

## COMMENTARY: Accelerating the pace of automotive retail's digital transformation

The coronavirus outbreak will finally accelerate the growth of online purchases within the automotive industry. Today, the march to digital is still taking place at a surprisingly restrained rate. Over the last few weeks I've spoken with 50 car dealerships and only three felt that their digital efforts were meaningfully driving online sales results. The potential is there, but still underrealized.

The recent MAX Consumer Insights: Covid-19 Impact Survey indicated that a solid 86% of customers were still heading to the dealership to buy a vehicle.

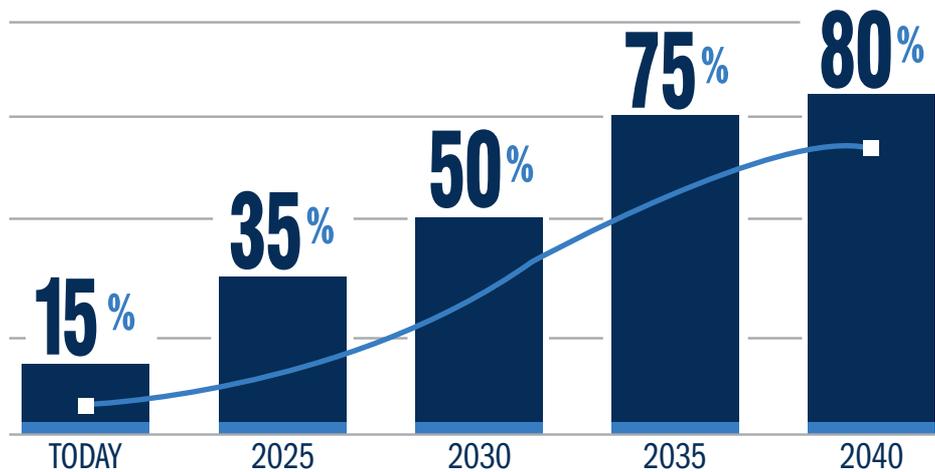
When will it change and what will the actual adoption curve look like?

Past estimates are not that far off yet. A January 2019 McKinsey & Company study had estimated that online purchase for used cars had the potential to grow from 6% to 25 to 50%, while new car sales would grow to roughly half that from zero percent to 10 to 25%.

They expected that used car sales would double from 6% in 2109 to 12% in 2020. Our own annual dealer survey was similar. Dealers indicated that 15% of their vehicle sales were delivered outside the dealership. In 2025 they expected their sales delivered outside the dealership to be 34%, and 47% in 2030.

We didn't ask them to imagine beyond the 10-year horizon, but if we think about the transformation broadly as sales moving to dominantly online experiences including some deal formation online, I expect the adoption curve to continue to grow aggressively through 2035 then stabilize around 80% in 2040.

### PROJECTION: PERCENT OF SALES WITH DIGITALLY DOMINANT DEALS



Source: 2020 MAX Digital Retailing Study

What evidence do I have? A few core trends. The first is that today overall ecommerce growth in the U.S. looks like the chart below and has been on a similar upward trend since 1992. Ecommerce is a long-term sustained trend that isn't going away and doesn't show any signs of flattening.

On the consumer behavior side, there are many signs that the growth has only begun. As we get comfortable making purchases in other retail categories, particularly during this crisis, our comfort with the largest retail sector of automotive will only continue to grow. Back in 2016, a *USA Today* article noted that millennials are the big catalysts behind ecommerce, making the majority of their purchases online. Those numbers will only increase with continued social distancing.

So, what about the dealership side? Why have we been so slow to embrace ecommerce? The short answer is because the people and financial systems to date had benefitted more from the traditional model.

The people who will continue to drive the coming change are moving into place. According to the NADA 2018 Workforce Study, millennials are the largest single generation in our workforce at 42% of the automotive workforce, compared with 28% for Gen X and 23% for baby boomers.

As they move into positions of power, their digital ways will come with them. The cultural norm for these digital natives is to look for the best price, not to have to bargain for it. During this pandemic, information sharing while not comfortable for many dealerships has expanded meaningfully. The generational changes have been accelerated and will further fuel the rise of the informational product expert and decline of the traditional sales role beyond the current crisis.

Financial structures that served the industry in the past will not survive the next decade. Rising cost of facilities, high inventory holding costs and declining profit margins driven by our transparent marketplace will accelerate consolidation pressures and tip the scales towards online models disproportionately. As the battle to win customers moves increasingly online, the advantage of larger retailers grows. Larger pools of inventory simply outperform smaller ones in winning any search.

The benefits of digital retailing have not yet consistently outweighed the costs in



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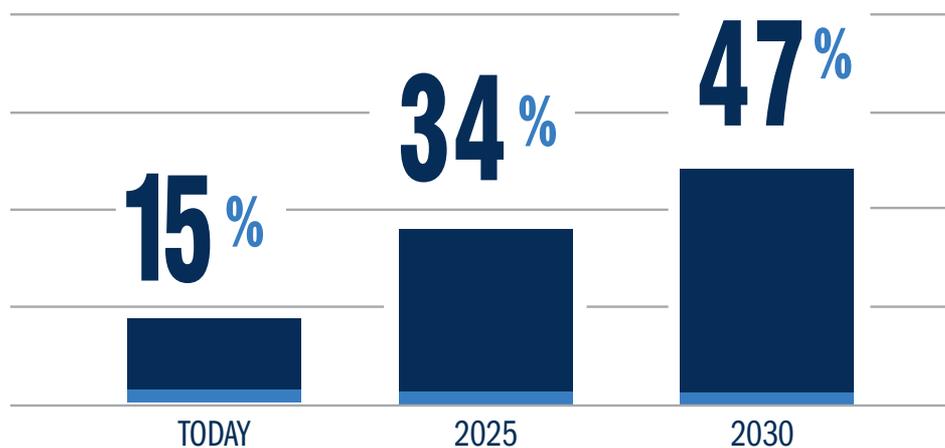
terms of both process changes needed and direct financial investment. Thirteen of the 50 dealerships I spoke with on this topic were using a free service provided through their OEM. By far the most popular approach has been the path of least resistance, but that will change as the digital channel grows by necessity with employees working from home and leaner staffs stretched to do more remotely.

The structural transformation of the dealership will mimic a Carvana-like model with lighter physical footprints and heavier online presence. All vehicles will be represented online, but fewer vehicles will be present in the high-cost retail environment over time.

Improvements in manufacturing will allow inventory holding costs to shrink with increasingly accurate just-in-time inventory and built-to-order models. Front of the house staff will be most similar to current BDC staff in a customer support function, rather than traditional, sales-driven retail purchase path. A small variety of vehicles will be available on-site for test drives. F&I functions will continue to be minimized in store and driven online as much as possible. While signing a deal may remain in store with vehicle pickup, the process will be much closer to signing for a package delivery today. The current system and costs related to in store financing will shrink. Done well, profits will remain with well-merchandised protection plans and financing options available online.

While there will always be a percentage of the population that wants to buy in-person, especially for used cars, and the need for local service will remain, the dealership will be-

### PERCENT OF SALES DELIVERED OUTSIDE DEALERSHIP



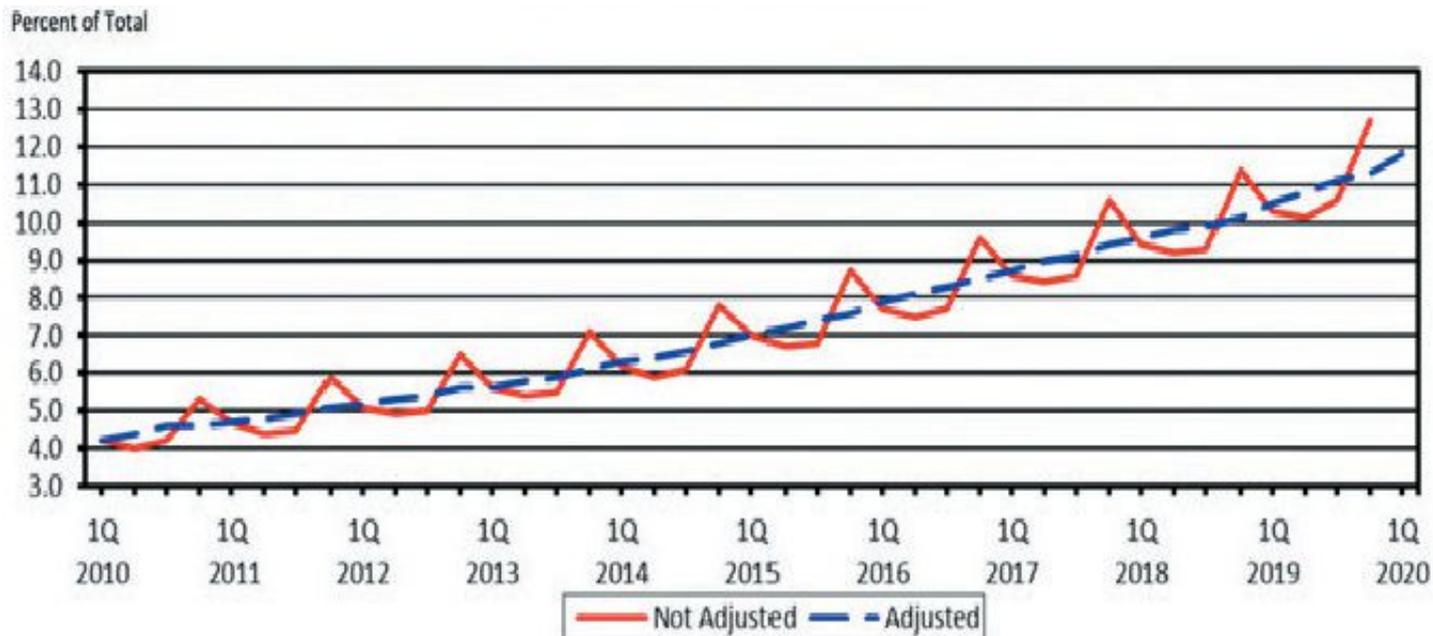
Source: 2020 MAX Digital Retailing Study

come a service and experience center to accommodate. That service and experience hub will be staffed with a fraction of the staff employed today to deliver lower costs to remain profitable into the future. Self-service options online and kiosks in store will help fill the roles staff fills today.

The full-scale digital transformation is coming, but remarkably, it's still coming slowly for now. You have the time to react and crawl, walk, run into this change. Start by tackling the cultural change and technology assistance needed to match your customer's online expectations in real life at your dealership today. Ready the plan for your full transformation. We have a unique opportunity to see the future coming. Take full advantage of that opportunity and prepare to deliver the best experience possible through each phase of the digital adoption curve.

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## ESTIMATED QUARTERLY U.S. RETAIL E-COMMERCE SALES AS A PERCENT OF TOTAL QUARTERLY RETAIL SALES: 1ST QUARTER 2010 - 1ST QUARTER 2020



Source: Census.gov

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