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IMPACT OF E-COMMERCE ON AUTO DEALERS

Final Report

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INTRODUCTION

The automobile retail sector has experienced some consolidation over the last twenty years. The number of new-car dealerships has fallen from 28,500 in 1979 to an estimated 22,250 in 2000. Mergers and acquisitions by publicly owned dealerships have been one important factor influencing this trend. Nonetheless, the industry remains highly competitive and fragmented.

This report examines the impact of electronic commerce on small businesses in the automobile retail sector. The availability of pricing and product information on-line has already substantially changed the way consumers purchase automobiles. Traditional dealerships have embraced this technology and small businesses have made substantial progress in integrating Internet commerce into their existing dealership businesses. The growth of pure-play Internet automobile retailers has been limited by franchise laws and regulatory barriers that require auto dealers to maintain a physical presence in local markets.

This report is divided into seven sections. Section 1 briefly reviews the literature. Section 2 provides an overview of the market. Section 3 describes the economics of auto retailing, including factors affecting small business competitiveness in this market. Section 4 examines the major industry players, including large dealer groups, Internet companies and small traditional dealerships. Section 5 discusses the impact of e-commerce on these market actors. Section 6 provides an analysis of various policy issues affecting automotive retailing including both issues related specifically to Internet commerce and issues that relate to the automotive retail industry generally. Section 7 provides the conclusions of the study.

1. LITERATURE REVIEW

The economic literature on auto retailing has focused on consolidation and the emergence of electronic commerce as two important trends affecting the industry. Economists have found that electronic commerce has had a number of different market impacts. For instance, Morton et al found that Internet car referral services have reduced retail auto prices and dealer gross profits.[1] Given the lower cost associated with on-line referrals and purchases, they argued that on-line transactions were nonetheless more profitable.

A.T. Kearney found that electronic commerce may encourage industry consolidation by making auto retailing more competitive. The automobile retail market is characterized by the use of the Internet as a direct marketing and sales tool, the erosion of physical market boundaries of traditional dealerships and the availability of extensive consumer information on the Internet. They forecast that fiercer competition and shrinking profit margins would drive weaker dealerships out of business, or encourage their sale to larger industry actors.[2]

PriceWaterHouseCoopers reviewed merger and acquisitions activity in the automotive sector, including vehicle manufacturers, component manufacturers, retail and distribution, aftermarket, rental and leasing services. They found that dealership consolidation hasn't immediately produced efficiencies in auto retailing. Operating margins at large dealership groups have not outpaced many of their smaller competitors.[3]

A University of Michigan Transportation Research Institute study identified consolidation, superstores, disintermediation, the Internet and micro-marketing as the most significant trends affecting the retail automobile industry. The study interviewed executives and marketing professionals in auto retailing and manufacturing to evaluate how industry leaders perceive current and future market conditions. Manufacturers tended to see the Internet as a more

[1] Fiona Scott, Morton; Florian, Zettelmeyer; Jorge Silva, Risso. **"Internet Car Retailing"**. National Bureau of Economic Research, Working Paper 7961, October 2000.
[2] A.T. Kearney. **"E-tailing Strategies for Automakers and Dealers"**. A White Paper on E-business solutions
[3] PriceWaterHouseCoopers**. "1998 PricewaterhouseCoopers Global Automotive Deal Survey"**. 1999

significant sales channel than dealers. Both parties agreed that the distribution system should evolve from a manufacturer push system to a customer pull system to reduce inventories.[4]

Other research has considered the policy implications of electronic commerce. A recent study by the Progressive Policy Institute examined the impact of electronic commerce in a number of different industries, including wine and beer wholesaling, auto retail, music retail, travel services, brokerage services, banking, real estate, legal services, educational services and medical services. In many industries, middlemen were employing political pressure to protect their market positions. The study recommend that states repeal franchise laws restricting auto sales to traditional dealerships.[5] A Consumer Federation of America study came to a similar conclusion. It argued that since most competition is inter-brand, the market would suffer little if the retail networks of each manufacturer became more consolidated, either through direct on-line sales or the expansion of large dealer groups.[6] The National Association of Automobile Dealers commissioned a study to examine the role of electronic commerce in auto retail. It found that traditional dealerships perform many services that cannot be delivered through direct on-line sales.[7]

[4] Michigan University, Transportation Research Institute. **"Competing for Customers: The Future of Automotive Retailing"**. August 2000
[5] Atkinson, Robert. **"The Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting Consumers"**. Progressive Policy Institute. January, 2001
[6] Cooper, Mark**. "A Roadblock on the Information Superhighway: Anticompetitive Restrictions On Automotive Markets"**. Consumer Federation of America, February 2001
[7] Hyatt, David**. "Franchise Laws in the Age of the Internet"**. National Automobile Dealers Association. January 2001

2. INDUSTRY OVERVIEW

Franchised new-vehicle dealers comprise a critical component of the retail economy. In 2000, industry revenue rose to $654.1 billion. New-car dealership sales were approximately 19 percent of total retail sales. Over 80 percent of the franchised new car dealers in the U.S. are considered small businesses. The Small Business Administration defines a new car dealership as small if it has annual revenues of $21 million dollars or less. Used car dealerships are considered small if they have revenues of $17 million or less[8]. This report focuses on new car dealerships, although we also review market developments and the impacts of electronic commerce in other industry sectors where they are relevant.

2.1 Manufacturer-Dealer Relationships

The market in which small dealers compete is influenced by the policies and practices of automobile manufacturers. The way in which manufacturers structure franchise agreements and build their products largely define the function that auto retailers serve.

New car dealerships operate under the franchise system. In return for the right to sell the product of a manufacturer, a dealership agrees to perform specific services for the manufacturer. These services include maintaining a showroom with a certain size and decor, insuring that sales staff are qualified and knowledgeable about the product, maintaining the equipment, parts and personnel necessary to service the manufacturer's vehicles, assisting the manufacturer in marketing and advertising their products and abiding by certain pricing requirements.

The franchise system serves several functions. The system enables manufacturers to maintain some control over how their product is priced, promoted and sold. Additionally, franchise agreements enable manufacturers to guarantee a level of after market service. This is necessary because in a perfectly competitive market, dealerships would have incentives to set prices,

[8] SBA. Small Business Size Standards, Effective October 1, 2000.

promotional activities and service at levels that would be sub-optimal from the perspective of the manufacturer. This is because the return on a sale for a given dealer is less than the total return on an extra sale, which includes both the dealer and the manufacturer markup. Thus dealers have incentives to sell fewer vehicles, but at higher prices.

Unconstrained by franchise agreements, dealers may also have incentives to provide less information about the product and fewer promotional services. If dealers generate information by investing in a showroom, inventory and providing publicity, consumers will have incentives to obtain information from dealers who provide it, but then purchase their vehicle at a lower price from dealers who do not provide this information. "This free-riding by dealers reduces the total supply of publicity and information, which decreases the final demand for cars".[9] Requirements written into franchise contracts that compel dealers to invest in their showrooms and provide other informational services address this issue. In short, manufacturers currently have substantial power in determining how their products are sold. Manufacturers choose to structure the retail channel to provide maximum promotion and sales of their products.

The distribution system for automobiles is largely based on "push" marketing. Manufacturers often produce more vehicles of a particular model than the market can absorb. They then must rely on direct-to-customer rebates, dealer and customer incentives, subsidized financing, and pressure sales tactics to push vehicles out to the customer. The reliance on traditional dealerships to sell less popular vehicles is necessitated by the fact that customer tastes are hard to predict and there are long lag times between when a vehicle is ordered and when it can be manufactured and delivered to the customer. The design of new models and the re-tooling of factories to produce them makes the time-to-market for new products so long that additional uncertainty is introduced in forecasting consumer demand. As a result, manufacturers are required to make large fixed investments in manufacturing and marketing new vehicle models, and are often left with excess capacity and the need to maximize sales volumes for particular models to cover their fixed costs.

[9] Arrunada, Benito; et al. **"Contractual Allocation of Decision Rights and Incentives: The Case of Automobile Distribution."** September 11, 2000.

The function of automobile dealerships in this marketing system is to provide a sales channel that is capable of aggressively moving less popular vehicles. Dealerships that meet their sales targets are rewarded by being allowed to purchase larger numbers of more popular models. Often customers are required to compromise their preferences to purchase a vehicle from stock. Most on-line automobile retail sites seek to improve the customer purchase experience in some way. To a great extent, much of the consumer dissatisfaction with the sales process is a result of the push marketing model that is predominant in the industry.

Nonetheless, manufacturers are striving to increase customer satisfaction with the buying process. Ford's effort to make their supply chain more efficient and consolidate their network of dealers is one example of this. Ford's supply chain strategy is to improve order-to-delivery time for vehicles from approximately 50 days to 15 days. One component of this effort is to improve forecasts of customer demand. It was thought that involving dealers in the forecasting process could enhance accuracy. Regional mixing centers are being used to optimize scheduled deliveries. In addition, order amendment processes that allow orders to be changed for color or trim are being deployed[10].

Current order-to-delivery times have limited the ability of on-line retailers in the automobile sector to duplicate the performance of on-line businesses in other retail sectors. A number of on-line sites currently seek to employ a build-to-order model for automobile retailing. This retail model has several compelling advantages. First, consumers get to configure and order the vehicle they want. On-line build-to-order retailing also reduces the cost of carrying inventory and other costs associated with a traditional retail operation. In 1999, approximately 17 percent of new vehicle sales were custom ordered.[11] However, most consumers are currently not willing to wait 50 days to receive a new vehicle. Thus, the viability of build-to-order retailing for automobiles depends on the ability of manufacturers to reengineer their supply chains to decrease delivery times for new vehicles.

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[10] Austin, Robert. **"Ford Motor Company: Supply Chain Strategy."** Harvard Business School Press, Case 9-699-198, April 16, 1999.
[11] Deutsche Bank, Roland Berger Strategy Consultants**. "Automotive E-Commerce, A Reality Check"**. June, 2000.

Manufacturers have also sought to decrease the costs and improve service of distribution by reducing the number of dealerships. For example, in 1998 Ford launched Auto Collection, an effort to consolidate dealerships and rationalize its distribution network. Ford initially developed Auto Collection as a laboratory to demonstrate to dealers the cost and service advantages that could be achieved through consolidation and cooperation. Ford estimated that twenty four percent of a vehicle's cost was associated with distribution and retailing. They believed enhanced efficiencies in distribution could increase Ford's market share.

Ford sought to emulate the retail performance of foreign manufacturers who employed far fewer dealerships in the U.S. Toyota, for example, had managed to cover the entire U.S. market with 1,200 dealerships, as opposed to the 4,500 employed by Ford.[12]

Auto Collection was based on a one-price selling strategy. The program sought to redesign the sales process to better serve the customer. The sales force was compensated on the total number of vehicles sold, as opposed to the profitability of these vehicles. This new compensation plan was designed to encourage dealers to scale back aggressive tactics and seek to work with the customer to find the best vehicle.

Through its subsidiary, the Ford Investment Enterprise Company (FIECo), Ford purchased a share of dealerships in five markets and consolidated them into limited liability corporations. Owners exchanged their shares for cash or stock in the consolidated dealership. The first markets entered were San Diego, Tulsa, Salt Lake City, Rochester (N.Y.) and Oklahoma City. Ford's strategy sought to consolidate all or most of its franchises in these markets. Approximately 25 percent of the dealerships joining the partnerships were closed, since these markets were considered over-dealered.

State franchise laws allowed different levels of Ford ownership. In some states, FIECo was allowed to own up to 100 percent of dealerships because it was a separate corporate entity from

[12] Bell, Marie. **"Automobile Retailing in the U.S.".** Harvard Business School Press, Case 9-598-014, March 17, 1998.

Ford. In other states, franchise laws required specific terms of ownership, or prohibited majority ownership by manufacturers and their subsidiaries.

FIECo found that one price selling often reduced sales initially, and increased staff turnover. The program was successful at increasing inventory turns and reducing floor plan interest which is the interest paid on inventory. FIECo believed that additional savings could be achieved through the implementation of information systems allowing shared inventory and customer relationship management data. One drawback to the program was that centralized purchasing and marketing strategies were often inferior to the local marketing and inventory management practiced by entrepreneurial owners who were closer to their customers[13].

On June 26, 2001, Ford announced that it will sell its stakes in dealerships in New York, Oklahoma and Utah, and eventually terminate its Auto Collection program completely. The company canceled the program to improve dealer relations. GM has canceled a similar program in which it planned to purchase up to 10 percent of its dealers.

2.2 Retail Market

The automotive retail sector in the U.S. has gone through several distinct stages of development. The current automobile retail distribution system originated around 1911. Automobile dealers were one of the first applications of the franchise system. Initially, manufacturers retained tight control over franchisees, restricting dealers to selling the products of a single manufacturer. Because auto manufactures maintained the right to revoke franchises on short notice or issue new franchises, they had substantial market power over dealers. It was not uncommon for dealers to be threatened with revocation of their franchise, or the establishment of new competitor franchises, if they were unable to move inventory.

Following a Federal Trade Commission investigation in the 1950s, manufacturers modified their franchise agreements. Dealers were issued five-year franchises, which could not be revoked

[13] Hallowell, Roger. **"Auto Collection: Ford's Better Idea for Selling Cars and Trucks".** Harvard Business School Press, Case number 9-800-030, October 15, 1999.

without cause. The industry continued to be dominated by small entrepreneurs who operated from a single location and sold the products of one manufacturer. Because auto manufacturing was a concentrated industry and auto retail was fragmented, manufacturers retained significant market power over dealers.

Auto retailing changed substantially during the 1970s. With the entrance of foreign auto makers into the American market, the market power of American manufacturers was reduced. Multi-franchise dealerships became common as foreign manufacturers expanded in the U.S.

Consolidation accelerated in the retail system with the rise of the mega-dealers, having sales of over $100 million. The mid-1990s saw a number of dealer groups, such as Republic Industries (AutoNation) and United Auto Group, go public to raise capital to acquire dealerships. The industry has been slow to consolidate, with the three largest public dealership groups controlling less than 5 percent of the market. The purpose of creating consolidated dealer groups is to achieve economies of scale. Some in the industry believe that consolidation would be happening faster if the economics of the industry supported it.

3. THE ECONOMICS OF AUTO RETAILING

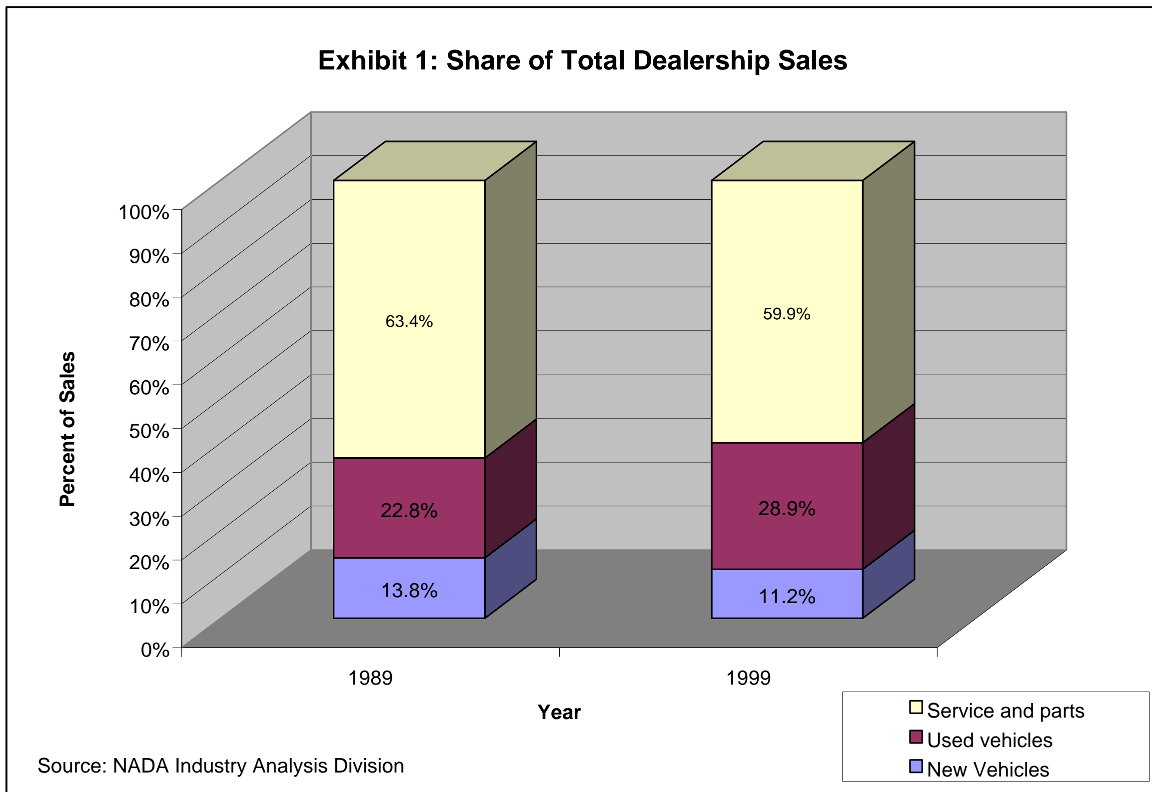
Profit maximizing retail activity seeks to increase sales while minimizing the cost of sales. Cost of sales includes the cost of the product (price paid to manufactures for inventory), as well as the expenses required to operate a dealership. These operating expenses include payroll, advertising, rent and floor plan interest. The difference between the price charged customers and the price of product purchased from suppliers is the gross margin. To obtain operating profits, a dealership must have a gross margin that is larger than its operating expenses. Table 1 shows a financial profile of an average dealership. The source of this information is financial surveys conducted by the National Automobile Dealers Association's (NADA), Industry Analysis Division.

Table 1: Average Dealership Profile

Financial Variables (as a percentage of sales)	1993	1994	1995	1996	1997	1998	1999
Total dealership gross margin	13.4%	13.1%	12.9%	12.9%	12.8%	12.9%	12.6%
Total dealership expense	11.8%	11.3%	11.5%	11.4%	11.4%	11.2%	10.8%
Net profit before taxes	1.6%	1.8%	1.4%	1.5%	1.4%	1.7%	1.8%
New vehicle department sales	60.0%	60.3%	58.6%	58.1%	58.6%	59.0%	59.9%
Used vehicle department sales	26.4%	26.9%	29.0%	29.5%	29.0%	29.4%	28.9%
Service and part sales	13.6%	12.8%	12.4%	12.4%	12.4%	11.6%	11.2%

To compare the performance of different dealerships, financial ratios are employed that compare gross margin, expenses and profits as a percentage of sales. Table 1 shows that dealership gross margin as a percentage of sales has declined from 13.4 percent in 1993 to 12.6 percent in 1999. Expenses as a percentage of sales have declined faster, falling from 11.8 percent in 1993 to 10.8 percent in 1999. While numerous factors have influenced the decline of margins and expenses over time, one important factor has been the increase in average dealer size. Large dealerships can amortize payroll and other expenses across a larger volume of sales, thus maintaining profitability in the face of smaller gross margins. The size of the average dealership, measured in annual sales, has increased from approximately $16.5 million in 1993 to $27.3 million in 1999.

Dealerships derive their sales from three primary sources: new vehicle sales, used vehicle sales and service and parts sales. Exhibit 1 examines how the mix of these revenue sources has changed over time. Used vehicle sales have increased in importance, rising from 22.8 percent of sales in 1989 to 28.9 percent of sales in 1999. This can be attributed to the increased stock of nearly new vehicles available from expired customer lease agreements. Consumers also appear more willing to purchase used vehicles as the quality of automobiles has increased over time.



Service and parts sales have declined somewhat, falling from 13.8 percent of sales in 1989 to 11.2 percent of sales in 1999. New vehicle sales composed 63.4 percent of dealership sales in 1989, falling to 60 percent in 1993. During most of the 1990s, new vehicle sales contributed only a small amount to dealership profit. Dealers tended to make the majority of their profit on used vehicles and service, where the gross margins were higher.

Another way to view the automobile retail industry is to examine how the cost of automobiles is influenced by each component of the distribution system. During the 1990s, the cost of distributing automobiles has become a major concern. American manufacturers, who have

largely solved vehicle quality problems, have come to view improvements in the automobile distribution system to be of primary importance to enhancing competitiveness.

One of the driving factors behind investment in electronic commerce has also been the desire to reduce the cost of distribution. Table 2 shows how the cost of each element of the distribution system affects the manufacturers suggested retail price (MSRP). The data is derived from Price WaterhouseCooper's *Measuring the Automotive Retail Revolution* and Mckinsey and Company's *Automotive Retailing*. It shows that forty percent of the manufacturer suggested retail price can be attributed to distribution cost, while production costs compose about 60 percent of the MSRP.

The table provides two breakdowns of distribution costs, one by source and one by use. The breakdown by source is of particular interest here. About 20 percent of MSRP, half the cost of distribution, is the result of business management and operation (BMO) costs of dealerships[14]. Other dealership distribution costs include interest charges (2 percent), dealer advertising (3 percent) and profit (2 percent). The rest of the distribution cost is composed of manufacturer advertising costs (3 percent), dealership discount (3 percent), manufacturer discount (6 percent) and lease loss (1 percent).

A number of manufacturers and on-line retailers have attempted to implement a direct sales business model, believing that it could reduce distribution costs substantially, providing cost savings as large as 27 percent of MSRP. Many of these efforts have had difficulty duplicating the strengths of traditional retail franchise operations on-line. Consumers need traditional dealers for service and vehicle trade-ins. Most customers also need a location where they can inspect a vehicle and test drive it prior to purchase.

Table 2: Distribution Cost of Automobiles As a Percentage Of Manufacturer Suggested Retail Price (MSRP)

COST CATEGORY	% of MSRP

[14] Note that these costs are not directly comparable to the expense ratio, gross margin and profit figures above, since these include sales and expenses associated with used vehicle and service and parts components of a dealerships business.

TOTAL COST IN PRODUCTION			60
TOTAL COST IN DISTRIBUTION			40
BREAKDOWN OF DISTRIBUTION COST BY SOURCE			
Dealer Subtotal			30
Discount		3	
Interest		2	
Advertising		3	
Profit		2	
BMO Cost		20	
Manufacturer Subtotal			10
Discount		6	
Advertising		3	
Lease loss		1	
TOTAL COST IN DISTRIBUTION			40
BREAKDOWN OF DISTRIBUTION COST BY USE			
CONSUMER GETS			10
Dealership Discount		3	
Manufacturer Discount		6	
Lease loss		1	
DISTRIBUTION CONSUMES			27
Dealer			
	Interest	2	
	Advertising	3	
	Profit	2	
	BMO Cost	20	
Manufacturer			3
	Advertising	3	
TOTAL COST IN DISTRIBUTION			40

Nonetheless, manufacturers are still experimenting with direct sales and dealer consolidation in the hopes that additional savings can be squeezed from distribution. A number of manufacturers are attempting to reduce logistics costs associated with moving product by rail. For instance, DaimlerChrysler and Union Pacific Corp. recently announced the creation of Insight Network Logistics, a company that will deploy an Internet based solution to improve automobile rail shipment times from 12 to 9 days within one year. "Increased efficiencies as a result of the new company should help reduce Chrysler costs by about $280 million over the

next six years."[15] GM and Ford are also currently engaged in similar ventures with Consolidated National Freight (CNF) and United Parcel Service (UPS).

The automobile distribution system has experienced a gradual consolidation over time. Exhibit 2 shows that the number of new car dealerships has declined steadily over the last two decades. The number of new car dealerships has fallen from 28,500 in 1979 to 22,250 in 2000. Much of this decline is the result of the closure of small dealerships in rural areas and the consolidation of existing dealer networks in growing markets.

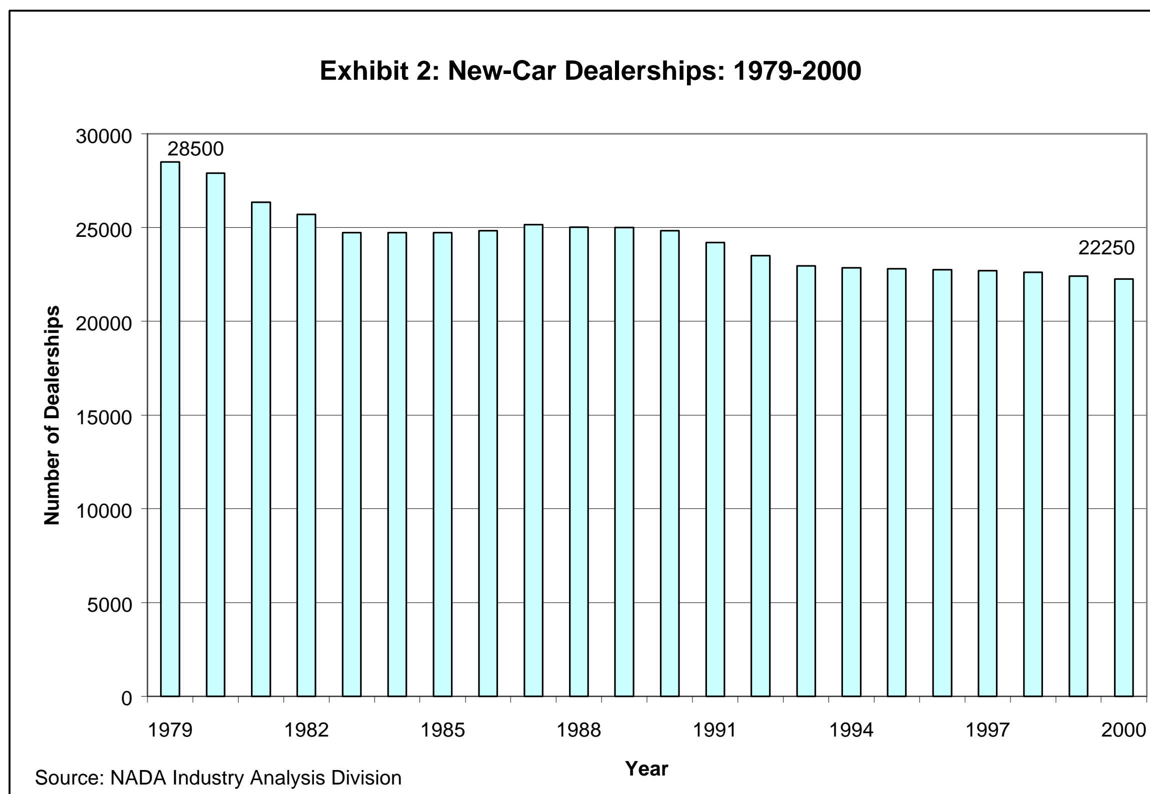
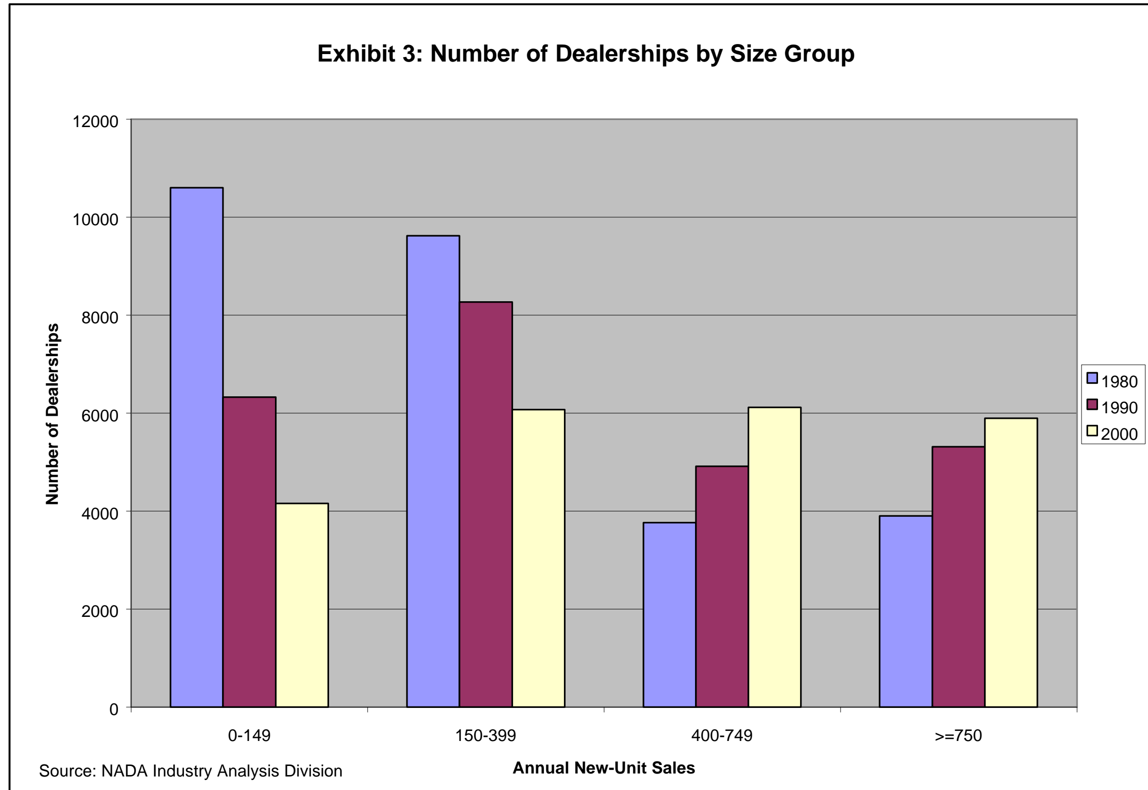


Exhibit 3 shows the number of dealerships by dealer size group. Four dealer size groups are defined based on the number of new vehicles sold annually at dealerships. The data show that the number of dealerships in the two smallest size groups declined between 1980 and 2000. At the same time, the number of dealers in the two largest size groups, selling between 400-749 and 750 or more vehicles, increased over this same time period.

[15] Reuters. **"USA: DaimlerChrysler and Union Pacific form web venture"**, August 1, 2001.



Paul Taylor, an economist at NADA, argues that improvements in the transportation system may have had a greater impact on the number of dealers than the emergence of electronic commerce. For instance, between 1950 and 1960, the number of dealerships declined from 46,821 to 36,336.

As consumers became more mobile, existing dealerships could serve a larger market area, with customers driving further to buy vehicles at larger dealerships that offered better selection. Additionally, as population shifted to more densely populated areas, fewer dealerships were required to serve the same population.

Another factor affecting dealership closures is the demographic makeup of the population of dealership owners. Many of the existing owners are near retirement age and do not have heirs to whom to pass the family business. Public companies such as Auto Nation and Sonic Automotive have been able to acquire dealerships at lower prices because of the number of dealerships coming onto the market.

3.1 Economies of Scale

Critical to the evaluation of the prospects of small businesses in on-line automobile retail is the role of economies of scale in Internet retailing. Many analysts have argued that there are substantial economies of scale in on-line commerce that will favor large retail operations. Economies of scale derive from both real and pecuniary factors. Real economies of scale refer to those elements of scale that allow a firm to operate more efficiently and achieve greater outputs per unit of input. Pecuniary economies of scale occur when a retailer obtains a size that provides it with market power over its suppliers. The retailer can use access to its network of stores as a bargaining chip to induce suppliers to provide it with preferential prices or marketing allowances.

It does not appear that substantial pecuniary economies of scale currently exist in the automobile retail market. There are only a few manufacturers of automobiles, and these companies have, for the most part, maintained control over the retailing of their products through franchise agreements. Thus, large retailers currently do not obtain preferential prices from manufacturers. A small dealership pays the same price for a vehicle as a large dealership.

While multi-franchise dealerships are common, manufacturers still retain some control over which dealerships are allowed to have multiple franchises and whether vehicles are shown in separate showrooms. For instance, GM is currently suing 25 of its dealers for selling non-GM brands in GM showrooms. GM dislikes dual showrooms because other brands often offer sales people cash incentives. These marketing payments provide sales people incentives to steer customers away from GM brands. State franchise laws in some states restrain manufacturers from disallowing dual showrooms.[16]

Specialization and division of labor are important efficiencies that a large scale of operation allows. For instance, many small auto dealers may not have staff on hand who possess the technical skills necessary to maintain a website. The specific knowledge and skills to market and promote an on-line store are also different than those required to run a traditional store.

[16] **"GM will sue dual-showroom dealers."** Automotive News. July 31, 2001.

Technological sophistication of Internet commerce does not seem to impose a major barrier to dealership participation in on-line commerce. Information technology service providers, such as Cobalt or Reynolds & Reynolds, reduce the economies of scale associated with some of the more technically challenging aspects of setting up a database-driven, electronic commerce site. The number of dealerships with websites has risen from 47.1 percent in 1997 to 83 percent in 2000. Approximately 97 percent of dealers with websites had staff dedicated to monitoring and maintaining the website. On average, dealers dedicated 1.4 employees to this task. Of those dealerships that didn't have a website, 59 percent planned to construct one in the next year.[17]

Another source of economies of scale is indivisibilities of marketing. These result from two sources, indivisibilities of advertising and cross selling. In the on-line market, advertising plays an important role in drawing customers to a site. Scale economies exist in advertising because a certain level of advertising expenditures is required to get the attention of the consumer. Once a substantial amount has been invested in advertising, the expenditures necessary to maintain recognition of a product or brand is substantially less than that required to obtain this recognition initially. In the on-line world, attracting the attention of consumers is one of the greatest barriers new entrants face.

Two major on-line automobile retailers have partnered with large electronic commerce sites to attract traffic. Carsdirect.com is a member of the Amazon.com Commerce Network. Amazon has invested in Carsdirect.com and features them as a trusted partner on their website. AutoTrader.com spent significant sums building brand awareness, including purchasing a Super Bowl advertisement. It currently has a strategic partnership with eBay and is featured on their site. Both of these sites have benefited from the strength of the brands with which they have become associated.

In some cases, manufacturers may have sought to prevent large retailers from building a national brand and commoditizing their products. For instance, industry publications reported

[17] National Automobile Dealers Association. 2000 Dealership Internet Survey Results.

that AutoNation did not attempt to create a national brand for their dealerships because of pressure from manufacturers. Currently, AutoNation's stores utilize regional brands, and often customers may be unaware that they are purchasing from an AutoNation controlled franchise.

Nonetheless, independent retailers who do not have the resources to create a national brand can make their inventory available on third party sites. Independent dealers have a number of alternatives to put their inventory on-line. Referral sites, such as autobytel.com, manufacturer sites, such as Forddirect.com and collaborative marketing efforts, such as driverseat.com, all allow dealers to list inventory on-line. Indeed, since customers prefer to purchase vehicles from dealers within their own geographic area, listing inventory on the site of a third party that aggregates inventory and allows the customer to locate vehicles within their geographic region is often a more effective sales strategy.

On-line retailers can achieve economies of scale by cross selling different products. In a land based retail format, there is a scale of operations that can become too large and daunting for a consumer to navigate. On-line, there are no physical limitations to the number of products that can be merchandised. Electronic search tools can allow a consumer to more effectively navigate through large volumes of products. The Internet retail format is information rich and can intelligently recommend products related to a consumer's original search. For instance, some sites selling used vehicles also refer customers to vehicle parts and accessories appropriate for the vehicle they are viewing.

Another important economy of scale is related to the ability of large companies to raise capital more easily than small businesses. If the costs of investigating a loan do not rise as quickly as the size of a loan, economies of scale are said to exist in finance. Additionally, if a large business is able to spread risks over a number of operations, scale may reduce risk and allow for funding to be secured on more favorable terms. Large public dealership groups can reduce the cost of financing by issuing commercial paper.

There are also economies of scale in on-line retail associated with holding inventory. Larger retail operations can reduce the risk of holding inventory. As sales volumes grow, it becomes easier to predict the demand for specific vehicles and option configurations, and to hold the

necessary inventory. The ability to hold a larger inventory allows retailers to provide customers with the exact vehicle they want. AutoNation's website, for example, provides customers the ability to search the inventory of its dealers.

Nonetheless, small dealerships who list their inventory through third party sites, such as driverseat.com, can provide customers the ability to locate the specific vehicle they want. Most of the major on-line auto sites list the inventory of franchised dealers with whom they have partnered. Economist Paul Taylor at NADA believes that scale economies in inventory management are exhausted at a relatively small size, near the six dealership threshold.

Learning by doing is an economy of scale that is typically associated with high tech industries. Learning by doing refers not just to the scale of an operation at any given time, but to the total volume of output over time. Learning by doing suggests that the price of a product will fall as a business produces a greater volume of this product over time. In on-line commerce there is a substantial element of learning by doing. New entrants into the field discover the best methods of operation through a process of experimentation. Those following in their footsteps may incur higher costs. There is some evidence that dealers who have had sites longer attract more traffic and sell more vehicles.

Table 3 shows comparative financial ratios for the major auto retailers and NADA's estimate of the average dealership. The data show that the top three dealer groups use labor more efficiently, having average sales per employee ranging from $641,000 to $744,000, while the average dealership has sales of $562,372 per employee. The three largest dealerships marked up their inventory slightly less, having gross margins between 85.3 percent and 85.7 percent. It is difficult to compare operating costs as a percentage of sales, as the calculation of this statistic differs between entities.[18] The average dealership is slightly more profitable than the major dealer groups, having net income before taxes of 1.8 percent of sales. The picture that emerges from this data suggests that large dealer groups may have higher labor productivity, although

[18] The NADA average dealership operating cost include only payroll, advertising, rent and equivalent and floor plan interest.

according to other financial measurements, economies of scale have not clearly manifested themselves.[19]

Table 3: Comparative Financial Ratios
Major Auto Retailers Compared to Average Dealership Profile

Financial Ratio	Auto Nation	Sonic Automotive	United Automotive Group	Average Dealership
Number of Dealerships	375	165	120	22,250
Sales Per Employee	641,000	662,000	744,000	562,372
Sales (Millions)	20,610	6,053	4,884	608,093
Number of Employees	31,000	9,400	7,500	1,081,300
Inventory Turnover	6.6	7.3	6.8	NA
Gross Margin	85.29%	85.71%	85.62%	86.6%
Operating Costs (% of Sales)	13.00%	15.60%	20.70%	10.9%
Net Income (% of Sales)	1.60%	1.23%	0.40%	1.8%

[19] It may also be the case that family owned dealerships may have individuals on the payroll who are friends or family members. The lower labor productivity of these dealerships may reflect the operating philosophy of the owner, who may choose to include compensation of these employees as a business expense instead of maximizing profits by paring unproductive employees from the payroll.

4. MAJOR INDUSTRY ACTORS

There are six public new car dealerships. These are AutoNation, Sonic Automotive, United AutoGroup, Group 1 Automotive, Lithia Motors, and Crown Group. The three largest public auto retailers are Auto Nation, Sonic Automotive and United Auto Group. The success of these companies, or similar ones, in consolidating dealerships and achieving economies of scale, will have important implications for the future of small automobile dealers. Each of these companies is described in more detail below.

AutoNation, Inc.

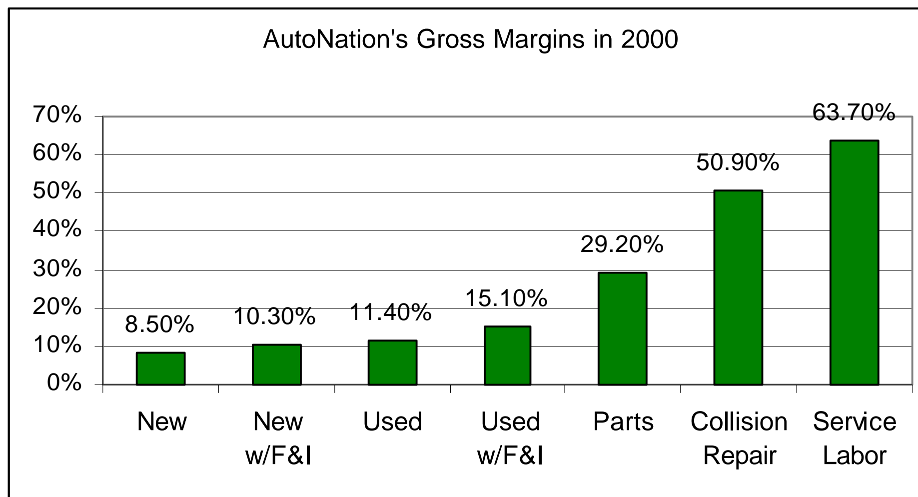
AutoNation, Inc., headquartered in Fort Lauderdale, Florida, is the largest automotive retailer in the United States, with more than 400 new-vehicle franchises located in 26 major metropolitan markets in 19 states, predominately in the Sunbelt. The company offers 39 different brands, including those manufactured by GM, Ford, Chrysler, Toyota, Honda, Nissan, and almost all luxury brands.

The company was originally a solid waste service business incorporated in 1980. During 1995-96, it entered the electronic security services, automotive retail and car rental businesses through numerous acquisitions and changed its name to Republic Industries, Inc. It later sold its electronic security business in 1997, seperated its solid waste services and changed its name to AutoNation, Inc. in 1999, and spun off its automotive rental businesses in 2000.

Starting December 2000, AutoNation closed 23 company-owned used vehicle megastores and subsequently converted the company's remaining megastore facilities to franchised new vehicle dealerships. The company operates each of its dealerships under a franchise agreement with a manufacturer and acquires new vehicles directly from the manufacturers. Each of AutoNation's automotive franchises sells new and used vehicles, and offers financing for vehicle purchases, extended service contracts and other finance and insurance products, as well as aftermarket products such as vehicle accessories, upgraded sound systems and theft deterrent systems.

Almost all of the company's dealerships also provide a wide range of vehicle maintenance and repair services. In most of its key markets, they also operate collision repair centers.

AutoNation, Inc. is also the largest retailer of automobiles on the web, providing on-line inventory of over 100,000 vehicles. In addition to AutoNation.com, AutoNation's e-commerce group manages more than 270 websites throughout the company's network of dealerships. AutoNation has a marketing agreement with Priceline.com and powers AOL AutosDirect as its exclusive retailer. MSN Carpoint, the web's most popular car-shopping site, selected AutoNation as its primary marketer and distributor of sales leads. Together, the AutoNation e-commerce network sells sales leads to more than 1,800 dealer subscribers.

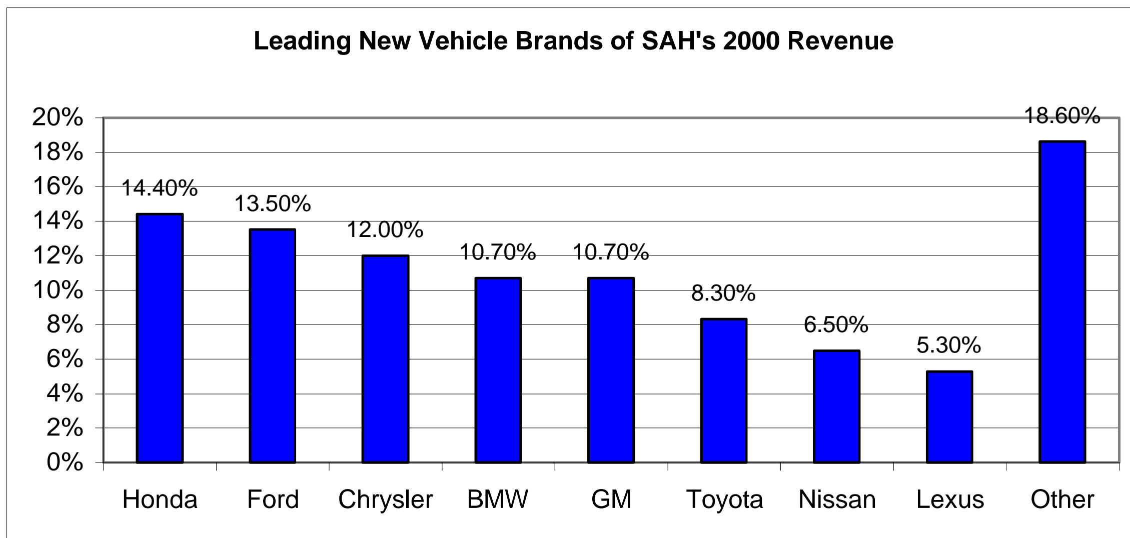


Sonic Automotive, Inc.

Sonic Automotive is the second largest publicly-owned dealer group in the United States. It has operations in 13 states, focused on 14 metropolitan markets, predominantly in the Southeast, Southwest, Midwest and California. Founded with five dealerships in 1997, Sonic has grown through a slew of acquisitions and currently operates about 165 franchises and 30 collision repair centers. Sonic sells more than 31 brands of cars and light trucks. Approximately 27 percent of its new car sales are luxury brands.

Sonic Automotive completed the largest acquisition in auto retailing history with the acquisition of San Fransisco based FirstAmerica Automotive. The Company acquired and integrated 73 dealership operations in 1999.

Each of Sonic Automotive, Inc.'s franchised dealerships is managed by a dealer operator and offers comprehensive services including sales of both new and used cars and light trucks, replacement parts and vehicle maintenance, warranty, paint and repair services. The company also arranges extended-warranty contracts and financing and insurance for its automotive customers.



Sonic promotes Internet marketing though SonicAutomotive.com, individual dealership's websites, manufacturers' websites, and third party referral sites that provide traffic to its dealership. In February 2000, the company announced that it will implement competitive online purchasing at its dealership through bbcn.com. In April 2000, the company entered into a marketing agreement with Greenlight.com, an internet car buying site. Greenlight was subsequently purchased by CarsDirect.com

United Auto Group, Inc.

United Auto Group, Inc. (UAG) is a leading operator of franchised automotive and light truck dealerships and related businesses, with 121 dealerships in 19 states, Puerto Rico, and Brazil.

Currently the company represents 32 makes and owns 21 collision centers operated as an integral part of a new vehicle franchise. Equipped with a service and parts department, each of UAG's new vehicle dealership also sells used vehicles.

The company selectively acquired dealerships with established earnings record and retained experienced management. It looks into areas with superior population and job growth prospects for opportunities.

UAG focused on increasing businesses with higher margins such as services, used vehicle sales, and after market products. The service and parts business has provided important recurring revenue streams and helped mitigate the effects of automotive sales downturns. Subsidiaries United Auto Care and United Auto Care Products offer aftermarket products and services, including extended service contracts. The company is currently exploring the possibility of constructing several new regional repair centers to act as central collision repair centers in geographic hubs.

The company holds a minority stake in CarsDirect.com, a direct online automotive provider, and utilizes the site in an effort to increase its online car sales. Along with Penske Automotive Group, Inc., UAG intends to jointly build an automated transaction system that links the companies in a streamlined logistic solution for vehicle supply.

Table 4 shows measures of management efficiency for the top three auto retailers. These measures include income per employee, revenue per employee, receivable turnover, inventory turnover and asset turnover. Each of these statistics measures the outputs obtained for a given level of input. Income per employ is calculated by dividing the total profit by the number of workers. Revenue per employee is another general measure of labor productivity. Scale economies can be achieved if a business can amortize its labor costs across a greater volume of sales.

Table 4: Measures of Management Efficiency for the Top Three Auto Retailers

Management Efficiency	Auto Nation	Sonic Automotive Group	United Automotive Group	Public Auto	S&P 500
Income/Employee	11,000	7,000	5,000	8,000	18,000
Revenue/Employee	654,000	652,000	689,000	592,000	304,000
Receivable Turnover	17.9	50.6	27.9	18	6.9
Inventory Turnover	6.6	7.3	6.8	6.5	8.4
Asset Turnover	2.2	3.6	3.2	2.5	0.4

Inventory turns measures how efficiently a business utilizes inventory. As a dealership achieves a higher inventory turnover, it incurs less floor plan interest charges as a percent of sales. Inventory turnover is calculated as the latest 12 months' cost of sales divided by the average inventory from the most recent quarter and the year earlier quarter.

Receivable turnover measures how effective a business is at getting paid. It is calculated by taking the latest 12 months of sales and dividing by the average receivables from the latest two quarters. Asset turnover, which is simply sales divided by assets, can show both how capital intensive a business is, and how well it uses assets to produce revenue.

Table 4 compares the top three auto retailers to public auto dealers, and the S&P 500. The S&P 500 is a widely followed benchmark of stock market performance. It includes 400 industrial firms, 40 financial stocks, 40 utilities and 20 transportation stocks. The data show that while AutoNation, the largest dealer group, leads the top auto dealers in income per employee, it does not exceed the other top dealerships in any other management efficiency category. The rapid growth of Sonic Automotive may be inflating some of its financial ratios. Comparing the top dealer groups, there are no clear advantages to the differences in scale among them.

While owning an auto dealership is a capital intensive retail business, it is less capital intensive than the average of S&P 500 companies, which is weighted towards industrial, financial and utility stocks. Average asset turnover for public auto dealers is 2.5, while the S&P 500 has

average asset turnover of 0.4. Auto Nation, the nations largest dealership does not appear to be significantly more capital intensive than the average public dealership.

4.1 Major Automotive Internet Sites

Automotive Internet sites may be broadly classified into several categories. These include referral services, brokers, direct sales, classified advertisement sites, reverse auctions, media sites and dealer sites. Each of these is described below in more detail.

4.2 Referral Sites

Autobytel.com

Autobytel.com was the first mover in the Internet auto referral services business. Pete Ellis, a former owner of 16 automobile dealerships, founded the company. It began operation as a Prodigy service under the name Auto-By-Tel in 1995. The company grew rapidly and had 1996 sales of $5 million. Edmunds.com accounted for 49 percent of Auto-By-Tel's traffic in 1997. Auto-By-Tel increased marketing expenditures to broaden the site's reach. It was the first Internet company to purchase a Super Bowl advertisement, spending $1.3 million in 1997. In 1998, the company changed its name to Autobytel.com. In 1999 it went public raising $100 million.

Autobytel.com made most of its money from referral fees. A referral subscription fee would typically be about $1,000 per year for a dealer, although it varied based on location, the type of franchise and the level of Internet penetration in the market. The company provided value to customers by giving them information and a low no-haggle price. For dealer's, the company provided a stream of customers who were ready to buy. Marketing studies estimated that a customer would deal with an average of five different dealer sales people when they purchased a vehicle in the traditional fashion. A dealer selling through Autobytel.com could close a sale with a single contact.[20]

[20] Moon, Youngme. **"Autobytel.com".** Harvard Business School, Case 9-500-015, May 10, 2000.

Nonetheless, Autobytel.com currently faces a precarious market position. Numerous companies have entered the referral market. Many dealers view Autobytel.com as a potential competitor. The company's efforts to expand into service, insurance and finance have placed it in competition with its dealers for their most profitable lines of business. Recently Autobytel.com launched wholesale.autobytel.com to reposition itself as a player in business to business markets. Wholesale.autobytel.com is a dealer auction service for used cars, providing real time bidding. On April 11, 2001, Autobytel.com announced an agreement to merge with Autoweb.com.

In May, Autobytel.com announced a test partnership with GM to put the inventory of twenty two Washington DC area dealerships online. GM wanted to test how much inventory their dealers were willing to put online and to experiment with the notion of listing market prices for vehicles as opposed to listing sticker prices. GM is paying Autobytel $1.6 million for their role in this partnership. Nonetheless, Autobytel.com has lost revenue and customers to manufacturer lead generation services, and it reported that its sales were down in the second quarter of 2001.[21]

Microsoft CarPoint

Microsoft CarPoint was initially conceived as a CD-ROM informational product in September of 1994. In March 1995 the product concept was changed to an Internet based online application. In the beginning, the site provided product reviews and links to referral services such as Auto-By-Tel. In May of 1997, Microsoft negotiated a deal with Reynolds and Reynolds and became a referral transaction site which competed with Auto-By-Tel.

Microsoft developed proprietary software that interfaced with Reynolds and Reynolds inventory management system and allowed dealers to upload their inventories to the site. Reynolds and Reynolds had relationships with a large percentage of dealers and used its sales force to promote the product. In return, they received thirty percent of dealer subscription fees.

CarPoint had three primary sources of revenue. Dealers paid a flat subscription fee to be listed on the service. For used car dealers this was approximately $400, while new car dealers paid

[21] Patsuris, Penelope. **"Autobytel Hits the Skids."** Forbes.com, August 8, 2001.

about $1,000. The site sold memberships to customers that provided special deals on auto related products. CarPoint also collected fees for the placement of advertising, primarily from automobile manufacturers.

CarPoint's primary competitors in the referral market were CUC AutoAdvantage.com, AutoWeb.com and Auto-By-Tel. The referral business model provided value to both dealers and customers. Customers received information about available vehicles and dealers obtained access to customers who were ready to buy. This reduced sales costs and streamlined the buying process. Dealers were able to pass some of these savings along to customers.[22]

Several new competitors emerged in the online vehicle sales market in 1999. Some of these companies competed directly with CarPoint in the referral market. For instance, StoneAge.com allowed sellers to list used autos for a one-time fee of $20. The site skimped on marketing expenditures and relied on word of mouth advertising. It claimed to facilitate the sale of 108,000 cars and $2 billion in sales revenue in 1999.

OpenAuto.com launched a slightly different referral service in September of 1999. Instead of relying on exclusive relationships with local dealers, the service offered customer bids to all local dealers and allowed them to reply. A customer could then shop between responding dealers. The site obtained revenue from a $150 dealer registration fee.

GM BuyPower

Manufacturers entered into a number of ventures to promote direct sales. In March of 1999, GM launched BuyPower to reduce its dealers reliance on third party referral services such as Auto-By-Tel. The site provided free referrals for GM's dealers and allowed GM to collect customer data and experiment with a build-to-order model that could provide substantial cost savings.

GM BuyPower is the first, largest, and most comprehensive manufacturer’s automotive buying service on the web with over 6,000 participating dealers and more than 500,000 new GM

[22] Bajaj, Avnish; Haithcox, Steffan; Kadyan, Michael. **"Microsoft CarPoint"**. Harvard Business School Press, Case Number 9-898-280, August 21, 2000.

vehicles. The test site was first launched in four Western states (California, Oregon, Washington, and Idaho) in October 1997. It later became nationwide in March 1999 and currently has sister sites in 23 other countries through links at globalbuypower.com. e-GM, a business unit of GM launched in August 1999, had its first assignment to link GM BuyPower and GMAC financing, to provide one point access for purchasing, financing, and/or insuring a GM car. e-GM integrates GM's e-commerce efforts, encompassing over 100 websites and OnStar Service, an onboard navigational and communications system which uses global positioning system and cellular phone technology to provide in-car services.

GMBuyPower has been successful in driving traffic and qualified leads to dealers, building online relationships, and finally increasing sales. In the first half of 2000, the site recorded about one million visits per month on a consistent basis. From March 1999 to March 2000, the site drove more than 20,000 sales. During the four months starting April 2000, it generated a 130 percent increase in inventory searches and 85 percent increase in dealer messages.

The website has been constantly updated and improved. The main portion of the site features a six-step guide that allows car buyers to research, build, and locate the vehicle that suits their needs. Those who already know what they need can use the car locator function with options to build one's own, to get the dealer's best prices, or to search among the inventory. The MSRP and dealer prices of individual vehicles are listed, along with the location and contact information of GM BuyPower manager. Consumers can ask all car buying questions, request the dealer's best quote, schedule a test drive, or discuss a trade-in with GM BuyPower manager, who will respond in 24 hours. For those who want to design their own vehicles, they can choose the style, exterior, interior, and various options to submit a customer order and track the assembly of their car through the website.

The webpage displays a list of tools that assist consumers' vehicle purchase decision. "Model Details" contains information regarding standard features, optional equipment, and trim level. Consumers can also request a printed brochure and view vehicle images. "Comparisons" allows car buyers to compare a GM vehicle to other manufacturers' models with information from AutoSite, an independent third party. "My Files" allows interested car shoppers to store up to ten vehicles they are considering and email GM BuyPower managers messages. "Great Deals"

presents current promotions from selected GM models. "Estimate Payment" calculates monthly payments for different financing options. "Calculate Budget" allows users to enter their income and expenses and delivers an estimated vehicle price with monthly payments. GMAC Credit accepts online preapplication for credit from GMAC financing. Kelley Blue Book gives an estimated value for a trade-in vehicle. "Locate Dealers" helps find a nearby GM BuyPower dealer. "Certified Used Vehicles" provides a three-step search function based on price, year, model, body type, and geographic location.

Driverseat.com

Driverseat.com is a joint effort of National Automobile Dealers Association (NADA) and the Cobalt Group (CBLT). NADA represents more than 19,600 of America's franchised new vehicle dealer members, holding nearly 40,000 separate domestic and imported new vehicle franchises. CBLT is a leading technology service provider in the automotive industry. CBLT has established relationships with about 5,000 dealer website clients, over 10,000 parts locating system dealer clients, 16 manufacturers, and more than 50 of the largest dealer groups in the United States. Cobalt also operates DealNet.com, one of the best-known automotive destination websites, and PartsVoice.com, a leading auto parts locating and data management service.

Launched in June 2000, Driverseat.com is a comprehensive resource for online automobile purchasing. All NADA members are able to link their sites to the portal. Through Driverseat.com, consumers can access NADA's used-car guide and search Cobalt's dealer clients' inventory. Together, this new car dealer driven car shopping site provide direct links to approximately 19,000 dealers and carries nearly one million new and used vehicles listed in inventory, including about 550,000 new vehicles. This is the world's largest online vehicle inventory.

Consumers can either start their search with finding a dealer or a vehicle, or they can research price and model information before they determine which type of vehicle to research. For the new vehicle purchase, the site offers both dealer invoice price and MSRP, including optional items and value packages. Car buyers can also request a quote from a qualified dealer. Links to manufacturers' websites, model comparisons, model reviews, option reviews and car shows all

attempt to assist consumers in getting the right kind of vehicle. Associated products such as financing and service information are also provided.

For used vehicles, the website offers similar services such as inventory search, price quotes and financing. Additional information regarding used vehicle values can be obtained through the link to nadaguide.com. Finally, the Lemon Check service allows car buyers to enter the VIN and zip code to check a particular vehicle's history from CARFAX.

Driverseat.com also offers consumer advice, featuring step-by-step car-buying advice and ways to settle consumer disputes, among other tips. Auto buyers can work directly with the dealership online, by phone or in person to get additional information or to complete the transaction. Dealers can provide a wide range of direct services to online car shoppers, including two crucial pieces of information – pricing and real-time vehicle availability.

Brokers

Referral sites ostensibly offer haggle free prices, but their lack of control over the dealership meant that some dealers tried to haggle anyway. By maintaining control over the entire buying process, vehicle brokers guarantee the shopping experience for the consumer. Perhaps the most well known vehicle broker is CarsDirect.com. CarsDirect.com purchases vehicles from dealers and resells them to customers.

Direct Sales

Direct sales of autos over the Internet is currently dominated by online site-dealership partnerships. Initial entrants into this market attempted to cut traditional dealers out of the loop, but were stymied by a variety of state and local regulations. Other entrants were limited by poor relationships with manufacturers. CarOrder.com acquired low rent dealerships to serve as distribution centers and to satisfy franchise requirements for a local presence. The intent was to sell cars online through a national Website, using a network of car dealerships as distribution points. The effort backfired when auto manufacturers balked at granting

franchises to the company. In February, CarOrder.com's major investors pulled the plug and shut the company down.[23]

FordDirect

FordDirect has enjoyed more success by partnering with existing dealerships. Headquartered in Dearborn, Michigan, FordDirect is an independent internet-based enterprise formed in late August 2000 with Ford Dealer Council. This new enterprise is jointly owned and supported by participating Ford dealers and Ford Motor Company. An independent management team is appointed by the venture's board of directors. The venture is a partnership between an automotive dealer body and a manufacturer.

Trilogy, Ford's partner that develops and operates all of Ford's e-commerce customer initiatives, was selected by FordDirect to provide the expertise and execution of this e-commerce platform. FordDirect started operation in December 2000 in New Jersey and has been expanding on a state-by-state basis and currently includes 21 states. These states represent about 70 percent of Ford's annual car and truck sales in the United States.

FordDirect.com allows consumers to configure, select, price, finance, initiate the purchase and schedule and delivery of a new car or truck online. Automotive shoppers can choose specific cars or trucks with desired color, options, and trim from available inventories at their preferred dealers. A special Ford e-price reflects the maximum price a dealer may charge a consumer for their configured vehicle through FordDirect. The transaction will be facilitated by a selected local Ford dealer who offers off-line assistance both during and after the sale.

A vehicle search starts either from defining vehicle features or selecting a preferred dealer. Available features include model, color, options, engine, and transmission, using vehicle data direct from the manufacturer. While selecting different options, auto buyers can see the impact on estimated monthly payment. Matching vehicles in the inventory is then presented along with a detailed summary with the VIN and MSRP. Applicable promotions and special APRs available for new vehicle purchases can be provided. Once interested buyers choose a particular

[23] Harris, Donna. **"Car Order, Out of Cash, Out of Business."** Automotive News. March 5, 2001.

vehicle, they can request a price quote. FordDirect offers free delivery to locations of choice within 25 miles or customers can also pick up at the dealer. Online financing can be obtained through FordCredit with quick response. Help sites and contact information are also accessible for those who need assistance.

For Ford Motor Company and Ford dealers, the site yields information regarding consumer demand and thus helps avoid shortages of hot vehicles and overproduction of cold models. The e-price offer may cut the practice of haggling. It could also limit the margin the retailer can charge.

On July 2001, AutoTrader.com, the top used car site in the world, was selected to power FordDirect's Used Vehicle Search Platform, which includes all available used vehicles from participating Ford dealers. These inventories are also available on AutoTrader.com. These changes extend participating Ford dealers' online reach.

Classified Advertising

Online classified advertising was also a business model pursued by a number of Internet ventures. In 1999, Yahoo!'s automobile section and Cars.com were the two largest automobile classified services. Cars.com allowed dealers to list their entire inventory and with greater detail than was possible in newspapers. They charged dealers a fixed fee ranging from $500-$1,000. Yahoo! provided free listings and made money from advertising.

AutoTrader used a slightly different model. Listings were free, but it charged for preferred placement. By partnering with Automated Data Processing, the company was able to gain access to the inventories of 5,000 dealers. In March, eBay made an all-cash equity investment in AutoTrader.com, which is currently part of the privately held Cox Enterprises media empire. eBay and AutoTrader currently offer a co-branded website to sell used vehicles. eBay attributes over a quarter of its revenue to automotive related products.

Reverse Auction

Priceline employed a reverse auction business model when it entered the online auto retail market in 1998. Customers were allowed to name their own price on specific models. These prices were then sent to dealers. If the transaction was completed, Priceline was paid $25 by the purchaser and $75 by the dealer.

Media/Information Sites

Numerous sites have offered informational content related to automotive retail. Typically these sites make their money from advertisements and marketing relationships with major auto manufacturers and retailers. Edmunds.com is one of the most prominent of these sites.

Edmunds.com

Edmund's Automobile Buyer's Guides were first published in 1966. The guides armed consumers with the information necessary to navigate the new car buying process. In 1995, the company sold almost 500,000 units and made substantial profits.

After experimenting with a CD-ROM product, Edmund's launched its website in 1994. The site grew quickly and by 1996 was averaging over 16,000 hits per day[24]. This web based business model was substantially different than its traditional business. Instead of selling information, Edmunds.com put the contents of its guides on the web for free and collected revenue from promotional activities.

Edmunds.com partnered with Auto-By-Tel, allowing customers to request referrals to auto dealers by filling out a form on the Edmunds.com site that linked to Auto-By-Tel. Edmund's collected a finders fee of a few dollars for each customer referred to Auto-By-Tel. Another source of revenue was referrals to GEICO. Edmund's also experimented with promoting the sale of selected J.C. Whitney catalog auto parts. Customers would be referred to specific products when they were viewing makes and models that could benefit from these items.

[24] Sviokla, John. **"Edmund's -- www.edmunds.com."** Harvard Business School Press, Case 9-397-016, July 22, 1996.

In September of 1999, Edmund's changed its name to Edmunds.com. A month later the company raised $10 million in venture capital. In December 1999 the company launched the Edmunds.com Marketplace, which enabled consumers to view third party vehicle reviews, comparative pricing information and vehicle history information all in one place. Additionally, the site provided users the capability to sell their own used automobiles.

Edmund's Custom Work Books allowed consumers to order customized reports on vehicles providing side-by-side comparisons. These reports could be taken to the dealership during the car buying process. Edmund's Town Hall, launched in January 1998, sought to build a community of car buyers by creating forums for discussion of new and used vehicles. Edmunds2go offered wireless access to vehicle information from Palm VII, other PDA's and cellular phones.[25]

The company faced substantial competition from sites such as Kelly Blue Book, CarPoint, Cars.com and Auto-By-Tel. Edmunds.com sought to differentiate itself by collecting its own vehicle pricing data and providing the PowerShopper portal that gave consumers access to an array of shopping sites from a single point.

Dealer Sites

Dealer sites also became more ubiquitous in the late 1990's. Republic Industries launched AutoNationusa.com in 1999. By leveraging their large dealer network and reducing response times to Internet referrals, the company was able to sell 15,000 vehicles by July of 1999.[26] AutoNation is the largest retailer of autos on the Internet. Most independent dealers have also successfully launched sites and integrated these with their dealership operations. These sites are discussed in more detail in the following section.

[25] Akers, Christina. **"Edmunds.com".** Harvard Business School Press, Case Number 9-701-025, September 26, 2000.
[26] Morris, Gillian. "**Microsoft CarPoint in 1999"**. Harvard Business School Press, Case Number 9-898-280, August 21, 2000.

5. IMPACT OF THE INTERNET ON SMALL AUTO DEALERS

The Internet has had a significant impact on the automobile wholesale and retail sectors of the economy. The Department of Commerce measures the volume of e-commerce sales as part of its survey of retail sales. Table 5 shows the volume of motor vehicle, parts and supplies sales at the wholesale and retail level for 1999 and 1998. The e-commerce sales numbers do not provide four digit NAICS code detail for retail sales, and hence do not break out new vehicle sales separately.

Table 5: Retail Sales and E-Commerce Sales for Automotive NAICS Codes

NAICS Code	Description	1999 Sales	Coefficient of Variation*	1998 Sales	Coefficient of Variation
4211	Wholesale Trade - Motor vehicles, parts and supplies				
	Total Value of Sales	197,092	2.8	173,240	2.8
	E-commerce Value of Sales	33,018	4.3	29,533	4.2
	E-commerce as % of Total Sales	16.8%	0.4	17.0%	0.4
	% distribution of E-commerce Sales	24.6%	0.8	27.1%	0.8
441	Retail Trade - Motor vehicle and parts dealers				
	Total Value of Sales	783,156	1.1	699,552	0.7
	E-commerce Value of Sales	1,876	6.6	421	16.4
	E-commerce as % of Total Sales	0.2%	< 0.05%	0.1%	< 0.05%
	% distribution of E-commerce Sales	12.2%	0.7	8.4%	1.0

***Coefficient of Variation** - Is a statistic that is used to determine the degree of relative dispersion. It extends standard deviation analyses. By definition, standard deviations are statistical measures of absolute dispersion. Therefore, it is difficult to compare the variability of two different value classes or values within those classes. It is computed by dividing the standard deviation by the mean.
* Source of the data is the Department of Commerce

E-commerce sales have had a more significant impact at the wholesale level than at the retail level. The data show that E-commerce sales composed 0.2 percent of total retail sales in 1999, up from 0.1 percent of sales in 1998. At the wholesale level, e-commerce sales composed 16.8 percent of total sales in 1999, up from 17 percent in 1998.

The Department of Commerce uses a restrictive definition of e-commerce sales, requiring that the sale be finalized and executed online. Thus their data does not count Internet referrals, or sales where the customer completed paperwork at a dealership.

NADA's 2000 Internet Dealership Survey highlighted the substantial role that Internet commerce plays in retail sales. When asked "Have you completed any sales totally (except for delivery of payment and vehicle) over the Internet?", 62 percent of dealers responded that they had. On average, dealers completed 6.2 sales exclusively over the Internet.

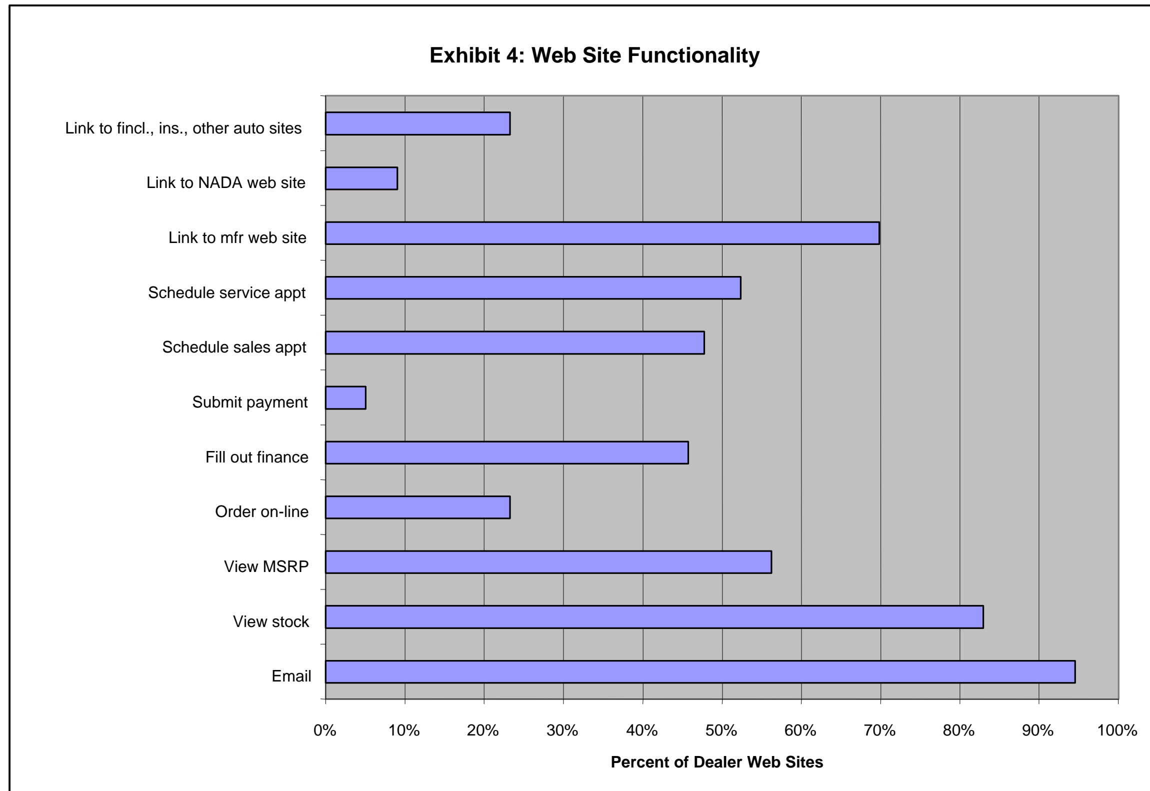
Many dealerships used the web for communication with suppliers or to sell other products. Approximately 12 percent of dealers used their site for business-to-business (B2B) communication with suppliers. Nonetheless dealers clearly believed that the most important feature of the Internet was its ability to enhance communication with customers. When asked, "Which contributes more to your bottom line?", 95.5 percent of dealers identified communicating with customers, while only 4.5 percent identified B2B communication with their suppliers as more important.

For those dealers who belonged to online buying services, about 40 percent of web leads were generated by these services. It is not clear what role Internet buying services will play in the future. The percentage of dealers belonging to a buying service actually declined in the last year, falling from 54 percent in 1999, to 40.5 percent in 2000.

Both small and large dealerships have embraced the Internet as a sales tool. Approximately 83 percent of dealerships have websites, and 97 percent of these sites are interactive. NADA's 2000 Internet dealership survey found that many dealerships have launched fully featured websites, incorporating substantial functionality for the customer to obtain pricing information, view dealer stocks, order online and schedule services.

Exhibit 4 shows the percentage of dealer websites having a variety of features. The most common feature offered on dealer websites in 2000 was email with 94.5 percent of sites offering this feature. About 82.9 percent of sites allowed customers to view stock and 69.8 percent of

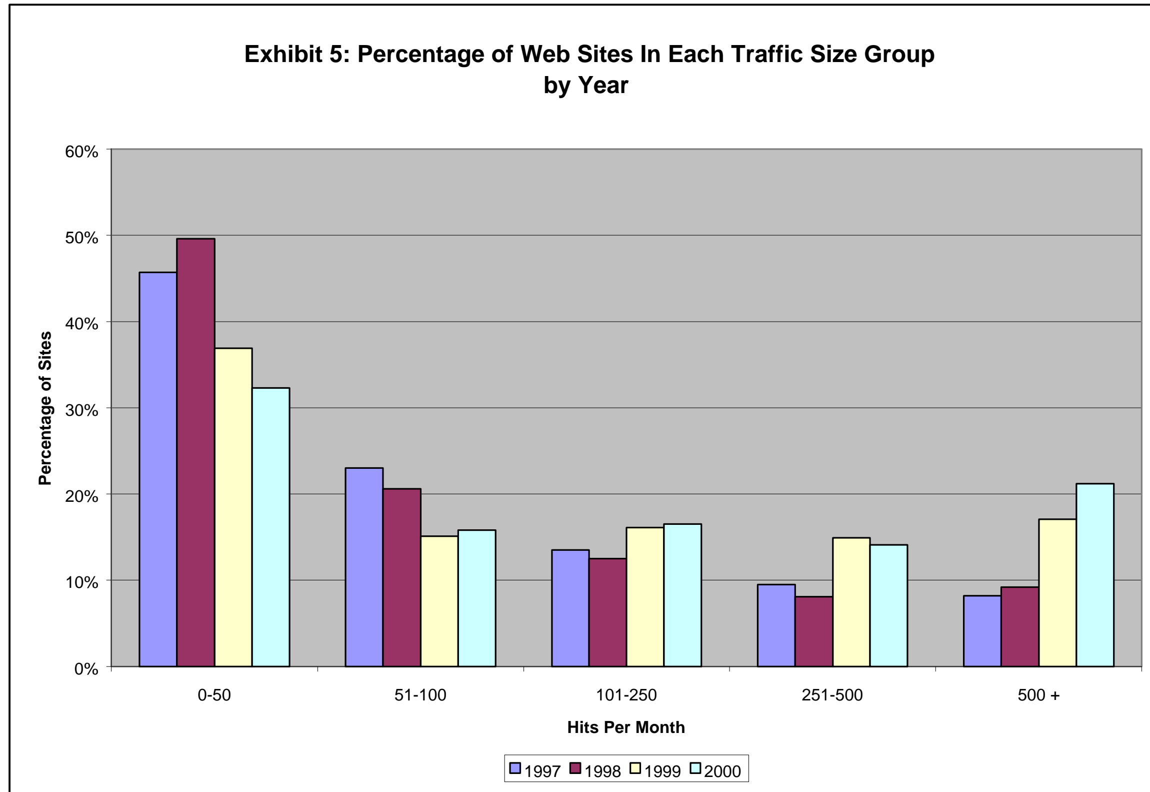
sites linked to the manufacturer. Other common features were viewing the MSRP (56.2 percent), scheduling a service appointment (52.3 percent), scheduling a sales appointment (47.7 percent) and filling out finance applications (45.7 percent). Almost 23.2 percent of the sites allowed customers to order online, although only 5 percent allowed them to submit payment electronically.



* Source: NADA 2000 Dealership Survey

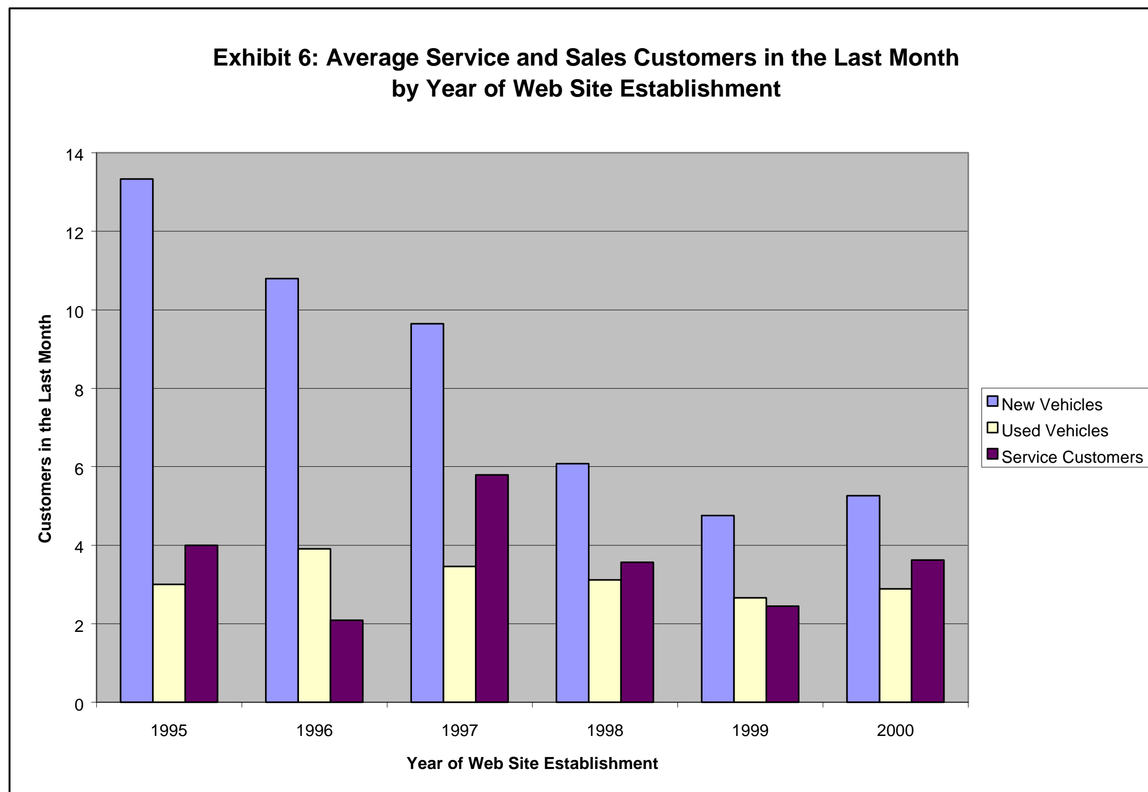
Not only have dealers been successful in launching fully featured websites, but they have also made progress in learning how to use them as a marketing vehicle. There is evidence that there is a learning curve associated with selling online. Exhibit 5 shows the percentage of websites falling in each size traffic grouping. Sites that attract more hits per month are more likely to generate leads and sales for the dealership. Exhibit 5 shows that the percentage of sites falling into the smallest traffic size groups has declined over time. As dealers have experimented with the best way to drive traffic to their site, they have become more effective over time. The

percentage of sites attracting over 500 hits per month has consistently increased between 1997 and 2000.



The success of dealers in driving traffic to their sites has also translated into sales for their dealerships. Those dealerships who have been on the web since 1995 average 13 new-vehicle sales a month through their sites. Those venturing online within the last two years averaged only 5 vehicle sales per month. Exhibit 6 shows the average number of sales and service customers in the last month, by year of web site establishment. The data show a clear learning curve in the sale of new vehicles. Those sites that have been online the longest average the most sales per year. The pattern is less clear for used vehicles. There does not appear to be a regular relationship between the year of web site establishment and the number of customers in the last month. For example, the number of used vehicle customers generated by sites founded in the year 2000 is not markedly different than the number of used vehicle customers generated by sites founded in 1995.

One important impact of the Internet on dealers has been to reallocate the way in which dealers spend their advertising budget. Exhibit 7 shows the change in advertising expenditures over time. Between 1989 and 1999, the average dealership shifted the allocation of advertising expenditures. Typically less was spent on old media, such as newspapers and radio. A greater percentage of advertising dollars were spent on television, direct mail and other. Exhibit 8 breaks out advertising expenditures, including a category for Internet. It shows that dealerships spent, on average, about 5 percent of their advertising budget on the Internet in 1999.



Another significant impact on dealers is pressure on prices. A number of studies have suggested that consumers who use the Internet to research and obtain a vehicle pay lower prices than consumers who do not.[27] The ease of obtaining information on the Internet allows consumers to shop in a larger market area for vehicles. Increased competition among dealers is the result of this, with it attendant pressure on prices.

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[27] Fiona Scott, Morton; et al. **"Internet Car Retailing."** National Bureau of Economic Research, Working Paper 7961, October 2000.

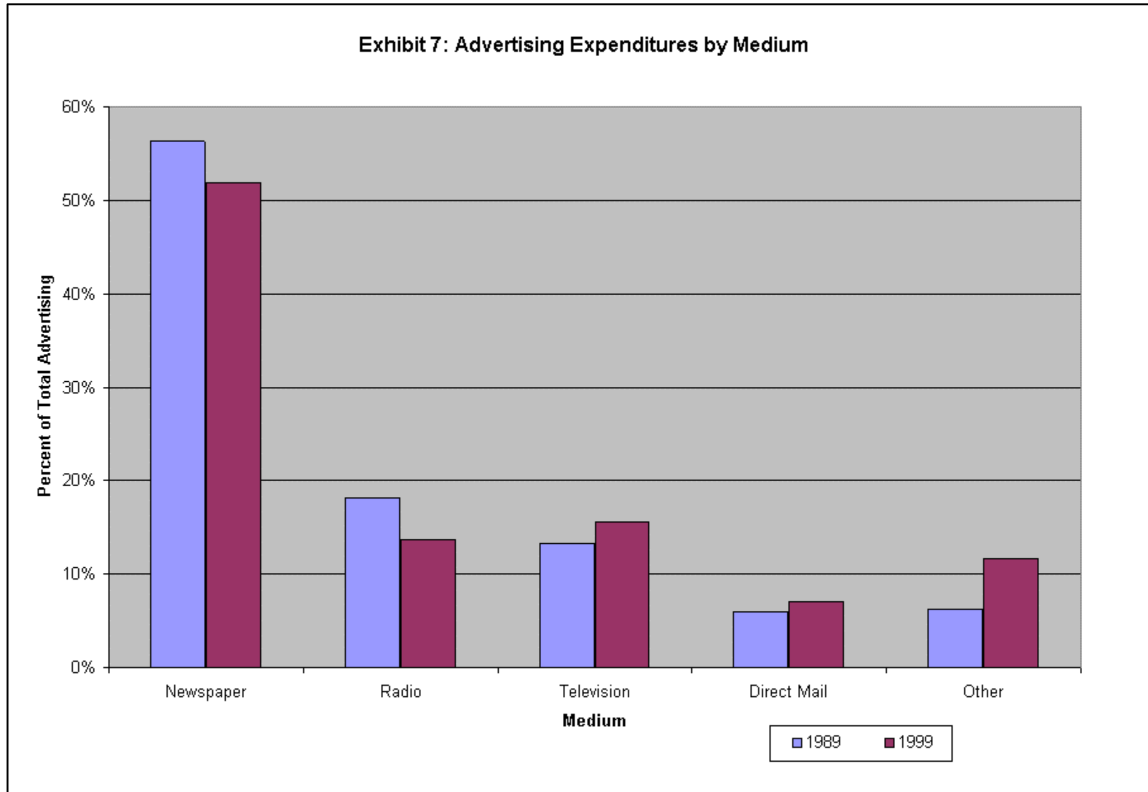
Exhibit 7: Advertising Expenditures by Medium
60%
50%
40%
30%
20%
10%
0%
Percent of Total Advertising
Newspaper
Radio
Television
Direct Mail
Other
Medium
1989
1999

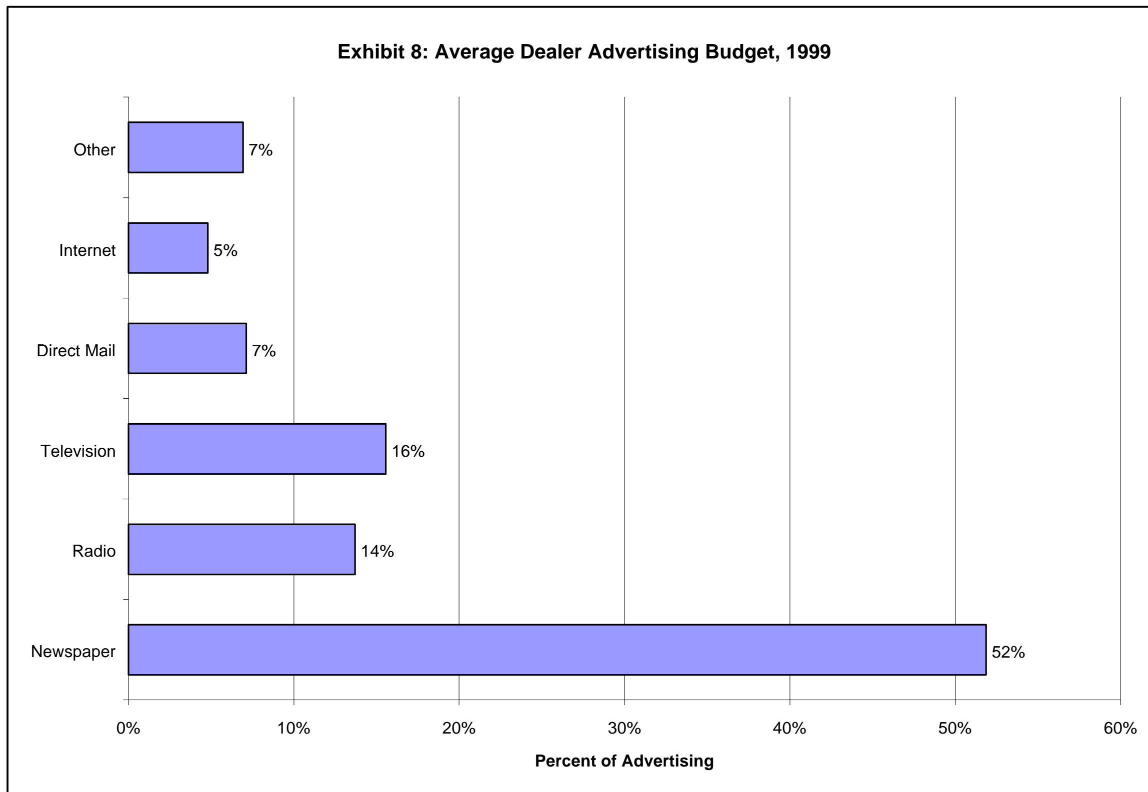
Exhibit 8: Average Dealer Advertising Budget, 1999
Other
7%
Internet
5%
Direct Mail
7%
Television
16%
Radio
14%
Newspaper
52%
0%
10%
20%
30%
40%
50%
60%
Percent of Advertising

The Internet is allowing new niche markets to emerge in B2B services. The movement of business processes onto the Internet has had a significant impact on the relationship between suppliers, dealers, and retail customers.

B2B commerce is facilitating transactions between dealers and their suppliers. For instance, the Business to Business Commerce Network Inc. (BBCN.com) allows dealers to buy office supplies, specialized vehicle equipment, car accessories and parts via the web. The Retail Auto Exchange (e401.com) was recently launched to offer a similar online dealer procurement network. The movement of procurement processes onto the web is likely to produce efficiencies for all types of businesses. Small businesses that are not currently using Electronic Data Interchange (EDI) to facilitate procurement may find the Internet allows them to reap the benefits of electronic buying by reducing technical and cost barriers to adoption. B2B commerce also plays a role in allowing dealerships to manage their inventory more efficiently. Services such as WholesaleCarsOnline.com, enables dealers to buy and sell vehicles online with other dealers. Markets that allow small businesses to reduce inventory risk could help them compete more effectively against larger dealerships that have achieved scale economies in inventory management.

A number of Internet service providers have emerged to assist dealers in serving their customers. For instance, Interval Inc. specializes in the development and maintenance of personalized web pages for automobile dealer customers. The service alerts customers to specials, sales promotions, recall notices and provides other information about their vehicles.

Overall, the emergence of electronic commerce has enhanced the competitiveness of markets, by expanding the market area in which dealers can draw customers from and increasing the number of potential dealer competitors. Since substantial scale economies have yet to emerge though, this market has not been unfavorable to small businesses. While the Internet has proven to be an effective sales tool for auto dealers, large retailers have yet to employ national advertising and branding strategies that would allow them to capitalize on this. Industry publications have reported that manufacturers have discouraged large retail chains from building national brands. State franchise laws have limited the ability of on-line competitors to challenge the position of traditional auto dealers.

While electronic commerce has had important impacts on the auto retail industry, state franchise laws, and other public policies have played an important role in mediating and structuring this market impact. A number of these are described in more detail in the following section.

6. POLICY ISSUES

As automotive retailing becomes more consolidated, the existence of laws and regulations that have economies of scale in compliance will become more important for small businesses. A number of policy issues are likely to be important to small dealers in the near future. These include both issues related specifically to Internet commerce and issues that relate to the automotive retail industry generally.

6.1 Internet Related Policy Issues

Privacy regulation is one of the most significant policy issues affecting Internet commerce in the automotive retail sector. This report thus covers this issue in greater detail than the other regulatory issues. The Gramm-Leach-Bliley Act requires automobile dealers who provide certain financial services to notify customers of their privacy policy and to permit customers to opt-out of information disclosure to third parties. State franchise laws also significantly affect Internet commerce by providing a barrier to entry for on-line retailers. Additional privacy and access regulations on Internet commerce are likely to be promulgated in the future. Each of these policies is described below in more detail.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act (GLBA) was designed to effect sweeping reforms of financial services regulation in the United States. Issues addressed ranged from the elimination of regulatory barriers between banking, investment banking and insurance to financial information privacy protection.

Financial information privacy provisions were addressed under Title V of the GLBA. Sections 502 and 503 of subtitle (A) requires financial institutions to make certain disclosures regarding their privacy policies and to give certain individuals the opportunity to prevent the institution from releasing information about them to certain third parties. Subtitle B renders illegal the

practice used by certain data collection services and other parties of obtaining nonpublic personal financial information from financial institutions by misrepresenting their right to such information.

In implementing the provisions of sections 502 and 503, section 504 required federal agencies such as the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), the Secretary of the Treasury, the National Credit Union Administration (NCUA), the Securities and Exchange Commission (SEC) and the Federal Trade Commission (FTC) to establish regulations sufficient to carry out the requirements of subtitle (A).

Each agency is required to establish appropriate standards for financial institutions subject to their jurisdiction. The agencies are also to consult with each other and with representatives of state insurance authorities to assure that the regulations are consistent and comparable.

The FTC is required under the Federal Trade Commission Act to make and enforce regulations for any financial institution or person not subject to the jurisdiction of any other agency or authority. Under FTC's Privacy Rule, an institution is prohibited from disclosing (directly or through an affiliate) any nonpublic information about a consumer to a nonaffiliated party unless the institution has provided the consumer with a privacy policy notice and an opt-out notice. The following are the key features of the rule:

- Financial services firms are required to develop privacy standards regarding sharing a consumer/customer's confidential data with corporate affiliates and other companies.

- A customer relationship involves a continuing relationship between a consumer and a financial institution in which the financial institution provides one or more financial products or services to the consumer that are to be used primarily for personal, family or household purposes.

- A consumer is a person who does not have a continuing relationship but has obtained a financial product or service that is to be used primarily for personal, family or household purposes from a financial institution.

- Disclosure notices are to be provided such that each consumer can reasonably be expected to receive actual notice in writing, or if the consumer agrees, electronically.

- The consumer must be given a reasonable opportunity (at least 30 days) to opt-out of the disclosure before making such disclosure.

- A privacy policy notice should be given to a customer at least once during any twelve-month period during the continuation of the customer relationship.

- Entities that come within the broad definition of financial institution will not be subject to the disclosure requirements of the rule if they do not have consumers or establish customer relationships.

- The rule excludes from the term personally identifiable financial information, information that does not identify a consumer, such as aggregate information or blind data that does not contain personal identifiers such as account numbers, names or addresses.

- The Privacy Rule prohibits an institution from disclosing, other than to a consumer reporting agency, an account number or account code for a deposit account, credit card account or transaction account of a consumer to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to the consumer.

- The privacy policy notice, opt-out notice and marketing provision do not apply if an institution discloses nonpublic personal information in connection with servicing or processing a financial product or service that a consumer requests or authorizes.

According to the FTC, the GLBA privacy provisions applies to any entity that meets the definition of a "financial institution" regardless of whether it is part of a financial holding company or not. The Privacy Rule defines a financial institution as any institution that engages in activities that are financial in nature or relate to financial activities described in section 4(k) of the Bank Holding Company Act[28]. This broad interpretation of the GLBA to include non-traditional financial institutions poses some difficulty in determining whether a particular entity is at least partly engaged in financial activities and thus is a financial institution.

According to the FTC, the following are examples of entities that would be considered as financial institutions:

- Retailer that extends credit by issuing its own credit card directly to consumers.
- Personal property or real estate appraisers.
- Auto dealer that regularly leases automobile on a non-operating basis for more than 90 days.
- Career counselor for employees in financial occupations.
- Check printing business.
- Business that regularly wires money to and from consumers.
- Check cashing business.
- Accountant or other tax preparation services that is in the business of completing income tax returns.
- Business that operates a travel agency in connection with financial services.
- Business that provides real estate settlement services.
- Mortgage broker.
- Investment advisory company or credit counseling service.

[28] Section 4(k)(A-E) of the BHCA provides that the following activities are to be considered financial in nature: (A) lending, exchanging, transferring, investing for others, or safeguarding money or securities, (B) insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of any of the foregoing, in any State, (C) providing financial, investment, or economic advisory services, including advising an investment company, (D) issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly, (E) underwriting, dealing in, or making a market in securities.

An internet auto retailer will be subject to the requirements of the privacy rule only if it fits the FTC's definition of a financial institution and if it has consumers or establishes customer relationships. Based on this requirement some internet auto retailers will not be subject to the current requirements of FTC's privacy rule. Determining whether a particular retailer would be regarded as a financial institution may require consultation with appropriate regulatory authorities. However, retailers who engage in any of these two activities will be regarded as a financial institution and would be subject to the privacy rule.

- Internet auto retailers who (directly) offer financial services such as credit/financing in addition to their services.

- Retailers who lease automobiles on a non-operating basis for more than 90 days.

A retailer is not regarded as a financial institution if it offers customers "lay away" or deferred payment programs, if it accepts payment in the form of cash, checks, or credit cards it did not issue. Some internet auto retailers who do not fit the description of financial institutions might be engaged in reporting activities that contravenes certain requirements of the privacy rule. As a result, each firm would have to examine the following situations for compliance:

- How nonpublic personal information is obtained from financial institutions.

- How the organization discloses nonpublic personal information to third parties or to affiliates.

- Whether a particular disclosure to a third party is subject to an opt-out notification or whether it qualifies for an exception.

Like all other firms, small businesses that fit the FTC's definition of financial institutions can be expected to incur some compliance costs. These costs will be associated with actions, such as

computer reprogramming, changes in operational policies, bulk mail costs and contracts with third parties. A quantitative estimation of this additional spending will require more research work. However, relative to larger firms these additional costs are likely to impose a greater financial burden on small businesses.

For example, the cost of informing consumers of a dealer's privacy policy can be substantial. A dealership that has been in business for an extended period of time could have a database containing information on hundreds of thousands of customers. Doing a mail-out to a population this large can be very costly.

Future Developments in Internet Privacy Law

In 2000, both Senator McCain and Senator Fritz Hollings introduced privacy bills that dealt with the collection and sharing of information online. Sen. McCain's bill, which was co-sponsored by Sen. Kerry, had set opt-out as the privacy standard. Sen. Hollings introduced legislation with an opt-in standard. McCain has indicated that he will re-introduce his privacy legislation this year, with an opt-in standard for sensitive financial and medical information, and an opt-out standard for other information.[29]

Sens. Ron Wyden and Conrad Burns recently sponsored a privacy bill that is considered more industry friendly. There are discussions underway to craft a compromise bill. The primary impact of all of the privacy legislation currently under consideration would be to extend the types of rules that currently apply to financial service providers to other industry actors, including retail and media companies online.

Rehabilitation Act Amendments

Regulations recently issued by the Access Board pursuant to the Rehabilitation Act Amendments of 1998 require government web sites to be accessible to the blind. The rules require video and graphics to be accompanied by descriptive text that allow blind users to navigate these sites.

[29] **"Senate Committee Considers Internet Privacy"**. AIM's Internet Politics Insider, Vol. 4 No. 28, July 12, 2001

Some industry observers have speculated that regulation of commercial web sites may not be far behind.

The costs of such a regulation would vary according to the size and complexity of an Internet retailer's site. The cost, as a percentage of sales, would likely fall as the size of an Internet retailer increased. This is because the cost of web site improvements for any particular site are largely fixed, but can be amortized across a larger volume of sales for those sites with the greatest number of customers.

State Franchise Laws

State franchise laws include restrictions that prevent new franchises from being licensed if a market is already well served by existing dealers, state laws preventing manufacturer owned dealerships and state laws requiring auto dealers to have a physical presence in the state. Only two states had laws that restricted new franchise licenses in 1970, this number increased to 36 in 1983 and 41 in 2000.

Franchise laws prohibit manufacturer owned dealers from selling autos in 40 states. Direct sales of automobiles on-line by manufacturers or other agents without a physical presence is prohibited in every state except Alaska. Current franchise laws that restrict entry favor small businesses operating traditional dealerships. At the same time, these laws have made it difficult for new online businesses to enter this market.

6.2 Other Policies Affecting Automobile Dealers

A variety of other public policies affect the competitiveness of small automobile dealers in the retail market. We examine these policies as well because economies of scale in regulatory compliance in other areas may have synergistic effects when combined with scale advantages in Internet commerce. These issues include the Robinson-Patman Act, proposed mandatory binding arbitration legislation, state dealers' rights laws, ADA hand control requirements, the Family Medical Leave Act, and OSHA ergonomic regulations. This list is not meant to be exhaustive, but merely reflects

the issues most often mentioned by national and regional auto dealer associations as having an impact on small businesses. Each of these is described below in more detail.

Robinson-Patman Act

The Robinson-Patman Act is a law that makes it illegal for suppliers to charge discriminatory prices to customers unless such prices are needed to meet the competition, are cost justified or meet certain other criteria. The law was passed to limit the ability of power buyers and large retailers to extract preferential prices from suppliers. Currently small auto dealers pay the same price for vehicles as large dealer groups.

One area where differential pricing is occurring is in dealership rating programs such as Ford's Blue Oval program. Ford uses surveys to rate the quality of its dealerships. To obtain Blue Oval status a dealer must maintain high customer service ratings and comply with other requirements. Dealers who are certified as Blue Oval get a 1.25 percent rebate on vehicle purchases.

The Ford Dealer Alliance is currently suing Ford, alleging that the Blue Oval program establishes a two tiered pricing structure for the industry that is illegal under the Robinson-Patman Act. Ford maintains that its program merely provides legal performance bonuses to dealers for good performance.[30]

Mandatory Binding Arbitration

Manufacturer franchise agreements currently require auto dealers to waive rights they have under state law and accept arbitration to settle a variety of disputes. Dealers have lobbied for changes in federal laws to prevent these types of agreements from being binding. On October 4, the House passed HR. 534, a NADA backed anti-arbitration bill, but the session ended before further action could be taken.

Mandatory binding arbitration disadvantages small businesses because larger dealer groups may have more leverage in negotiating with manufacturers. Small dealerships may not receive the same level of service from manufacturers and may require other avenues to resolve disputes.

State Dealer Rights Laws

State automobile dealers associations have been lobbying for changes to dealer rights legislation at the state level. In a number of states, these laws do not incorporate language explicitly requiring automobile manufacturers to deal in "good faith" with automobile retailers. For instance, Oldsmobile dealers were required to invest money in improving their showrooms only a short period before GM decided to cancel the brand. A number of state associations believe that including the good faith clause in state legislation can improve the manufacturer-dealer relationship.

ADA Hand Control Requirements

Under the Americans with Disabilities Act, dealers are required to install hand controls to allow disabled customers to test drive and purchase any vehicle model. Some state associations identified this as a requirement that could have a disproportionate impact on small businesses. Smaller dealerships that do not have spare mechanics to perform these installations on short notice may need to pull mechanics away from revenue producing work. Large dealerships, employing a greater number of mechanics, are more likely to have available mechanics to perform these installations at little additional cost to the dealership.

Family Medical Leave Act

The Family Medical Leave Act covers businesses employing fifty or more employees, twenty or more weeks in the year. The Act applies to those employees who have worked for an employer for 12 months and at least 1,250 hours. A covered employer must grant an eligible employee up to a total of 12 workweeks of unpaid leave during any 12-month period for one or more of the following reasons:

- for the birth and care of the newborn child of the employee;
- for placement with the employee of a son or daughter for adoption or foster care;
- to care for an immediate family member (spouse, child, or parent) with a serious health condition;
- to take medical leave when the employee is unable to work because of a serious health condition.

[30] Mary Connelly, "**Blue Oval Battle Looms for Ford, Dealers"**. Automotive News. March 19, 2001

The Family Medical Leave Act is a law that can have a disproportionate impact on small businesses. Small dealerships are often more dependent on particular employees to perform specialized job functions. If temporary workers are unable to adequately fill these positions, small dealerships are more likely to suffer adverse consequences when they are required to hold key job functions empty while employees are on leave. Larger organizations are more likely to have slack capacity and overlap in job functions that may make the departure of particular employees of less concern.

Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)

A number of state dealership associations identified CERCLA as one of the costliest federal laws applying to dealers. CERCLA can make dealers who have used EPA certified waste haulers liable for the improper disposal of used oil and other waste that occurred at a third party facility. Disputing CERLCA liability in court can be costly. Small businesses often lack the financial resources to exhaust their legal options. The possibility of such liability claims emerging in the future for existing dealerships can also reduce the resale value of small dealerships.

OSHA Ergonomic Regulations

OSHA adopted a new ergonomics rule in November of 2000. On March 20, 2001, Bush signed legislation to repeal this rule. OSHA is currently conducting a number of public forums to obtain input from industry and lay the groundwork for a new rule-making process.

Industry groups lobbied against the previous ergonomics rule for a number of reasons. First, the standard required employers to pay 90 percent of the salary and benefits of workers who must take time off to recover from a workplace musculoskeletal disorder (MSD). Industry associations argued that this requirement established a two tiered workplace injury compensation system and illegally superceded the existing state workers' compensation laws.

Second, the rule focused on injury management, which NADA believed was already addressed by state workers' compensation laws. The rule required employers to identify risk factors for

MSD in the workplace and develop corrective programs to change work procedures and equipment. Industry representatives argued that the rule was ambiguous and impossible for small businesses to comply with. One NADA witness noted, "it inappropriately assumes too much knowledge and expertise on the part of small business people, and focuses too much on identifying injuries instead of eliminating hazards."[31] Some argued that the costs of the rule would fall disproportionately on small businesses, who were unlikely to have the in-house health, safety and ergonomics expertise to develop work procedures and programs to achieve compliance.

The rule would have covered all employees who perform manual handling tasks, including dealership service and body shop technicians. The requirement would have been extended to all other job categories, such as dealership sales staff and office personnel, once one employee in that position developed a work-related musculoskeletal disorder (MSD). Dealerships would have been required to assess whether MSDs occurred in their workplace and to report these injuries to OSHA when they occurred. Another NADA area of concern was how dealerships would assess whether workers had an MSD and determine if it was caused by a work related activity.

NADA suggested an alternative regulatory approach to reducing MSDs in the workplace could seek to "list specific sets of activities and conditions posing significant work-related MSD hazard risks, particularly for small businesses. These specific, narrowly-defined, and objective lists of hazards (preferably industry and job specific) should be accompanied by equally specific, narrowly-defined and objective lists of fixes and remedies."[32] Such an approach would provide clear guidance on how to reach compliance with the law.

6.3 Future Developments

There are numerous policy issues that affect small automobile dealers at the Federal, state and local levels. A number of industry watchers believe that the cost of some of these regulations falls

[31] Mike Morrissey. **"New OSHA Ergonomics Standard Harmful To Small Business".** NADA News, http://www.nada.org/content/MediaCenter/PressReleases/Leg_04_27_00.htm
[32] Mike Morrissey. **"New OSHA Ergonomics Standard Harmful To Small Business".** NADA News, http://www.nada.org/content/MediaCenter/PressReleases/Leg_04_27_00.htm

disproportionately on small businesses. Further research is needed to quantitatively assess the magnitude and impact of these costs on firm survival, growth and profitability.

Additional privacy legislation is currently being considered in the Senate. Currently, some automobile dealers are covered by restrictions under the Gramm-Leach-Bliley Act, but future legislative efforts will attempt to expand the population of dealers subject to notification and disclosure requirements.

7. CONCLUSIONS

The most important factor driving innovation in auto retail is the need to improve the experience of buying a new vehicle. Most consumers find purchasing a new auto to be stressful and unpleasant. On-line purchasing, no-haggle pricing and a number of other innovations are targeted at better customer service. Manufacturers also believe build-to-order auto sales can reduce inventory, manufacturing and marketing costs.

A number of factors protect the position of small businesses in auto retail. First, manufactures still largely control the way that their products are retailed. The franchise system protects small businesses from discounting by on-line retailers and large retailers. Preferential prices are unavailable to large buyers, and small businesses compete on a relatively level playing field. The traditional full service dealership plays an important role in the marketing of automobiles. Manufacturers have yet to find an on-line vehicle to replace the functions that traditional dealerships serve. State and local franchise laws further serve to insulate small dealerships from new entrants into the market.

Traditional automobile dealers have embraced Internet commerce and have made substantial progress in integrating it into their existing businesses. Most dealerships have gone on-line and appear to be making progress in learning how to effectively use the technology to make money. Consolidation in the industry continues, and the average size of dealerships is still rising. Clear advantages to scale have yet to emerge though. Manufacturers have largely pulled back from their attempts to purchase significant portions of the retail side of the business. The benefits of local marketing, ownership and entrepreneurial salesmanship still provide small businesses with significant competitive advantages in this sector.