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Executive Summary

Factory Image Programs

An NADA Research Project

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Genesis. The National Automobile Dealers Association (NADA) launched the Factory Image Program study in August 2011 in response to numerous expressions of concern by NADA members about the automakers' facility upgrade programs. These programs, intended to encourage dealers to invest in store expansion, modernization and standardization, can place significant financial burdens on dealers, yet there is little hard evidence on the return of investment this spending might yield. As a result, the facility investment decision is all too often based on opinions, assertions and anecdotes, which is no way to conduct business. Accordingly, NADA undertook this objective, unbiased and neutral study of the various factors that drive the economics of facility programs. Our goal was to open up a dialog in which all parties can discuss facility requirements on a more rational, informed and fact-driven footing.

Context. What this study *could not* do is provide a "silver bullet" solution that would work equally well for the more than 16,000 diverse dealers and two dozen OEMs that are working through facilities issues in a wide variety of situations every day. At the most general level, virtually everyone in the American auto industry agrees that dealers, OEMs and consumers alike are justified in expecting that new cars be sold from clean and modern facilities that are supportive of the car brand. However, the devil is in the details, and this project deals with those details about which there is much less agreement.

Method. Our research process was straightforward. We conducted in-depth, confidential interviews with everyone and anyone who might have insight into the problem. We spoke to dozens of dealers (public and private, large and small, highline and mass-market), 12 OEMs and experts in various aspects of automotive retailing (attorneys, CPAs, buy/sell brokers, facility appraisers, architects, designers, lenders, economists and equipment vendors). We also sought insights from other retailing industries with experience in facility upgrade programs, including franchised restaurants and hotels.

Top-Level Findings. In summary, dealers are supportive of the *concept* of facility programs, but wary of their *economics*. Expert observers such as CPAs and dealership brokerages tend to echo this view. The OEMs for their part are understandably enthusiastic about the programs, but approach them in very different ways, which tends to undermine dealer faith in their value. And consumers seem to be mostly indifferent. These top-level views are interesting, but not granular enough to provide guidance as to how to improve facility programs. For that, we looked deeper into the issues, both those that addressed the three “layers” of facility programs (Expansion, Modernization and Standardization) and those that cut across these layers. For each issue we developed recommendations for improvement.

Issues by Layer. Expansion involves correctly sizing dealership sales, storage and service areas to meet current and projected demand. Modernization investments bring the store up to contemporary standards both inside and out. Standardization aims to ensure that every dealership carrying a given brand looks more or less alike. Our findings by layer, with suggestions for resolving issues, include:

1. **Expansion** generated the least argument and OEM/dealer tension among our interviewees, partly because it is the only layer where hard numbers are often available. But improvements can be made (and the ROI on spending improved), by the OEMs:
   a) Providing more realistic forecasts of space requirements;
   b) Stabilizing such forecasts so that they do not shift over time; and
   c) Updating capacity formulas to fit modern practices (e.g. extended service hours that increase bay capacity).

2. The **Modernization** layer of facility programs generates more controversy because while the costs are clear, the benefits are at worst minimal and at best un-quantified. We believe it is incumbent upon OEMs to do a *much* better job of:
   a) Demonstrating to dealers the business case for Modernization; and
   b) Reassuring dealers that the necessary spending is as cost-effective as possible (e.g. by loosening design specs that increase costs with no corresponding increase in customer value).

3. The **Standardization** layer creates the most contention because its benefits are *very* unclear. Accordingly, we would ask OEMs who do insist on high standardization levels to revisit – and explain – their motivations for asking for this degree of “cookie cutter” design across their dealerships.

Issues Cutting across the Layers. Among these issues were timing, size bias and design for the future:

1. **Timing.** Many dealers told us, "Now is an especially bad time for factories to be asking for upgrade spending," citing the recession as their reason. As we looked into this, we concluded that actually the present day may be a *good* time to invest, given an improving economy, strengthening dealer profits, low interest rates (for facility loans) and cheap construction costs. Not all dealers are on a profitable footing, of course, and for them facility investments may indeed need to be deferred.

2. **Size Bias.** A refrain we consistently heard was that facility programs were biased against smaller dealerships. For example, an entryway that might cost $100,000 for a large store would still cost more than $20,000 for a store doing one-fifth the volume. Factories try to adjust for this scaling problem with "tiered" levels of requirements, but we believe they could do more in flexing programs for small stores.

3. **Design for the Future.** Many interviewees worried that factory facility programs could lead to building "monuments" or dealerships that were well suited to today's needs, but which would be obsolete by 2020. For example, as more of the car purchase moves online, a dealership might be able to devote fewer square feet to office space. We suggest that OEMs and dealers together research the changing retail environment so that the stores built for today will also be successful for tomorrow.

Recommendations. Our recommendations emerge from the various issues analyzed above, grouped into three topic headings: Value, Cost and the Future.

1. **Value.** It should be clear that we firmly believe that it is incumbent upon OEMs to provide dealers with more persuasive business cases for investment in facilities, especially for Modernization and Standardization expenditures.

2. **Cost.** Even for those dealers who are convinced of the value of facility programs, there is equal conviction that the cost of these programs is needlessly high. The typical estimate of how much more costly it is to execute one of these programs, compared to doing it oneself, is 20%-30%. Accordingly, we urge individual OEMs and their dealers to work together to tackle cost levers such as unnecessarily high or rigid materials and fixtures specifications, needless limits on the numbers of qualified vendors and unstable volume forecasts, etc.

   Further, we encourage OEMs to revisit again how they "tier" their programs to make them more affordable for the smallest rural stores. Beyond these structural cost issues, there are also needless costs incurred during program implementation due to poor communications, unclear chains of command and antagonistic behavior on both sides. Our further recommendation is for dealers and OEMs alike to step back, recognize their mutual interests and dependency, revisit how many resources they need to devote to the process (e.g. OEM field staff and dealer principal attention), and – most crucially – "turn down the heat" in regards to rhetoric, complaints and accusations.

3. **The Future.** Our first two recommendations deal with the here and now—the costs and benefits of current facility programs. However, by generating and sharing research into retailing trends, we would recommend to both OEMs and dealers alike to jointly tackle the issue of whether the dealerships we are building today are going to be the successful dealerships of tomorrow.

Conclusion. Factory facility programs, which scarcely existed a few decades back, are now part of daily reality for U.S. new-car dealers. While almost everyone involved agrees with the principles of such programs (give the customer clean, modern and brand-supportive facilities), there is significant disagreement about the details of their design and implementation. At their core, these issues relate to uncertainty about the benefits of the programs and worries about their excessively high costs.

It was the goal of this NADA research project to bring all the various perspectives on this issue out into the open by speaking with a wide range of industry participants. Based on those discussions, we then made recommendations as to how each OEM and its dealers, working together, might reduce some of the tensions between them over these issues. If this report helps all concerned parties, even in a small way, to discuss more productively and positively and to resolve the issues that surround these programs, then we will consider the effort to have been worthwhile.

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NOTE: The full report is available at www.nada.org/facilitystudy