Car Dealerships Are a Bad Deal for Customers

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The car dealership model no longer provides the value it once did. Letting market forces prevail is what's best for customers.

Last week New Jersey started enforcing a ban on direct sales by Tesla Motors of its path-breaking model S. Tesla's direct sales have also run into hot water in a number of other states: Ohio lawmakers are debating a ban on Tesla's direct sales and Texas, Arizona, and Virginia are also opposed. Proponents of a ban on direct sales claim that they are acting in the interest of customers. But is it the interests of customers they're following or rather the bidding of the powerful car dealership lobby?

Car dealers and more generally intermediaries represent an extra layer of companies in the supply chain that clearly increases costs to customers. But in many cases they also serve important functions in a supply chain and can create more value than the inefficiencies they cause. Let's look at whether these functions are needed in the car market:

1. Search and discovery: In the same way eBay helps turn one person's junk into another person's collectible or AirBnb makes your empty guest

room a hotel room, intermediaries can help buyers find sellers. Beyond finding the right seller, an intermediary might help match the buyer to the best product for her, providing important guidance and product information. In disaggregated markets with many sellers and buyers and where search costs are high, intermediaries provide considerable value. But the car market is no longer like this. With product information widely available on the Internet, numerous knowledgeable automobile blogs, websites, most customers can investigate different cars themselves. Further, the test drive can be done via a few product galleries (as is the case with Tesla). The rest of the dealership infrastructure is, basically, redundant from a search and discovery perspective.

2. Relationship management and trust: In markets with many small unknown sellers and buyers intermediaries can create trust between the buyer and seller and help facilitate transactions where none would have happened otherwise. The Hong-Kong based intermediary Li and Fung's entire business model is **based on orchestrating trust based relationships between garment factories in Asia and other low cost locations and established clothing brands**. Again this is not the case with the auto-industry. Most sellers are very established companies with strong reputations and do not need local dealerships to help establish trust with the customer.
3. Local inventories: Intermediaries can hold inventory in order to provide instant delivery to customers. This was a major role of car dealerships when cars were made to a few limited standard specifications. Today, cars can be increasingly customized. In most European markets a majority of cars are made to order: a customer places the order and the car is then manufactured to exact specifications and shipped directly. This is increasingly happening in the US with higher-end cars and also with cars popular with the younger generation that prefers an individualized product rather than a cookie-cutter vehicle.
4. After-sales service: Historically, car dealerships and intermediaries have been an important interface for maintenance of cars. But cars have become much more reliable than they were when most of the dealership network was set up. A new well-engineered car rarely needs any special maintenance in the first 7-8 years of its life. And with a large

established certified network of repair shops, a car dealership is not necessary to provide the limited maintenance a car might require.

To sum up, our assessment of the ways in which you would expect dealerships to add value suggests that there no pressing case to be made for protecting car dealerships from market forces. In the same way as when travel agents were disintermediated by websites and direct sales, the quintessential auto dealership may now be counting its last days, only creating more inefficiencies in the supply chain than the value it provides.

The process of intermediation and disintermediation in different industries is an essential part of innovating business models. It is these innovative business models that have created industries where none existed before and created immense value for customers. State governments in Texas, New Jersey and Virginia by intervening in the process are not only retarding the innovative processes at the heart of new business creation, but may also be harming their constituents.

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