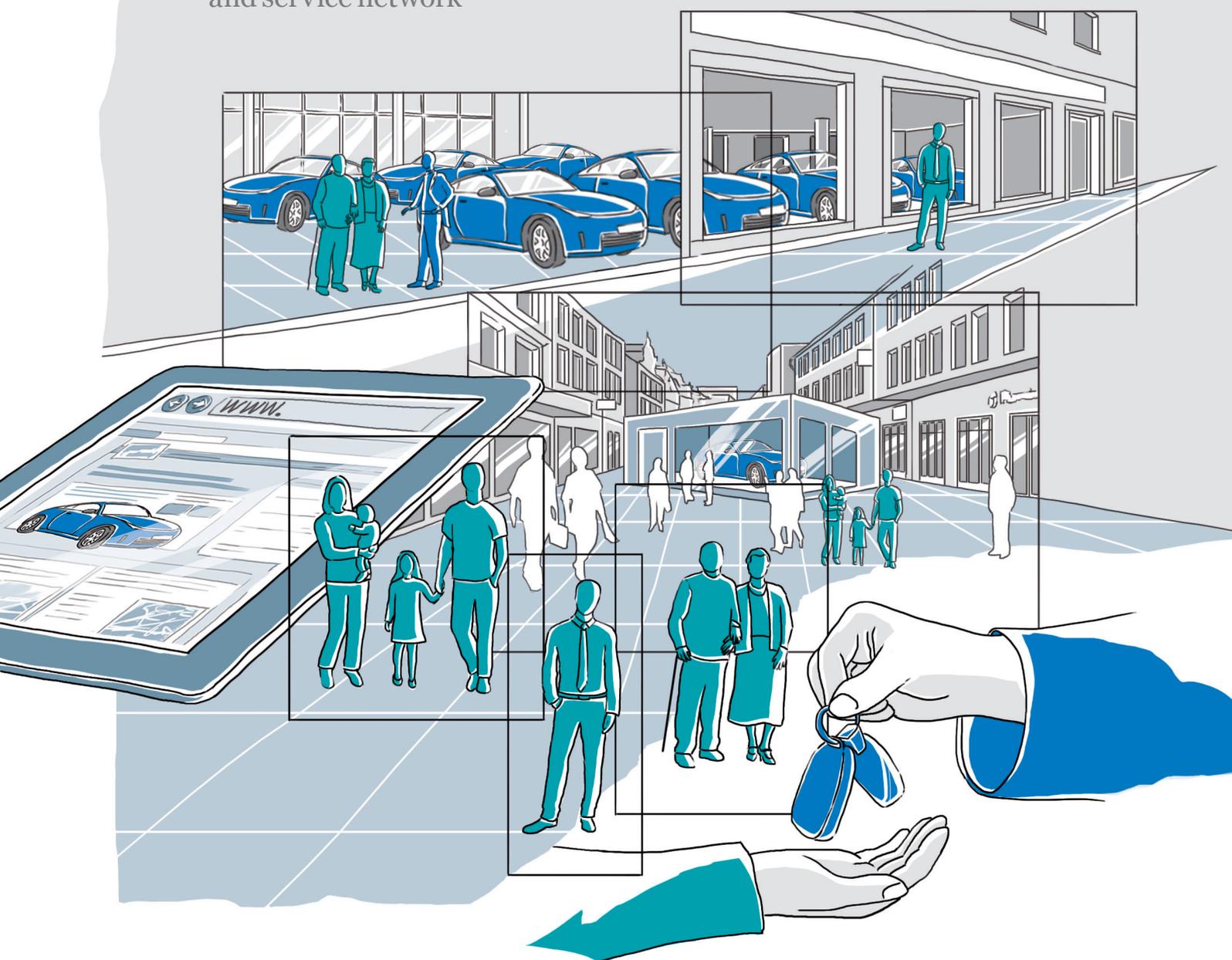


Advanced Industries

Innovating automotive retail

Journey towards a customer-centric, multiformat sales
and service network



Consider a few staggering facts about the changes in automotive retail

In China, the number of car dealerships has **more than doubled in the last 5 years**, while in the US and Europe it has fallen by **15%**

27% of German automotive dealers registered losses in 2013, up from 9% in the previous year

The average number of customer visits to dealers before buying a car has dropped

from up to **5** to frequently **just 1** for some brands in some geographies

More than 80% of customers take test-drives during the car buying process, underscoring the continuing strategic importance of dealers

Roughly **500,000** cars are traded on eBay Motors' Web site every year

AutoScout24, Europe's biggest online car market place, registers **more than 300 million** visits on profiles of cars on offer per month

85% of customers still use the dealer touch points, but **1 in 4 customers** is not satisfied with his dealer experience in the car buying process

More than **one-third** of customers would consider buying a car online

New-car sales account for less than 20% of dealer margin in the US and often have even negative returns, but financing and warranties are becoming ever more important as sources of dealer income

Almost **90%** of customers use dealer Web sites or OEM Web sites in the early steps of their decision making journey

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Executive summary

McKinsey's 2013 Retail Innovation Consumer Survey, a proprietary analysis of approximately 4,500 customers across the US, Europe, and China, along with other McKinsey surveys and industry analyses shows that automotive retail across the world is undergoing substantial change. Multiple drivers are at work.

Changes in customer behavior call for enhanced touch point management. The rise in mobile technologies and social media is redefining interaction and communication patterns, altering customer behavior as a result. Digitization is revolutionizing the sales and service process, and other industries are already leading the way in innovating their retail formats.

Innovative products and technologies require a sales and service process upgrade. As automotive technologies advance, cars are becoming ever more complex. The know-how expected of sales and service staff is reaching ever higher levels of sophistication.

Industry pressures are challenging dealers' current business model. Networks are consolidating in mature markets as saturation and competition increase. The financial sustainability of traditional dealership models is questionable in many countries.

The good news for dealers is that most customers still rely on them – especially in the decision phase of the vehicle purchasing process. They want to test-drive a vehicle before buying it, and vehicle servicing is still very much an “offline necessity.” Dealerships will therefore remain a crucial touch point in the customer decision journey.

The key will be to transform today's dealer network into a profitable, modern, multiformat sales channel that combines the opportunities of the online world with the strengths of the traditional dealership channel. This will require the introduction of new retail formats and technologies for communicating with customers and supporting the sales and service process. But even more important will be the strategic optimization of the current dealer network. The number of traditional dealerships is likely to go down as a result. Another change anticipated is that dealerships will differentiate and specialize in specific areas of the customer decision journey, including the service experience. At the same time, automotive original equipment manufacturers (OEMs) will have to better integrate their various customer touch points, and manage them holistically. The goal of this integration is to ensure that the OEM's set of touch points follows potential buyers throughout their day-to-day lives in ways that are convenient and informative from a customer perspective.

Successfully steering this transition will result in a higher return on new-car sales for dealer networks while also significantly upgrading the customer experience. Those that do not move ahead could find themselves driven out of business in the mid to long run. Advanced dealer networks are already starting on this transformation journey. Their early successes are self-reinforcing, as they occupy the best locations, attract most awareness online, and gain faster and better customer insights via advanced data management, effectively giving them a defensible and sustainable advantage. So there is no time to lose – the time to act is now.

Major trends reshaping the automotive retail industry

McKinsey has combined existing insights on global trends with research on customer preferences, its insights into the automotive industry, and lessons learned from other industries. As part of this analysis, we have identified three key trends that we expect to significantly change the automotive retail landscape as we know it today.

Changes in customer behavior call for improved touch point management

Compared to a decade ago, customers today are experiencing new sales processes in many industries and categories, such as unique shopping experiences in branded electronics stores, online retail with advanced customer relationship management, including intelligent product suggestions, or seamless integration of online and offline business. Automotive OEMs and dealer networks are aware of these trends and have started piloting new concepts, accompanied by big public-relations moves.

Car buyers nowadays design their decision and experience journey individually from a multitude of different touch points. McKinsey's 2013 Retail Innovation Consumer Survey showed that over 80 percent of new-car and almost 100 percent of used-car customers now begin their journey online, meaning that dealers have lost their role as the primary source of information as well as their power over the information shared and their ability to influence the customer. As might be expected, the role of online sources is even more pronounced among customers between the ages of 18 and 34. Close to 90 percent of these customers use an extensive variety of online sources – OEM and dealer Web sites, social media, blogs, and forums – to gather information and compare offers, moving the purchasing decision towards the online world. The rise of mobile technologies, tablets, and social media is also redefining interaction and communication patterns, while technological innovations, such as mobile apps, multimedia walls, and 3D configurators, are opening up new opportunities to transform the in-store experience.

Consequently, the number of customer visits to a dealer before the purchasing decision is made has tumbled: dealers often get just one chance to strike lucky. McKinsey's research has shown that OEMs and dealers need to fight an online battle to earn the right to get that one chance. This includes optimizing their own Web presence, but also integrating traffic from third-party Web sites, such as Kelley Blue Book, Consumer Reports, or JD Power in the US. Many customers find these third-party Web sites very useful for comparing different models side by side, making it hard for OEMs and dealers to compete for attention in the online space. Customers are increasingly well informed and thus more demanding, while dealers are not yet sufficiently prepared for the new challenges ahead.

Innovative products and technologies require a sales and service process upgrade

Deep technical understanding of the car and all available features has become a key requirement for any sales person and is gaining ever greater importance as new technologies enter the market, vehicles with electrified powertrains, for example, or more advanced infotainment and active safety technologies. Customers expect dealers to know about more than just the latest models and technical features. They also come armed with questions about new applications and their connectivity to other

devices, such as smartphones and tablet computers. As a result, more and more OEMs are starting to upgrade their retail landscape by piloting new retail formats, such as boutique-style stores in prime city center locations – Tesla Stores, Audi City Cyberstores, BMW i Stores, Mercedes-Benz Visionary Stores, for example – online stores, such as BMW’s customer interaction center, or the Mercedes-Benz connect me stores.

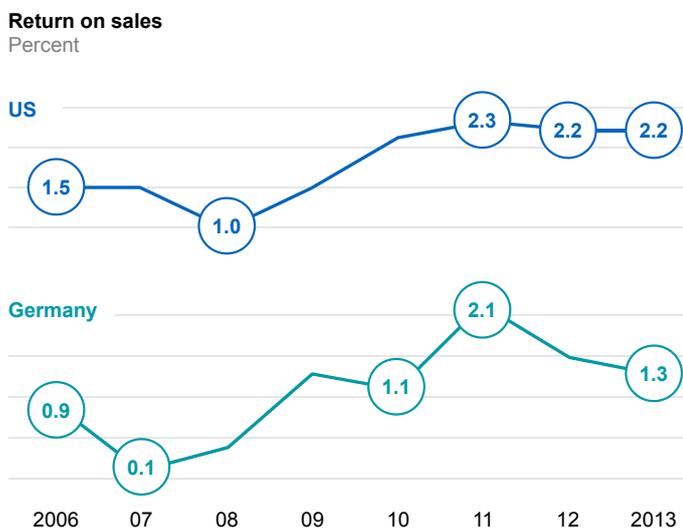
At the same time, OEMs are beginning to upgrade existing dealerships by equipping them with the latest technology – 3D configurators, video screens/walls, etc. They are also bringing in product experts and advisors able to answer customers’ questions with the assistance of interactive information applications on iPads. Audi, for example, has recently opened the first Audi City, a cyberstore that uses multitouch tables for model configuration, Powerwall screens to present specific models, and lounges for consultations in a private setting. However, no OEM seems to have yet initiated a comprehensive transformation covering their entire retail network.

Industry pressures are challenging dealers’ current business model

In times of increasing saturation in developed markets such as Europe and the US, automotive OEMs and dealer groups have started to rigorously restructure, consolidate, and improve their dealership networks by implementing new processes and standards. These include efforts to set and closely track performance measures – such as metrics on conversion rates through the sales funnel or average discount per car – to identify laggard performers and actively monitor and manage dealer performance. Meanwhile, OEMs are continuously increasing their expectations regarding the implementation of corporate identity, resulting in the imposition of additional conditions. These often include single-

After recovering from the macroeconomic challenges of the financial crisis dealer margins are again at a level of around 2%

Exhibit 1



The number of new car dealers¹ decreased from 21,500 to 17,600 in the US and from 16,000 to 13,300 in Germany between 2006 and 2013

¹ Distribution partners, including double-counting for multiple-brand dealers
SOURCE: NADA; Autohaus; McKinsey

brand restrictions, organizational and financial separation between the dealers' used-car and new-car business as well as minimum marketing budgets. In line with this, ever more OEMs are adding terms to their dealer contract renewals that give them the right to set up an online channel, partially bypassing or at least augmenting the traditional dealership channel as well as increasing their control over the dealership's appearance and operations.

Furthermore, increasing competition among OEMs and dealers combined with a shift to smaller and in most cases also less profitable models have brought dealer margins down to a level of around 2 percent of sales, deviations being more or less solely due to changes in macroeconomic conditions (Exhibit 1). While emerging markets are currently experiencing greater profitability, especially from new-car sales, the trajectory there looks the same. In China, for example, returns have started to decline as OEMs try to aggressively expand their dealership networks to increase their sales and market share. Despite the number of dealerships having almost doubled over the last five years, margins as shown by publicly available financial information are less than 2 percent for some of the top Chinese automotive dealer networks.

Trends in automotive retail offer new opportunities for sales tools and data management

Interview with Patrick Pélata, Chief Automotive Officer and Executive Vice President of salesforce.com

What are the key trends that will change dealer management and sales force management in the future?

Omni-channel expectations. Most consumers start their shopping journey online and expect continuity across channels and for the dealer to have ready access to the information they shared on that journey. Dealers and OEMs need to collaborate to provide this seamless brand experience.

Harmonized lifetime customer experience. OEMs are increasingly focused on loyalty vs. conquest and on managing a lifetime of customer engagement with the brand. As a result, OEMs are increasingly concerned with and focused on influencing the business process and technology decisions of their dealer partners to ensure a consistent experience for the consumer and across their distribution network.

Mobile first. Employees at the dealer need to be able to act and react in real time, when with the customer. They increasingly expect mobile access to technology and simplified user experience and in no place is this more important than in the high turnover arena of retail vehicle sales. OEMs and dealers can improve the onboarding and effectiveness of dealer sales personnel by providing simplified user experience accessible by smartphones that enable them to better serve their customers during vehicle demos and on the showroom floor.

What is your view on tools and technical innovations in the future of sales force steering?

The future of automotive retail sales is a “one-desk” cloud-based solution whereby disparate solutions are integrated and accessed through a single sign-on and common user experience that can span the desktop and mobile devices and can be accessed anytime anywhere to serve the needs of the customer. The simplified interface is complemented with gamification and real-time incentives that reinforce successful sales behavior. At the same time, managers are empowered with real-time mobile dashboards so they can remain on the showroom floor for coaching and customer support.

Which changes do you see on the OEM sales organization side?

OEM sales organizations will need to become more consultative and provide data-driven recommendations to the dealers on how they can adjust to optimally improve the customer experience. At the same time, OEM organizations will need to leverage their scale and take the lead with investing in advanced technology such as virtual showrooms and mobile sales assistants that will be financially and technically out of reach for all but the largest dealer groups.

“Big data” has become a buzz word also in Automotive Retail. How can you facilitate the integration of the OEM database with de-centralized managed dealer information?

Big data in automotive retail spans into three areas: already existing data in OEM and dealer databases, big “social” data and data coming out of the connected car. The existing hodge-podge of data is mostly vehicle centric and sometimes has basic lead information, and is not well integrated with one another. Compounding this is that big data in the form of connected vehicle data is coming online quickly. First, OEMs must get their own house in order with a single view of the customer across marketing/leads and customer service/warranty. Next, they need to facilitate a single view of the customer at the dealer that seamlessly integrates with the OEM. Finally, OEMs will need to devise the sharing rules of connected vehicle data and determine how, what and when is shared with the dealer. Customers should be empowered to co-own their usage data and clearly understand how it is intended to be used and be able to opt-out.

The future of dealers

Instead of battling against the challenges in automotive retail in an effort to cling to the current business model, dealers should focus on mastering the challenges and taking advantage of current trends. We have delineated the concept of a future automotive retail landscape based on the findings from McKinsey's 2013 Retail Innovation Consumer Survey, highlighting how dealers and OEMs can transmute the challenges they face into benefits and innovate their own business model.

Opportunities for dealers

Unlike in other industries, such as electronics or publishing, where the importance of traditional dealerships has diminished, bricks-and-mortar car dealerships will remain a crucial customer touch point for at least three reasons:

- Most customers will always want to physically experience the vehicle before purchase as it is typically one of their largest investments.
- They also frequently seek expert advice on optional equipment and further services (such as insurance and financing options) as well as detailed information that is either not available or not conclusively answered online.
- Both OEMs and customers continue to value the personal aspect of the sales process, which forms the basis of brand representation, customer retention, and service offerings.

Exhibit 2

A cross-touch-point retail strategy is needed as customers are effectively maneuvering multiple touch point categories

Average number of touch points used/experienced per category



SOURCE: McKinsey 2013 Retail Innovation Consumer Survey

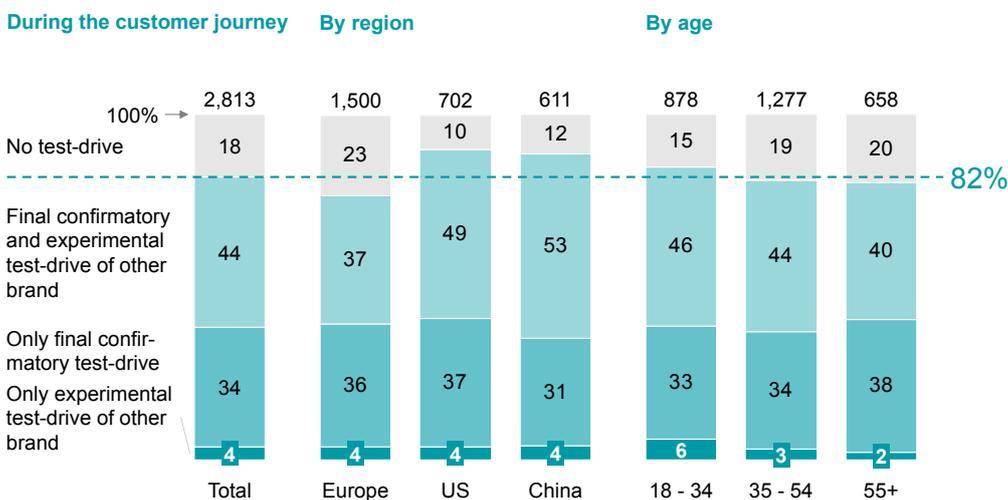
Now that customers are maneuvering multiple touch points, a retail strategy across well-defined touch points promises to be the key for holistically addressing the customer decision journey. Customers are making use of offline sources, such as referrals from friends or colleagues, as well as online and dealer-related information to evaluate products during both the information and the decision phases. They also require service after purchase, and may become repeat customers when their next purchase comes around. The customer decision journey is thus a loop involving multiple touch points. McKinsey research shows that customers use an average of two or more dealer-related touch points during each phase (dealer brochure, test-drive, or dealer consultation, for instance; more than one may be experienced during a single dealer visit), since only the dealer can provide physical access to the product (Exhibit 2).

This is particularly true for used-car sales as it is hard to describe the exact state of a used car in text and pictures: potential buyers want to physically examine the car before making a purchasing decision. Another vivid example of this desire for physical experience is the test-drive, which is traditionally one of the most critical dealer-related touch points. A cross-regional analysis of customer preferences as part of McKinsey’s 2013 Retail Innovation Consumer Survey clearly indicates the dealer’s importance during the purchasing process for customers in all regions and age groups. Overall, an average of 82 percent of customers conducted at least one test-drive as part of their buying process (Exhibit 3). Despite their preference for the online channel for many phases of the purchasing process, even younger customers still want to physically feel and experience the car of their choice before making a final decision. As these customer insights show, it is critical to design and execute a superior test-drive experience for the customer, ranging from providing a well-selected route to giving a targeted explanation and demonstrating the vehicle’s features in a convincing way.

Dealers will remain essential for organizing test-drives – every customer group sees this as a vital source of information

Exhibit 3

Importance of test-drives
Percent



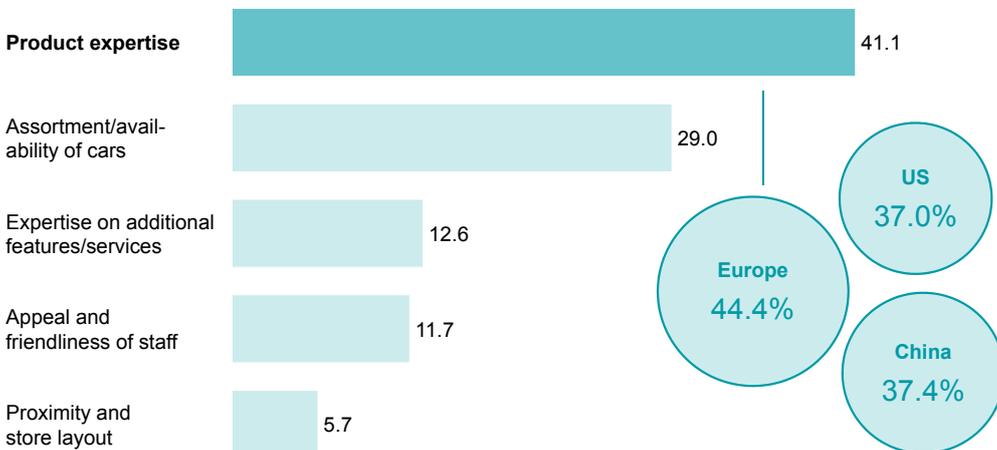
SOURCE: McKinsey 2013 Retail Innovation Consumer Survey

The second reason that traditional car dealerships will remain crucial in the customer decision journey is to satisfy customers' need for expert advice. Our survey shows that over 40 percent of customers rank product expertise as the most important element of a dealer consultation (Exhibit 4). As customers increasingly collect general information online, dealers are ever more being viewed as an advanced "second-level support" for questions and doubts that neither the online configurator, the OEM Web site, nor the various car forums or third-party Web sites are sufficiently able to clarify. Market research shows that the need for further consultation after an online search is higher for cars than for most other consumer products, such as electronics or even pharmaceuticals. On top of this, advice on additional services around a car purchase will become increasingly important, whether financing options, insurance solutions, new features, or updates that can be sold to the customer during the lifetime of the car.

Finally, dealerships will also remain crucial in the customer decision journey as the personal trust between sales staff and the customer plays a central role, especially in the case of conflicting information or tight trade-off decisions between brands and vehicle models. After the sale, OEMs will continue to require a strong dealer network – to serve as local brand ambassadors and provide customers with high-quality vehicle maintenance and service in a convenient location.

Exhibit 4 Dealer expertise is key as most customers expect the dealer visit to yield additional information not easily found online

Importance of key elements during the dealer consultation
 Percent of respondents who ranked respective elements as their no. 1 priority



SOURCE: McKinsey 2013 Retail Innovation Consumer Survey

The role of dealers and OEMs in the future retail landscape

Thinking about how to translate these three reasons for the enduring importance of bricks-and-mortar car dealerships into real operations of the future, it is certain that any optimization will reduce the number of traditional retail outlets as we know them. We expect a shift from undifferentiated dealerships to a landscape of much more differentiated formats, including an increased number of pure service points, as all OEMs need to ensure comprehensive service coverage. Consequently, dealerships as retail formats will not vanish but will have to decide which part of the customer decision and experience journey they want to focus on: brand awareness building and messaging, product experience, sales transaction, or parts and service.

At the same time, new specialized formats are being introduced to enhance the customer experience and increase the efficiency of the retail landscape. McKinsey’s 2013 Retail Innovation Consumer Survey focused on a detailed analysis of appeal ratings for six new format archetypes: test-drive centers, superstores, city stores, online stores, mobile/pop-up stores, and home visits (Exhibit 5).

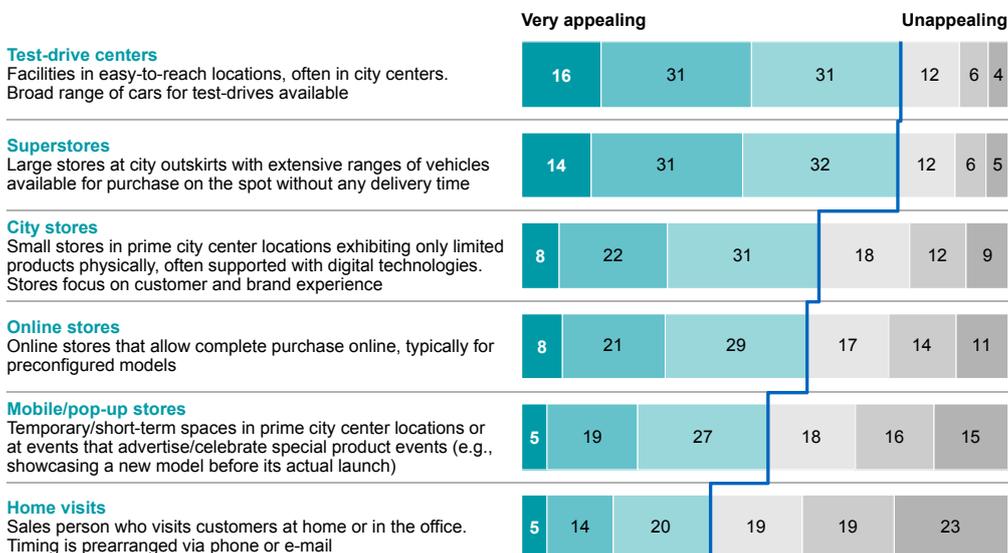
These new formats will cover specific parts of the customer decision journey that had previously been the task of the traditional dealerships: a test-drive center, for example, will serve customers of a number of dealerships close by; city stores will provide tangible and compelling first experience of a car model to potential customers of several dealerships.

Customers strongly desire new formats

Appeal of new store formats to customers

Percent of respondents scored format on a 6-point scale

Exhibit 5

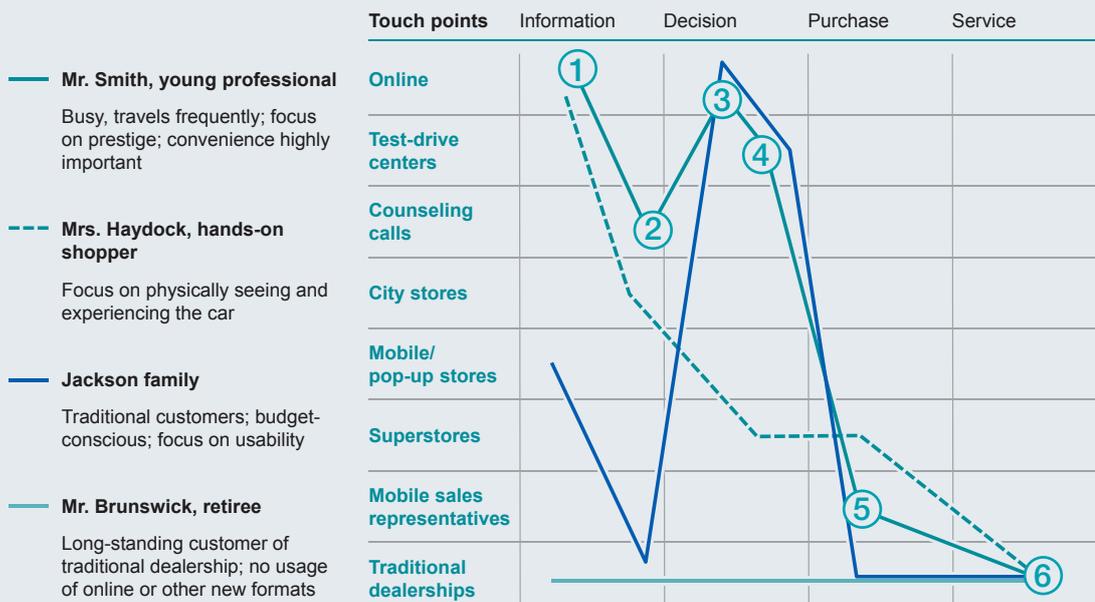


SOURCE: McKinsey 2013 Retail Innovation Consumer Survey

Exhibit 6

The future retail setup will have to accommodate various customer profiles along multiple touch points

EXAMPLE OF CUSTOMERS



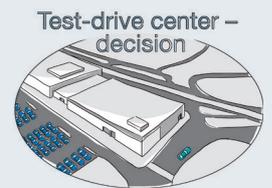
1

- Colleague shares image of new car on Facebook and tweets about it
- Young professional starts research online



4

- Can test-drive his exact car due to large selection available
- Large off-road track allows a test-drive in extreme conditions



2

- Curious about several facts, he calls the OEM's service line
- Detailed information mailed to him with link to OEM configurator



5

- Sales representative comes to his office during a business trip
- Orders car immediately and has it delivered to his local dealership
- Personal handover and voucher for first service appointment



3

- Customizes the perfect car to fit his budget online
- Books test-drive at test-drive center



6

- Serviced at regular intervals at traditional dealer
- High satisfaction with convenience and local representation



SOURCE: McKinsey

Customers will follow different paths across touch points along the decision journey, such as looking up information online before receiving a counseling call, purchasing from a mobile sales representative, or having their car serviced at the local dealership (Exhibit 6). Customers do not distinguish between OEM-controlled outlets and independent ones. They expect a seamless experience across all touch points, both on- and offline. This means that OEMs and dealers will need to integrate their respective data sources to be able to understand and most efficiently serve their customers. Integrated data sources allow them to allocate the right expertise, offerings, and resources to the various customer touch points to increase the ultimate conversion rates and experience for the customer.

While this is a challenge for OEMs and their current data systems, it also offers the unique opportunity to build a central customer database, combining all available customer information along the entire decision journey and across all touch points. As well as ensuring a smooth end-to-end customer experience, this can also generate a whole new level of customer intelligence, enabling OEMs to derive new customer insights. This in turn enhances marketing return on investment (RoI) while reducing marketing spend. The major investment required to create these integrated touch point management databases means they are unlikely to be funded by dealers. OEMs will most often be in the lead, establishing them as central data and insight managers. That said, we believe that dealers also need to build local customer insights and databases in their respective micromarkets, efficiently gathering and effectively evaluating critical information to guide customers in their decision making journey.

Successful integration will allow OEMs and dealers to comfortably accompany customers with very different requirements through various touch points. This will result in optimized conversion from interest to purchase and to increased aftersales and service revenues for both traditional dealerships and specialized service locations as a side effect.

Transformation journey – how the future could unfold

The key to future dealership success will be the transformation of the dealer network into a modern, multi-format, innovative sales and service environment. To achieve this, McKinsey has developed a transformation approach consisting of three building blocks:

- The first building block is to build the foundations of excellent dealership performance by measuring and managing performance (including benchmarking) and optimizing dealership performance within the network.
- The second building block deals with enhancing dealership performance via innovation, defining a new – or at least enhanced – business model, and starting to test these innovations on customer experience.
- The third building block encompasses transitioning to new retail formats and innovations by developing a holistic rollout plan across the network and implementing the enhanced new retail strategy.

First building block: building the foundations of excellence

McKinsey's analysis reveals a significant performance spread within typical automotive dealer networks across all relevant dimensions, such as area coverage, profitability, and customer satisfaction, always identifying a significant fraction of the dealership portfolio of any OEM's network within the "underperforming" cluster (below average). Improving the performance of this cluster will increase the profitability of the entire current network. This will be important as it is a means of financing the new retail formats and sales and service innovations – reinvention can only work on a sound foundation.

Enhancing this foundation for excellence involves changing mindsets and capabilities. McKinsey has identified some common building blocks for improving conversion rates to actual sales from its extensive experience in supporting organizational capability building, including intelligently understanding and assessing customer preferences (such as usage, sales/service and brand preferences), using attractive service offers and introducing bundles with financing products, to mention just a few examples.

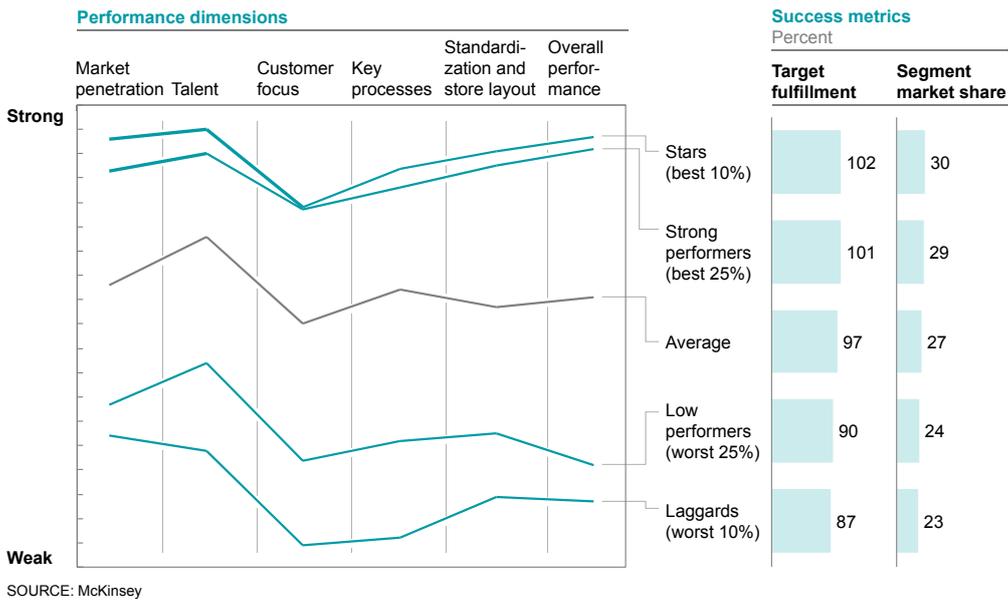
The first step and a key element in this process is enhancing the foundations by performance management using clearly defined metrics and implementing new process and quality standards to reduce performance disparities along all relevant dimensions (a 360-degree approach) (Exhibit 7). This will ideally include conducting annual reviews of the entire dealer network as well as systematic internal and external benchmarking. In a first step, it is crucial to identify the relevant drivers behind performance metrics – these will differ depending on country, region/micromarket, and OEM. The input metric of dealer performance (along the dimensions of standardization, key processes, customer focus, etc.) correlates strongly with relevant metrics of operational success, such as target fulfillment rates and segment market share. It is essential to analyze root causes underlying gaps to target or benchmarks and consistently develop counteractions to drive performance. This process needs to be owned by the dealer leadership team, supported by OEM regional managers as engaged business advisors.

In a second step, specific improvement opportunities along the drivers of performance have to be addressed, with tailored actions for each dealer, ranging from specific trainings to process redesign. To prioritize these actions, customers' satisfaction with certain aspects of the purchasing process needs to be matched to the respective importance of these elements. This will allow dealers to focus on the most important steps, ensuring that resources dedicated to improving customer satisfaction and

Rigorous implementation of standards and performance tracking is vital to reducing performance spread

Exhibit 7

Exemplary dealer network



conversion rates in the customer purchase funnel (decision making journey) yield substantial bottom-line results. Successful performance enhancement programs have managed to significantly increase market share in the relevant segments and achieve improvements in operating performance.

Second building block: enhancing dealership performance by innovating formats and the customer decision journey

While reducing performance spread is a prerequisite for improving current retail network performance, it will, on its own, neither ensure future success nor transform today's dealer network into a modern, multiformat, innovative sales and service experience for the customer.

New technologies, such as fully integrated customer relationship management and dealer performance management systems, are a good place to begin the digital innovation that can help enhance the performance of traditional dealerships. They enable both dealers and OEMs to better utilize available customer data and provide real-time transparency and insights into retail performance. Audi, for instance, has begun supporting the digital marketing activities of their dealerships by offering dealers a standardized set of digital tools, including search engine optimization and banner advertisements, to help them generate more qualified leads. Many OEMs – Mercedes-Benz, BMW, and Ford, for example – have started equipping their dealers with iPads to provide their sales personnel with a tool to present the latest information on their car models to customers and increase both the efficiency and expertise of their sales and product experts. Implementing these new technologies and process

enhancements requires sound support from OEM regional or area managers. Their core activities will ultimately shift from monitoring dealers towards helping them upgrade their skills as well as managing and coordinating touch points.

Ultimately, retail sales format innovations will help better address customers' changing behaviors and amend the existing retail landscape accordingly. The combination of formats and their implementation should be consistent with the OEM's value proposition (brand positioning, product line offering, product and service differentiations, etc.). A premium OEM may choose to create a test-drive center with a strong emphasis on enhancing the customer experience and upselling, while a value/mainstream OEM might decide to focus on maximizing efficiency gains or even partner with other dealers to offer a richer test-drive experience. These new formats are not competing: they complement traditional dealership services and offerings as they would enable them to, for example, save on the high inventory carrying costs of organizing test-drives themselves. From the customer's perspective, acceptance of these new formats varies across age groups. While customers below the age of 55 strongly favor them, an average of only 46 percent above that age consider the introduction of new formats appealing, as revealed by McKinsey's 2013 Retail Innovation Consumer Survey. This highlights the importance of good transition management in capturing the young customer segment without losing the more mature customer segment. Looking at regional differences, new formats are most appealing to customers in China – suggesting that this type of dealer network transformation might be most effective there – but a significant fraction of customers in the US and Europe also express high interest (Exhibit 8).

One particularly interesting new format is the online store. Today, almost all OEMs and even most dealers are trying to launch some kind of Internet store where legally possible. Mercedes-Benz, for

Exhibit 8 Customers support new formats across geographies

Appeal of new store formats to customers

Percent of respondents who scored format 4 or higher on a 6-step scale (6 = very appealing)



¹ Weighted with average number of respondents per geography
 SOURCE: McKinsey 2013 Retail Innovation Consumer Survey

example, recently started offering a limited number of preconfigured versions of its A-, B-, and CLA-Class online in pilot countries. However, no OEM has yet managed to solve three major challenges related to stand-alone online stores:

- As touch points such as test-driving and physically handing over the car still require the presence of dealers, completely bypassing the traditional channel is not a viable option. Online stores are therefore predominantly used as clearing platforms for preconfigured stock vehicles or as “prepurchase” platforms.
- Aligning discount strategies between the on- and offline channels is a tough challenge. While OEMs are willing to offer higher discounts on stock vehicles to push their “unsold overproduction” or less desired vehicles into the market, they are not willing to erode their general price level or minimum net transaction price targets.
- As more touch points become a key part of a customer’s purchasing journey, the challenging question is which channel gets credit for the sale (and how the rewards will be divided).

Emergence of a new online store format in the US

Judging from a recent McKinsey survey of around 1,000 car buyers in the US, the vast majority of new-car purchases are already influenced by online sources, but actual online sales are extremely rare. McKinsey research indicates that this will likely change over the medium term in the US. Two key factors underlie this prediction.

First, our survey indicates that roughly one in three US customers does not just do online research but would already also seriously consider buying his next car online. For online shoppers, the primary motives are convenience, such as saving time by avoiding the physical trip to the dealership, the expectation of lower prices when buying online, and avoiding certain unpleasant elements of the sales experience at dealerships, such as “haggling over the price.”

Second, a multitude of players are already experimenting with online sales in the US market. They appear to fall into four categories. One is OEMs – such as GM – that provide their dealerships with an online sales capability (“Shop-Click-Drive”). Then there are dealer groups that follow a similar approach (e.g., AutoNation’s “Shop-Choose-Drive”). Established online brands are another, such as Amazon, which is piloting the sale of the Versa in cooperation with Nissan. The fourth category consists of independent third-party platforms, such as CarDirect. While a dominant model or player has yet to emerge, OEMs and dealer groups will need to build their online sales channels going forward to address the needs and preferences of this growing segment of the market.

However, it should be noted that the US automotive retail market is dependent on franchise laws that restrict free market competition and are not expected to be liberalized in the near future. Online sales therefore need to be arranged within the context of franchise laws, i.e., by leveraging dealers – a model followed by GM – through independent sites, such as CarDirect, or via current retailers, such as Amazon.

Both US customer demand as well as recent retail initiatives suggest increasing dynamics towards online as a real sales channel, even though legal obstacles exist. Sustainably implementing the initiatives and overcoming the legislative hurdles will be one of the key challenges for US OEMs in the years to come.

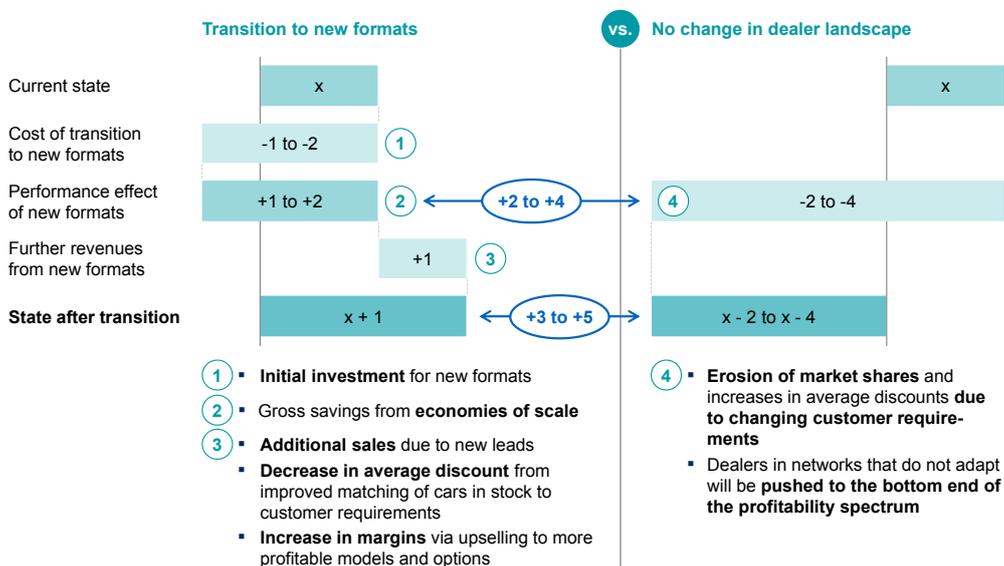
Alignment of the online world and the traditional dealership will be the backbone of any successful multichannel strategy. OEMs and dealers can only improve conversion from online traffic into qualified leads and sales for their dealerships by completely integrating all on- and offline formats of their retail network, thus fully capturing the true potential from online sales. This will require a seamless information management approach supported by targeted allocation of resources and funds along all major relevant online and offline/physical touch points. What is ultimately needed is an optimization model that considers RoI from a dealer and OEM standpoint as well as from the perspective of customer satisfaction.

Online stores and the other new formats, combined with the traditional automotive retail landscape, will change the business dynamics for OEMs and dealer networks. Shifting from a purely dealer-based network towards a multiformat retail landscape should pay off overall. To anticipate the future implications, McKinsey has run a simulation and found that this new model could yield significant improvements in the return on new-car sales.

The optimization of an OEM's retail network in Germany was modeled to simulate the financial impact a successful transformation could have on overall network profitability. Despite high upfront investment, the gains from new formats, such as test-drive centers, superstores, or an online store, could be as high as a 3- to 5-percentage-point greater return on new-car sales, compared to a scenario where no action is taken and challenging trends diminish the retail success of the traditional dealership landscape (Exhibit 9). The gains result from gross savings due to economies of scale and additional sales. However, total savings will depend heavily on specifics of the OEM's current network, requirements for the new target state, and the scope of the optimization. Furthermore, distribution of the total savings between customers, dealers, and OEMs will depend on the specific ownership structures, strategies of the parties involved, and competitive conduct.

Exhibit 9 Transition to new formats is achievable without loss in profitability

Average return on sales (RoS) on new car sales
Percentage points



SOURCE: McKinsey

McKinsey's simulation of potential network optimization

McKinsey conducted a simulation of a fictitious premium OEM's dealer network to estimate the financial implications of full-scale network transformation, including the introduction of new formats.

As the choice of each format and its different options (such as experience-oriented test-drive center versus efficiency-oriented joint venture with a rental car company) are highly dependent on the OEM's value proposition and strategy, the first step was to determine the ideal portfolio of formats. To ensure economic viability of each new format and outlet, minimum thresholds for each of the chosen formats were derived in a second step based on stand-alone business cases (e.g., minimum number of test-drives to operate). These thresholds as well as the current dealer network's configuration in the given area/country were used to derive an optimized network setup, including new formats, followed by a simulation of its financial implications on existing traditional dealerships.

In a third step, the results of this simulation were used to identify dealers experiencing significant negative returns in their new-car business. These were transformed into pure service points, while their original sales were distributed among the remaining dealerships in the specific region. This iterative process is repeated until eventually every further conversion of a new-car dealership into a service point would cause insufficient network coverage in the area.

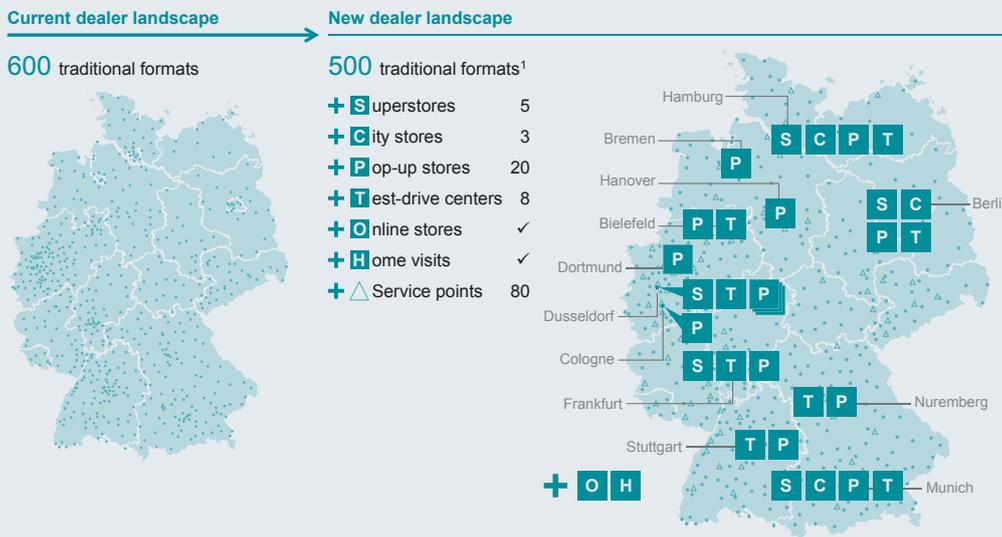
The improvement potential of holistic network transformation and the introduction of new formats, such as test-drive centers, city stores, and online, pop-up, and superstores, is based on the following five main drivers (see Exhibit 10):

- Boosting efficiency by introducing dedicated test-drive centers, reducing the number of demo cars required (for example)

Existing dealer network can be upgraded by integrating innovative formats

EXAMPLE

Exhibit 10



¹ Either reduction of number of stores or transformation to service points
SOURCE: McKinsey

- Lowering the cost of sales by implementing an integrated online channel
- Increasing economies of scale by further consolidating new-car sales and focusing them on fewer but larger dealer outlets while operating within reasonable travel distances for the customer to the dealership
- Reducing customer discounts by, for example, systematically ensuring that all the vehicles in stock actually match customer preferences
- Increasing sales and upselling potential, e.g., acquiring additional leads via pop-up stores and brand centers.

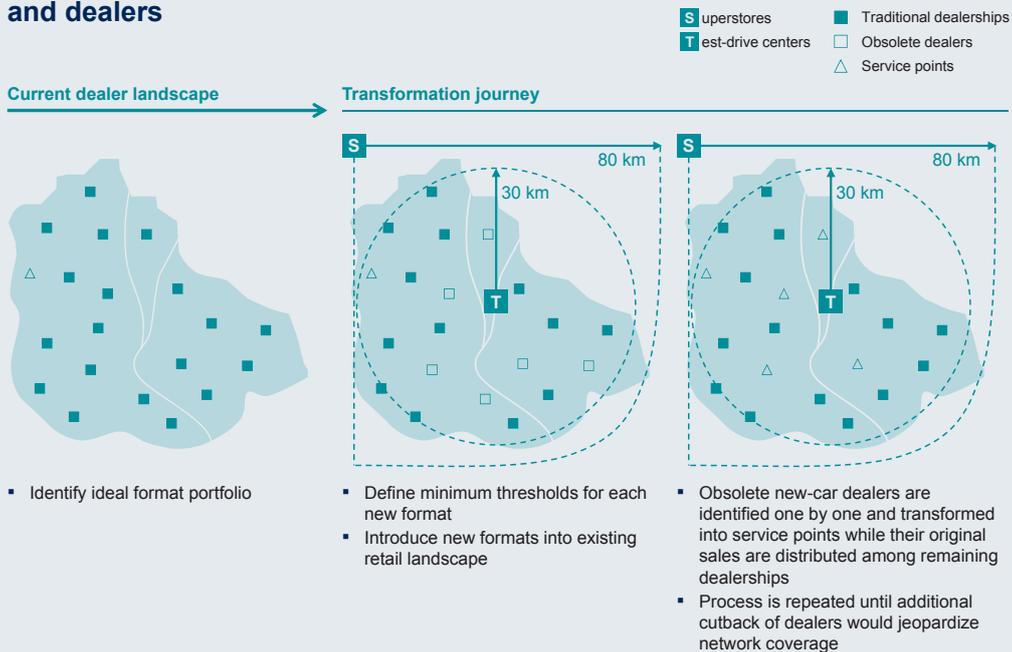
Altogether, the simulation at a network level indicates that the cost of introducing new retail formats would not just be fully compensated by efficiency gains (i.e., via eventual cost reductions) but also increase revenues via new leads and a decrease in the average discount level resulting from an improved customer experience. If no action is taken, the trends of changing customer behavior, increasing product complexity, and market pressure will likely lead to an erosion of market share, effectively reducing RoS by 2 to 4 percentage points, resulting in a 3- to 5-percentage-point gap versus successful transformations (depending on the OEM, the dealer network, geographical reach, and quality of execution).

When analyzing the dealership level, traditional dealerships could also benefit from the transformation. While operating costs are optimized via levers such as pooling demo cars and stock vehicles, the share of revenues potentially transferred to other formats is relatively limited, and frequently not even profitable at present. The traditional dealership's integration in the new network could therefore not just ensure sufficient compensation for delivering their vital offline physical support in the customer experience during the sales process, but also allow them to specialize their operations towards their more profitable after-sales and service business (see Exhibit 11). Individual results will obviously vary significantly across dealerships.

Exhibit 11

Introduction of new formats has positive effects for both OEMs and dealers

EXAMPLE



Third building block: launching the implementation process

The third building block is the retail transformation program, consisting of three implementation waves: laying the groundwork, testing first pilot projects to create momentum, and implementing a complete rollout to ensure sustainability.

Implementation wave 1: laying the groundwork

To start the transformation program, OEMs should systematically evaluate and continuously optimize the dealer network, and make a fact-based assessment of which dealers to invest in, and at what level, covering factors such as market opportunities, dealer capabilities, and competitive environment in the micromarket. Then, for prioritized dealers, they need to codify and share their knowledge about excellence in customer service, using techniques such as intelligent customer data analysis and introducing product experts to the sales floor.

McKinsey’s 2013 Retail Innovation Consumer Survey shows that there will be extensive region specificity in developing excellence in customer service – no one-size-fits-all solution will work once the boundaries of country/region and customer behavior have been crossed. Blogs and forums, for example, are top sources of information in the UK and China, whereas car and offline advertisements play a more important role in the US and Italy (Exhibit 12).

Market-specific approach required as several top information sources vary across countries

Exhibit 12

■ Important local source

Information source	Europe			US	China
	Germany	Great Britain	Italy		
Blogs and forums		■			■
Online marketplace	■				
Social networks					■
Test-drive	■	■		■	
Seeing the car and offline advertisements			■	■	
Online car configurator		■			
Family and friends					■

SOURCE: McKinsey

It is vital to recognize and understand the challenges and core principles to ensure sustainability of the transformation. The following factors make any transformation of an automotive retail network particularly challenging:

- Large number of dealership units. A transformation effort can easily include several hundred dealerships.
- Limited clout. In many networks, the dealers are independent entrepreneurs who cannot be forced to innovate their business models. They will not easily accept externally imposed changes but need to operate within the performance agreements and guidelines established between OEMs and dealers.
- Varying interests of the players involved and differing levels of capabilities amongst dealers. An existing dealership network will have members of different types and shades, extending from stock-listed international dealer groups to family-owned “local heroes.”

Implementation wave 2: running the pilot phase

OEMs need to get local support for the program from their regional and area managers to gain momentum for the transformation process. They should co-lead the transformation, and represent the “transmission belt” between the OEM and dealer network. Their role will ideally be to validate the effectiveness of the program on-site and, together with the dealer, to review progress, make adjustments if needed, and ensure consistent application of new processes/standards and cross-fertilization of best practices. In essence, these OEM area and regional managers should be transformation advisors and have the right skill set in terms of subject matter expertise (retail innovation, retail performance management, product know-how) and change management.

The pilot phase also requires combining tailored solutions with central architecture. Overall principles of the transformation need to be ensured as a central architecture, such as centrally defined formats and their combination as well as the steering governance. However, specific on-site solutions, such as the use of a 3D configurator, should be codefined with each dealer individually to create full buy-in and adapt to local micromarket needs.

A comprehensive transformation will start with testing and presenting first proof of concept to create showcases for the organization. This might, for example, involve transformation of one region, or testing new formats in a few cities. The rollout should follow after these initial tests, carefully analyzing lessons learned and immediately integrating feedback.

Implementation wave 3: ensuring sustainability

A transformation will not improve customer satisfaction and dealership performance without the right people to bring it to life. Laying the groundwork for a successful transformation will therefore also need to comprise redesign of the HR strategy. Key elements to consider will include the following:

- Recruiting and onboarding. Transforming into multiformat is not just a requirement for retail – it is also essential for sourcing top talent. Large online fan bases for car brands represent precious pools that need to be tapped. An equal recruiting focus needs to be given to expertise (such as technical knowledge of the vehicle and competitor know-how), sales competence, and soft skills/behavioral elements (“passion for the brand and customers”). It is crucial that sales and product experts demonstrate a deep understanding of the various segments and their preferences to better connect with different customer groups.
- People development and retention. It is important to offer and promote attractive and differentiated career paths to combat the high turnover rate typically observed in automotive retail, with clear steps on how to progress from the sales floor to compelling management and technical roles in the dealership and OEM. Classroom training will increasingly be substituted and augmented by on-the-job coaching.
- Targets and incentives. Institutionalized scorecards and performance dialogs will remain crucial. However, alongside measuring target achievement per se, greater attention also needs to be paid to how the target has been achieved.

It is therefore essential to ensure top-management focus and priority. Successful transformations need to be spearheaded by top management, such as the CEO of the organization or the head of sales (global and/or regional). Regular dialogs with dealers/the dealer council are crucial to underline the importance of the initiative and keep partners informed. The individual progress of each dealer should be reviewed regularly, at quarterly implementation progress meetings, for instance.

These three waves complement and build upon each other. It is crucial to tackle all of them for sustainable success. However, the emphasis put on each of the waves as well as the topics within each wave can and should be customized to the situation, players, and stakeholders. This ultimately represents both the managerial challenge and the key success criteria.

Outlook

The major trends reshaping the automotive retail industry will translate into significant degrees of change ahead for the dealer landscape, which naturally leads to speculation about the future of car dealerships and whether they will survive or fade into history. One of the most remarkable insights to emerge from our research is the potential new role of the physical car dealership and dealer networks in general.

Effectively combining traditional dealerships with innovative retail sales and service formats will not work as a standardized approach. The strategy and model needs to be tailored to different geographies and customer segments to offer the latest technology without alienating existing customers. Customizing the approach, continuously monitoring changing customer behavior and agreeing on a new work and profit sharing model with dealers will be the key challenges in ensuring successful implementation of the innovative retail setup. The evolving nature of these challenges means that design of the innovative retail blueprint is not a one-off effort but a journey of constant adaptation to changing realities.

The first steps of this journey are currently being taken by most OEMs piloting new formats and touch points. However, which OEM or dealer group will lead the way by holistically transforming its traditional dealership structure and introducing new formats at scale remains to be seen. Being a first mover in such a volatile environment is not without risk, but has the potential, if implemented successfully, to yield significant customer satisfaction and economic benefits in the transition phase and beyond. Early successes will likely be self-reinforcing, as early movers occupy the best locations, attract most awareness online, and gain faster insight via advanced data management. This effectively gives OEMs a competitive sustainable advantage, based on their upgraded and more innovative retail network. Players who are willing to innovate and test new formats and services in the market place, selecting the winners and rolling them out with speed and rigor, will find that they are able to create a competitive advantage in the pursuit of automotive industry leadership.

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