# Prepared Remarks of
# NADA Chairman Mark Scarpelli
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Good afternoon, everyone.

Over the last several years, one of the topics you've heard me – and the NADA chairmen who preceded me – talk about fairly regularly is this idea of tension between good intentions and unintended consequences.

A lot of this conversation has been directed at our leaders in Washington, D.C.

Every so often, we in the retail auto industry would see various policy proposals and ideas crop up that might have actually been well-intentioned, but that would have real-world, unintended, negative consequences to the business of selling and servicing vehicles to our millions of customers.

Very often, these were unintended consequences that policymakers just didn't see – and sometimes, unfortunately, they chose not to see them.

But they were always consequences that would hit our customers – the car-buying public – right in the pocket.

And so, time and again, NADA set out to explain these unintended consequences in the hopes that we could find a better way forward – a way that accomplished a policy objective, but protected our customers in the process.

Some of these examples will be very familiar to you in this room who cover our industry as closely as you do.

When the Consumer Financial Protection Bureau wanted to eliminate dealer discretion in auto financing – supposedly to create a level playing field for consumers – we explained that an unintended consequence of their approach would be the elimination of the ability of many consumers to get discounted financing rates at the dealership, as well at the tightening of credit more generally for customers who need it most.

So we proposed an alternative policy that would ensure the fair credit compliance that we all were seeking, but in a way that also preserved the ability of dealers to offer discounts to their customers.

I'll give you another example. When a few senators wanted to ground every single recalled vehicle at the dealership – even for minor defects such as a peeling visor sticker or a misprinted phone number in the owner's manual – we explained that doing so would create a consumer trade-in tax for <u>every</u> unremedied recalled vehicle currently on the road.

This tax would be, on average, $1,210, and as much as $7,000 dollars for some higher-end vehicles. So we said that maybe a better way to address the recall problem was a greater emphasis on producing replacement parts, and getting those parts on dealer shelves as quickly as possible. Let's focus on remedying the recalls, rather than unfairly taxing consumers for a manufacturer's mistake.

As you know, the list goes on.

But it's shorter than it used to be because, thankfully, our message was delivered and received. It was a message that said, "Hey, we get that you are trying to move the ball forward. And we don't fault you for that. But your prescription for improving the situation will likely make things worse – worse for our customers, worse for the car-buying public, worse for everyone."

Well, today I'm continuing the conversation about good intentions versus unintended consequences, but I need to direct it toward a different audience. And this one hits much closer to home: Our OEM partners.

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The specific area of manufacturer "good intentions" that I want to discuss in greater detail is the one that, I believe, carries the greatest potential for unintended, negative consequences. And, quite honestly, because these unintended consequences might not be fully understood. But they are very, very real. And they are potentially very, very damaging.

And this is the ongoing proliferation of market strategies such as indiscriminate price coupons and unfair stair-step incentive programs.

Although the industry is coming off a very good month, everyone here knows that we are likely still in the midst of a lengthier sales plateau.

So it is critical for dealers to be working with their manufacturer partners, arm-in-arm, to figure out how to best provide our customers with the vehicles they want at prices they can afford, and in a way that instills confidence in the sales and service process.

You've heard me talk about unfair stairstep incentive programs before, and my mantra has not changed.

According to Cox Automotive, buyers who identified their dealer as promoting transparent pricing reported significantly higher dealer satisfaction scores – 71 versus 53 percent – than those who said their dealership was not promoting transparent pricing.

Notice that I said “transparent” pricing, and not necessarily “lowest” pricing.

Today’s customer just wants to be treated fairly. They’ve gotten over the mental hurtle of what vehicles cost by the time they’ve gotten to the dealership.

According to that same Cox research, new vehicle purchasers spend 7 hours researching their purchase online – out of a total of 13-plus hours of shopping time. And 74 percent of today’s vehicle buyers ended up purchasing the vehicle they selected online when they arrived at the dealership. And thanks to the Internet, customers know generally what they’re going to pay.

So, in a world where customers rightfully expect fairness and transparency in price, why do so many manufactures still deploy unfair marketing strategies that produce huge discrepancies in price between various customers – discrepancies that aren’t transparent, that can’t be explained rationally, and that run afoul of everything our customers really care about?

I’ve said many times before that these stair-step incentive programs are trust killers. But today I’m going to put the situation in much starker terms.

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Any dealer who’s had to deal with these programs can tell you that that they are not only trust killers, but they’re brand killers, too.

Not being able to offer two customers the same price on the exact same equipped vehicle, just because they came into the dealership on different days of the month, destroys consumer confidence.

Every dealer knows this, but NADA wanted to quantify it.

So, over the summer, NADA brought the question to a respected economic research firm, the Analysis Group, for an independent examination of what the use of stairstep incentive programs accomplish – both good and bad – in the marketplace.

The results were pretty eye-opening.

Let’s take a step back for a moment and consider, as the Analysis Group did, what these programs are intended to do. It’s fairly straightforward: Drive sales by lowering prices.

But in reality, these programs have severe unintended consequences for consumers, which are leading to severe unintended consequences for manufacturers – and none of them are positive.

Let's start with price. And the biggest problem here might be the most obvious one: While prices come down for some consumers, they certainly don't come down for all consumers. And what that does is create huge discrepancies in prices for every consumer.

And these discrepancies aren't transparent to consumers because they're manufacturer-to-dealer. Consumers simply don't see them.

But let me tell you what consumers do see. Well, for shoppers of brands that use stair-step incentive programs, they see large discrepancies in price for the same or similar vehicles across different dealers. Or, worse, at the same dealer, but at different points in time. Or, even worse still, a discount applied to a vehicle they don't want, but that can't be applied to a vehicle they do want.

So consumers see: 1) wild discrepancies and fluctuations in prices; and 2) discrepancies that aren't transparent, and that can't be explained by pointing out meaningful differences in the product itself.

That lack of consistency, lack of transparency, and lack of explanation is leading directly to a lack of trust – lack of trust in both the individual dealer, and, in fact, lack of trust in every dealer who also carries that make.

And when you have a lack of trust in every brand dealer – Guess what? – you have a lack of trust in that brand itself.

And that lack of trust in the brand leads directly to a lack of loyalty to the brand.

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The Analysis Group looked at reams of actual sales and customer survey data – including JD Power PIN data and consumer satisfaction surveys – and combined it with their expertise and a host of economic information to assess how this dynamic is affecting the manufacturers themselves.

And they concluded that, over time, the consumer's lack of loyalty to the brand would lead to less consumer demand for that brand. Yes, that's right: To less demand for that automakers' vehicles in general.

Let's pause for a second and consider more closely what that really means.

To start, you have a program designed to increase sales volume. But you achieve higher volume only by lowering prices. So you aren't creating new demand, you're just dropping to a lower point on the demand curve. But because you've done so in a way that erodes desire for your brand, you've actually created less demand – you've created a new, lower demand curve

And on a new, lower demand curve, you only have two choices: You can sell fewer vehicles, or you can further lower prices just to be able to sell the same amount you would have originally.

You know what they call that? A downward spiral.

Actually, the Analysis Group has a slightly different name for it: They called it a "death spiral."

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I am not going to go through the entire report with you today, because we have decided to share it with the manufacturers first. We believe it's just that important. And we want to have constructive conversations with them about where we can go from here.

But I will share a few sentences that I think summarize these key findings very well.

> "Stairstep programs can increase sales volume in the short run while simultaneously decreasing demand.
>
> However, an increase in sales due to an aggressive stairstep program should not be confused with an increase in either consumer demand or the value of the manufacturer's brand.
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> In fact, manufacturers who use stairstep programs aggressively risk damaging their brand in the long run and entering a death-spiral of declining demand that eventually no amount of discounting can profitably overcome."

We will be sharing these findings, as well as further findings from the Analysis Group that I have not gotten into today – including data on what happens to residual values, used vehicle prices, and consumer satisfaction among brands that aggressively use stair-step incentive programs compared with brands that don't – with all of our manufacturer partners as we complete the latest round of Dealer Attitude Survey meetings later this month.

It is my sincere hope that this analysis and our ongoing conversations are truly constructive in nature.

America's dealers and manufacturers have the same exact goal – selling our inventory in large volume and at competitive prices. But we believe that goal should be achieved in the right way: Meaning in a way that enhances customer experience, and that maintains the integrity of the brand.

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As troubled as I am about these stairstep incentive programs, I am also concerned about a what I'll refer to as "factory creep," or the further attempts to exert more OEM control over dealership operations.

I have travelled all over the country this year and I have met with hundreds of auto dealers. I've had countless conversations, meetings, and dinners with dealers and dealership managers of all sizes; in all locations; representing all brands; and serving all kinds of customers.

But to one degree or another they all expressed concerns with increasing attempts by their manufacturer partners to run their stores.

And this is happening through the increased deployment of factory programs that permeate beyond sales and into the service department and the parts department; and programs that pay incentives for costly but not necessarily needed facility upgrades.

The specific concern I have is that, at the end of the day, all that these programs are really doing is eroding the entrepreneurial spirit and so much of the decision making about what it takes to run a modern auto dealership successfully.

And it's time to ask an honest question: As an industry, do we really want that? Do we really want de-facto factory stores?

Do we really want stores run, not by local businesspeople who know their customers and care about their communities, but instead by essentially corporate managers who are just dispatched to the regional retail outlet, and who have none of their own skin in the game?

Because the best part of being an entrepreneur is that I'm not looking for a handout. Not to be too blunt about it, but I want to be profitable because I sell and service a lot of vehicles for a lot of valued customers. I don't want to be profitable just because I'm getting the most incentive payments from my manufacturer.

I fear that we're getting away from that. And so do many car dealers around the country.

But before we go too much further down this road, I want us to consider, again, some unintended consequences of further factory control.

Selling and servicing cars and trucks in this country takes a lot of people: 1.1 million to be exact.

What's better? 1.1 million employees working for, at most, 30 companies, all headquartered in three or four locations? Or 1.1 million people employed by about 16,500 local businesses spread all across this great country of ours?

Let me ask the question a different way: When a natural disaster strikes a given area, who would you rather have on the ground lending a hand? Corporate managers? Or local businessmen and women who have lived, worked and raised their families in these communities for years, sometimes generations?

I know who I'd rather have.

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Earlier this summer, I wrote a column – that was as much a communication to NADA's 16,500 dealer members as it was an open letter to our manufacturer partners – in which I reminded everyone involved in the retail auto industry that a good relationship is a two-way street.

Ours is a symbiotic relationship that has stood the test of time, and that is ready to take on the next 100 years of making and selling cars and trucks – if we let it.

And so to our manufacturer partners, I say: Let us be entrepreneurs. We're pretty good at it.

Thank you, and I'll be happy to take your questions.

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