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AUTOMOTIVE DISTRIBUTION BETWEEN GLOBALISATION AND LOCAL CONTEXTS: THE ROLE OF DEALER GROUPS IN EUROPE

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This paper looks at the reorganisation process taking place in the car distribution industry, with particular reference to the profile of franchised dealers of larger size (dealer groups). While in the past manufacturer strategies were aimed at achieve territorial coverage through a high number of franchised dealers, whose growth was often restrained in order to limit their acquisition of bargaining power, current pressures towards concentration, plus new attitudes by manufacturers are stimulating the growth of retailers who manage relationships with a growing number of manufacturers (brands) and in a growing number of areas (market territories).

Among the most relevant pressures there are:

- ✓ a very low profitability,
- ✓ high competitiveness (particularly intra-brand, that is among dealers representing the same franchise),
- ✓ the opportunities lying in the new information and communication technologies and the unfolding implications of the new regulation (Block Exemption).

There are also some other aspects (e.g. succession problems) which in some cases enhance the drive towards an increased role of dealer groups. But while there is a general trends towards an increase in scale and scope of dealer groups in Europe, when looking at the individual markets, one sees that such trend towards higher concentration takes place at various speeds, and through various forms. Dealer groups feature different traits and strategies in each market, without any 'one best way' yet emerging. Furthermore, initial evidence from research on the performance of dealer groups indicates that scale does not necessarily represent an answer to the system pressures, as it does not translate automatically into better performance (profitability). This underlines even further the fact that there is no current single 'attractor' model, but rather a range of strategies unfolding, with a considerable degree of experimentation.

This document is based upon research carried out by the author and other colleagues within the ICDP (International Car Distribution Programme[1]). It must be said that while in the UK market there is a considerable amount of information available on dealer groups, in the other major European markets research had to make extensive use of other means such as direct contact with retailers themselves in order to acquire basic information.

THE EUROPEAN AUTOMOTIVE DISTRIBUTION SYSTEM

The car distribution system in Europe as in other major countries has gone through over a century of history which can be broadly divided into a few main stages. The *first stage*, which developed between the nineteenth and twentieth century (similarly to what happened in the USA), featured the establishment of a mixed distribution structure which utilised branches (manufacturers' wholly owned sites used for direct sales), distributors (wholesalers who managed large stocks of cars in relevant geographic areas and channelled cars to consumers through retailers, traditionally named dealers), agents (in charge of collecting orders from customers, but with a very simple organization).

With the expansion of the European automobile market after World War One, a *second stage* emerged, with the gradual disappearance of distributors, as manufacturers tried to increase the degree of control over distribution channels, and the growth in the number of dealers (frequently through an upgrading of the agents), along with the change of their legal status into franchised dealers[2]. The franchised dealer was granted a territory in which he carried out sales on an exclusive basis, without any other dealer of that make being present.

With the further commercial expansion triggered after World War Two, a *third stage* emerged in which the scheme of the exclusive franchised dealer became widespread in all major European countries. The changes were brought along by a strong expansion in the automobile demand which stimulated in Europe a mass market similar to the one which had developed in the USA since 1915. Inevitably, mass production required also mass distribution with initiatives aimed at solving the needs generated by the new situation.

With the spread of sales through a network of exclusive dealers, a sort of vertical quasi-integration of automobile manufacturing and distribution was established. The dealer network was made of independent operators, but their marketing policy was dictated by obligations entailed in the franchising contract, from which the individual dealer could not diverge without risking losing the contract with the car maker.

But after some decades enjoying a situation of a seller's market, from the 1970s a series of changes occurred in the European automobile market, which gradually led to a buyer's market. Among the most relevant factors of this transformation, which matured in the middle of the 1980s, there are the oil crises, with the subsequent considerable inflationary push, the entry of Japanese competition in the international automobile market, and the gradual disappearance of first-time buyers, on behalf of a replacement demand.

The final outcome of this great transformation consisted in the dramatic fall in profitability levels in the US and European automobile industries which were forced to

[1] ICDP (International Car Distribution Programme) is the world's largest cooperative research network into all aspects of car distribution and after-sales, established in 1994 (www.icdp.net).

[2] The dealer is an independent operator who is granted the mandate to sell vehicles manufactured by a car maker to the end customer. He buys cars on his own, and sells them on a retail basis, while the agent operates in name and on behalf of the car maker. On the first experiences on the Franchised Dealer System in the USA see: Epstein [1926], Hewitt [1956] and Pashigian [1961].

undertake a massive reorganization process. After major efforts by automakers in the manufacturing and component supply side in the 1990s, it became soon evident that the full exploitation of the transformation also required changes in the downward stages of physical vehicle distribution in target markets, and of vehicle commercialisation. As a consequence, a vast reorganization process between car manufacturers, dealers and drivers began, which is currently seeing a lot of experimentation in place.

It must be said that one cannot speak, from the standpoint of commercial strategies, of a 'European distribution system' intended as a highly homogeneous entity, given the considerable elements of diversity which exist across the various countries, with respect to commercial attitudes and needs. Such system must be intended instead as a set of common main aspects, whose evolution has been influenced by specific traits of each national market. While in many cases market trends are partly reducing those differences (e.g. rationalization, dealer formats imposed by car makers, pan-European car distribution strategies), with some markets showing some degree of convergence, in other cases the achievement of a unitary distribution system is still restrained by considerable specificities (e.g. the highly differentiated taxation regime[3] in the different member states).

When looking at the European distribution system in more detail one can find a set of differences, linked to regional/national diversities, which have also determined different evolutionary paths[4]. On the whole there are about 55,000 franchised dealers, which are estimated to be controlled by about 45,000 owners (sales in Western Europe amounted to about 16.9 million vehicles in the year 2000). About 81% of dealers are exclusive to franchises which belong to a single automaker[5], while 66% of them are exclusive just to one make. But while for example in Germany there are about 15,000 main dealers with a rather low throughput (sales per dealer), on the contrary the UK industry is highly concentrated, with the leading 20 dealer groups owning 12% of the total outlets in the market, and around 60% of cars being sold by dealers operating two or more outlets. Another element of differentiation is the extent of downward integration by car manufacturers (manufacturers or importers owning dealerships): while such feature is not present in the UK and is very limited in Italy, in other markets such as France and Germany some manufacturers operate a large number of owned outlets.

Differences across European markets can be found also with respect to profit structures, where UK dealers tend to be more reliant on profits deriving from after-sales, finance and used cars business, while other markets (particularly Italy) are more reliant on profits on new car sales.

THE PRESSURES FOR REORGANISATION

There are concurrent market, industry and regulatory forces which are exerting some pressure over the distribution system, pushing towards a profound reorganisation process. A considerable effort towards a leaner system implies the reorganisation of the network structure. Car manufacturers have acknowledged the contradictory effects deriving from the old-fashioned strategy of increasing the number of dealers (for maximum territory coverage and market share), and are generally moving towards a dramatic reduction in number of intermediaries, aiming at three main objectives:

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[3] See Volpato [2000].
[4] See also Buzzavo et al. [1994].
[5] For example Fiat-Alfa-Lancia, GM-Saab, or Ford-Mazda.

- ✓ to reduce intra-brand competition among dealers of the same franchise;
- ✓ in such a way, to make it easier for dealers to achieve economies of scale;
- ✓ to regain the share of 'dealer discount' which presently dealers are forced by the competitive game to give away to customers, in order to close the sale.

The trend for concentration is facilitated by a set of concurrent factors: the amount of financial resources needed to efficiently and effectively operate a car dealership has increased, particularly due to the high investments in brand-specific structures and resources. As a consequence of this, many car manufacturers invite dealers to carry out mergers and acquisitions, or to exit the business, particularly in cases where ageing dealer owners do not have possibility of generational turnover. Such concentration in some cases is also favoured by the low profit levels, where in some cases the 'book value' of a dealership (the sum of the value of its individual assets) exceeds its market value, hence there is a strong motivation to sell the business.

To this respect it is interesting to compare the European dealer structure with that of the US market, which has a market of a comparable size, although it benefits by a higher degree of internal homogeneity than Europe. In the USA there are about 22,000 dealerships which are owned by less than 15,000 companies. As a consequence, the number of owners in Europe has a ratio of three-to-one if compared to the US.

The rationalisation of networks across the major markets in Europe which occurred over the last five years is illustrated in figure 1, where 'contracts' indicates the number of franchised contracts held by manufacturers with dealers, and 'outlets' represent the number of sales outlets. While outlets remain rather stable, the reduction in the number of contracts indicates a process of concentration among players, with an increase in the average size of dealer companies, with the emergence of dealer groups.

Figure 1.-*Trend in franchised dealer networks in Europe (1997-2001)*

	Contracts	Outlets
France	-18%	-2%
Germany	-17%	-13%
Italy	-9%	+1%
Netherlands	-25%	+2%
Spain	0%	+18%
UK	-19%	-14%

Source: *European Car Distribution Handbook 2001*

With the acceleration in merger & acquisition processes, in many cases manufacturers are aiming at establishing stronger relationships with fewer intermediaries, who are granted representation for the different brands of the group within a given territory. This means that in most cases a franchising contract for the Fiat brand is tied with Alfa Romeo and Lancia, while similar processes happen for manufacturers such as Ford (with Mazda and Jaguar), General Motors (with Saab), Renault (with Nissan), Mercedes-Benz (with Chrysler). This rationalisation translates into a reduction of dealer numbers. In the case of Fiat Auto, for example, the number of dealers in Europe has halved over the last five years[6].

At the end, the process should yield some savings on the cost of distribution for car makers, equal to the lower discount granted to dealers, and with an improvement in the profitability of dealers, which over the last years have experienced troubled operational conditions. However, doubts over this possibility are more than legitimate, mainly for two reasons. Looking at the recovery of efficiency the experience of various decades in managing dealer networks has shown that large size (that is a large number of vehicle sales per year) does not automatically translates into economies of scale and therefore into an efficient management. As in any other industry large size is a necessary but not sufficient condition in order to gain adequate economies. Only with adequate managerial practices a large scale dealership can achieve high profitability levels, as many cases of failure of large and very large dealers in Europe show. Consequently, it would be necessary for car makers to carry out a learning process driven by part of the dealers in order to achieve high managerial standards. A result which so far car makers have not been able to achieve, neither with respect to dealers, nor with their own branches (owned-outlets), some of which have been shut down and some others have been sold to dealers given the unsatisfactory results.

Another crucial aspect lies in the new managerial skills and processes required to cope with the new transformation. When a few traditional dealerships traditionally managed through a marked entrepreneurial attitude, with specific managerial styles, are merged into a larger company, a marked shift in the degree of professionalism, specialisation and management control is needed, which in many cases implies a burdensome and complex process of reorganisation, whose scope is far from being fully grasped.

Another aspect heavily influencing the reorganisation of the European automotive distribution system is the recent change in the regulation affecting vertical restraints (that is the franchising contracts between manufacturers and dealer). The recent regulation (1400/02) considerably innovates the previous one (1475/95), with an overall approach which makes it less different from other industries than in the past. While the implications of the regulation are quite complex and in many cases difficult to fully assess[7], it is relevant to underline that the new discipline grants a higher degree of freedom to dealers. On the one hand it is easier to acquire representation of another brand, without incurring in very high costs as in the past. On the other hand, a dealer can acquire another dealer of the same franchise without the need for the manufacturer to authorise the purchase. On the whole, these aspects create more opportunities for dealer groups wanting to grow in size and scope.

[6] In the domestic market the number of dealers has reduced from 1,407 in 1992 to less than 700 in 2000, while the total number of dealers in the other European markets decreased from 2,976 in 1992 to less than 1,500 in 1999, with a target of about 1,000. The objective is to achieve an average throughput of 1,000 units sold per dealership in Western Europe.

[7] For a more detailed examination of the new regulation and its implications see Tongue [2003]. For a comparison of the European regulation versus the US and Japanese context see Buzzavo and Volpato [2001].

THE ROLE OF DEALER GROUPS

Dealer Groups in the distribution system

As said, the reduction in the number of franchised dealers is associated with a growing role of larger companies ('dealer groups'). Pressures on retailing, combined with the opportunities created by the new Block Exemption, have increased expectations that retail concentration would eventually occur in car distribution just as it has for most other consumer products. But when looking at the concentration process in place, it is worth trying to ascertain what are the drivers pushing franchised dealers to increase their size, hence establishing dealer groups. When one looks at what economies of scale dealers can achieve, one can see that they are not massive. With respect to purchasing cars, there currently seem to be very narrow possibilities to achieve economies of scale, at least within the current distribution scheme adopted in Europe, which does not allow larger players to fully leverage their size to achieve volume discounts as it generally happens in other industries. For parts (and other supplies such as lubricants) there are better opportunities, which could be improved further by the new regulation. With respect to marketing, on the one hand a larger scale of operation allows economies in communication, but stretching the activity outside a given area implies difficulties in leveraging current strengths, hence additional costs. When looking at overheads, consolidation might yield savings, but one must not forget any additional cost brought along with consolidation processes itself. In funding, a larger size could leverage a stronger financial structure, albeit a growth of risk must be taken into account as well.

Figure 2.-*Key advantages and disadvantages of the different dealer group strategies*

SINGLE BRAND, SINGLE REGION *Advantages* Compact, focused approach Low complexity, interface cost Limit intra-brand competition "Standardised" marketing policies *Disadvantages* Lack of market power Growth constraints	MULTI BRAND, SINGLE REGION *Advantages* "Big fish in a small pond" approach Limit intra-brand and inter-brand competition Scope for dealer brand communication Pool ancillary offerings (e.g. body shop, used cars) *Disadvantages* Interface costs (e.g. DMS, etc.)
SINGLE BRAND, MULTI REGION *Advantages* Low complexity, interface cost Limit intra-brand competition *Disadvantages* Management complexity Individual outlet management	MULTI BRAND, MULTI REGION *Advantages* Portfolio approach, hedging risk (of manufacturer losing share, frictions with manufacturer, or single regional decline) *Disadvantages* Cost, complexity, span of control No real economies of scale?

On the whole, this brief summary of the possible drivers for scale indicate that there are some advantages as well as some disadvantages, and on the whole it seems that for automotive franchised dealers there are less opportunities lying in scale than in many other retailing sectors.

One interesting way to look at the growth strategy for a dealer group is to look at two main dimensions, that is: the broadening of the franchise coverage (acquire more brands), or the broadening of the geographic coverage (manage more territories). This depends clearly on the status of the group, on the current situation and the prospects for the brand(s) in question, as well as the entrepreneurial culture and management resources available within the company. Figure 2 provides an overview of the key advantages and disadvantages of the various approaches adopted by dealer groups.

An overview of dealer groups in the European markets

In the UK market, where there is much information publicly available, there have been sizeable dealer groups for several decades, although the extent of retail concentration remains quite low. As a matter of fact, the largest dealer group in 2002 accounts for 3% of new car sales (a very similar scale to that 10 years ago, albeit a different company occupies the top spot). Many groups remain privately owned with about a dozen quoted public companies among the top 100 groups. Just as a reference, in the US market during the 1990s there have been dramatic and high profile examples of large scale approaches to car retailing (e.g. CarMax in used cars and AutoNation in new and used cars). However, private ownership of a local dealer business has traditionally been a well-established norm. Since the mid-1990s quoted dealer groups have grown rapidly, albeit the overall level of concentration is still, once again, quite low with the largest (AutoNation) accounting for 3% of the market. Lately some dealer groups have started to show interest in expanding into Europe, with United Auto Group (UAG) in particular making acquisitions in both Germany and the UK.

While it is almost impossible to acquire a highly accurate description of all franchised dealers (hence of all dealer groups) in each market, research has focused on gathering information for the 50 largest dealer groups in each major market, trying to draw a profile of different situations and strategies. Firstly, it is very interesting to ascertain the market share of the top dealer groups (share of new car market registrations). One can see that the UK market stands out as a unique situation, where the top 50 dealer groups control about one third of the new car market. The French market follows (with a 19% share), and Germany and Italy fall behind. It is interesting to note that in the US the top 50 dealer groups control about a 10% share, not too differently from France and Italy (it must be said however that the top 50 groups in the US represent a much smaller percentile, given that the total number of dealers is close to 20,000 outlets).

Figure 3.- *Market share of the top 50 dealer groups by country (aggregate)*

	France	Germany	Italy	UK
Market share	19%	13%	11%	37%

Source: *ICDP estimates 2003*

Research conducted by ICDP has aimed at identifying the key characteristics of the largest groups, calculating an average profile for a dealer group falling within the 50 largest in each major market (figure 4). As previously pointed out, UK groups are largest, with on average more than twice as many outlets and three times as many brands in their portfolio. Given that a retailer could represent more brands, but they may fall under control of a same manufacturer (brands belonging to a given manufacturer group), it is more interesting to know how many manufacturers (rather than how many brands) a retailer relates to, as this provides an important indication of the dealer group strategic profile. There is a striking degree of consistency in the number of brands owned by the top 50 dealer groups in France, Germany, Italy and the Netherlands (about four brands), while the number of manufacturers varies.

The orientation towards used cars varies considerably, with the German and UK dealers showing a higher used-to-new ratio (the ratio between used car sales and new car sales for a dealer). Italian dealer groups, as one would expect, stand right at the opposite, given the traditionally low attitude towards used car management in Italy. Groups seem growing in terms of the number of outlets they control (they are about double than they were five years ago for Italian and Dutch dealer groups).

Figure 4. *Profile of the top 50 dealer groups by country - averages*

	France	Germany	Italy	UK	Netherlands*
Total sales (€ m)	256	334	139	710	180
Employees	675	842	213	1,535	633
New car sales	10,000	6,350	6,100	19,700	5,500
Used car sales	6,700	7,400	3,000	16,900	4,200
Used:new ratio	0.67 : 1	1.16 : 1	0.47 : 1	0.9 : 1	0.76 : 1
Number of outlets	19	17	10	35	15
Growth in number of outlets in the last five years	N/A.	+25%	+92%	+39%	+108%
Number of brands	3.9	4	4.3	12	3.9
Number of manufacturer groups	1.9	1	2.3	7	2.2

Source: *ICDP 2003 - * Netherlands: data for the top 25 only*

As previously said, dealer groups can grow in terms of brand portfolio (number of brands represented) and in terms of market portfolio (number of territories in which they operate). On the basis of the information collected for the 50 largest groups it has been possible to classify the dealer groups according to their strategic profile. The horizontal axis indicates the number of brands, intended as the number of manufacturer brand groups. Hence a dealer group will fall in the left side if it manages brands from a single manufacturer groups, and in the right if there are more manufacturers involved. The vertical axis indicates the number of geographical areas: a dealer group will fall in the lower part if it focuses on a given geographical area, and it will fall in the upper part if its activities spread over more than one area. By crossing these two dimensions, there are four corners of the figure in which dealer groups can be mapped according to their profile.

If one looks at the German market, the most common approach for a dealer group is to operate with a single manufacturer group and within a single geographical area (65% of groups). The remaining dealer groups split almost equally among the other segments. In Italy the situation is similar, with a dominance of single-manufacturer and single-territory groups (44%), but there are about one fourth of groups managing many brand groups and territories. Differently from Germany and Italy, in the French market there isn't any 'dominant' trend, with about one third of dealers falling in the bottom left corner of the figure and another third falling in the bottom right. Interestingly, the UK is at the other end of the spectrum, with half of the dealer groups managing more brand groups in more than one geographical area. Furthermore, there are 34% of dealer groups operating with a single manufacturer but in more than one area. This confirms the multi-region approach as a typical feature of the UK market.

CONCLUSIONS

As seen, recent trends highlight some growth in size and scope of dealer groups across Europe. Trends such as low profitability, a marked change in manufacturers' attitude towards groups, succession problems, growing capital and managerial requirements to manage a dealership could trigger further consolidation in the near future. In particular, the new Block Exemption is likely to increase the scope of activity for groups in general, with rationalisation of portfolios and a range of choices being taken by dealer groups (acquire, sell, swap, close). There are also some interesting examples of dealer groups operating on an international scale, with the most recent and fast growing example of the US-based United Auto Group (UAG) which after holding operations in Brazil has acquired dealerships in Europe.

In France, where manufacturers play a considerable role in distribution (through *succursales*), dealer groups are growing at an interesting pace, albeit there is no single clear strategy emerging yet. In Germany the traditional heavy reliance of dealers on after sales profits could imply higher vulnerability, and perhaps a drive towards possible further concentration if service demand continues to fall due to higher vehicle reliability and the new Block Exemption generates an increase in competition. In Italy most dealers show a strong geographic focus, and experiments of dealers operating on distant locations generally failed. Albeit the dealer industry is still largely controlled by families there are some cases of banks acquiring stakes in dealerships. The UK is highly concentrated when compared to continental markets due to many factors, including a high fleet content and very active financial markets (the largest dealer groups are publicly traded).

Research carried out by ICDP has not collected data on customer experience and perceptions. Also, the research has not stretched to directly gather measures of performance of individual groups in order to carry out comparisons. However, it has been possible to gather some indications of group performance through various sources, which albeit not leading to sound and final conclusions do provide interesting insights. On the whole, it appears that size does not necessarily yield improved profitability. In Germany, for example, research conducted by the IFA in 1998 has shown that larger dealers tend to have a lower net profit rate. Data gathered in France through ICDP research has allowed mapping of the net profit on turnover from groups operating with different strategies: although the statistical sample is not very large, groups operating more than one region have lower profits than those focusing on a given area. In the UK research carried out by the Grant Thornton firm has led to the calculation of a 'complexity' index for dealer groups. What emerges rather clearly is that the higher the complexity (the size, the number of brands, the number of outlets plus the geographic spread), the lower the return on capital employed.

On the whole, research has highlighted considerable variation by market, and also considerable variation within markets, hence no single model emerging. The most robust approach to date appears to increase scale while minimising complexity and maintaining focus. There appears to be a declared focus for a regional approach, with a manageable number of brands and manufacturers: regional focus still appears to be a key feature in most cases, leveraging control of a given market area.

When looking at the future, while many signals seem to indicate room for further consolidation, it will be interesting to ascertain what role dealer groups are going to play in the overall distribution system. Clearly, more time and research is needed in this area to provide the necessary answers to such questions.

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