willing sellers has hampered significant consolidation. However, compression of gross margins, increased capitalization requirements and other factors will influence owners to sell. Couple this with the factory's increasing demands for facility upgrades along with the true need for some dealerships to relocate and rebuild; we will find more dealers who are unwilling to commit the capital needed to undergo major real estate renovation projects that may take decades to pay off. When a downturn in the market occurs, the number of sellers will increase which will accelerate consolidation. This future is consistent with surveys that tell us nearly half of the current dealers expect to be retired by 2030.

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Why will there still be willing buyers in such a market? Large successful groups have the economies of scale to maximize net profits. They can centralize some operations and purchasing to wring out a few extra percentage points of gross retention. They also are likely the ones with cash available and access to the capital necessary to complete acquisitions and make facility upgrades.

While consolidation of stores into ever larger groups is easy to see, these will likely be regionally based groups of 20-30 stores. Those are the dealer groups that have shown to be the most efficient in growth, management and staffing.

Single-point stores will still thrive, and in many markets will be the right fit for the local community they serve.

The Dealership Location

Dealership facilities are more complex than they appear on the surface. Facilities must balance the desires of the manufacturers, the needs of customers, reasonable capital expenditure by dealers, state franchise laws, existing dealership property, and the local regulatory environment.

Yet, there are some forces that will work towards shaping the future look of dealerships. The current trend of bigger is better, does not necessarily hold true as dealerships look to have faster throughput of inventory, cleaner "retail" environments and more efficient operations. If future dealerships must sell more vehicles, with fewer salespeople at lower operating costs, the logical conclusion is that dealership locations will shrink in physical size and footprint. The high price rents and real estate frontage on desirable highway and premier retail locations will be cost prohibitive for a large facility and footprint. Increasing throughput per store could help off-set these fixed costs, but the market for total vehicles sold does not project enough growth for this to occur.

Since rent and occupancy expense is a big budget item, it will need to coincide with the revenue structure of the dealership. So, why has there already not been a greater movement to reduce facility costs?

Moving to a smaller footprint are counter to most manufacturer goals. For obvious reasons, when the factory does not have any costs of building ownership it may want the biggest one it can force on the dealership body, with the most storage, parking and access. While dealership average annual unit sales continue to grow, there will be slumps in brands or even the economy that will put tremendous pressure on lowering occupancy costs. This will also put stores that currently operate on lower volumes at risk.

The only tactic to chisel away at the dealership's occupancy costs is marginally at specific operations. For example, off-site storage facilities have allowed dealerships to reduce costs. In the next decade, we should see improvements in efficient vehicle inventory management curtailing the need for storage space. Dealership consolidation does allow for the grouping of operations such as vehicle preparation, reconditioning and business offices into central, lower cost facilities. In some cases, off-site service facilities allow for servicing many makes in a much lower rent district.

Higher Cost To Enter

Regardless of the future value of an individual franchise brand, as the decade progresses the multiple of earnings for the valuation of dealerships will increase (with the exception of a few franchises due to market forces). By 2030, the multiple will be greater than the current multiple ranges that often exceed three to five times earnings (with desired brands climbing higher and multiple factors influencing valuation to an individual buyer and seller). The injection of private equity against public companies, the ability of large groups to have a lower cost of capital and the ability to leverage their presence in the marketplace will drive values higher for selective and desirable stores. There will be brands and markets that will not be as distinctive.

Besides, or in some cases in spite of, the franchise brand, the dealership's real estate position (i.e., not overly built-out or burdensome) and the purchasing group's ability to economically assimilate the store into its other operations will be key to the dealership's valuation.

New Entrances From Automakers

One question for the future of franchise values is the possibility of new brands entering the market. Chinese and Indian brands are expected most, but one cannot discount the possibility of a new technology player entering the market as well. The fear is that one of these new players might try to circumvent the franchise protections like Tesla did, and enter with factory-direct stores.

For the foreseeable future those countries' domestic demand will outstrip the need to export into the U.S. In an age where experienced, well-organized manufacturers are fighting to maintain fractional market share, the entrance of yet another automaker into the market does not look probable. But by 2030, the need for these manufacturers to establish themselves in the U.S. market will be strong. In fifteen years, there is probably a new technology that we cannot even consider yet that will impact the new vehicle market.

Human Resources And Staffing

Not only will dealerships be selling to a new generation of consumers but they will be hiring them as well. Indicators show that Generation Y employees are more risk adverse and prefer security in employment over pure dollars. That would make most commission-based plans difficult for them to accept. What they will likely respond to is an improved benefits package and a clear job path. This group of workers also values their time and is less willing to work 60 hours a week that is often required in sales and F&I positions.

Because of the specialized nature of future transactions and business development activities, training at dealerships will also need to be increased to both comply with laws and maximize the individual's results.

By 2030, vehicles will be mandated to be in communication with each other and support common platforms to move towards autonomy, as well as the manufacturer's proprietary systems. This will require a level of "IT support" that must be trained into future technicians.

Greater Regulation And Consumer Protections

A given trend in the retail automotive industry is increasing regulation and consumer protections. Few industries are as heavily regulated as retail automotive and no participant or observer of the industry expects that to change over the next thirteen years. As noted previously, as new regulations come into play, dealerships must increasingly rely on technological solutions to assure compliance. Good technology will not be free and only dealership groups of a certain size or scale will be able to economically comply. Such regulations will also certainly come at a cost of compliance and potentially reduced gross. The prediction of regulations requiring flat rate finance reserves and limited grosses by statute will compress the traditional F&I margins.

YOUR 2030 FINANCIAL STATEMENT

While financial performance varies widely by manufacturer, location, and size, we know there are trends that compose the average dealership. Like everything in retail automotive, we begin with new vehicle sales. The projected 2030 annual vehicle sales vary depending on the source, but 17.4 million units seem to be the median prediction. This is approximately the results from 2016 and slightly higher than the predicted 2017 sales. The dealership count is projected to grow modestly 0.1 to 0.2 percent per year according to Urban Science. Yet, based on factory programs pushing smaller dealerships for more capital investment, Auto Team America believes the dealership count will decline 1.7 percent by 2030. If those two factors hold true, the average store would sell 984 vehicles per year compared to the current 971, or a small 1.3 percent increase.

In order to make an easier comparison, the following projected chart is shown in current (2016) dollars.

Average Dealership Financial Profile

	2016	2030
Total dealership sales	$57,325,082	$58,403,781
Total dealership gross	$6,446,202	$6,368,279
Total dealership expense	$6,214,871	$6,308,094
Net operating profit before taxes	$231,331	$ 60,185
New-vehicle department sales	$34,958,688	$35,272,062
New-vehicle department gross	$1,247,551	$1,025,868
Used-vehicle department sales	$15,585,396	$15,943,860
Used-vehicle department gross	$1,304,192	$1,234,925
Service and parts sales	$6,780,999	$7,187,859
Service and parts gross	$3,894,459	$4,107,486
Other Income	$1,041,378	$1,130,561
Total Profit	**$1,272,709**	**$1,190,746**

As discussed previously, our projection calls for compressed grosses in every department except we believe service and parts will hold steady. The one line in this projection not showing a reduction is Other Income. The impact of Other Income items certainly varies between franchises. Volume bonuses, stair-step programs, facility money, customer satisfaction rewards, and a seemingly never ending list of behavior controls from the factory have supplanted earning profits from the public.

Auto Team America's analysis shows that a majority of dealership net income (across all brands) is generated from these types of programs. Often times this does not include volume bonuses that are added into new vehicle gross. While Other Income may include dealer produced income such as documentary fees, rental vehicle income, investment income, etc.; for many dealers, it means factory-to-dealer payments.

The fear is that factory program cash is forever at the whim of the manufacturer. If the store relies on Other Income for its net income then it is in a precarious position when working with the factory relationship. Further, even if the factory payouts remain the same but are changed from monthly to quarterly or semi-annually, the dealership has to be sufficiently capitalized to survive the dry season in between the incentive payments.

Our dealer surveys reinforce the idea that dealers expect to rely more heavily on factory cash payments as a make-up of their income in the future. Regardless of what form they take or demands they place on dealers, our survey respondents clearly indicated that Other Income will continue to be a major factor in dealership profitability.

Turning to the manufacturer's side, the dealership's reliance on payments has become something of a paradoxical golden goose. Instead of laying golden eggs of "Other Income" for dealership benefit, it has become necessary that the manufacturer's goose keeps laying those eggs or their distribution channel will collapse. Unless something replaces this income for dealerships, manufacturers will be obligated to find ways to continue providing financial incentives and support to dealers.

CONCLUSION

In the film Jurassic Park, the character Dr. Ian Malcolm famously says, "Life finds a way." While detractors have called dealerships dinosaurs for decades, like those creatures in the movie independent retail automotive dealerships always find a way to survive and thrive. Dealerships have over one-hundred years of history that shows they have the innovation and spirit to effectively adapt to changing market conditions. While this paper has suggested several areas that could negatively impact your business, by recognizing the challenges Auto Team America sees a positive future ahead for franchised dealerships.

Executive Summary

As a result of the shift in consumer demands, desires and habits regarding retail and specifically, new vehicle shopping and purchasing, we anticipate the following will occur by 2030:

- The big disruptors to retail automotive stores will not have occurred by 2030, but could be near the horizon. Dealerships continue to be independent franchised operations, but will have to diversify into the definition of providing transportation services to consumers.
- There will continue to be different paths to profitability in the dealership. While consolidation will continue, there will still be plenty of opportunities in the market for single-point operators.
- Shrinking gross profit margins will be offset by a lower cost structure.
- Smaller staffing requirements will result from the use of technology to be more efficient.
- Technology will continue to increase communication with consumers in the sales and service process.
- The F&I department will face the greatest transformation from technology and regulatory changes.
- Increasing consumer regulations will continue to shape the dealer's business model.
- Dealership values will increase as the earning multiples will be higher.
- Factory influence over the day to day operations of the dealership will be expanded. Costly facility requirements mandated by the factory will cause some dealers to sell.
- Variable gross margins will be compressed and will need to be compensated by direct dealer payments from the manufacturers.

Acknowledgements

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