Transformations in Automotive Retail

— Working Paper for UNI Global Union —

Introduction

For many decades, the automotive industry has been at the forefront of debates concerning technological and economic change and its social implications. This remains very much valid today with the green transition, which to a considerable extent depends on technological and organizational transformations of the automotive value chain. Though it is only one piece of a sprawling ecosystem ranging from massive steel production capacities to huge vehicle servicing networks, manufacturing has historically been the main — indeed, largely the only — focus of these debates. This has happened for good reason: automotive manufacturing has pioneered new technologies and business models and has borne the brunt of the social impact of these changes. The automotive value chain have proved to be much more stable over time, with little reason to speak of major structural change.

For automotive retail, the status quo is no longer as secure as it was in the past and present transformations concern dealership networks and not just vehicle assembly plants. In terms of social impact, potential major shifts in automotive retail are just as important as industrial changes. In Japan, for example, approximately 1 million people work in automotive sales and services, out of which 571 thousand directly employed in automotive retailing — compared to 890 thousand people working in automotive manufacturing.[1] In Europe, 1.4 million people work in vehicle sales, 641 thousand work in the sale of vehicle parts and accessories and a further 1.3 million are employed in vehicle maintenance and repair; combined, these figures are above the 2.6 million directly employed in the automotive industry per se.[2] To be sure, automotive retail is a sector of huge importance for economies and societies across the world. It should also raise considerable interest for trade union organizing efforts.

This working paper outlines the major challenges facing automotive retail today, from the conjunctural aspects related to COVID-19 and ongoing supply shortages to the structural changes related to the transition to electric vehicles and its potentially vast implications for the way vehicles are sold and serviced. The purpose is to provide unions in the sector with an up to date analysis of what the stakes are for both businesses and employees and to anticipate future change..

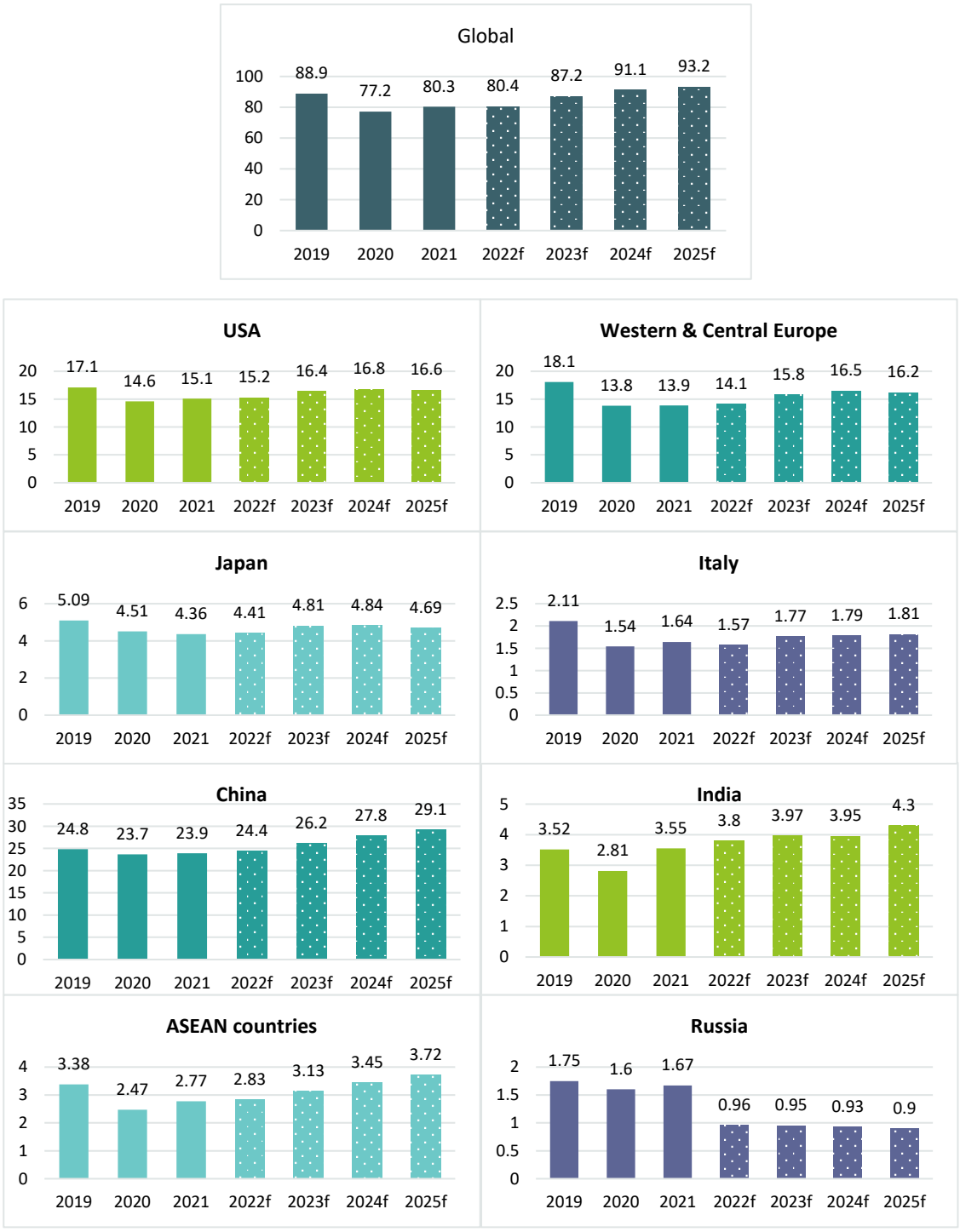
Recent developments and outlook

Together with the semi-conductor shortages and now rising inflation, the COVID-19 pandemic was just one of a series of major shocks that automotive sales have seen since the beginning of 2020. That year, global sales dropped by 13.4%, from 88.9 million light vehicles sold worldwide in 2019 to just 77.2 million in 2020. As with most industries, the magnitude and the speed of the decline were without precedent; as opposed to other parts of the economy, however, automotive sales are a long way from recovering to pre-pandemic levels — indeed, a recent forecast indicates this would occur only in 2024. For automotive retailers, this of course means that business volume will remain subdued over the

[1] Japan Automobile Manufacturers Association, *The Motor Industry of Japan 2021*, p. 3.
[2] ACEA, *The Automobile Industry Pocket Guide 2021/2022*, p. 7.

medium term and that associated risks could get worse over time, leading, for example, to potential restructuring and job losses.

Light vehicle sales forecast (Source: IHS Markit, May 2022)



Since automotive markets are highly regionalized, it is expected that we do not see similar trajectories across the world. Indeed, there is a major difference between the mature markets in North America, Europe and Japan and markets that have yet to reach saturation, such as China, India and South-East Asia. Even if COVID-19 had a major impact globally, recovery is proving much slower in the USA, Europe and Japan and there is a wide consensus that these markets will in fact never recover to pre-pandemic levels: in Japan, the sales peak until 2025 is forecasted to be 5% below 2019 levels and in

Europe it would be even lower (-9% vs. 2019 forecasted for 2024). Further granularity would be required to understand European market dynamics: Southern European markets like Italy are still barely above three quarters of the 2019 sales volumes (1.64 million vehicles in 2021 vs. 2.11 million in 2019), while in countries such as the UK recovery has been occurring much faster. Certainly not as fast as in Asia, where there is still great potential for growth and where forecasts show a surpassing of pre-pandemic sales volumes in 2023 at the latest. The outlier among large markets with high growth potential is of course Russia, where sales have collapsed as a consequence of the war in Ukraine and are forecasted to continue to decline over the next period. All this means that automotive retailers operate in very different contexts depending on the region and country where they are located.

The current environment is highly uncertain and both 2021 and the first half of 2022 have proved that there is always room for more pessimism for the automotive market. Post-pandemic recovery was initially expected to happen already in 2021, but then the unexpected global semi-conductor shortage cut global volume by 10 million vehicles and supply chain problems are expected to persist for the foreseeable future. Rising inflation across the world could make things worse, as many consumers will become more reluctant to buy new vehicles.

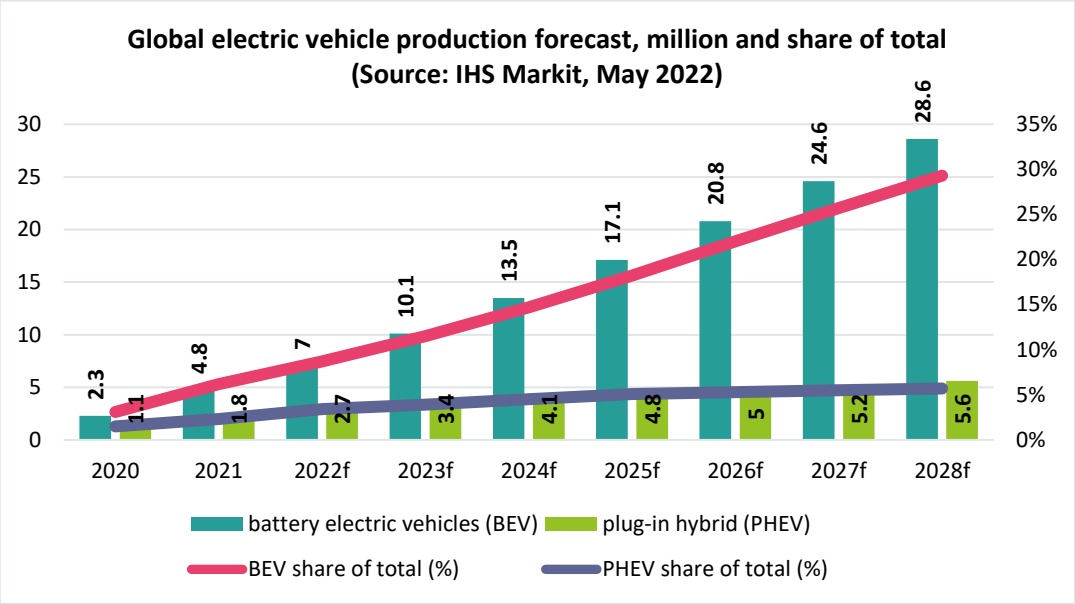
These cumulative shocks are impacting the automotive value chain in different ways. Surprisingly or not, 2021 has been a historically good year for automakers in terms of profitability, as they employed a "Stop & Go" approach to supply shortages, which meant focusing production on the most profitable vehicles while mothballing other production capacities. Such an approach shifted a large part of the burden to suppliers, who generally do not enjoy such operational flexibility and typically have a weak bargaining position in relation to vehicle manufacturers. In their turn, dealerships faced unprecedented low stocks, shortages and prolonged delivery times, all triggering discontent on the part of buyers, many of whom headed toward the used vehicle market as an alternative. On top of this, dealers also faced additional pressure from vehicle manufacturers demanding a reduction of dealer margins.

The transition to electric vehicles

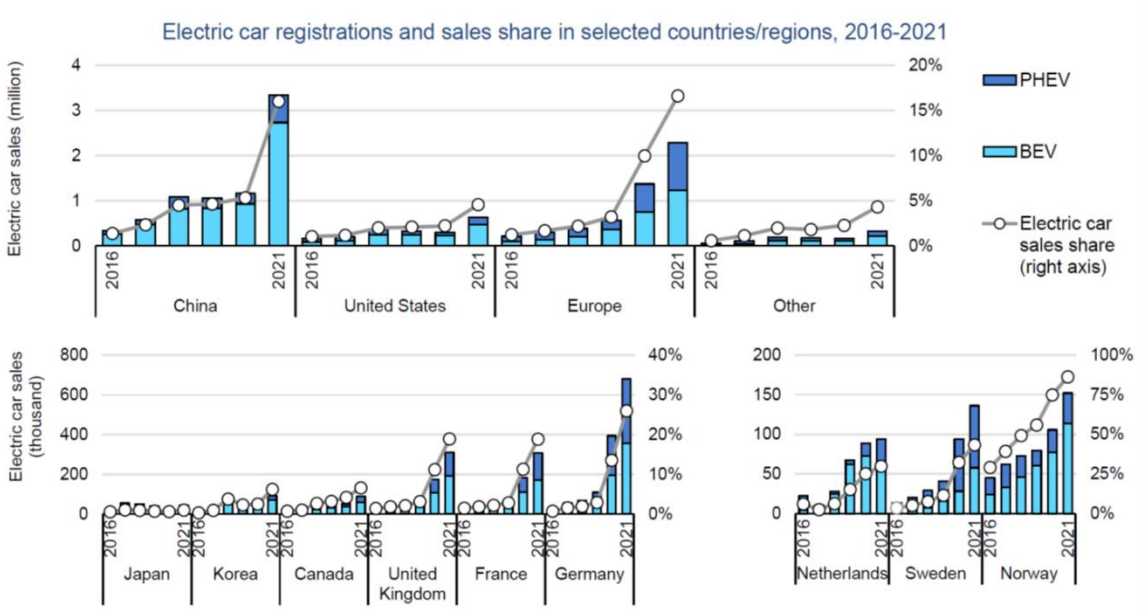
At any other point in the long history of crises facing the automotive industry, these would have been broadly regarded as conjunctural turbulence for an industry that would eventually get back to business as usual; the only question would be how much time it would take. There are plenty of reasons to believe this is no longer the case, since there are not just conjunctural factors at play in the current crisis facing the industry. In other words, even without COVID-19, the semi-conductor shortages or mounting geopolitical tensions, the automotive industry is in the middle of a structural transformation that is likely to overhaul its entire value chain, from suppliers to retail and servicing. This transformation is driven primarily by tightening emissions regulation, which are catalyzing rapid advancements of electric powertrain technology and are forcing significant changes in dominant business models. The latter are mainly adaptations to the huge uncertainty regarding the future trajectory of the automotive market and the considerable stress the electric vehicle (EV) transition is already having on business finances — electric vehicle production requires massive investments in R&D and manufacturing, but is not yet profitable.

In 2021, 6.6 million electric vehicles were sold worldwide, out of which 1.8 million plug-in hybrids and 4.8 battery electric vehicles (BEV). Until relatively recently, it was believed hybrids would serve as a

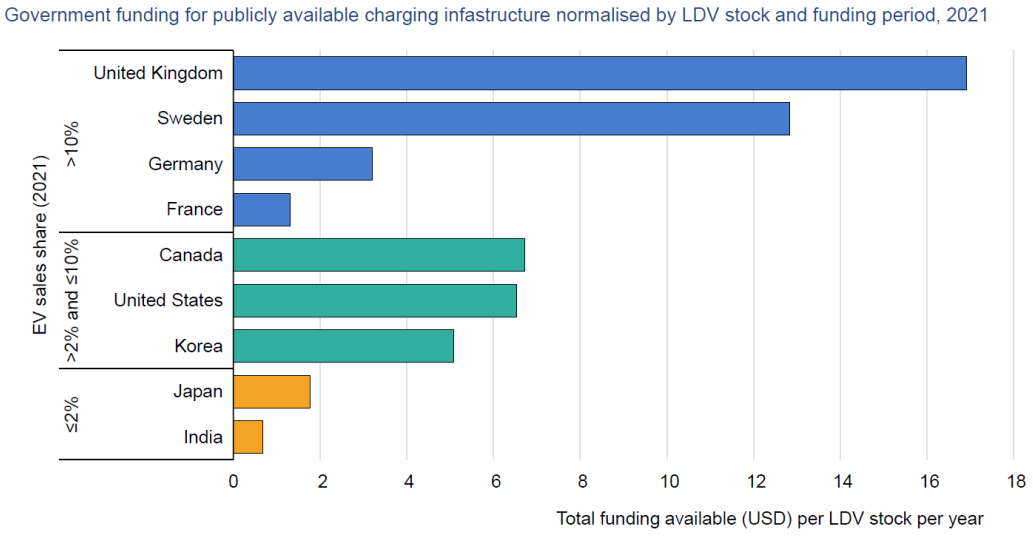
transitional technology until battery electric vehicles become more capable and affordable. Tightening regulation and more-rapid-than-expected technological advances have rendered this hypothesis invalid: the standard view today is that the transition will be directly to battery electric vehicles, with limited growth potential for hybrid technology. Forecasts show global BEV production volumes will increase to 28.6 million by 2028, or almost 30% of total global volumes.



The transition has so far been highly uneven, with China and Europe far ahead of all other regions in terms of electric vehicle registrations. Both in China and in Europe, this has been driven by public policy and quick adjustments made by vehicle manufacturers. In Europe, internal combustion engines will be banned in new cars starting with 2035 and many European automakers have announced even earlier dates for the full transition to the BEV technology. The US EV market is small by comparison, but there is some indication of stronger growth in 2021.



Source: International Energy Agency, Global EV Outlook (May 2022)



Source: International Energy Agency, Global EV Outlook (May 2022)

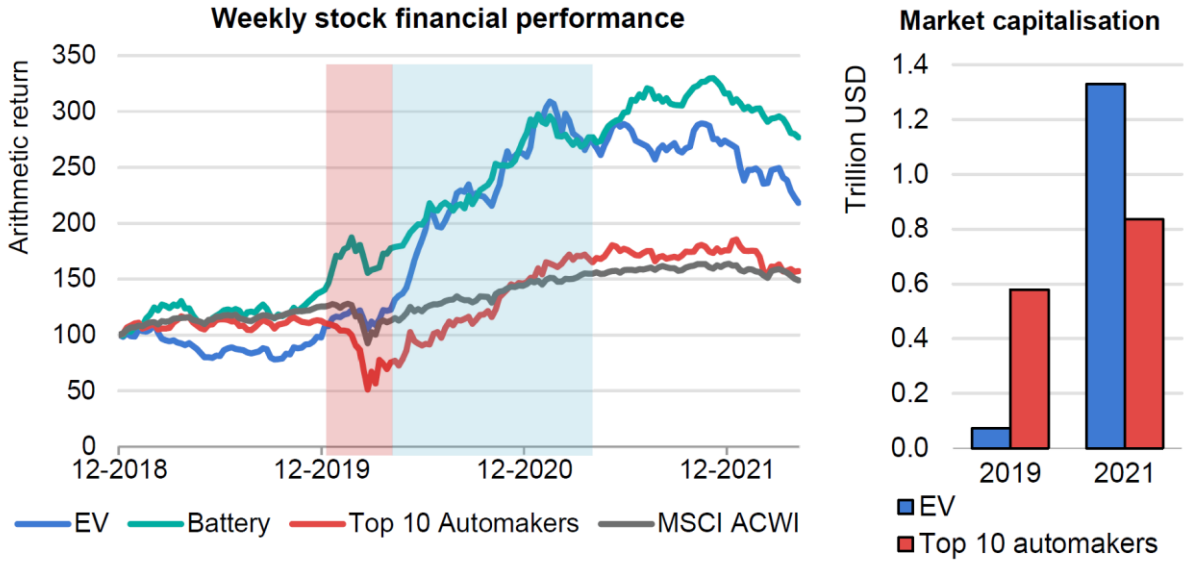
The obvious outlier is Japan, one of the major global automotive markets where there is as of yet little sign of a genuine electric vehicle transition. While electrified vehicles comprised a third of Japanese new vehicle sales in 2021, the vast majority of these were so-called "mild" hybrid vehicles, for which electric motors play only a support role for the combustion engine and that cannot be charged using an electrical outlet. A recent report on the state of the Japanese market states three reasons why Japan has so far lagged behind other major automotive markets: limited availability of electric vehicles, poor investments in battery manufacturing, and lack of charging infrastructure.[3] Regarding the latter, the report states that Japan has just 7600 fast chargers, 40% of which are installed at car dealerships. By comparison, approximately 600 thousand fast chargers were available worldwide, meaning Japan had just 1.2% of the global total.[4]

This situation has to do with the restrained policy response on the part of the Japanese government and the cautious approach of Japanese vehicle manufacturers when it comes to electric vehicles. Indeed, Japanese government funding for publicly available infrastructure is among the lowest among major automotive markets, while until recently all Japanese automakers emphasized hybrid or even hydrogen-fueled powertrains as their technologies of choice, not battery electric vehicles. Things might change rapidly and automakers indeed now consider a quicker transition to BEVs as a more likely development. Toyota has announced its intention to sell 3.5 million battery electric vehicles by 2030, or more than a third of its entire sales volume. With the exception of Nissan, other Japanese carmakers have made no announcements that they intend to switch strategies. The European experience shows, however, that radical changes of strategy can occur quite quickly, as indeed seems to be the case with Toyota.

From the very beginning, the EV transition was regarded as having a revolutionary potential for the automotive manufacturing value chain, with the most complex and highest value-added components (engines and transmissions) being entirely replaced by novel components such as batteries and

[3] RouteZero, *Japan and the Global Transition to Zero Emission Vehicles*, May 2022, p. 6.
[4] International Energy Agency, *Global EV Outlook*, May 2022, p. 46.

electric motors, with which the industry has historically had limited experience at best. Investments in these new technologies and production capacities is putting a huge strain on automakers' finances and many are struggling to fund their EV investments and work out the new technologies. Pure electric vehicle companies like Tesla have encountered no such problem, with their stock market capitalization skyrocketing with toughening regulation and technological advancement. In other words, the acceleration of the EV transition has meant that Tesla has managed to attracted increasingly large amounts of money on the stock market, managing to finance considerable investment in research and developments as well as production; this is not the case for traditional carmakers. Their lackluster stock market performance versus new EV specialists (in other words, their relative difficulty in attracting funding) has triggered unprecedented reactions on the part of some traditional automakers. For example, both Ford and Renault have announced they would split their EV and traditional operations into entirely different companies and that they are doing this in order to be able to catch up to the likes of Tesla. This is not to mean that all automakers will follow suit —both Ford and Renault have faced considerable difficulties in recent years, which is not the case for all automakers — but it does show that nothing is off the table when it comes to finding the best solution to deal with the transition to electric vehicles. As we will see in the next section, the implications for automotive retail are substantial and there is a good chance that EV retail will look entirely different than combustion engine vehicle retail.



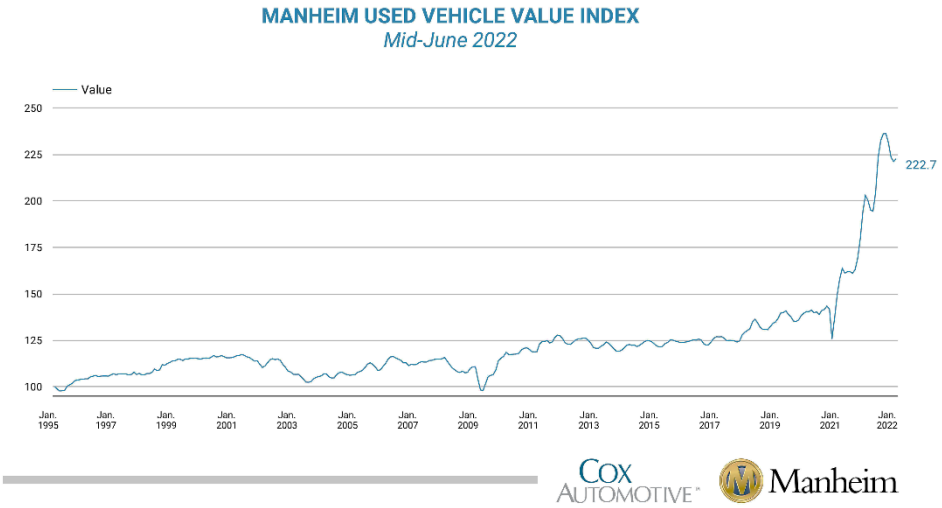
Source: International Energy Agency, Global EV Outlook (May 2022)

Implications for automotive retail

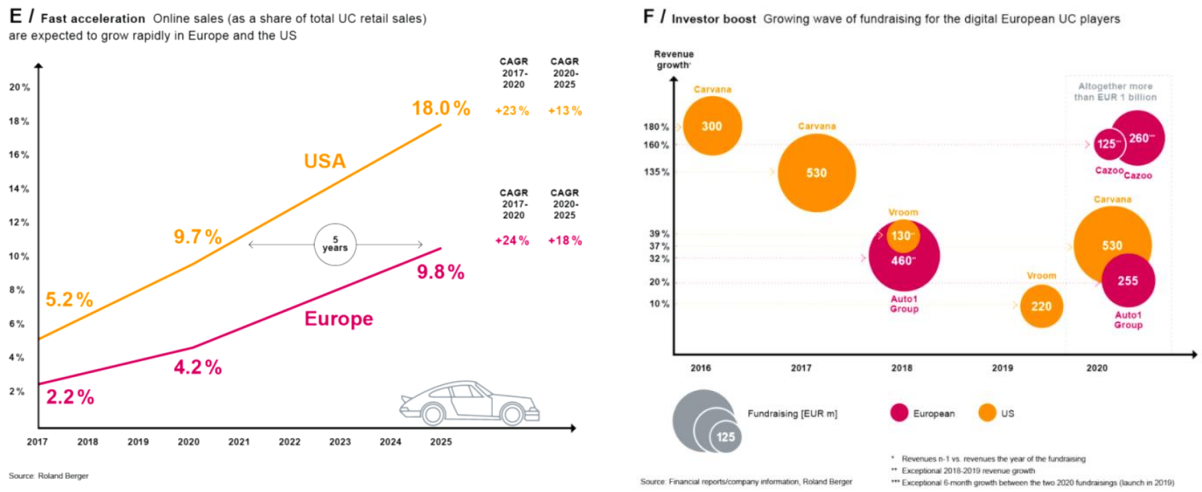
Car dealerships have several revenue streams: the sale of both new and used vehicles, as well as aftermarket and servicing activities. The transition to electric vehicles can lead to massive transformations of all these markets.

The impact on aftermarket and servicing could be similar to what is discussed concerning powertrain manufacturing capabilities: since pure electric vehicles require fewer parts, are less complex and are expected to be more reliable from a mechanical point of view, these activities could see dramatic decline. Recent estimates indicate a drop of up to 40% in car owners' aftermarket spending on parts

battery electric vehicles versus internal combustion vehicles.[5] Nevertheless, a negative impact on dealership revenues should be visible only in the long term, since it will take some time for battery electric vehicles to become dominant and even more for the legacy combustion engine vehicle fleet to be phased out. Internal combustion vehicles will remain on the road for a long time to come and at least until electric vehicle market shares increase significantly, it is unlikely that dealers will see a significant decline of aftermarket revenues.



In the short- and medium-term, aftermarket activity should in fact grow, especially since the used car market has become hugely attractive and as buyers should postpone acquisitions in a time of high economic volatility. There is no doubt that the used car market has boomed during the pandemic and has remained at historical highs largely due to supply shortages for new cars. The Manheim used vehicle value index (the most used price index for used vehicles on the US market) increased to over 220 at the beginning of 2022 from below 150 in the months prior to the pandemic (equivalent to a price increase of 45-50%). With semi-conductor supply shortages expected to continue and as inflation will harm consumer confidence, dealerships active in the used vehicle market should expect brisk business for some time to come.

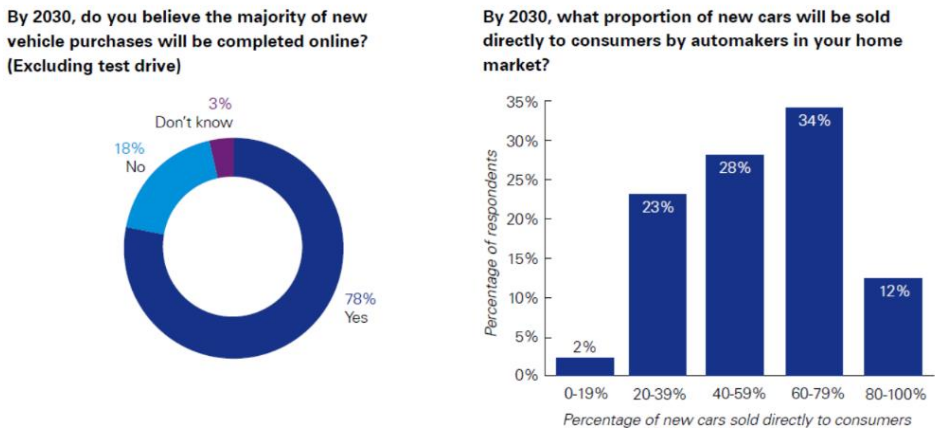


Source: Roland Berger, The Online Boom in Used-Car Sales (April 2021)

[5] McKinsey, *A turning point for US auto dealers: The unstoppable electric car*, September 2021, https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/a-turning-point-for-us-auto-dealers-the-unstoppable-electric-car.

The used car market boom will not benefit all used vehicle retailers equally. As with retail in general, the pandemic has accelerated the growth of online used car sales, which reached 9.7% market share in the US and 4.2% in Europe in 2020. A forecast by Roland Berger indicates that by the middle of this decade e-commerce market shares could reach 18% in the US and 9.8% in Europe.[6] The boom in online sales for used cars is attracting a lot of attention, with new online specialists drawing considerable interest from investors looking for high-growth business opportunities. The US company Carvana has raised over 1.3 billion euros of funds between 2016 and 2020, while European used car online retailers Auto1 Group and Cazoo raised 715 and 385 million euros respectively between 2018 and 2020. This rise of online sales is likely to have the same effects as in other markets, with brick-and-mortar retailers increasingly under pressure as e-commerce gains market share.

Online sales are also advancing rapidly for new vehicles, a development that is part of a far-reaching reassessment of dealers' role in the automotive chain on the part of automakers as they try to respond to the challenge of the EV transition. Tesla's distribution model, which at present means 100% online sales without any dealerships, currently serves as an inspiration for the entire industry. Initially, Tesla started with a network of stores that it ran itself, with no third-party dealers, claiming that traditional dealers were unprepared to properly market and sell battery electric vehicles. In February 2019, Tesla announced it would close its store network and have online sales only, which it claimed would allow a reduction of up to 6% of the price paid by the customer.[7] Even if shortly thereafter Tesla made a new announcement it would in fact keep most of its store network, the consequences for its retail employees were dire as they saw their incomes significantly reduced due to the elimination of sales commissions and bonuses.[8] Two years later, Tesla announced a new push to reduce its brick and mortar sales network and strengthen its focus on delivery centers fulfilling online orders.[9] While it still has some physical stores, it is clear that Tesla's long-term objective is to push for online sales as much as possible and cut down its store network as much as the market allows it.



Source: KPMG, Global Automotive Executive Survey 2021

[6] *Roland Berger, The Online Boom in Used-Car Sales (April 2021).*

[7] "Tesla shifts to online-only sales, will close stores to drive vehicle costs down", February 2019, https://www.teslarati.com/tesla-closing-stores-online-only-sales/.

[8] "Tesla's online-only sales strategy disguises massive pay cuts", March 2019, https://electrek.co/2019/03/11/tesla-online-sales-strategy-disguises-massive-pay-cuts/ .

[9] "Tesla (TSLA) launches major shift in retail strategy: cheaper locations, remote working, and more", July 2021, https://electrek.co/2021/07/28/tesla-tsla-major-shift-retail-strategy-cheaper-locations-remote-working/.

Tesla's retail strategy involves circumventing dealers entirely by selling cars directly to customers, and trying to do so as much as possible via the online channel. At present, there are clear indications that this is where the entire industry might be headed . A KPMG survey among automotive industry executives from 2021 would appear to confirm that this is indeed the case: 78% of respondents said they believed the majority of new vehicle sales would happen online by 2030 and 75% of respondents believed by then over 40% of new cars would be sold directly to customers, without going through dealer intermediation.[10] This would be a generalization of the Tesla distribution model. The implications for automotive retail would be substantial: a reduction of brick-and-mortar operations, limited to no autonomy for individual stores, and potential pay cuts for employees.

"Indirect" vs. "direct" automotive retail	
Indirect	**Direct / Agency**
Dealers are independent entrepreneurs	Dealers act as agents of vehicle manufacturers, with limited autonomy
Dealers own and manage stocks	Stock ownership remains with vehicle manufactures
Dealers set discounts, negotiate prices with customers and have flexibility for their profit margins	Final prices are fixed by vehicle manufacturers. Dealers receive a per-sale fixed commission

The increasingly dominant view today is that a large part, if not all, of automotive retail will shift from the traditional "indirect" model based on independent dealers to a "direct" model in which sellers act as agencies for vehicle manufacturers. This would mean that car sellers and manufacturers remain separate entities, but the independence of the former versus the latter is severely reduced. Today, dealers own and manage vehicle stocks and have the freedom to negotiate prices with their customers and can thus make independent business decisions on profitability targets. Shifting to an agency model removes much of this autonomy, as stocks remain in the ownership of automakers who also set prices paid by the customer, while paying a pre-established commission per sale to the dealer. This

Carmakers' announcements regarding their distribution business model

Volkswagen: direct/agency sales model for ID family (battery electric vehicles) in Germany, renegotiation of dealer contracts, and common IT system for retail partners.

Audi: direct/agency sales model for EVs starting in 2023.

Mercedes: direct/agency sales model in Sweden, Austria, South Africa and New Zealand. May 2022 announcement: 10% reduction in dealerships globally, 15-20% in Germany, 25% online sales by 2030.

BMW: direct/agency sales model piloted in South Africa. Ongoing discussions to shift Europe to a direct sales model entirely for Mini starting in 2024 and BMW from 2026.

Stellantis: massive overhaul of distribution network started in 2021, including unilateral triggering of contract renegotiations; targeting 33% online sales by 2030.

Toyota: direct/agency sales model in New Zealand. Toyota has refrained from making big announcements regarding its distribution strategy.

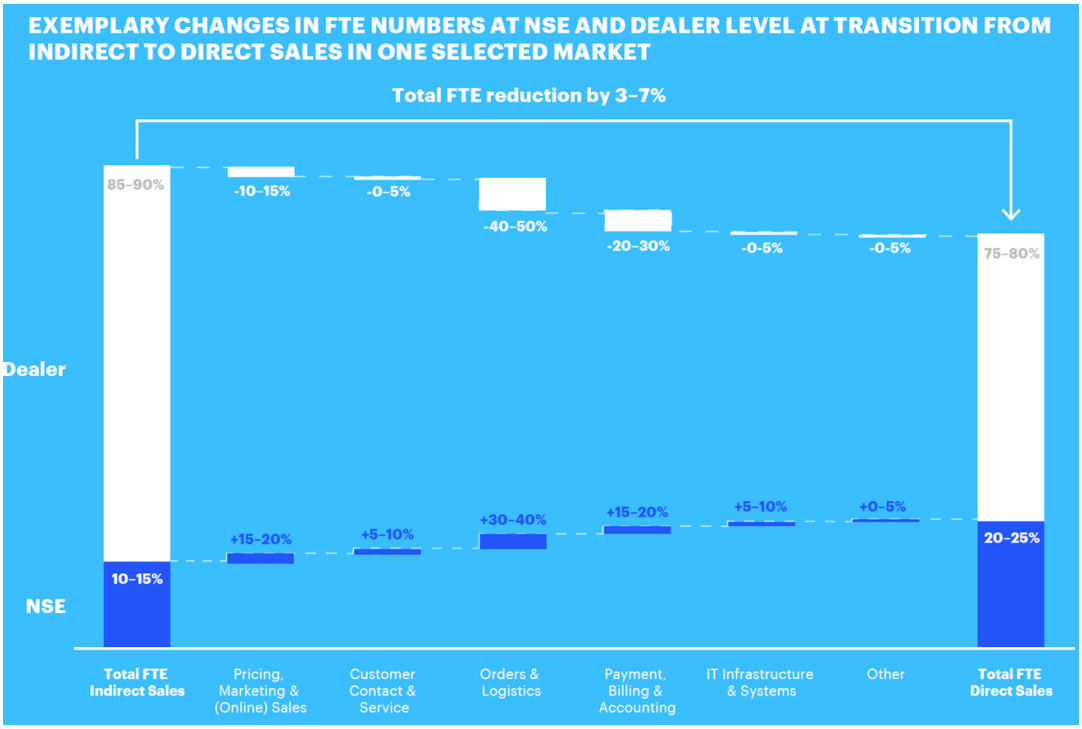
Volvo: 100% online sales by 2030.

Ford: fixed price for Mach-E, explicit emulation of Tesla.

[10] KPMG, Global Automotive Executive Survey 2021.

would effectively subordinate dealers to automakers in a similar way to manufacturing suppliers, allowing vehicle manufacturers to increase their profit margins by pushing dealers' margins down. The risk is that, similar to suppliers, much of the additional pressure vehicle manufacturers put on dealers is transferred to employees and trade unions.

Recent announcements by European and American automakers indicate that they are aggressively shifting to direct sales models. Huge players like Volkswagen and Stellantis have announced they will renegotiate dealer contracts and will target a more "hands on" approach to retail, while the likes of Ford and Volvo have announced their intention to emulate Tesla. The main reasons behind this shift is transparent: automakers are doing everything possible to improve profitability of what are currently loss making electric vehicle operations; they also need to be able to reduce prices for what currently are comparatively very expensive vehicles. Estimates are that a compression of dealer margins as a result of the shift to direct sales could reduce distribution costs by as much as 12% and reduce the total cost of a vehicle by 3%.[11] If prices remain constant, this 3% would be directly transferred to automakers profitability. Apart from this, vehicle manufacturers are certainly also profiting from the turbulence brought by the EV transition to shake up the traditional balance of power within the automotive supply chain in their favor.



**NSE = automakers' own national sales entities; FTE = employee full-time-equivalent.*
Source: Accenture, Direct. A New Way for OEMs and Dealers to Thrive in Times of Disruption, 2019, p. 35

Once again, the shift from an indirect to a direct sales model involves a considerable loss of business autonomy for car dealers. It also very likely involves a loss of employment, as physical sales networks contract and some functions become centralized and/or move entirely online. An assessment by Accenture indicates a potential reduction of total automotive sales employment of 3 to 7%, but behind such relatively small figures lie much more substantial employment shifts.[12] In the indirect sales model, dealership employment comprises 85-90% of total sales employment, with carmakers own

[11] Roland Berger, „Agency sales model. Automotive Sales News #2", May 2021, p. 12.
[12] Accenture, Direct. A New Way for OEMs and Dealers to Thrive in Times of Disruption

sales operations (national sales entities) taking up the rest 10-15%. Since the transition to a direct sales model means much more direct involvement for automakers, we can expect a shift of sales jobs from dealers to vehicle manufacturers. According to the above-mentioned assessment, the share of automakers' in total sales employment could increase to as much as 25%, a scenario in which the decline of employment at dealers would go as high as one quarter versus present levels. This is before even discussing changes in skill requirements, working conditions, or wages, for all of which there are plenty of reasons to believe will be just as significant.

Conclusions

The conjunctural (pandemic and supply shortages) and structural (electric vehicle transition) challenges facing the automotive industry are accelerating the organizational transformation of automotive distribution, with carmakers facing massive pressures to reduce costs and not lose touch with EV specialists like Tesla. In this context, car dealerships are facing several challenges:

- The EV transition is going to reduce the aftermarket business in the long-run, although in the short- and medium-term aftermarket demand is going to continue to grow.
- The used vehicle market is booming, but new pure digital players are pushing for a large scale shift toward online sales in this market.
- For new vehicles, automakers are increasingly aggressive in pushing for a direct / agency sales model in order to cut costs and redistribute profit margins in their favor.

While it is unlikely that physical car dealerships will disappear any time soon, a significant transformation of the sector is very likely to happen over the next decade:

- Increased focus on activities that cannot be transferred online (e.g., test drives, deliveries).
- Increased subordination to and even takeover by automakers.
- Acceleration of mergers and acquisitions, as the environment becomes increasingly difficult for smaller companies. This could lead to the emergence of "mega dealers" that might be able to stand up to the pressure from carmakers and employ diverse business strategies (for example, omnichannel sales).
- Diversification of activities: mobility services, vehicle refurbishment.

While most of these changes still have a long way to being fully materialized, employees and trade unions in automotive retail need to be prepared for historical transformations of traditional business models, with potentially huge implications for employment, skills and pay. Understanding what these changes consist of, what drives them and what their consequences can be is a first step in defending the interests of automotive retail workers in such turbulent times. Based on the analysis presented here, the overall challenges to workers and trade unions in automotive retail are similar to what is presently happening in manufacturing. Aggregate job losses might not be that big of a problem, with the prospect of a substantial reshuffling of employment between dealers and carmakers means that many people could lose their jobs while others find employment easier. Beyond the quantity of jobs per se, there are shifts in job content, working conditions and skill requirements — in other words, concerns over job quality should be at least as high on the agenda as those regarding job quantity. Finally, since increasing financial pressure plays a major role in the ongoing transformation of automotive retail, workers' compensation is probably going to come under increased scrutiny. Given

these similarities, there is a case to be made that a "just transition" for automotive workers is not an issue of concern just for people employed in manufacturing, but also for the many workers in automotive retail.

Abbreviations

EV: electric vehicle

BEV: battery electric vehicle