RETHINKING AUTOMOTIVE INCENTIVES

Pandemic supply chain impacts mean there is no going back to the old thinking on incentives

The pandemic changed consumer habits forever. As retailers are adjusting, automotive manufacturers are also adapting to historical changes to the retail environment. Pandemic shutdowns of manufacturing lines coupled with a shortage of chips have created a new automotive marketplace where demand outstrips supply.

Tight inventory is new territory for the industry, and it looks like the condition will persist into 2023 and possibly beyond, in particular for electric vehicles. The lack of cars has impacted consumers, dealerships, and automotive OEMs. Sales incentives, which had been a primary tool for years to spur demand when sales softened, are now almost nonexistent. In fact, the pandemic and the resulting supply chain crunch may actually bring an end to sales incentives as we have known them. That means now may be the perfect opportunity to rethink incentives and the value they deliver in today's new automotive retail environment.

BUILD-TO-ORDER IS THE WAY FORWARD

Now there is an historic opportunity for both auto manufacturers and dealerships to change how cars are purchased. Leading North American automotive manufacturers have already changed their manufacturing plans to reduce days' inventory to lower levels. While this unique retail environment is constraining sales volume, OEMs are also achieving record profitability. Manufacturers are also taking advantage of customers now embracing the build-to-order model.

Many auto customers want the same direct-to-consumer experience offered by new entrants such as Tesla, Lucid, or Fisker, where a vehicle can be ordered online using a mobile application and for which there are no sales incentives other than federal and state tax credits.

For franchised dealerships, the effect of lower inventory and more build-to-order sales is that customers are willing to pay the manufacturer's suggested retail price (MSRP) for a vehicle, especially battery electric ones. As a result, dealer and OEM profitability has soared. The new reality of automotive retail is that automotive brands do not need to rely as much on incentives to sell. In fact, many new car buyers are waiting for vehicle delivery after a test drive, instead of driving a vehicle off a dealer lot.

RETHINKING THE SALES-INCENTIVES APPROACH

Even before the pandemic, automotive manufacturers were beginning to examine how incentives could be improved to focus on brand experience and loyalty, instead of on transaction price. A personalized approach is a compelling way forward, instead of the traditional generalized programs that are not tied to customers or their unique preferences.

The average price for a new vehicle in the US rose $6,220 in 2021, compared to $3,301 in 2020. Not surprisingly, manufacturers facing supply shortages have been focused on vehicles with the highest profit margins. At the same time, the average incentive spend per vehicle was down from $2,291 to $930 over the same period – a dramatic drop. The incentive spend as a percentage of the manufacturer's suggested retail price is also down 3.4 points from 2021.

LOW INVENTORY, SALES AT STICKER

Manufacturers are also assessing their retail sales and distribution models to bring vehicles to market that buyers want, that deliver value, and that keep the brand relationship strong. In this environment, lowering a price may not result in a consumer keeping the relationship with the brand.

Customers of direct-to-consumer battery electric brands such as Lucid and Fisker enjoy only the incentives offered by federal and state government for EVs. These price discounts are funded by the government, not the sales and marketing budgets of these EV auto companies. This also supports the "one price" approach where customers do not expect discounts and they are not offered. This is the model that traditional automotive manufacturers should emulate moving forward.

The one-price model online retailers such as Tesla, Lucid, and Fisker (and back in the '90s the old Saturn brand) employ has also shown that customer experience can be more positive since there is no negotiating on the price. This reduces the time customers and dealer salespeople spend completing the sale of a vehicle. And even if customers are not eligible for a tax incentive, they are getting a much more transparent experience when they know the price going in.

And there is one more strike against traditional incentives: there is some concern that if dealers do not offer the same deal to all customers, they could face legal action. So future incentives also need to comply with state and local regulations. This may be solved by having one blanket incentive offered to everyone, with options for buyers to consent to customization.

THE RIGHT INCENTIVE STRATEGY

The pandemic revealed how scarcity can increase profits for manufacturers and dealers and that buyers will wait for a car they want, and it also underscored the importance of brand experience. Rather than incentives being focused on making the sale, they should shift to keeping customers with the brand.

This is a good opportunity to think about strengthening the relationship with the buyer as well as expanding it. For example, future incentives probably will not be $2,000 off the sticker price but something longer lasting, like software-on-demand or free streaming in your car, in partnership with a service, or new offers such as the ability to drive the car of your choice for a weekend.

Even when the supply chain returns to more normal levels, the industry must decide if the days of dealer lots filled with cars will return. Manufacturers want to produce the proper mix of vehicles and features that drive demand and keep inventories optimized to demand. And dealers have also realized the benefits of less inventory volume. There is no going back to the way it used to be. It is time to rethink automotive incentives to be more focused on customers and their experiences, rather than on a transactional, one-time discount.

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