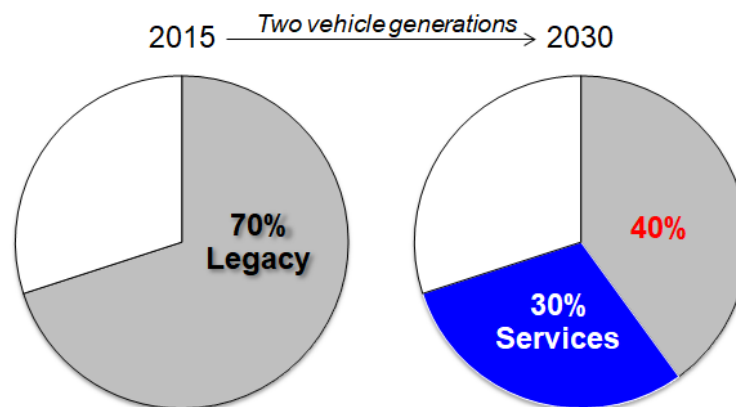


The Auto Service Shift and 7 Gaps

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The Service Shift

Meta research reveals that industry observers, consultants and investment bankers agree: The auto industry is caught up in a shift away from the traditional business of selling vehicles & parts to providing mobility centric services (see diagram). The shift is epic, because services are a very different type of business - with subscriptions and incremental annuity cash flows, new operations and KPIs (Rayport & Jaworski 2004, Chase & Dasu 2001, Chase & Garvin 1989). Furthermore, the shift is rapid - in less than two vehicle generations - and enormous in size, as indicated in Figure 1. For incumbents - OEMs, suppliers, and channel partners alike - continued success requires building a different business system and processes while “keeping the wheels on the bus.”



Sources:

*McKinsey Center for Future Mobility, 2017; Automotive revenue shares:
Legacy 73% -> 40%, services <2% -> 30%*

*Rethink, Transportation 2017; Auto OEM revenue share:
Legacy 79% -> 42%, services <1% -> 35%*

Figure 1: Shift of Automotive Revenue Shares

Lessons Learned: Music, Movies, Mobility

The good news: The auto business is not the first industry hit by digitization and its ensuing service shift. There is plenty to learn from others: For example, media and entertainment companies have learned valuable lessons adjusting to new search and social media competition as well as to streaming, cord-cutting customers (Meeker 2018).

Our Research

We have consolidated lessons learned, synthesized our own work on shared services, subscription businesses and electric mobility startups, and teamed with service experts and scientists to extract critical insights for the auto business: The 7 gaps.

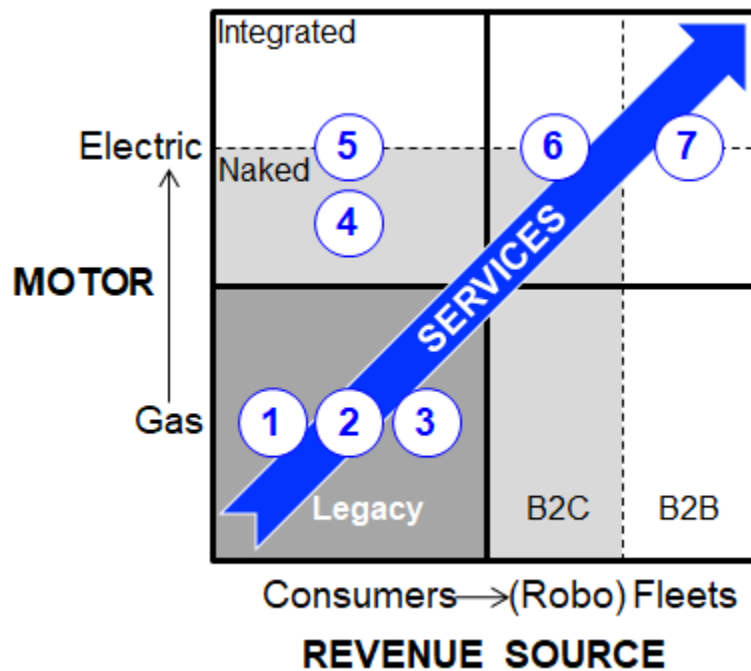


Figure 2: The 7 Gaps - A Customer and Revenue Centric Summary

The 7 Gaps

Following Peter Drucker's experience that predictions are usually nonsense (Drucker 2017), our view is not so much a forecast, as it is rather an amplification of what is already visible to the trained eye of a seasoned executive or scientist today. For each of our gaps we are highlighting one or two pioneers who are temporarily, at this point in time, leading the competition.

1 Social Media Gap

Today, it has become common practice to search on YouTube for "How To" advice: How to jumpstart a car, how to extend life of your printer cartridge. Very few customers have ever read automakers' Owner's Manuals. Instead customers learn about your product on social media. Therefore, social media ought to be **built into the product experience from the beginning**, at the engineering stage, instead of being added as an afterthought by the Marketing department. Leader: An extreme example is probably Tesla with its \$0 traditional marketing budget. Another example is the Mercedes Me app as a vehicle "remote control" and social media in itself.

2 Lifestyle Gap

To the extent that customers buy your vehicle to get from A to B, Uber or robo-Uber will be competition. Nobody needs a premium vehicle to get from A to B anymore. That's why premium brands have been adding to the product experience, for example, adding horsepower and getting involved with racing. However, not all brands have the heritage to authentically morph into a sports car marque, such as Porsche or Mercedes-Benz AMG. Furthermore, speeding is irresponsible and few of us ever drive on the Nürburgring racetrack. However, everyone of us is

eating, and daily, and several times a day. We don't suggest for an OEM to start a restaurant chain, but **premium has grown into a lifestyle experience**.

Leader: Mercedes-Benz has expanded lifestyle activities, with Classic Centers - and yes, the brand is indeed experimenting with coffee shops as places to see and be seen. Lincoln has also opened experience stores with a coffee bar.

3 "Skill" Gap

How to make life better and more convenient, how to make vehicles more easy-to-use for drivers? New benchmarks are set by outsiders. Smartphone apps like Google Maps are challenging onboard sat-nav systems and accessories margins. Even worse: these new entrants may usurp the automaker's customer relationship for upselling own services. The latest challenge are voice user interfaces and "skills" or apps, such as Amazon's Alexa (Crosby & Langdon 2017). In February, Bloomberg reported how Alexa has passed the inflection point with the iPhone, becoming **the "device" of the next decade**.

Leader: Hyundai was first to integrate Alexa with its Blue Link connected car app. For \$50 Anker's Roav Viva adapter allows drivers to use some of Alexa via smartphone in the car.

4 Dealership Retention Gaps

In "Kiss the Good Times Goodbye" industry veteran Bob Lutz has added another vision of doom and gloom for dealerships (Lutz 2017). The truth is indeed inconvenient at best. Dealerships are already facing profitability and retention pressure today. And all trends from **electrification and subscriptions to autonomous driving will hurt dealerships**. EVs don't need an oil change, have fewer parts and allow for over-the-air updates. If nothing is done, traffic will decline. If subscriptions catch on and reduce ownership, traffic would decline further. If robotaxis can reduce cost per per mile by 40% (Toyota's Gill Pratt in a 2017 Los Angeles Auto Show presentation), it would turbocharge subscriptions. With Waymo's launch of robotaxi service this year in Chandler, Arizona, the clock has started ticking.

Leader: Autonation has quickly teamed up with Waymo to service robotaxis.

5 Easy EV Gap

Why would any auto buyer pay more for less - and deal with added complications? Why buy an expensive EV and be left alone with range anxiety and charging confusion? "Naked" EVs without easy charging solutions better be cheaper. Premium households with their high electricity bills offer additional opportunities to **subsidize EV ownership through integrated home solar and battery solutions**.

Leader: Our mystery shopping confirms that Tesla is setting the bar very high with its easy-to-use Supercharger service and one-stop-shopping for home solar and batteries. Mercedes-Benz Energy is trying to follow Tesla's lead.

6 Subscription Gap

Ride-hailing, car sharing, point-to-point versus free floating - it seems that anything goes currently. Yet, subscriptions seem to be where success has been found in other industries; examples include Amazon Prime, Netflix and Office 365. Even airline rewards programs have

evolved **from frequent flyer programs into de facto subscriptions** with airlines rewarding dollars spent, not miles flown anymore.

Leader: Cadillac launched its \$1,500/month Book brandsharing service in 2017, Porsche Cars North America followed with Passport.

7 Fleet Gap

One common observation with the emergence of new technology is specialization and fragmentation along an industry's value chain and the repositioning of incumbents and **re-focusing of core competencies**. For example, the aviation business has fragmented into highly specialized segments of airplane manufacturers, aircraft leasing companies, and airlines and operators. Running an airline won't require making planes but excellence with yield and fleet management analytics.

Leader: "Daimler Financial Services invested € 1,1 billion to acquire Athlon, a leading fleet management company in Europe" (Daimler 2016).

Coming Next: Closing the 7 Gaps with Killer Apps from IoT Data Analytics

Each of the 7 gaps simultaneously presents an opportunity and a challenge. For example, the "Subscription Gap" could be a terrific opportunity for OEMs to upsell mobility services and foster loyalty. It may well become another F&I business, or much bigger according to Wall Street. However - and precisely because of its potential size - it is already attracting new competition. These new entrants tend to be very data and analytics savvy and may put the entire OEM-customer relationship at risk.

We will follow-up (Spring 2019) to illustrate examples for closing the 7 gaps. We will summarize how "killer apps" from the emerging field of IoT Data Analytics have been utilized to close gaps. Some of these solutions are already part of our curriculum and offerings at the Peter Drucker School of Management and in our Drucker Customer Lab.

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