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THE ROLE OF MANUFACTURER INCENTIVES AS CONTROL MECHANISMS WITHIN THE AUTOMOTIVE INDUSTRY OF SOUTH AFRICA

by

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DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Masters of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any other degree or for examination at any other university.

I further declare that I have obtained the necessary authorisation and consent to carry out this research.

I declare that all sources used in the preparation of this report are duly cited and acknowledged in the text and in the list of references.

The language in this research report has been edited by Mrs Idette Noomé (MA English Pret).

ALHEIT FISCHER

DATE

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EXECUTIVE SUMMARY

The automotive industry, one of the main contributors to the South African economy, has become a complex and competitive sector. Market competition has resulted in an environment in which automotive manufacturers and retailers have become increasingly competitive to survive in a captive market space and have implemented various control mechanisms in the dealer network to ensure sales optimisation and market share retention.

The automotive industry in South Africa is under continuous economic pressure and has to meet the challenge of changes in the automotive retail landscape. The dealer networks of the different brands represented in South Africa must evolve to deal with the management challenges they face in terms of market share retention of the particular brand they represent, as well as dealer profitability.

A retail organisation's success normally depends on a number of operational decisions that management must make on a daily basis. Moreover, these decisions affect the business's profitability and strategic placement in the market.

The study investigates the impact of automotive industry control mechanisms, notably the use of incentive models, in the context of the South African automotive industry. This investigation was done by means

of a quantitative approach, analysing public data. The purpose was also to assist the retail environment with a strategic approach with special reference to creating an independent retail environment.

The research has indicated that there is evidence that OEMs do attempt to control or affect profitability, market share and operational behaviour by using incentives, and that this does have a financial impact on the different brands reviewed. The control mechanism of additional sales incentives offered by the OEMs is intended to stimulate or drive the market. There is a clear indication from the trend analysis that this strategy may have a long-term negative impact on the retail environment. The respective brands should change their approach to the day-to-day operational management of their individual dealers.

KEYWORDS: automotive manufacturers, automotive retailers, control mechanism, South African automotive industry, retail incentives, strategic incentives, strategic approaches in the automotive industry

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CHAPTER 1

INTRODUCTION

1.1 Background to the research problem

The retail automotive industry in South Africa is currently facing the turmoil that usually accompanies an economic downturn. The impact of the current downturn is that, because of their high investment portfolio in the automotive retail sector in South Africa, most organisations in this sector will have to revisit the theories and approaches they applied in being successful in the past. This includes reevaluating how to sustain or adapt the infrastructure that currently exists within an environment that was (and still is) dependent on a range of factors that are largely out of the organisations' control.

South Africa is an emerging economy and is therefore exposed to various conditions that are typical of sensitive emerging markets. There are also some sectors in South Africa that are exposed to the monopolistic control of their manufacturers and original equipment manufacturers (OEMs) (Black & Mitchell, 2002). Nevertheless, in future, South Africa's automotive retailers may eventually be in the position to change their approach to markets by applying the same or different control mechanisms to change the strategy and contractual agreement they have with a manufacturer or particular OEM. The South African automotive retail industry is the end of

the manufacturing chain and is therefore highly dependent on the market approach of the automotive manufacturers (Eggert, Ulaga & Shultz, 2006).

The causal quantitative study reported on in this research report focuses on automotive retail dealers in South Africa to investigate the control of variable margins through incentives and how this influences the overall profitability of the dealer network and the market share of the OEMs and different brands presented.

A franchised automotive dealer's viability depends mainly on the menu or margin offered by the automotive franchisor or OEM with regard to the cost prescribed by the respective OEM for providing a certain brand and service to the customer (Arrunada, Garicano & Vazques, 2001). Most South African manufacturers offer a full model range for retail products and the dealer does not have to rely only on the success of one model or retail product, but can sell a range of products (Arnold *et al.*, 2009). However, the dealer still needs to be independent to absorb the relevant operating overheads.

1.2 Focus of the study

This study investigates, through a quantitative approach, the role of the automotive manufacturer incentives and the impact thereof on the profitability and long-term sustainability of the South African automotive dealer network, and the OEMs' control over the new vehicle market share.

1.3 Rationale for the study

Vehicle manufacturer operations in South Africa have a form of incentive model to drive sales target achievements. The vehicle manufacturers use variable incentives to control the retail sector to ensure that the OEMs achieve optimum performance downstream in the value chain (Barney, 1986). In addition, dealer incentives are based on the dealers' achieving certain OEM standards, and this does not form part of the normal retail margin earned from external retail markets through sales and service (Arrunada *et al.*, 2001). These incentives are offered over and above the normal margin that the dealer network relies on with regard to the product or vehicle to stimulate market share and product sales.

The role of manufacturer incentives and the control that manufacturers can exert on the independence of the retail environment can have a negative impact on automotive retailers if they depend solely on periodic incentives that are earned from and controlled by the manufacturers. Managing the strategic future relationship with the OEMs is therefore one of the challenges for the automotive retail sector in South Africa (Rosenzweig, Roth & Dean, 2003).

The future of this industry is critical for the overall economic development in South Africa (Black & Mitchell, 2002). However, without a sustainable automotive retail network, the question arises whether or not the OEMs will be in a position to manage the risk of losing market share, to retain

customer satisfaction and to maintain the high entry barriers for new products in future.

The fundamentals of incentive-based performance and the role it plays in the automotive industry has become one of the main mechanisms to drive market share. The success of such a strategy will determine if there is really a need for the dealer network to engage with the automotive manufacturers to safeguard their future investment interest (Germai, Claycomb & Droge, 2008).

Multi-nationals have received considerable attention in the field of economics and strategic management and control mechanisms (Gupta & Govindarajan, 1991). This relates to evidence that any multi-national is in a sense an individual enterprise (automotive dealer) with the constant need to make strategic decisions on future sustainability with reference to different incentive models that act as a formal control mechanism within this industry.

The motivation for the focus of this study is to assist with the future profitability of the automotive retail industry in South Africa. In addition, it will provide the industry with a relevant strategic mechanism to gear the business units for long-term independent profitability.

The level of dependence on each other is a vital factor in survival in this sector, and if the retail environment in this sector becomes more and more dependent on variable incentives that are used to control the performance of automotive retailers, this could spell disaster. But can the automotive

retail dealers implement a different strategic game theory to ensure they are independently aligned with the manufacturers?

1.4 Research problem

In the light of research already done with reference to incentives and the combined instruments of income that add additional profitability to the retail component of the industry, it is clear that some external factors cannot be controlled by either the manufacturer or the retailer (Miozzo, 2000). Along with the current crisis that the industry is facing due to the global meltdown, the South African motor industry has also experienced a decline in passenger vehicle sales as a result of the impact of the National Credit Act, which has tightened the lending criteria that apply to consumers who want vehicle finance.

Therefore, because of the global impact that the economic crisis has had on the automotive industry and its implications for this sector in South Africa, the time has come for the industry to re-evaluate its primary incentive control mechanisms (Garret, Covin & Slevin, 2009) in order to ensure that a new set of long-term strategic game rules are implemented to assist in developing the independence of automotive dealers in South Africa. The impact of the OEM incentive-driven strategy on the passenger vehicle market share in South Africa (whether negative or positive) also has to be assessed.

1.5 Outline of the study

In **Chapter 1**, the background to the study and the choice of research problem for investigation were set out. The focus of and the rationale for the study were explained, and the research problem was outlined.

Chapter 2 presents a literature review relevant to the empirical part of the study which follows in subsequent chapters. This review examines the following areas:

- strategy in emerging economies;
- supply chain and strategic management;
- upstream and downstream risk relationships;
- support systems and product strategies;
- supplier and retailer vertical relationships;
- business to business relationships; and
- business performance and incentive theories.

Chapter 3 specifies the research questions and hypotheses.

In **Chapter 4**, the research methodology used in the study is clarified, including the research design, the population and sample, the data collection process and the way in which the data was analysed. The limitations of this type of study are also discussed.

The results of the data analysis are presented in **Chapter 5**, using relevant graphs to make the results more accessible, while **Chapter 6** is devoted to a discussion of the results.

Chapter 7 contains recommendations relevant to the problem.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

The automotive industry is often referred to as one of the most global of industries (Black & Mitchell, 2002). The industry structure consists of a supply side and a demand side. The focus of the role players in the supply side is mainly to meet the needs of the demand side and protect the relevant brand market share (Demeter, Gelei & Genei, 2006).

The literature review in this chapter includes empirical, theoretical, critical and analytical data about the area that is explored in this study.

2.2 Emerging economies

Until the 1960s, automotive assembly plants in South Africa were protected by high import tariffs; and the domestic industry was seen as an assembly industry to service the needs of the local market (Black & Mitchell, 2002). As demand grew, the automotive industry changed to a market best described as a monopolistic competitive market.

Black and Mitchell (2002) explain that a monopolistic competition model implies that an increase in average cost will result in short-term losses for the manufacturing industry. This can force manufacturers to discontinue some models. They argue that discontinuation of some models could in

turn affect the different brands represented in South Africa's market, and that this will then shift the demand for different models of different brands, due to new market entries.

Black and Mitchell (2002) suggest that policy changes concerning import and export legislation have allowed greater global exposure. Although the South African automotive industry is part of the global market and the implementation of a global strategy in that market, there is a strong argument to be made for focusing on a regional solution to retain the local market and compete internationally (rather than to focus on globalization) to ensure the same output and performance as that in other countries.

Rugman and Girod (2003) refer to strategies that are triad-based and not global. The retail or automotive industry in South Africa can expand internationally but should have an intraregional approach to the market. Regional competition erodes the possibility of sustainable long-term profits and the possibility of building strong sustainability within the retail sector.

A lean management approach relies on understanding the value stream that adds value to a network or single business unit. In order to implement a lean system, one must understand the correct approach to the respective market and strategic tools that are available to help one succeed (Hines, Silvi & Bartolini, 2002).

Rugman and Collinson (2004) examined the regional sales and localised production of large automotive firms, but their quantitative study could find no evidence of companies that produce globally. Instead, production tends

to occur in sub-regional clusters and sales within the broad triad economies and none of the firms are globally oriented.

Automotive firms are also strongly engaged in a range of downstream activities and retail markets. Some of the literature suggests that most of the revenue earnings are regionally specific and therefore need to be aligned with the retail market and the specific economy in which an organisation operates (Rugman & Collinson, 2004).

Barney (1986) looked at strategic market competition and argues that the firms that currently own and control the resources can expect higher returns from the implementation of long-term performance strategies. However, within an emerging economy, a manufacturer, in this case, an automotive manufacturer can create imperfect competition in the market by implementing incentives as control mechanisms that are not aligned with overall macro-economic factors that apply in a country such as South Africa.

Environmental analysis seems unlikely systematically to generate the expected advantages needed to obtain above-normal results (Barney, 1986), because both the methodologies for collecting this information and the conceptual model for analysing it are in the public domain (Porter, 1980). Porter (1980) lists five forces that determine the industry profit, by influencing the product price, cost and profits (also see Figure 2.1), namely:

- buyer power, which determines the prices any firm can charge;

- the bargaining power of suppliers, which can influence the costs of raw materials and other inputs;
- the intensity of rivalry or competition, which can influence future pricing;
- the threat of new entrants, which can deplete market share; and
- the threat of substitutes, which imply better offerings to the market.

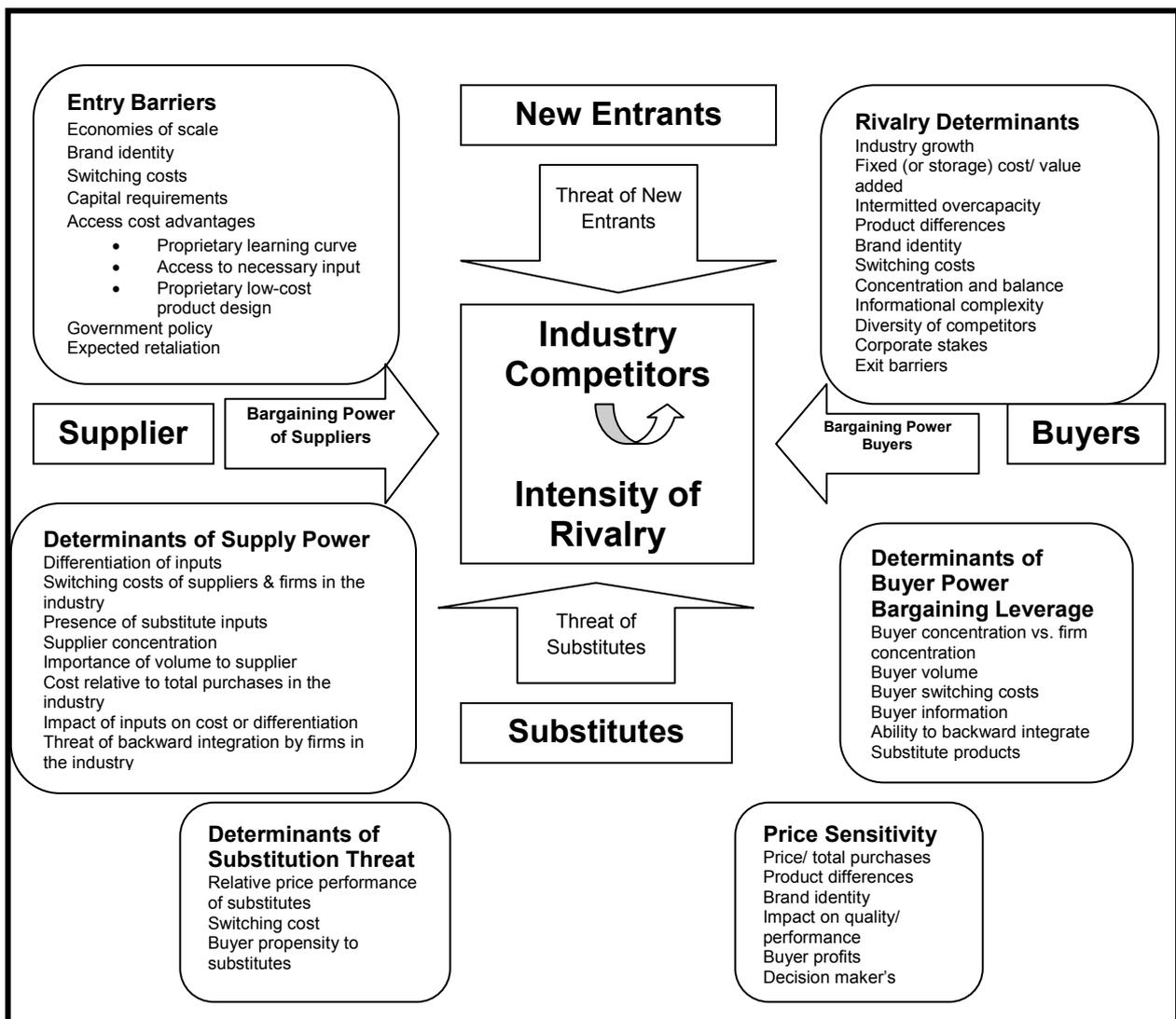


Figure 2.1: Porter's five forces Source: Porter (1980, cited in De Wit & Meyer, 2004:260)

Porter's (1980) five forces can assist in determining industry profitability because they can have a great influence on the different product prices and profits.

Buyer power, especially in an emerging economy, determines the performance of the retailer, as well as the price of the different brands. Buyer power can also influence the upstream behaviour of the manufacturer with reference to influencing the cost of material to ensure maximum profitability.

However, there is a constant threat of new entrants that are continuously investigating emerging markets. These new entrants are placing a limit on the retail prices and this can be why the automotive industry in the South African market is shaped through incentives as a control mechanism.

It may therefore be argued that the main source of competitiveness comes from the particular industry structure (Demeter *et al.*, 2006) and, as in other emerging economies, the South African automotive suppliers normally depend on market capacity, which can result in low bargaining power (Ogenyi & Blankson, 2000).

A clearly defined strategic partnership between the dealer and the respective manufacturer is important, because it can ensure a good understanding of local market demands and ensure long-term sustainability for both the manufacturer and the dealer (Demeter *et al.*, 2006).

2.3 Supply chain and strategic management

The relationship between the buyer and seller is important, for this can have either a negative or a positive influence on future performance (Boeck & Wamba, 2008).

Multi-nationals normally focus on their core competencies, and therefore tend to use local or international suppliers and distributors to ensure that all resources are used more economically and that they can sell more products (Prahalad & Hamel, 1990). Communication and information-sharing processes through the implementation of technology can assist with this relationship to ensure that the knowledge flow with reference to the buyer power of a particular brand is captured correctly in consumer behaviour research and competitor analysis (Boeck & Wamba, 2008).

With an integrated strategy and operations across all the functional areas, a dealer could achieve a framework of improvement with regard to sustainable profitability (Hines *et al.*, 2002). When the manufacturer and dealer networks have a more thorough understanding of each other's operational expenses and the financial investment needed to manage the day-to-day operations, this can assist both in redefining their future strategic business relationship (Hines *et al.*, 2002). One could refer to this as vertical integration with regard to the manufacturers' controlling their retailers where the products are sold.

With reference to the above statement from Hines *et al.* (2002), it should be noted that caution should not be integrated to such a level that power

struggles come into play and affect the future independence of the dealer network. With the implementation of an integrative approach, the holistic approach must be able to rely on five key management principles, namely understanding customer value, being able to understand the customer value, identifying the value stream that adds the value, creating a flow of product and information, using customer pull and in so doing seeking the potential for implementing a state of wasteless perfection (Hines *et al.*, 2002).

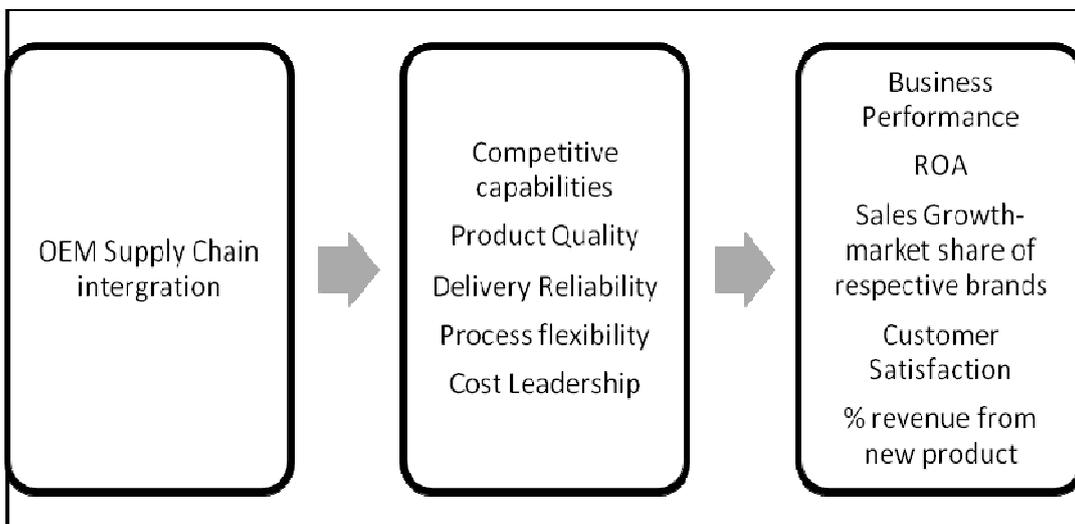
Positive management of the supply chain can lead to the implementation of the correct mechanisms to ensure positive retail chain activities (Arnold *et al.*, 2009). The first object of any OEM is to optimise performance with reference to the product in the market. If it can manage this area successfully, the OEM can achieve the implementation of incentives to monitor and control its respective market share.

The question remains whether or not an automotive retailer should be a stand-alone entity (Demeter *et al.*, 2006) of the supply chain or should be integrated with the manufacturer. Conversely, if integration does occur to the extent that there is solely manufacturer control over the retail environment, then incentive models will be of no importance for control, because the responsibility for success will lie only with the manufacturer.

Where large financial investments are at stake, it is important to ensure that the correct bilateral control mechanisms are based on the active participation of both retailers and manufacturers (Kabadayi & Ray, 2007).

It is imperative that the manufacturer has a high level of trust in its retailers, because this will enhance information-sharing and create opportunities to implement strategies to assist with preventing any loss in market share and with competing with new entrants into the market (Kabadayi & Ray, 2007). Figure 2.2 shows a model integration strategy.

Figure 2.2: Model integration strategy on competitive capabilities and business performance



Source: Rosenzweig *et al.* (2003:439)

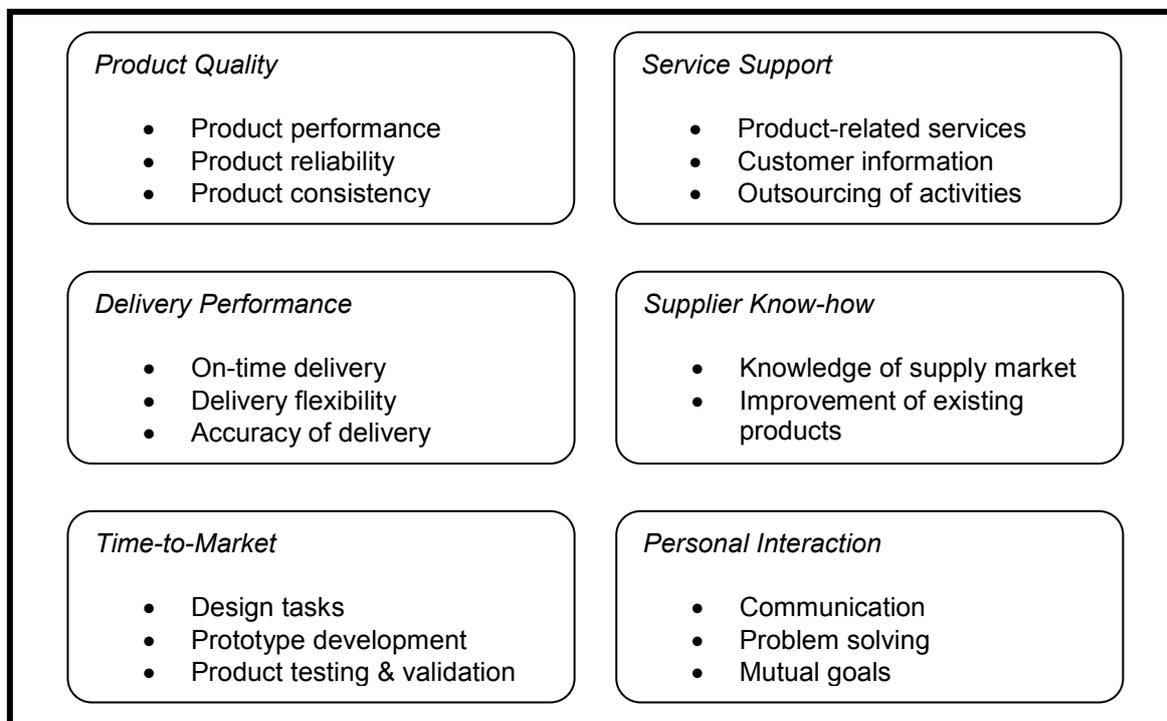
2.4 Upstream and downstream risk relationships

The manufacturer needs to control the risk to market. Therefore, there is sometimes a perception amongst dealers that the control of the marketing procedure by the manufacturer side might have a negative effect on the dealer network (Ogenyi & Blankson, 2000). Manufacturers control risk and position themselves by implementing various processes (Ogenyi & Blankson, 2000).

The implementation of these processes (marketing, sales, customer and service incentives) may make it seem as if the manufacturer/dealer relationship is highly asymmetrical (Ogenyi & Blankson, 2000). As a result of the unequal relationship, dealers could exhibit low cooperation, with little trust in stability in the future.

However, if a better relationship can be established, the supplier (vehicle manufacturer) could be in a position to manage key variables through the lifecycle of its dealer network (Eggert *et al.*, 2006). Consequently, as the model in Figure 2.3 suggests, manufacturers could manage their respective risks with various supplier initiatives (incentives) that are directly related to incentive models.

Figure 2.3: Management of risk with regard to market and supplier initiatives



Source: Eggert *et al.* (2006:21)

From the above conceptual model developed by Eggert *et al.* (2006), it is apparent that the manufacturer controls the various product and customer areas. In addition, the manufacturer is in the position to move and control the risk factors pertaining to the different dimensions that can influence the business lifecycle (Eggert *et al.*, 2006).

In the different business markets, suppliers rely heavily on the willingness of their downstream partners, the automotive dealers, to collaborate in risk-taking (Matthyssens & Vandenbempt, 2008). When a manufacturer controls its risk through the retailer, the manufacturer exposes the retailer to the retailer's own independent risks with regard to its independent financial stability (Eggert *et al.*, 2006). In taking this into account and discussing it in the research, it is important to realise that the respective dealer networks cannot and should not rely purely on incentive models, because if they do so, their independence would disappear, as the franchise would be controlled solely by the manufacturer.

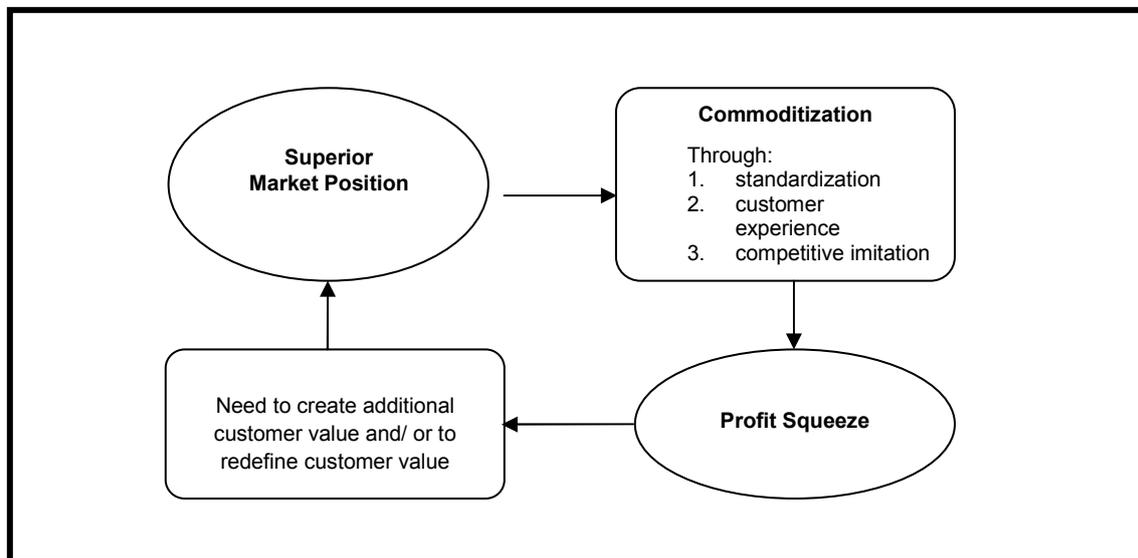
2.5 Support systems and product strategies

During the relationship lifecycle, it is important for the manufacturer to ensure there is proper support infrastructure to assist the dealer network (Eggert *et al.*, 2006). The implementation of the proper support systems improves the trust relationship between the manufacturer and dealers. Marginal costs for building a vehicle are low, while the costs for product development, manufacturing facilities and marketing are high (Parment,

2008). This fact underpins the reasoning behind incentive models which are designed to motivate the entire distribution chain to focus on volume.

Matthyssens and Vandenbempt (2008) argue that commoditization as a dynamic process can erode the competitive differentiation potential of a business and lead to the deterioration of the financial position of an organisation. They support this argument with the model in Figure 2.4.

Figure 2.4: The commoditization process



Source: Matthyssens and Vandenbempt (2008:317)

Starting in the upper left corner, the model shows the assumption that a company would tend to occupy a superior market position based on its differentiation strategy. For the sake of the argument set out above, the assumption can be made that the company has a competitive advantage in the respective market place (in this case, in the automotive industry) (Matthyssens & Vandenbempt, 2008). With regard to this aspect of the model, it should be noted that a differentiation strategy is also aimed at

generating higher profitability and raising entry barriers to the market to deter the competition (Porter, 1980). However, if this differentiation strategy with regard to additional incentive models is introduced from the OEM side, then the profit squeeze will revert to the respective dealer network.

Next, market forces such as the standardization of practices will boost customer experience with regard to the existing offerings in the market and the imitation of successful business practices by rivals will elicit commoditization. The impact for this industry is multi-faceted. Commoditization decreases the differentiation of a company in the market (Matthyssens & Vandenbempt, 2008). As a result, customers perceive products and services as being more or less the same and this then increases the customer's bargaining power.

This, in turn, affects the company's financial position and creates a profit squeeze for the business (Matthyssens & Vandenbempt, 2008). Commoditization of the dealer network in South Africa exposes the network to further financial insecurity, because power shifts to the consumer and strengthens consumer bargaining power, which in turn decreases the dealer margin.

Strategic resources are critical to realise a company's competitive advantage in the market – Hughes and Morgan (2008) refer to three intangible strategic resources that help to ensure and assist with continuous market fit:

- **Strategic commitment** – This commitment must come from both the OEM and the dealer network. Commitment can have important strategic value for all the parties involved, but an irreversible commitment can create difficulties down the line. Automotive retailers in South Africa have to decide on two types of commitment: first, being a tough competitor; or second, being a soft competitor (INSEAD, 2001).
- **Strategic support** – A mutual understanding with the relevant support structures has to be in place when incentive mechanisms are introduced.
- **Implementation capabilities** – This is a critical area for both the OEM and the dealer network to ensure that the strategy is goal-directed, which implies that a clear assessment must be available of the possible risk both the network and OEM can experience.

These resources can arguably provide the manufacturer with an avenue to improve overall market performance (Matthyssens & Vandenbempt, 2008). The challenge remains creating a platform for both dealers and OEMs to ensure mutual commitment with regard to their future objectives.

In addition, the implementation of sales incentive models to motivate the retail environment may create uncertainty with regard to the long-term sustainability of the manufacturer's product-to-market fit (Barker, Jensen & Murphy, 1988). OEMs should also be cautious: the incentive models introduced to drive sales and market volumes should not exceed the

overall costs, because the long-term impact of this can also affect the sustainability of the respective OEMs.

2.6 Vertical supplier and retailer relationships

Empirical data suggest a number of reasons why it is good for a manufacturer to retail through its own distribution channels (Parment 2008). Doing so allows the manufacturer to ensure control and standardization. It gives the manufacturer control over marketing activities, creates and maintains desired standards, gives it 'market tentacles' with regard to continuous information about the respective markets the OEM operates in and control with reference to over-capacity (the safety value controlling excess stock to the dealer network) (Parment, 2008).

Interdependence between any subsidiary and a manufacturer (corporation) creates positive functions with reference to knowledge inflows (dependence) (Gupta & Govindarajan, 1991). With different mechanisms, high outflows (counter-dependence) and high inflows can assist in creating strategic alignment with reference to market, customer and product activities.

Arrunada *et al.* (2001) empirically analysed the role of each element in the system contract terms and monetary incentives to prevent future conflict with reference to the relationship between manufacturers and dealer networks. Arrunada *et al.* (2001) reported two main sets of findings. Firstly, all contracts investigated limited the decision rights of the franchisee, while granting power to the manufacturer. In particular, dealers must reach

certain targets set by the OEM, must provide relevant financial information and must uphold quality standards. Secondly, the capability of the manufacturer, especially with reference to the larger networks, can enforce and provide incentives to their dealers (Arrunada *et al.*, 2001).

In general, automotive distribution centres around a vertical relationship between the OEM and dealers which is regulated through contractual agreements. The manufacturers control the supply of vehicles and write contracts to govern the mutual relationship between the OEM (manufacturer) and the dealer (Arrunada *et al.*, 2001).

The implication of the theory is that the intensity of monetary incentives related to sales and service should be higher: the higher the incidence of the relevant vertical and horizontal externalities, the more control the relevant financial mechanisms will have over the passing of variable margins (Arrunada *et al.*, 2001). There is a clear indication in the theory that the dependent variables are the monitoring of quality for customer service, the use of sales discounts and market share (Arrunada *et al.*, 2001). The independent variables are the effect of the following three variables on the assignment of decision rights: the number of vehicles sold, the total number of dealerships in the network and the length of the relationship. These mechanisms are there to enforce the rights of the OEM with regard to incentives and quasi-rents to constrain the dealers' behaviour (Arrunada *et al.*, 2001).

2.7 Business performance and incentive theories

Incentive strategies such as reward and compensation plans play an important role in multi-level distribution networks (Swan, Belanger & Manheim, 2004). This can have a positive or negative impact in practice (Barker *et al.*, 1988). There should be a clear focus on the economic contract entered into for compensation (as an incentive). Arrangements could have a long-term negative impact on a dealer if they are not managed in the right manner. An incentive model can influence the behaviour of an entire organisation (in this case, the dealer) (Eggert *et al.*, 2006).

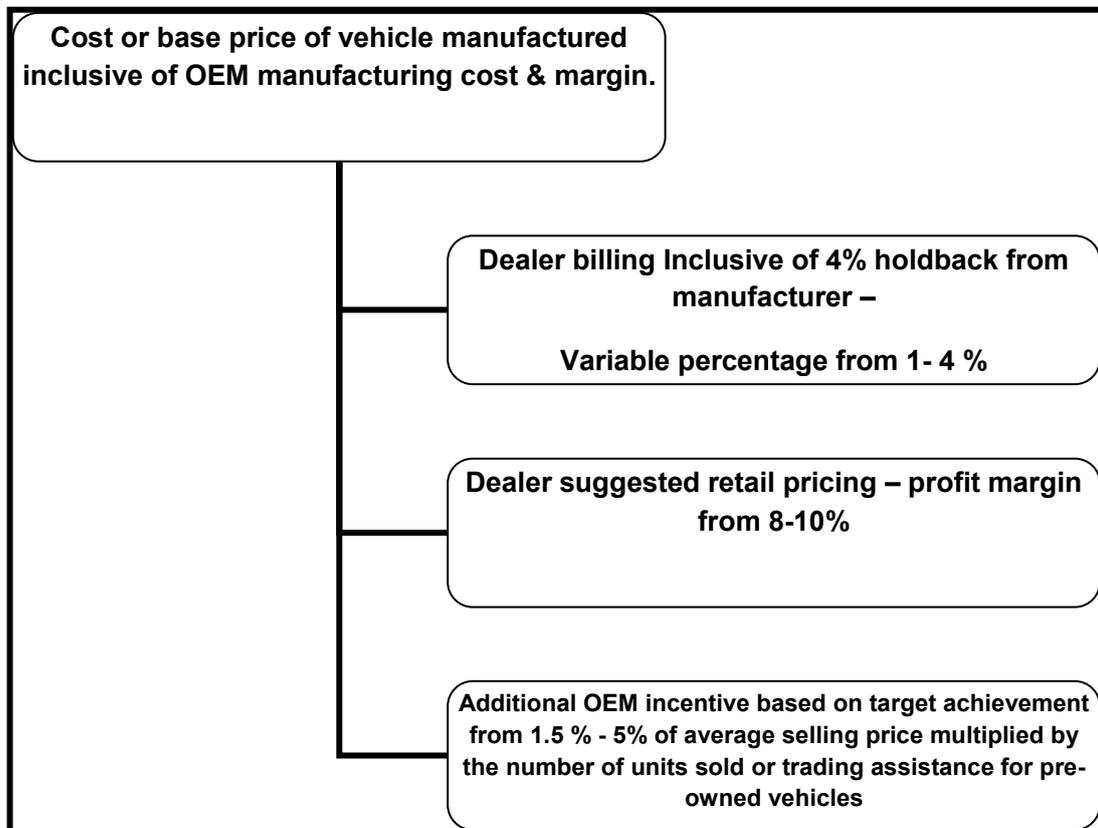
In the long term, direct negative results can accrue from the use of various incentives which the OEM offers to the retailer (Spring & Araujo, 2009). Dealers may sacrifice their long-term cash flow objectives, as well as the respective services and products they deliver to their customers to ensure that they earn their short-term performance incentives (Spring & Araujo, 2009). As a result, the selling of vehicles to achieve or earn incentives over the short term is becoming more of a priority than creating a sustainable and profitable business. This causes shifts in the relationship between product- and service-based approaches with a negative impact on the desire actually to deliver a service (Spring & Araujo, 2009). The existing OEM approaches, which tend to polarize products and services along simplistic lines, seem to influence the strategic behaviour of retailers (Spring & Araujo, 2009).

Buzzavo and Pizzi (2005) refer to product information and service delivery as vertical constraints that the manufacturers have to face in striving to improve the efficiency and the effectiveness of their distribution systems. The manufacturers must review their distribution strategies in order to reduce the number of franchise points.

The traditional relationship between auto-manufacturers and retailers can be seen as a typical 'stick' and 'carrot' approach (Buzzavo & Pizzi, 2005). The number of franchise points represents the number of franchise contracts in place with dealers, and therefore each dealer can operate one or more sales outlets, depending on its territory and its own strategy and business structure (Buzzavo & Pizzi 2005). Although each dealer can implement its own structure and operational strategy, it is important to note that the alignment with the franchisor must still be in place, because, if the retailer does not adhere to or achieve the prescribed parameters, such a contract can be cancelled.

With reference to the research problem, when a particular dealer achieves the manufacturer's targets, the dealer qualifies for additional manufacturer incentives. These models vary considerably between the different manufacturers. The problem, as has already been suggested, is that the dealer networks include these incentives in their actual profit earnings and this method of accounting causes a sizable distortion regarding the profitability of the entity (Smith, 2001). Figure 2.5 explains incentive models available from OEMs in South Africa.

Figure 2.5: Explanation of South African OEMs' incentive models



2.8 Entrepreneurial orientations in comparison to manufacturer demand

According to the theory set out by Lumpkin and Dess (2001), three components of entrepreneurial orientation create different dimensions in the context of decision-making by a business:

- the independence of the proactive and competitive aggressiveness within the industry;
- the entrepreneur's relationship to the firm's performance within the area of responsibility;

- the role of ‘fit’ in explaining the relationship to performance and proactive aggressiveness.

The concept of entrepreneurial competitiveness explains the mindset of the management within the business environment and the process management follows with decision-making with regard to day-to-day business practices (Lumpkin & Dess, 2001). In an industry lifecycle, an aggressive approach can add value and result in a higher success rate. In other words, there is enough market opportunity available for multiple entrants to succeed, but to achieve relative success in an industry, firms must display proactive behaviour in relation to the market (Porter, 1980).

The literature provides some insight in respect of the entrepreneurial model and the behavioural pattern with reference to risk and different dimensions of entrepreneurial orientation. The impact of entrepreneurial orientations is investigated further in this study to ascertain how the retail environment deals with different competitors when it is confronted with strategic decisions involving market uncertainty and profit opportunities (Lumpkin & Dess, 2001).

2.9 Conclusion

The literature refers to various aspects that can have an impact on the automotive environment in South Africa. Of these, only one aspect, namely control in the industry through the use of incentive models, is analysed in the current study with reference to the trends and the impact of various control mechanisms. The focus is the impact of this type of

control on strategic decision-making in the dealer environment. The research will assist the automotive industry with strategic decision-making with regard to the control of variable margin and independent sustainable success.

CHAPTER 3

RESEARCH QUESTIONS AND HYPOTHESES

3.1 Research questions

The research topic leads to the following research questions:

- **Research Question 1:** What is the role of manufacturer incentives as control mechanisms within the automotive industry of South Africa?
- **Research Question 2:** How does the variable margin move between the OEM and the dealer and what is its impact on the vehicle market share?

3.2 Hypotheses

The following hypotheses were tested in order to answer the above research questions:

- **Hypothesis 1:**

H₀: South African automotive dealers rely on the manufacturers' variable incentive based on sales performance to ensure profitability.

H₁: South African automotive dealers do not rely on the manufacturers' variable incentive based on sales performance to ensure profitability.

- **Hypothesis 2:**

H₀: Vehicle manufacturers in South Africa use incentive models to control their market share in the new vehicle retail market.

H₁: Vehicle manufacturers in South Africa do not use incentive models to control their market share in the new vehicle retail market.

- **Hypothesis 3:**

H₀: Through manufacturer incentive models as a control mechanism, manufacturers artificially report additional new vehicle retail sales.

H₁: Through manufacturer incentive models as a control mechanism manufacturers do not artificially report additional new vehicle retail sales.

The comments of Zikmund (2003) were borne in mind in the process of testing the hypotheses (see Table 3.1).

Table 3.1: Hypothesis testing

Decisions and Errors in Hypothesis Testing			
		'True State' of the World	
		H⁰	H¹
	Reject H⁰	Type I Error	Correct Decision
Decision			
	Do Not Reject H⁰	Correct Decision	Type II Error

Source: Zikmund (2003:504)

CHAPTER 4

RESEARCH METHODOLOGY

4.1 Research design

The study used a quantitative research approach in addition to the literature review (see Chapter 2). It was a causal research study.

According to Zikmund (2003), causal research is research conducted to identify cause-and-effect relationships amongst variables; and in causal studies, it is typical to have an expectation that a relationship will be explained. In a typical causal study, one variable is changed and one can then observe the effect on another variable (Zikmund, 2003). In this case, where the role of manufacturer incentives as a control mechanism was measured against the actual profitability of dealerships, the cause and effect could be measured. In such a situation, it needs to be proved that there is evidence for causality because it appears that the cause precedes the effect (Zikmund, 2003).

Research with the purpose of inferring causality should do the following, according to Zikmund (2003):

- establish the appropriate causal order or sequence of events;
- measure the concomitant variation between the presumed cause and presumed effect; and
- recognize the presence or absence of alternative plausible explanations or causal factors.

In statistical theory, a hypothesis is an unproven proposition or supposition that tentatively explains certain facts. This implies that with the assistance of statistical techniques, researchers are able to decide whether or not their theoretical hypotheses are confirmed by empirical evidence (Zikmund, 2003).

Correlations are the most popular technique to indicate the relationship of one variable to another (Zikmund, 2003). The correlation coefficient, r , ranges from +1.0 to -1.0 (Zikmund, 2003). If the value of r is 1.0, there is a perfect positive linear relationship; and if the value of r is -1.0, there is a perfect inverse relationship (Zikmund, 2003). A correlation coefficient indicates both the magnitude of the linear relationship and the direction of the relationship (Zikmund, 2003). Correlations can be very useful, but have an important limitation: they can only measure the strengths of a linear relationship (Albright, Winston & Zappe, 2006).

Generally the symbol H_0 is assigned to the null hypothesis and the symbol H_1 to the alternative hypothesis; and the purpose of the testing is to determine which of the two hypotheses is correct (Zikmund, 2003). The hypotheses for this study have already been set out in Chapter 3.

In this study, hypothesis testing was done to check whether the observed data (public data) would support the three hypotheses stated in Chapter 3, as suggested by Albright *et al.* (2006). Because the aim was a form of understanding, descriptive research assisted the use of public data to determine the characteristics of the population and the finding of answers

regarding the stated hypotheses, as suggested by Zikmund (2003). A quantitative research approach also emphasised and allowed for the analysis of the different variables.

4.2 Population of relevance and unit of analysis

The population of relevance was all automotive manufacturers in South Africa. From these, a convenience sample of data on franchisees from the six largest brands, controlling more than 70% of the entire passenger car market in South Africa, was selected (see Section 4.3 below).

The units of analysis were therefore the following six brands within Motor Retail South Africa:

- Toyota;
- Ford;
- VW;
- Mercedes;
- BMW; and
- Audi.

The method of data collection about this sample is discussed in Section 4.4 (below).

The population of relevance was selected because the six corporations hold different market positions in South Africa and have different brand images. Their degree of market involvement is also different: Toyota, Ford

and VW are mainly focused on cost leadership, whereas Mercedes, BMW and Audi specialise in the premium brand segment.

4.3 Sampling method and size

Normally, three factors determine the required sample size for a research project (Zikmund, 2003):

- variance of the population;
- the magnitude of error; and
- the confidence level.

When an acceptably large sample is collected from public data, the possibility of inaccuracy is far smaller and the research more accurate. For this reason, the sample sizes set out in Table 4.1 were selected.

Table 4.1: Sample size

Dealer brands	Number of franchisees in major metro areas
A	6
B	3
C	8
D	12
E	9
F	15

Another consideration was the fact that the sample sizes varied from franchise to franchise.

4.4 Data collection process

The process consisted of a public data collection, drawing data from the following websites and industry groups:

- Response Group Trendline (RGT);
- the National Association of Automobile Manufacturers of South Africa (NAAMSA); and
- the Sewells Performance group.
- Motor Retail South Africa.

The top six dealer franchises were chosen from the South African motor retail sector (specifically in Gauteng), this decision supported the project with clearly defined data. The data was sufficient with regard to the large metro areas because these brands control the largest portion of the South African motor retail brand market share. Public data over four years (2006 to 2009) was obtained, focusing on the data set out in Table 4.2.

Table 4.2: Data collected

OPERATING PROFIT
Dealership total incentive
Operating profit excluding incentive
TOTAL TURNOVER
GROSS PROFIT
Gross profit percentage including incentive
Gross profit percentage excluding incentive
Margin difference
TOTAL NEW U/SALES
Demonstrators registered
Total New
NAAMSA sales
Market share

Out of the South African automotive retail sector, the automotive retail public data available was identified to determine the incentives earned, differentiated through first gross (excluding incentives) and second gross (including incentives earned per brand).

Market share numbers were extracted from RGT, NAAMSA and the Sewells Performance group.

4.5 Data analysis approach

Once all the data had been gathered, the data was simplified into a spreadsheet (see Table 4.3) to assist with the testing of the hypotheses. The processing included using Spearman Rank Order Correlations to assist with the ranking of the different brands in order of preference and product class, as recommended by Zikmund (2003).

Table 4.3: Example of public data collection spreadsheet used for statistical analysis

Motor Retail South Africa - FDC Link							Collection Method
Manufacturer A-F	A	B	C	D	E	F	BRAND /Company
							SEWELLS
OPERATING PROFIT							
Programme Incentives							SEWELLS
Incentive Rebate							SEWELLS
Incentive Received							SEWELLS
Dealership Total Incentive							SEWELLS
Operating Profit excl. Incentive							SEWELLS
							SEWELLS
TOTAL TURNOVER							SEWELLS
GROSS PROFIT							SEWELLS
GP% Including Incentive							SEWELLS
GP% Excluding Incentive							SEWELLS
Margin Difference							SEWELLS
TOTAL NEW U/SALES							RGT -DATA
Demonstrators registered							MR SA
Total New							SEWELLS
Naamsa Sales							NAAMSA
Market Share							RGT -DATA

Non-parametric analysis was done, including a Mann-Whitney (or ranked-sum) test. This kind of analysis allows for testing group differences when the populations are not evenly distributed or when it cannot be assumed that the samples are from populations that are equal in variability. This is the alternative to the t-test for two independent samples (Zikmund, 2003).

Through the descriptive research process, the research determined the impact of incentives and market share control in the automotive industry of South Africa

4.6 Research limitations

The gathering of public data is normally inexpensive and less complex than other methods, but the data that is collected may be outdated or based on historical performance and so may not meet the exact needs of the research project (Zikmund, 2003). In this case, the data was as recent as possible, including figures for the current year (2009).

The confidence level could not be determined, because the size of the sample was too small, so the study only investigated the trends with minimal statistical manipulation. For the purposes of the research project, this was not relevant, but it is recommended that in future research the sample should be increased to include more dealerships in order to confirm the trends identified in this study.

CHAPTER 5

RESULTS OF THE DATA ANALYSIS

5.1 Introduction

The main aim of the analysis was to investigate the role of manufacturer incentives in the automotive industry and their relation to the total operating profit reported and market share figures. The study also focused on the relationship between the number of sales reported versus the number of registered demonstrator vehicles. The market share with the demonstrator vehicles included was compared to the market share when they are excluded. The results are set out to address the hypotheses set out in Chapter 3. The results are reported as follows:

- First, the results of the examination of the operating profit in total versus the incentive provided to companies and the net effect when the incentive was excluded are presented. This was done in order to focus on the hypothesis that South African automotive dealers rely on the manufacturer variable incentive based on sales performance to ensure profitability.
- Next, the results of the analysis of market share relative to the percentage incentive received are set out. This analysis focused on the hypothesis that vehicle manufacturers in South Africa use incentive models to control their market share in the new vehicle retail market.
- Finally, the results of the analysis of market share versus the percentage of registered demonstrator vehicles are presented. This

analysis focused on whether the manufacturers artificially reported additional new vehicle retail sales and the effect thereof on market share.

- The database consisted of the following figures for six companies over the period from 2006 to 2009: operating profit, dealership total incentive, operating profit excluding incentives, total new sales, number of demonstrator vehicles registered, total new sales (including demonstrator vehicles) and market share.

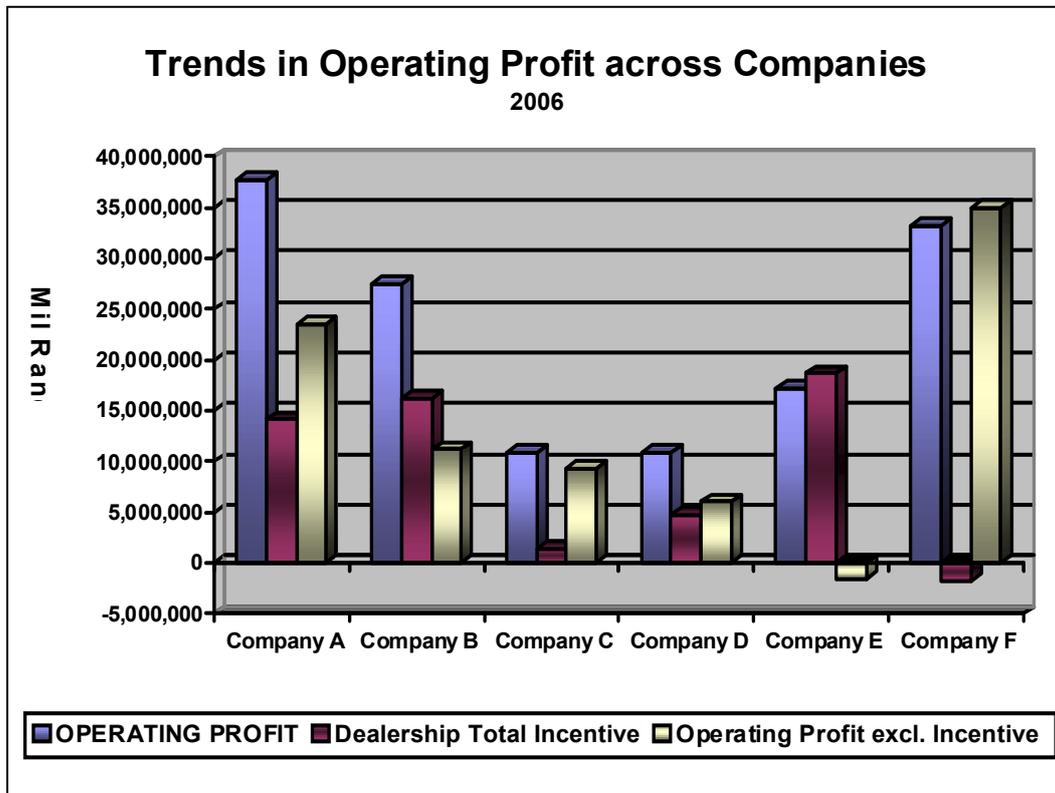
5.2 Results of the examination of the operating profit in total versus the incentive provided to companies and the net effect when the incentive was excluded

Figures 5.1 to 5.4 summarise the results on the total operating profit versus the dealership total incentive and the operating profit excluding the dealership incentives.

Note that the actual figures are not included in the graphs due to their magnitude and for presentation purposes.

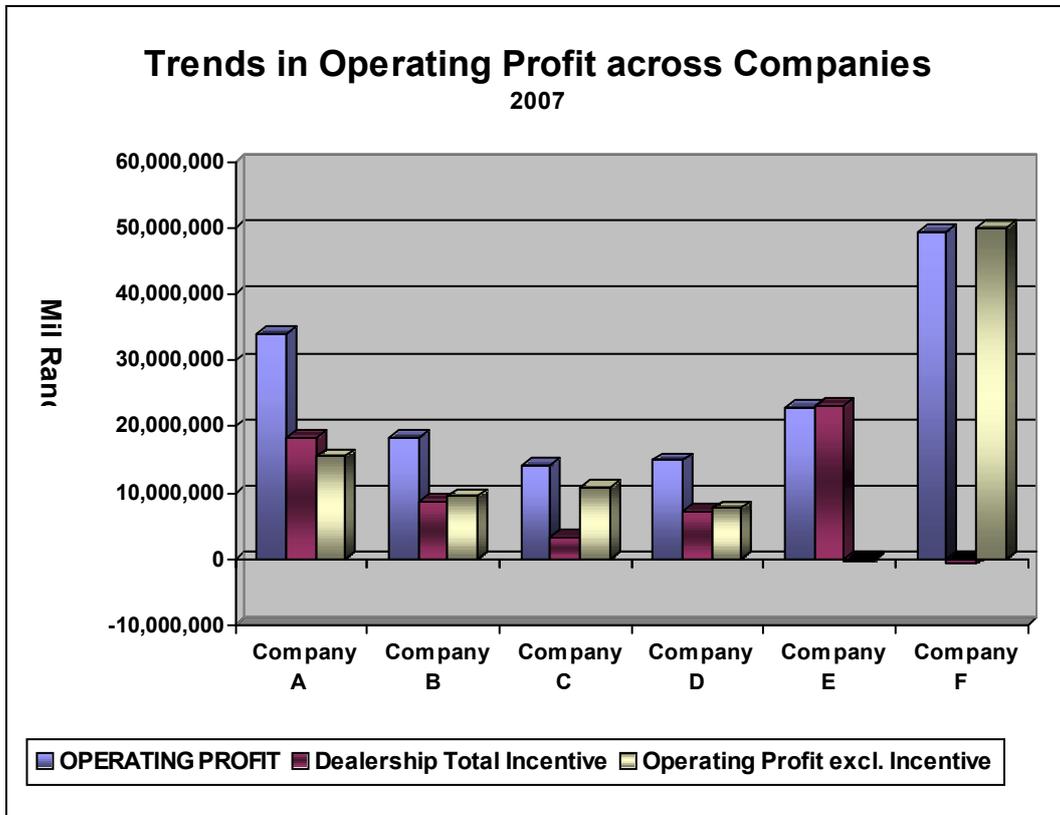
The companies in the sample are named Company A to F for the sake of confidentiality.

Figure 5.1: Trends in operating profit across companies (2006)



In 2006, the trend shows that, where dealership incentives were relatively small in comparison to the operating profit, the operating profit excluding incentives was higher. This was the case for Companies A, C, D and F. Company F actually had a negative value as an incentive. Company A reported the highest operating profit, followed by Company F; their operating profit does not seem to be inflated due to incentives. Companies B and E had allocated relatively higher incentives, with resulting lower operating profits excluding the incentive. Company E displayed a negative value, due to the fact that its dealership incentive was higher than its operating profit, which led to inflated values in terms of operating profits.

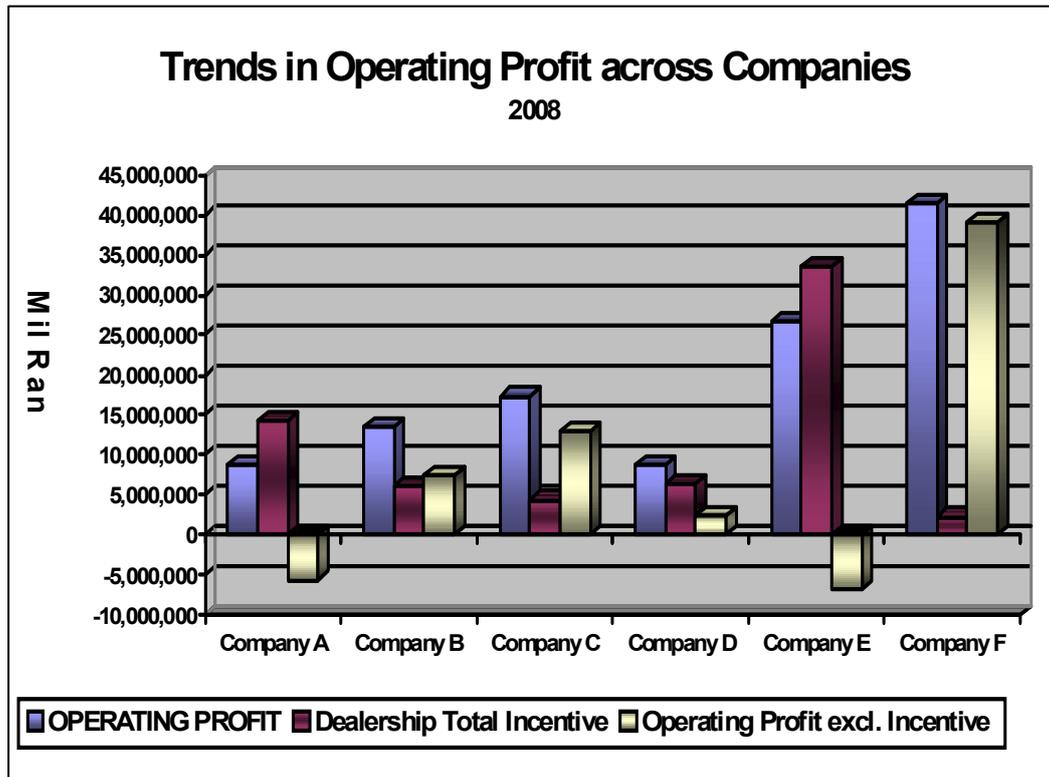
Figure 5.2: Trends in operating profit across companies (2007)



In 2007, Companies C, D and F still showed higher operating profits excluding the incentives, relative to their total operating profit, and still received smaller incentives, relative to their total operating profit. Company F's incentive still had a negative value and it showed the highest operating profit figures. In 2007, Company B displayed the same trend, whereas in 2006 its incentive was higher than its operating profit excluding the incentive. Company A showed the opposite trend to 2006, as its incentive was higher than its operating profit excluding the incentive. Company E still had practically no operating profit excluding the incentive, with an incentive slightly higher than its operating profit. The findings

confirm that the figures reported for the operating profit seem to be inflated by the inclusion of incentives.

Figure 5.3: Trends in operating profit across companies (2008)



The results in Figure 5.3 show that Companies B, C and F still had higher operating profits excluding incentives than the incentives received when compared to 2007. Companies D and E still had very low operating profits excluding incentives due to higher dealership incentives. The situation for Company E was even worse in 2008 than in the two previous years, with a negative value for operating profits excluding incentives, because incentives were much higher than the operating profit. Company A also

displayed this trend for the first time and its operating profit from 2006 to 2008 seems to have decreased.

Figure 5.4: Trends in operating profit across companies (2009)

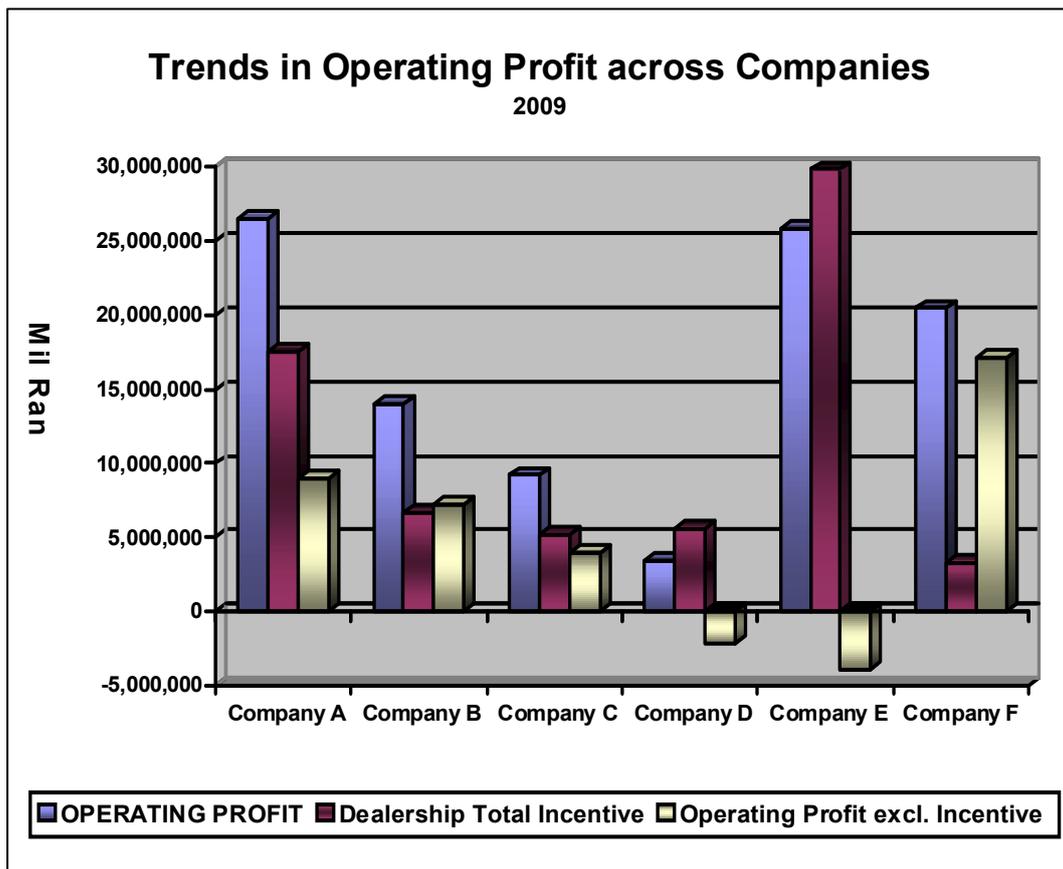


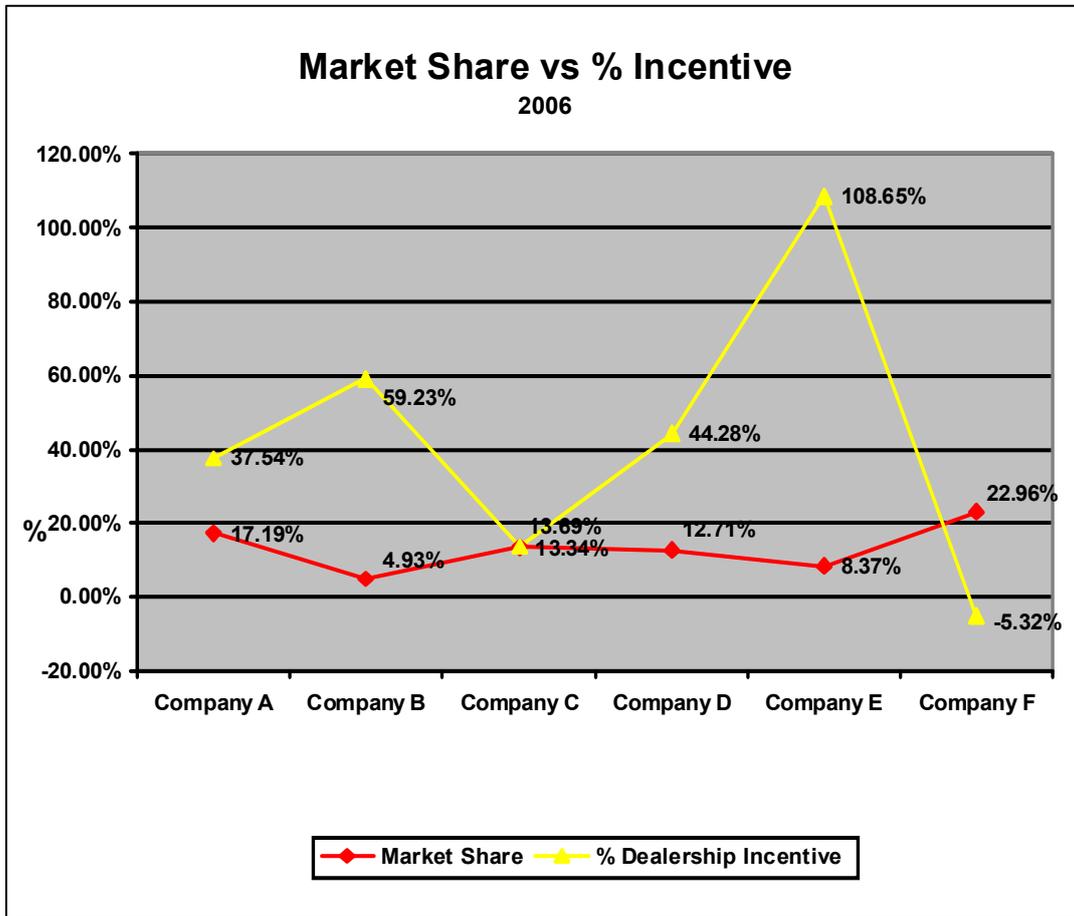
Figure 5.4 shows the results for the latest year. Companies B and F held their lead with operating profits excluding incentives exceeding the incentives received. Companies A, C, D and E showed lower operating profits excluding incentives, and Companies D and E had negative values, indicating that their incentives were higher than their operating profit. Once again, this result shows that incentives do seem to inflate operating profit values.

In summary, there seems to be a definite trend for higher incentives, especially if they exceed the operating profit excluding these incentives, to lead to lower profits shown without these incentives. In these cases, the operating profit seemed to be inflated by these incentives. Two companies (B and F) retained a lead by receiving smaller incentives and thus increasing their profits excluding these incentives over the years under review. Company C followed the same trend from 2006 to 2008, but in 2009, its incentives were higher than the operating profit excluding incentives. Even though Company A also had higher profits excluding incentives in 2006, the reverse was true for 2007 to 2009. Company D showed a deterioration from 2006/7 to 2008/9, as the incentives were higher than the operating profit excluding incentives in the last two years. Company E's incentives were higher than their operating profit excluding these incentives for all four years, to the extent that the incentives had a negative value.

5.3 Results of the analysis of market share relative to the percentage incentive received

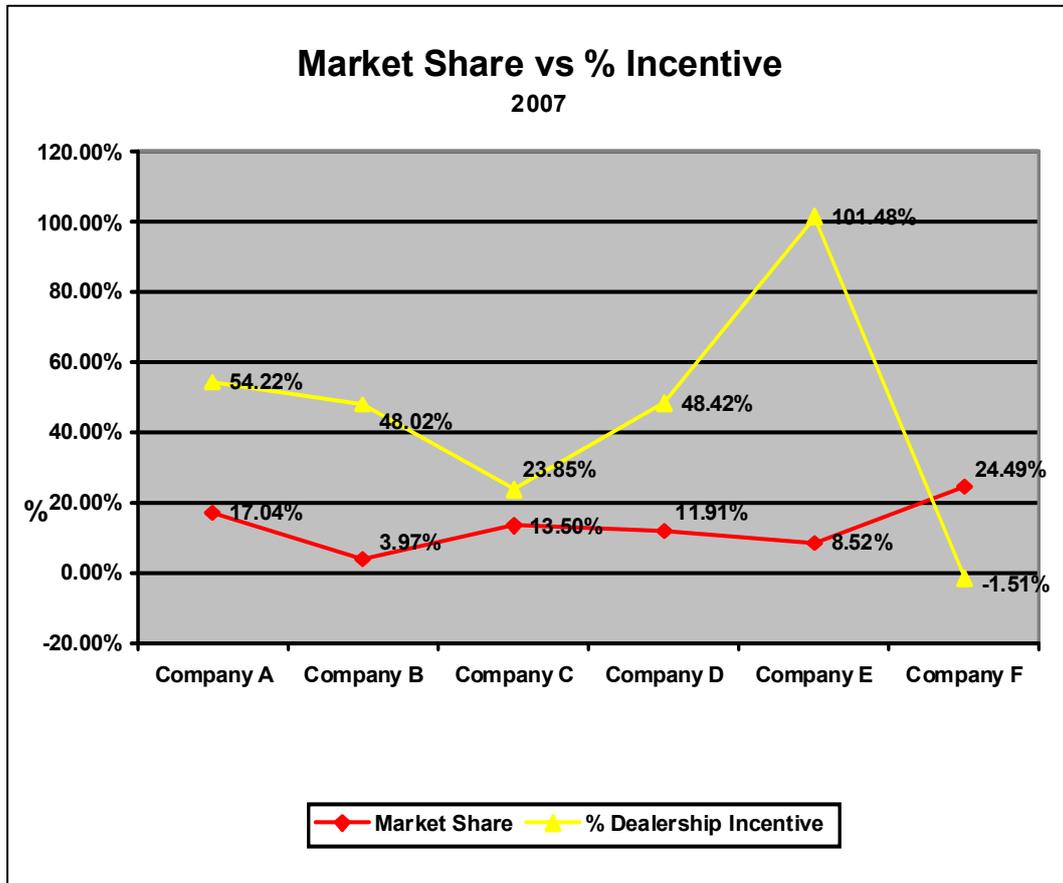
This section looks at the relationship between market share and the dealership incentive allocated to each company. In order to look at the trends, the incentives as a percentage of the operating profit were calculated. These results were then compared to the market share. The results of these analyses are presented in Figures 5.5 to 5.8.

Figure 5.5: Market share vs percentage incentive (2006)



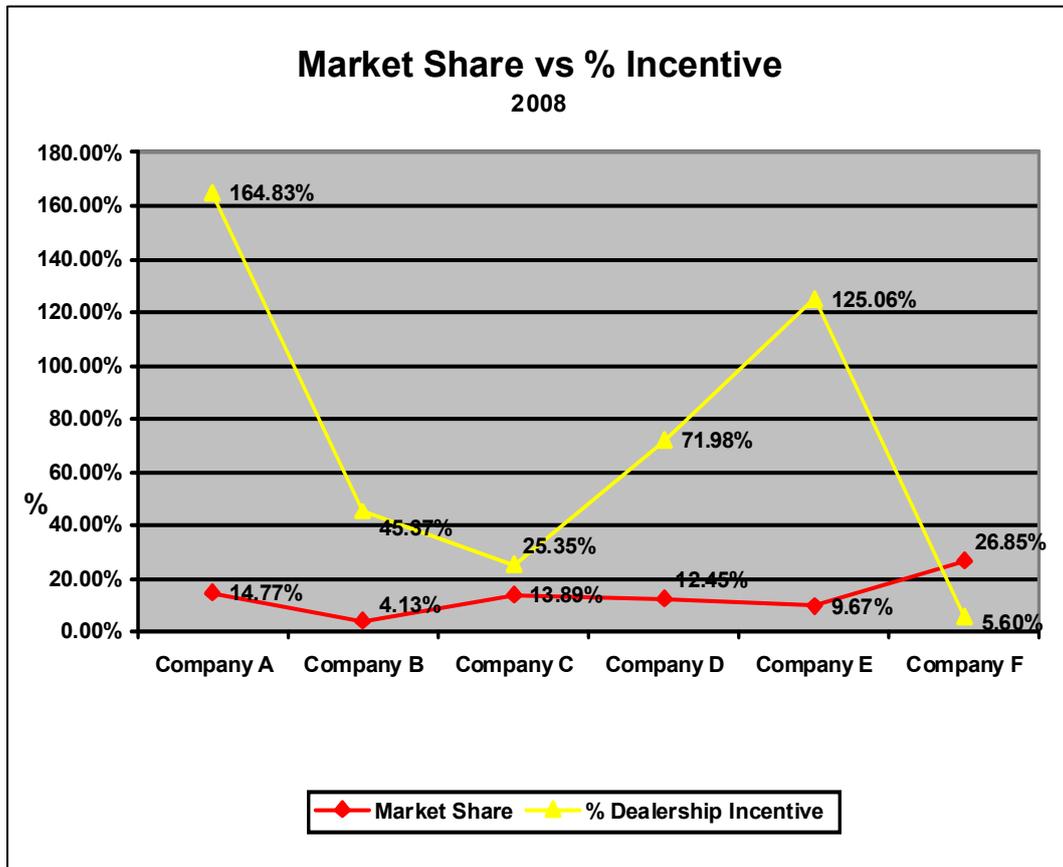
The results in Figure 5.5 represent the market share values versus the percentage incentive received for 2006. What stands out is that Company F, which had the highest market share, received the lowest dealership incentive. Companies B, D and E, with a lower market share, received the highest incentives. Company C, which received the second lowest incentive had the third highest market share. Company A received a higher incentive, but still had a slightly higher market share than Companies B, C, D and E.

Figure 5.6: Market share vs percentage incentive (2007)



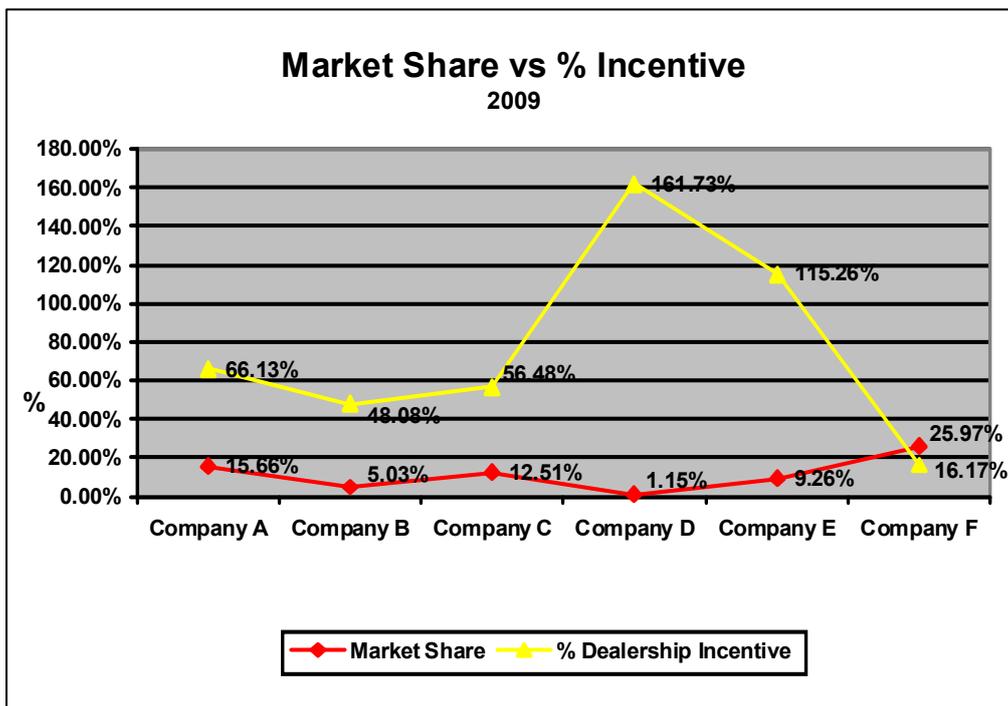
The results for 2007 reflect exactly the same trend as in 2006 (see Figure 5.6). Once again Company F had the highest market share and received the lowest dealership incentive. Companies B, D and E with the lower market share received the highest incentives. Company C, which received the second lowest incentive, had the third highest market share. Company A received a higher incentive than all companies except Company E, but still had a slightly higher market share than Companies B, C, D and E.

Figure 5.7: Market share vs percentage incentive (2008)



In 2008, the trends were much the same as in 2006/7, except in the case of Company A (see Figure 5.7), which received a very high incentive in 2008. At the same time, Company A's market share dropped by almost 3%. Company F still had the highest market share and received the lowest incentive. Company E, with the second highest incentive, still had a relatively low market share compared to the other companies.

Figure 5.8: Market share vs percentage incentive (2009)



In 2009, Company A moved back to its original position from 2006; and Company D, which now received the highest incentive, experienced a drop in its market share to the last position (see Figure 5.8). However, the main trend remained the same: Company F still received the lowest incentive but had the highest market share.

In addition to the graphs above, a Spearman Rank Order Correlation was calculated between the percentage market share and the percentage incentive received across the various companies and years. This was done in order to determine whether the relationship recorded in Figures 5.5 to 5.8 were actually statistically significant. The results of this analysis are presented in Table 5.1.

Table 5.1: Spearman Rank Order Correlations between percentage market share and percentage dealership incentive

Correlations				
			Market Share	% Dealership Incentive
Spearman's rho	Market Share	Correlation Coefficient	1.000	-.571^{**}
		Sig. (2-tailed)	#NULL!	.004
		N	24	24
	% Dealership Incentive	Correlation Coefficient	-.571^{**}	1.000
		Sig. (2-tailed)	.004	#NULL!
		N	24	28
		**. Correlation is significant at the 0.01 level (2-tailed).		

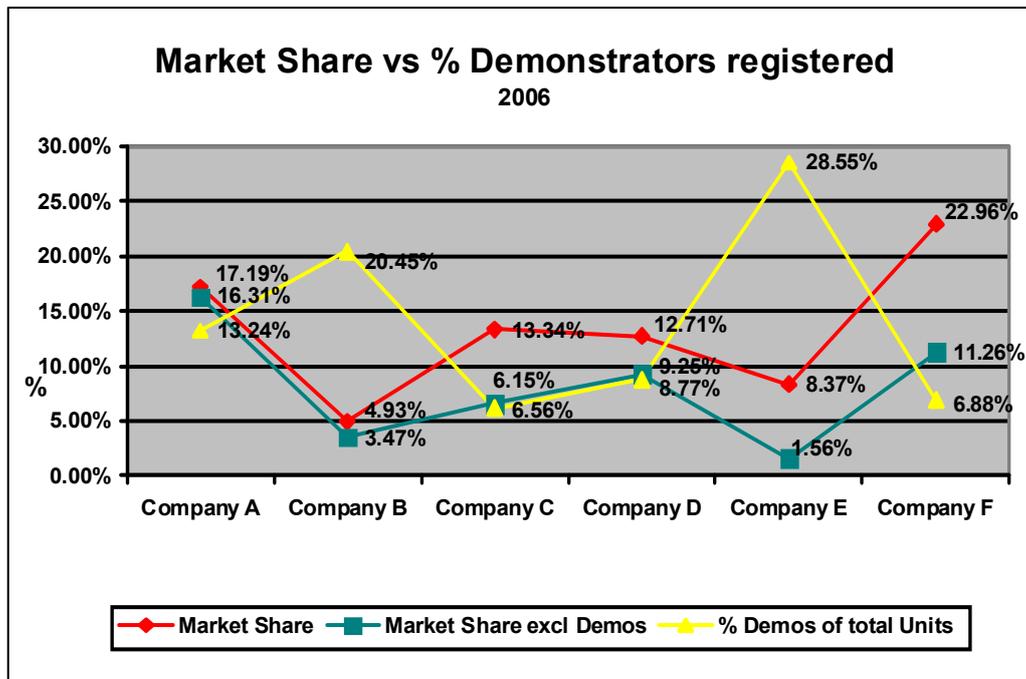
The results set out in Table 5.1 indicate that there is a strong negative correlation ($r=-0.571$; $p= 0.004$) between the percentage market share and the percentage dealership incentive received. This implies that the higher the percentage dealership incentive as a percentage of the company's operating profit, the lower the company's market share. The analysis thus confirms that, largely, lower incentive rates were associated with higher

market share figures and very high incentive rates were associated with lower market share.

5.4 Results of the analysis of market share versus the percentage of registered demonstrator vehicles

This section focuses on whether the manufacturers artificially report additional new vehicle retail sales and what the relationship is between the percentage of registered demonstrator vehicles and the market share. The percentage of demonstrator vehicles was calculated as a percentage of the total sales reported. Lastly, the market share was also calculated excluding the demonstrator vehicles and this can be compared to the original market share. The results are presented in Figures 5.9 to 5.12.

Figure 5.9: Market share vs percentage of registered demonstrator vehicles (2006)



The results in Figure 5.9 can be interpreted as follows: Companies B and E had the highest percentage of registered demonstrator vehicles as a percentage of their total sales. At the same time, they also reported the lowest market share. Companies C and D had relatively low percentages of demonstrator vehicles, with moderate market share. Company A had a slightly higher percentage of demonstrator vehicles with a slightly higher market share than Companies C and D. Company F also had a very low percentage of demonstrator vehicles, but had the highest market share. It is also clear that the market share excluding demonstrator vehicles was lower than original figures for all companies.

Figure 5.10: Market share vs percentage of registered demonstrator vehicles (2007)

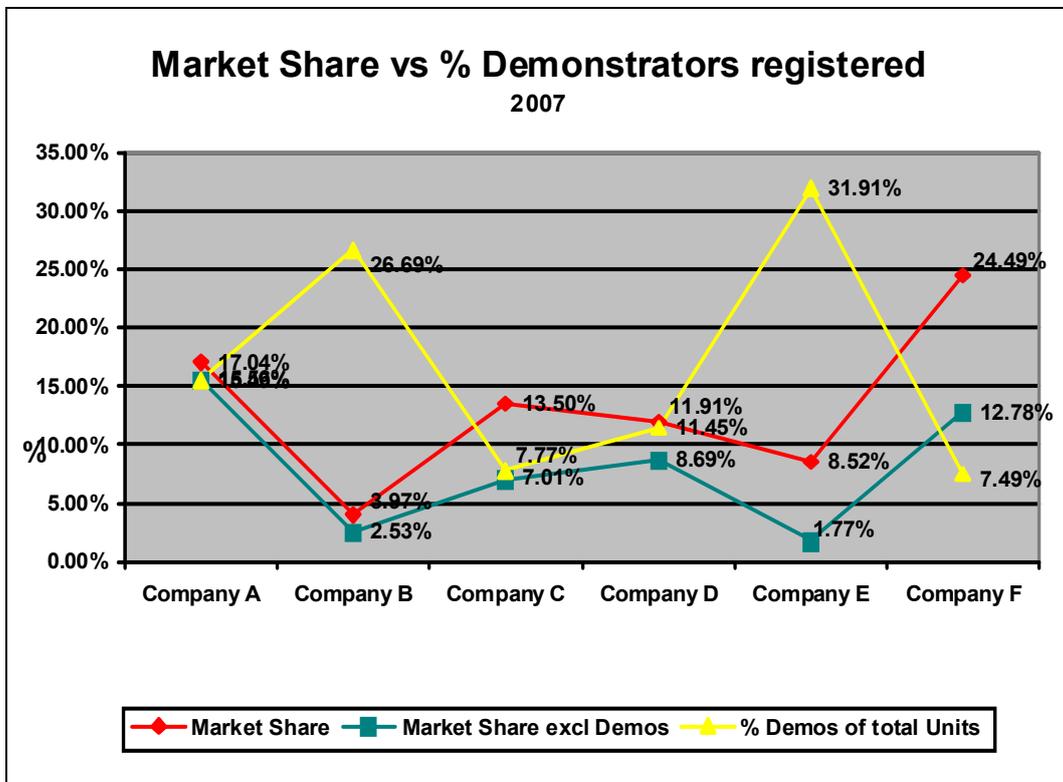
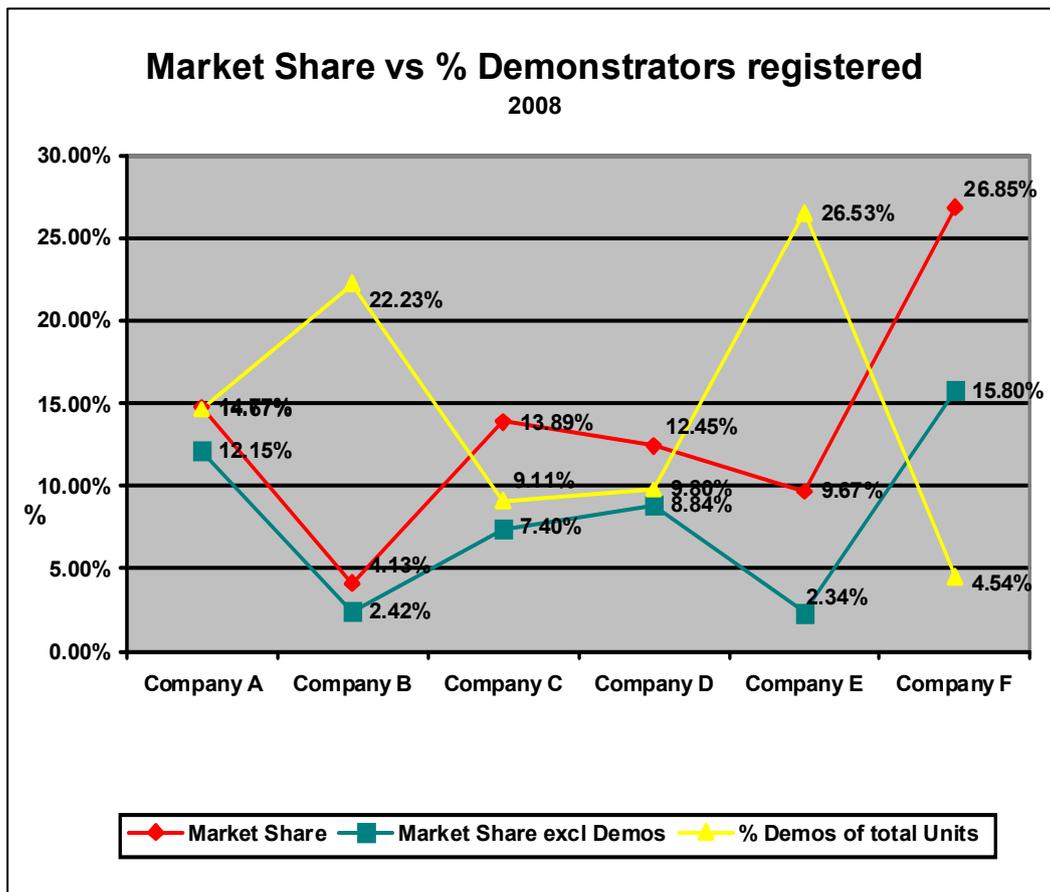


Figure 5.10 shows the results for 2007. The trend remains the same as for 2006, where a higher market share is associated with lower percentages of registered demonstrator vehicles, except in the case of Company A. Once again, market share excluding demonstrator vehicles was lower than with it included in the original market share figures.

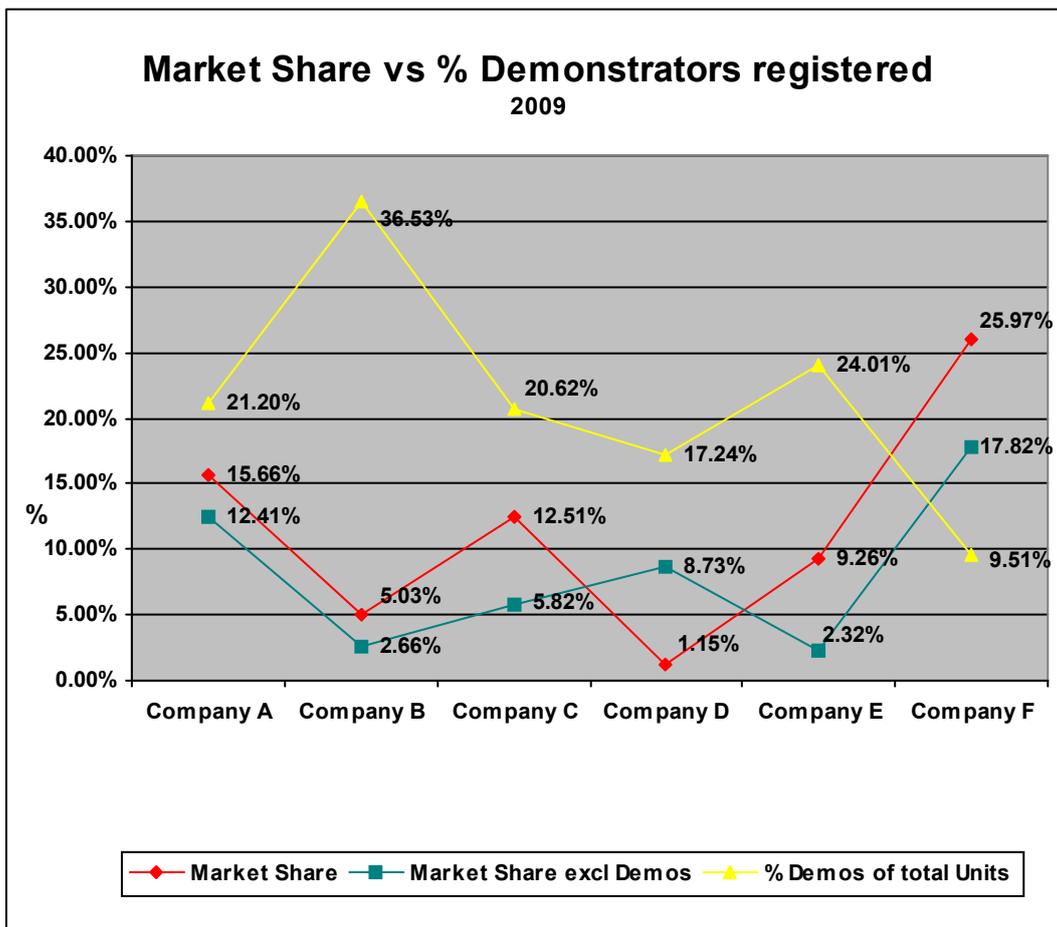
Figure 5.11: Market share vs percentage of registered demonstrator vehicles (2008)



The trends in 2008 were the same as in the previous two years (see Figure 5.11). Companies B and E once again had the highest percentage of registered demonstrator vehicles as a percentage of their total sales. At the same time, they also had the lowest market share reported.

Companies C and D had relatively low percentages of demonstrator vehicles with moderate market share. Company A had a higher percentage of demonstrator vehicles with a slightly higher market share than Companies C and D. Company F also had a very low percentage of demonstrator vehicles but had the highest market share. The market share excluding demonstrator vehicles was once again lower than the original figures including them.

Figure 5.12: Market share vs percentage of registered demonstrator vehicles (2009)



The trend changed, however, in 2009 (see Figure 5.12). Company B and E still had the largest percentage of registered demonstrator vehicles and a relatively low market share, but Company D, which had slightly fewer demonstrator vehicles, had the lowest market share. Company A had a higher percentage of demonstrator vehicles with a slightly higher market share than Companies C and D.

Company F once again had the lowest percentage of demonstrator vehicles with the highest market share. When one compares the original market share with, the trend remains the same, with the market share calculated excluding registered demonstrator vehicles lower than the original market share.

There was, however, one exception, namely Company D. In 2009, its market share excluding registered demonstrator vehicles was higher than the original market share. This could be due to the fact that its percentage of demonstrator vehicles was lower than that of Company C in 2009, but was higher than that of Company C from 2006 to 2008.

There seems to be a general trend for lower percentages of registered demonstrator vehicles to be associated with a higher market share. In order to determine whether this relationship is statistically significant, Spearman Rank Order Correlations were once again calculated. The results of this analysis are presented in Table 5.2.

Table 5.2: Spearman Rank Order Correlation between original market share reported and the percentage of registered demonstrator vehicles reported

Correlations				
			Market Share	% Demos of total Units
Spearman's rho	Market Share	Correlation Coefficient	1.000	-.709**
		Sig. (2-tailed)	#NULL!	.000
		N	24	24
	% Demos of total Units	Correlation Coefficient	-.709**	1.000
		Sig. (2-tailed)	.000	#NULL!
		N	24	28
**. Correlation is significant at the 0.01 level (2-tailed).				

The results in Table 5.2 indicate that there is a strong negative correlation ($r=-0.709$; $p=0.000$) between market share and the percentage of demonstrator vehicles reported. This confirms that, largely, the lower the percentage of demonstrator vehicles registered, the higher the market share and vice versa.

In summary, lower percentages of demonstrator vehicles registered were associated with higher market share. Conversely, high percentages of demonstrator vehicles registered were associated with lower market share. The results in Figures 5.9 to 5.12 also indicate that once the

percentage of registered demonstrator vehicles was excluded, the market share of all the companies under review dropped.

5.5 Summary of results

The results of this analysis focused on public data provided for six different brands or manufacturers over the years from 2006 to 2009. In summary, there seems to be a definite trend for higher incentives, especially if they exceed the operating profit excluding these incentives, to lead to lower profits shown without these incentives. Two companies (B and F) remained in the lead by receiving smaller incentives and thus increasing their profits excluding these incentives over the years. Company F showed the highest operating profit across companies over all the years. In 2006, Company B's operating profit was, however, much lower. Company C also had lower incentives from 2006 to 2008, but in 2009 its incentives were higher than the operating profit excluding incentives. Even though Company A also had higher profits excluding incentives in 2006, the reverse was true for 2007 to 2009. Company A had the highest operating profit in 2006 and came second highest in 2007 and 2009, but the operating profit seems to have been inflated by incentives, particularly in 2009. Company D showed a deterioration from 2006/7 to 2008/9, because the incentives were higher than the operating profit excluding incentives in the last two years. Company E's incentives were higher than its operating profit excluding these incentives for all four years, to the extent that the incentives had a negative value. Company E reported the third highest operating profit in 2006, 2007 and 2009, and the second highest in 2008.

These figures, however, seem to be inflated by the incentives, as these exceed the profits excluding incentives.

The analysis that focused on the effect of dealership incentives on market share indicated that the higher the percentage of the dealership incentive as a percentage of a company's operating profit, the lower its market share. This trend was confirmed by a statistical analysis in the form of Spearman Rank Order Correlations. The analysis thus confirms that, to a great extent, lower incentive rates were associated with higher market share figures and very high incentive rates were associated with lower market share.

The last set of analyses focused on the relationship between the percentage of registered demonstrator vehicles versus the market share of the companies. In summary, lower percentages of registered demonstrator vehicles were associated with higher market share. High percentages of registered demonstrator vehicles were associated with lower market share. These results were once again confirmed by statistical analysis in the form of Spearman Rank Order Correlations. The results also indicated that once the registered demonstrator vehicles were excluded, the market share of all companies dropped.

These results are interpreted and discussed in Chapter 6.

CHAPTER 6

DISCUSSION OF THE RESEARCH RESULTS

6.1 Introduction

The pressures in the new vehicle market in the automotive retail sector in South Africa are largely a function of a weakening demand and market competition with regard to new market entries (Black & Mitchell, 2002). Almost all vehicle manufacturers and importers operating in South Africa have incentive models to support their sales targets (Arrunada *et al.*, 2001). As single enterprises, the different dealer networks in South Africa must be in a position to adapt to the rapidly changing environment in this emerging economy (Black & Mitchell, 2002).

The practice of awarding such incentives arose from manufacturers' desire to reward performance and control dealer activities. A franchise dealer's viability depends mainly on the so-called menu of margin offered by the particular franchise (Arrunada *et al.*, 2001) in relation to the prescribed operational cost of providing the point of sale and service within the franchise's particular area of responsibility.

Through the implementation of manufacturer incentives, the OEM can position itself with regard to the support systems offered to the various networks, as well as plan its future product strategy. The results based on the six major brands represented in South Africa are discussed and evaluated according to the hypothesis statements set out in Chapter 3 to

ascertain the control that manufacturers have over the retail environment in respect of the variable margin.

In terms of the incentive models, the study focused on one specific area, namely the incentive models used by the respective OEMs (also see Figure 2.5) that are directly associated with the hypothesis statements in Chapter 3 adopted for a descriptive explanation of incentive models available from the respective OEMs in South Africa.

For the purposes of the research and to give a better understanding of the incentive model to a dealer network, the researcher adapted a current model as an example. The brand name is not indicated for the sake of confidentiality, due to future competitive impact that revealing the source could have. The example is intended to illuminate the data analysis. The incentive consists of a percentage of the average cost price from the factory returned to the dealer when the dealer achieves the target.

Table 6.1: Volume incentive model

Based on 100% target achievement	Model	Monthly	Annual	Total
Model A	All in model range or end of a model range	1.1%	0.45%	1.5%
Model B	All in model range or end of a model range	2.2%	0.8%	3.0%
Model C	All in model range or end of a model range	0.3%	0.2%	0.5%
Model D	All in model range or end of a model range	1.5%	0.5%	2.0%
Model E	All in model range or end of a model range	0.7%	0.3%	1.0%
Model F	All in model range or end of a model range	3.0%	1.0%	4.0%

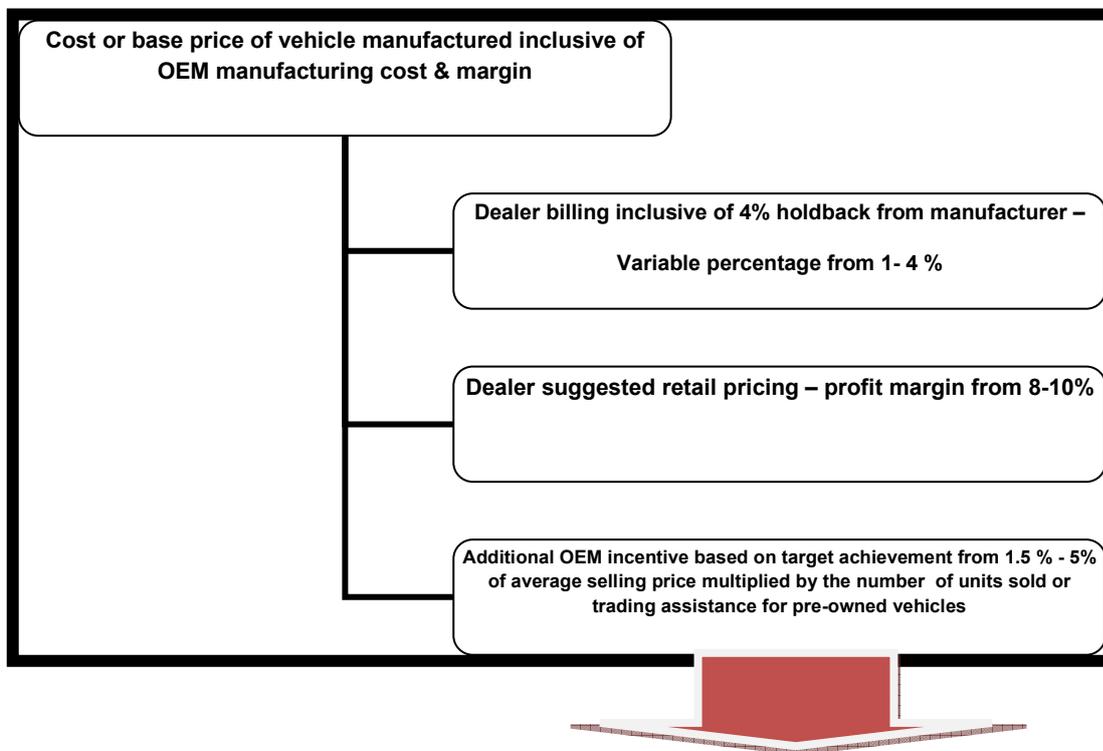
Source: Adapted from Motor Retail South Africa (2009)

As already discussed, it is imperative to understand the mechanism of how an incentive model offered by the OEM to its dealer network works. The incentive model is normally based on monthly sales volumes with the qualifying criterion that the dealer needs to achieve a minimum percentage of 100% of its target on new vehicles. The target is based on the overall brand market share from NAAMSA, calculated back to the dealers' area of responsibility. The dealer is measured on an overall target. Achievement of the overall target for the month entitles the dealership to the individual incentive amounts. Therefore the dealer has to focus on retailing the

correct model mix before any incentive can be earned. The dealer's performance must be on track to meet the cumulative annual target performance at all times – if the dealer under-achieves, the business forfeits any potential incentives or may even have to pay back incentives. The dealer only qualifies to keep a given month's performance incentive if the dealer is 85% on track (cumulative) to meet its annual target.

One must conclude from the above description of a typical incentive model in the industry (also see Figure 6.1) that it can force a dealer network to have a short-term focus. This in turn leads to a one-directional approach on an operational level, which creates a short-term strategic approach to the financial management of the business.

Figure 6.1: Descriptive explanation of the incentive models



Research based on the additional incentive normally targeted at improving market share and new vehicle sales

6.2 Hypothesis 1 – H₀: South African automotive dealers rely on the manufacturer variable incentive based on sales performance to ensure profitability

Black and Mitchell (2002) refer to the monopolistic competition model, which predicts that an increase in average cost will result in short-term losses for the manufacturing industry. The automotive industry is an industry that competes on a global basis in terms of its brand and market share (Rugman & Girod, 2003), but it is noticeable that regional competition in the South African market has become fiercer over the last couple of years, due to new market entrants and economic decline.

In response, automotive manufacturers in South Africa have introduced mechanisms to ensure a better vertical relationship with their dealer networks and to exert control over the dealers' operational behaviour (Barker *et al.*, 1988). A well-integrated and established incentive system can strengthen this vertical relationship to address a potential decline in market share and sales volumes (Swan *et al.*, 2004).

However, a commoditisation of the dealer network or retail environment to add potential value to the respective dealer network by means of performance incentives can also lead to a potential loss of profit. Such a loss of profit could result when the dealer margin deteriorates because the focus shifts from operational efficiency to a short-term focus on sales performance to target (Matthyssens & Vandenbempt, 2008).

The results set out in Figures 6.2 to 6.5 relate to Hypothesis 1:

H₀: South African automotive dealers rely on the manufacturer variable incentive based on sales performance to ensure profitability.

H₁: South African automotive dealers do not rely on the manufacturer variable incentive based on sales performance to ensure profitability.

Figure 6.2: Trends in operating profit across companies (2006)

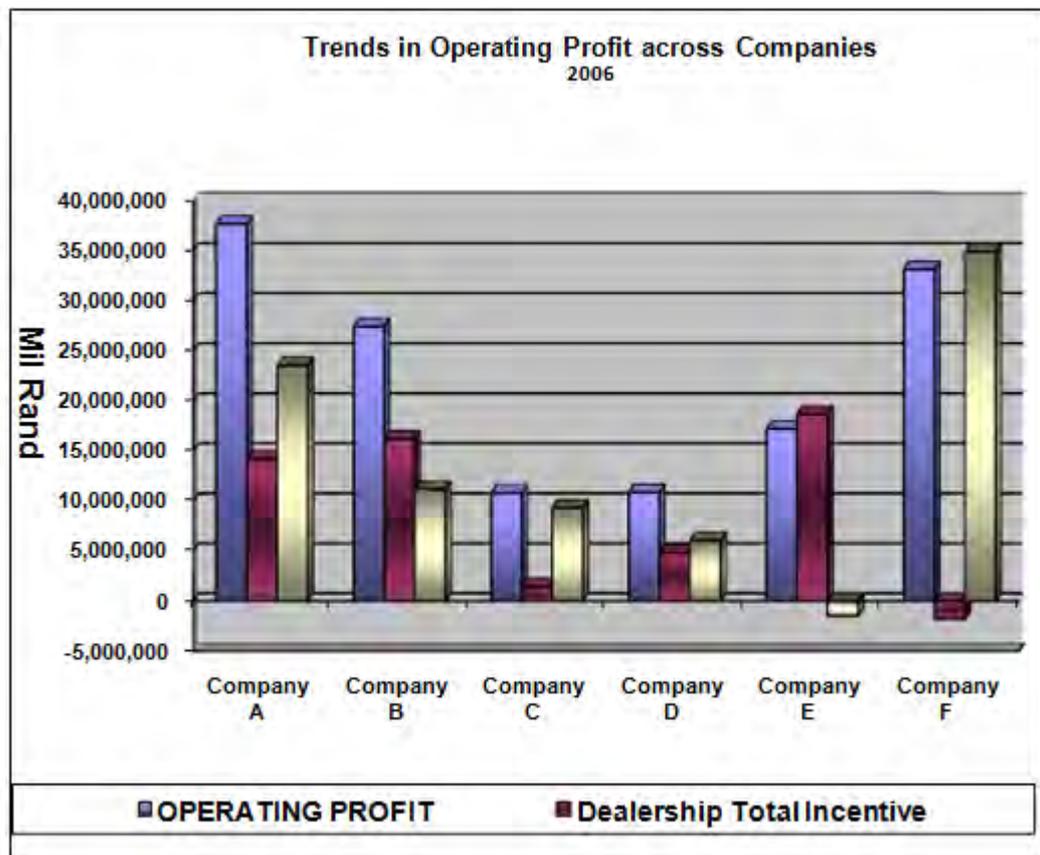


Figure 6.3: Trends in operating profit across companies (2007)

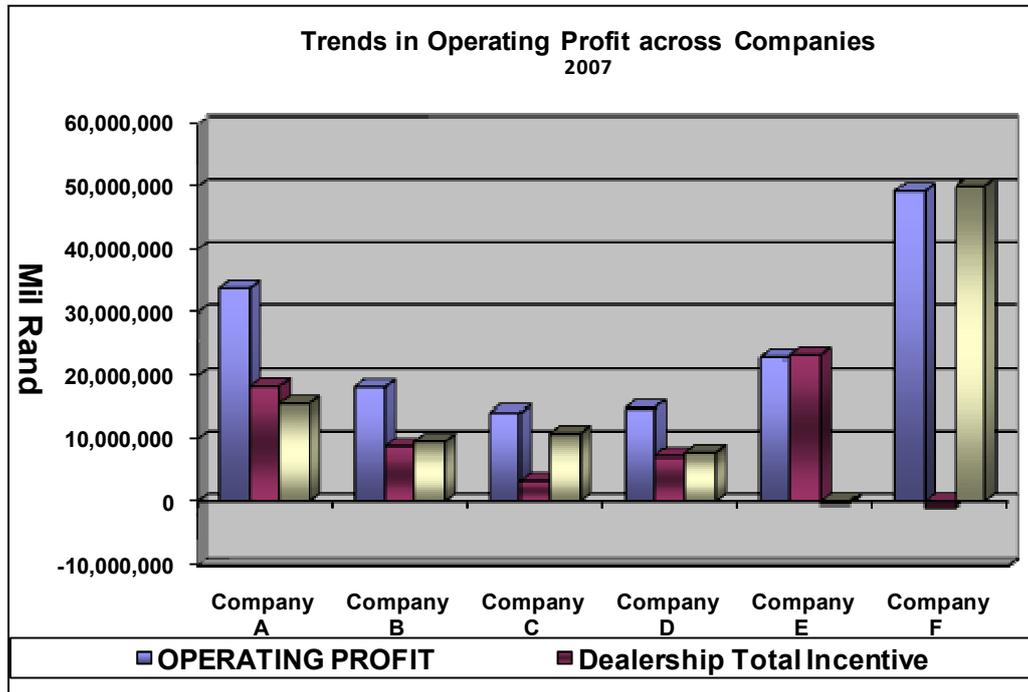


Figure 6.4: Trends in operating profit across companies (2008)

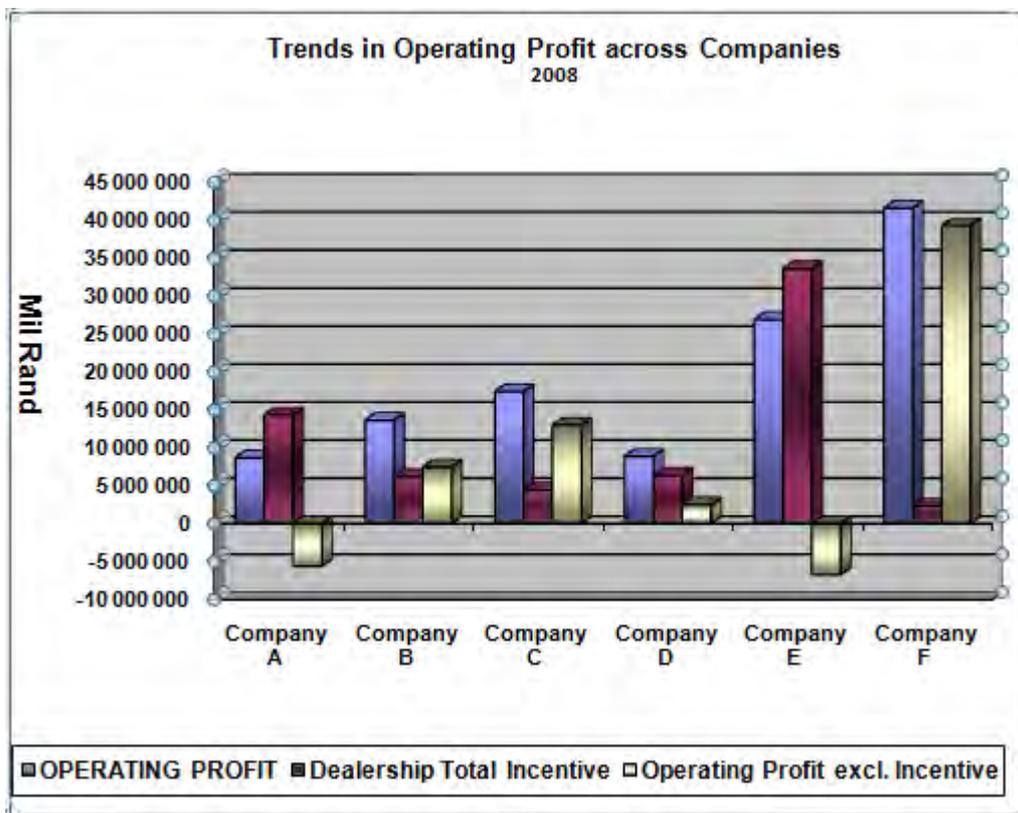
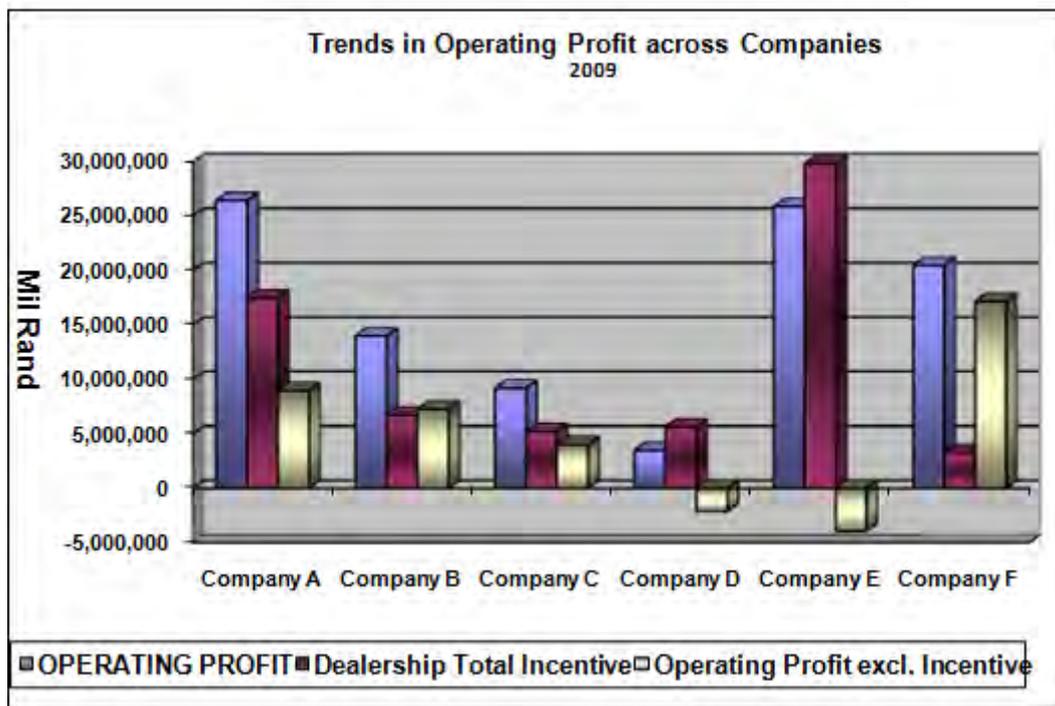


Figure 6.5: Trends in operating profit across companies (2009)



With reference to the above results in Figures 6.2 to 6.5, it is clear that there is a definite trend for higher incentives to lead to lower profits. This implies that true operating profit in the respective brands is definitely influenced by the variable incentive models that the vehicle manufacturers introduce on an annual basis.

In line with Porter's (1980) five forces model, the following six factors could motivate vehicle manufacturers to introduce incentive models to ensure market competitiveness and support the long-term strategies of the OEMs with regard to incentive models.

- protecting the respective brand market share by adding additional value to the product price through additional manufacturer incentives;

- securing buyer power within the respective franchises' areas of responsibility;
- controlling the potential threats of current and future substitutes that can have a negative effect on the particular brand's market share;
- influencing buyer behaviour by responding to price sensitive behaviour;
- controlling the medium- and long-term manufacturing volumes of the particular brands; and
- securing market and buyer information by putting in place incentive feedback mechanisms to enhance the vertical relationship between the franchisor and the franchisee.

Applying Porter's five forces theory can assist with industry profitability and can have a great influence on product prices and profitability. However, the buyer power in an emerging economy can determine the performance of retailers (Porter, 1980).

The power of buyers is the impact that the respective customers have on this industry – in general, when buyer power is strong, the relationship between buyers and suppliers in this industry comes close to what economists call a 'monopsony' (a market in which there are many suppliers of different brands and one buyer). Under such market conditions, the buyer can set the price and therefore a strong strategic partnership between the manufacturer and retailer is important (Hines *et al.*, 2002).

Such a strong partnership will take into account the overall financial investment of both parties involved in the supply chain to ensure independent profitability, as well as dependent market performance.

The manufacturer needs to control the overall market risk, but the management of key variables can affect the overall lifecycle of the dealer network (Eggert *et al.*, 2006). It is obvious that manufacturer incentives can represent most of a dealer's profitability.

Therefore, if this situation is not controlled, the independence of the retailers could be eroded and even disappear over time. The implementation of incentive models to motivate the retail environment can thus have a negative impact on dealer profitability (Spring & Araujo, 2009). In addition, it can create uncertainty for the manufacturers with regard to the product-to-market fit.

In the light of these comments, it is concerning that the results set out in Chapter 5 make it apparent that the dealer retail network in South Africa is becoming more and more dependent on incentive models to ensure profitability.

With reference to the data, the null hypothesis (H_0) for Hypothesis 1 ('South African automotive dealers rely on the manufacturer variable incentive based on sales performance to ensure profitability') is accepted, based on the finding that the higher the incentive contribution, the lower the profits for the six companies examined for the period under review.

6.3 Hypothesis 2 – H₀: Vehicle manufacturers in South Africa use incentive models to control their market share in the new vehicle retail market

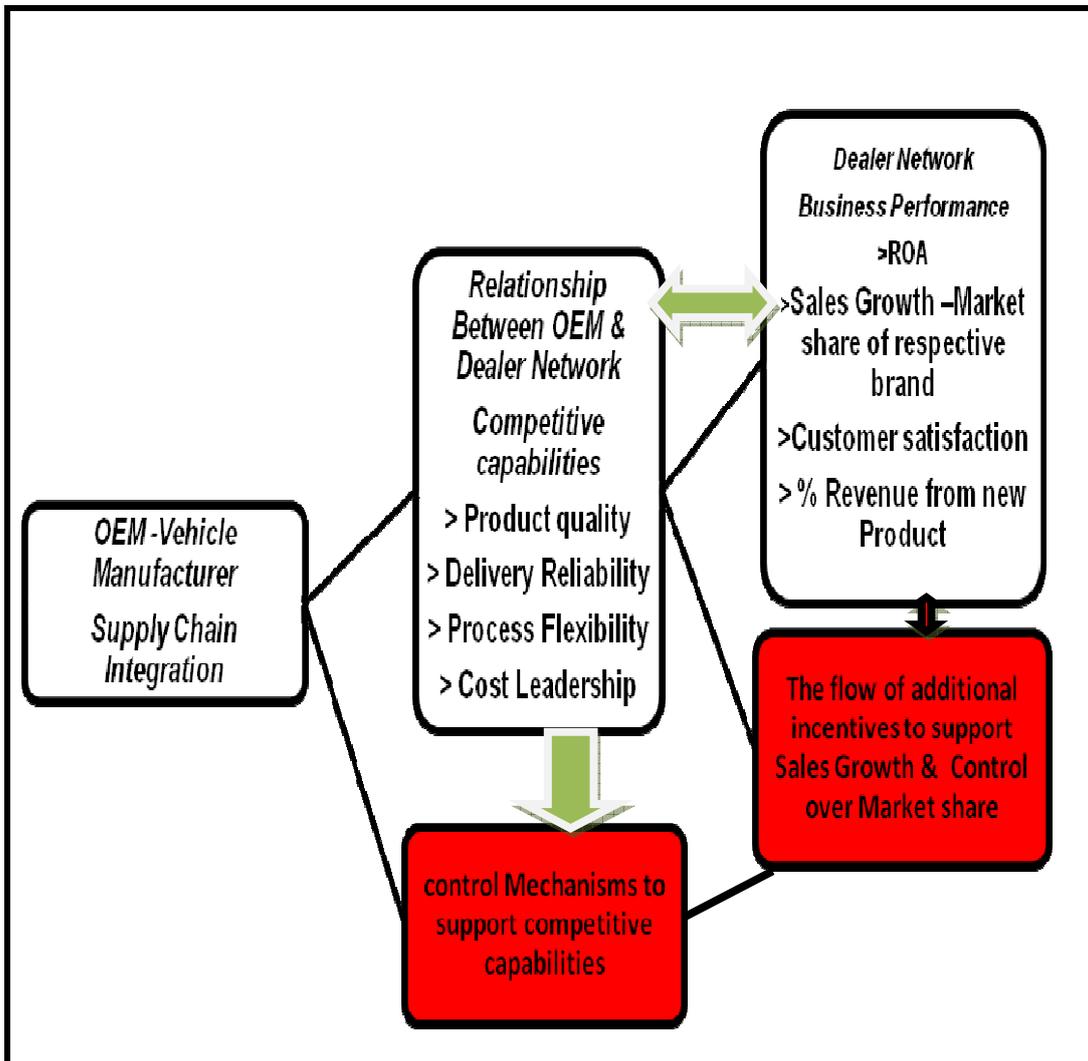
Incentive strategies such as reward and compensation plans play an important role in multilevel distribution networks (Swan *et al.*, 2004). This can have a positive or negative impact in practice (Barker *et al.*, 1988).

There should be a clear focus on the economic contract entered into for compensation plans (incentive schemes to the dealer networks). Arrangements could have a long-term negative impact on a dealer if they are not managed in the right manner.

An incentives model can influence the entire behaviour of an organisation (dealer) (Eggert *et al.*, 2006). This implies that models such as that by Rosenzweig *et al.* (2003) (see Figure 2.2) may have to be adapted.

In Figure 6.6, a new model based on that of Rosenzweig *et al.* (2003) is presented.

Figure 6.6: Adapted model of integrated additional incentives



Source: Adapted from Rosenzweig *et al.* (2003:439)

With reference to the above integration model adapted from Rosenzweig *et al.* (2003), there is a clear indication that the OEMs try to create a retailer focus on sales growth and market share. In this regard, the research did not provide enough evidence to measure customer service, return on assets (ROA) and revenue from new products introduced to the market place.

The dealer network does not include incentive earnings in operational financial year budgets and can therefore see incentive earnings as an additional income. However, when incentive management refers back to the daily operational management of the single enterprise, then this additional margin can be lost in the sale of the product because of discounting to ensure market retention – if a particular single enterprise does not perform to the set franchise agreement with the OEM (Arrunada *et al.*, 2001), the respective entrepreneur may risk cancellation of the agreement (Lumpkin & Dess, 2001).

The results set out in Figures 5.7 to 5.10 (also see Chapter 5) are relevant to the testing of Hypothesis 2:

H₀: Vehicle manufacturers in South Africa use incentive models to control their market share in the new vehicle retail market.

H₁: Vehicle manufacturers in South Africa do not use incentive models to control their market share in the new vehicle retail market.

Figure 6.7: Market share vs percentage incentive (2006)

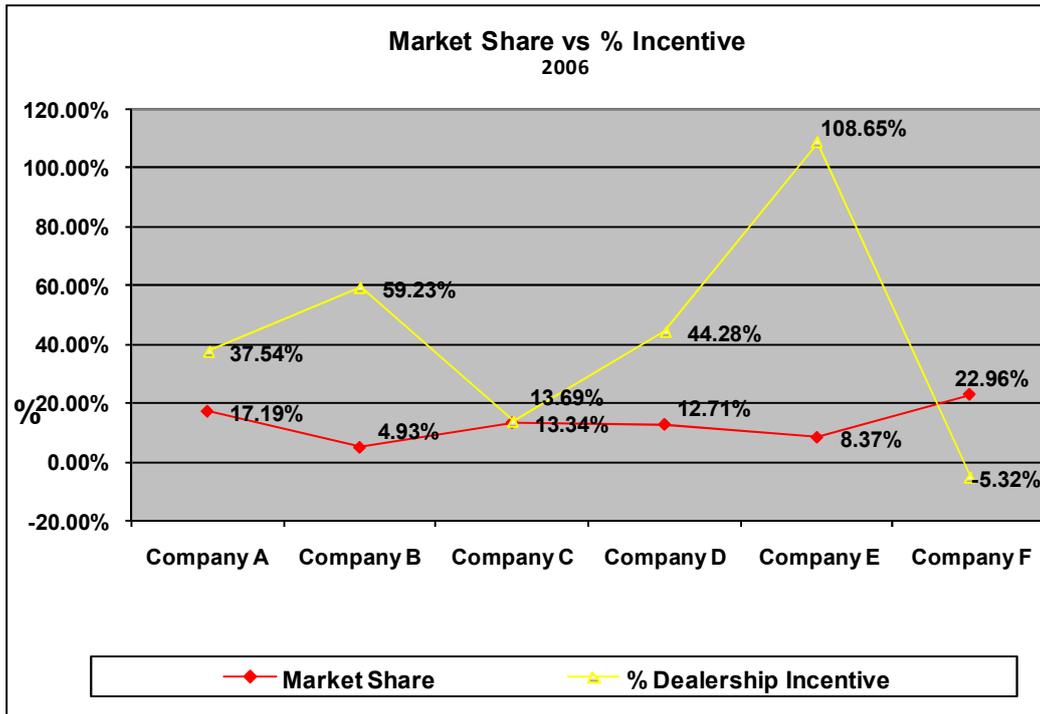


Figure 6.8: Market share vs percentage incentive (2007)

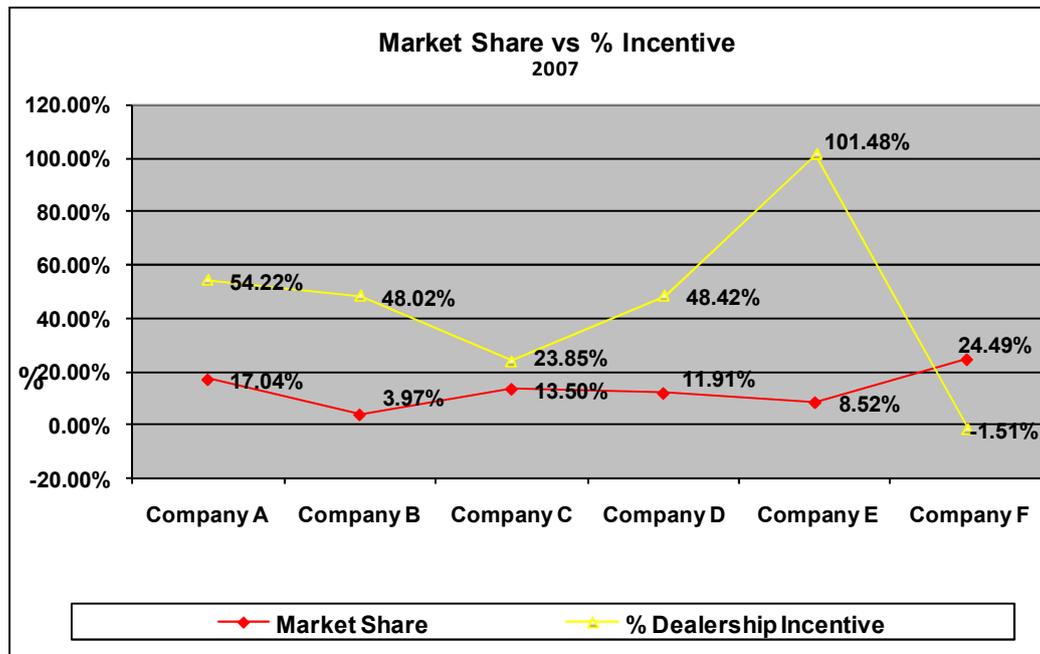


Figure 6.9: Market share vs percentage incentive (2008)

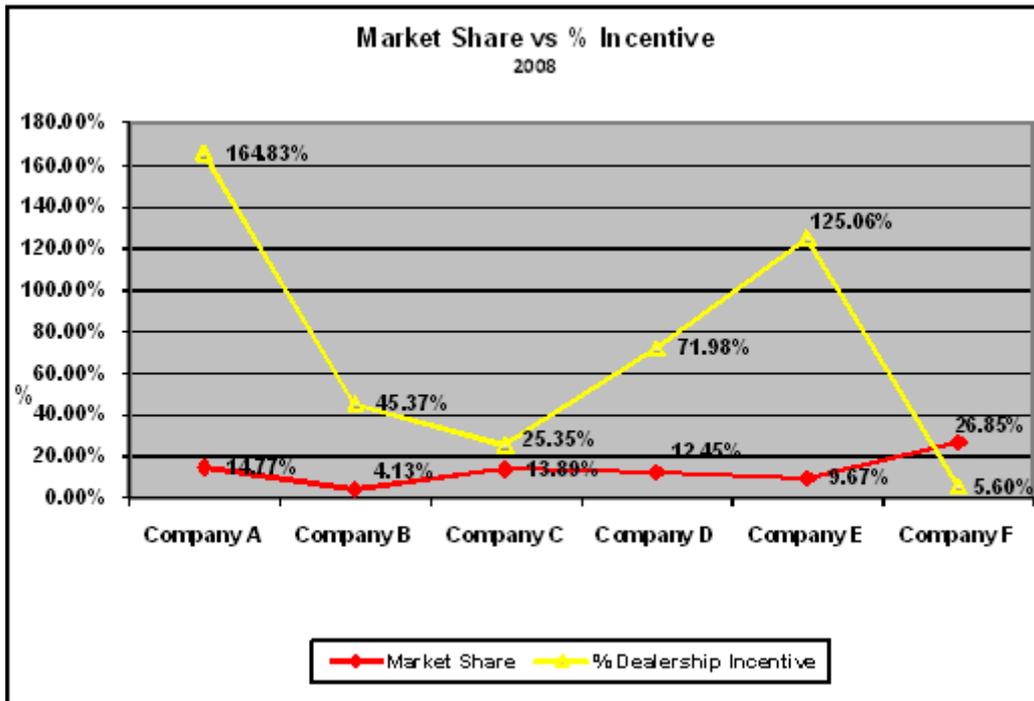
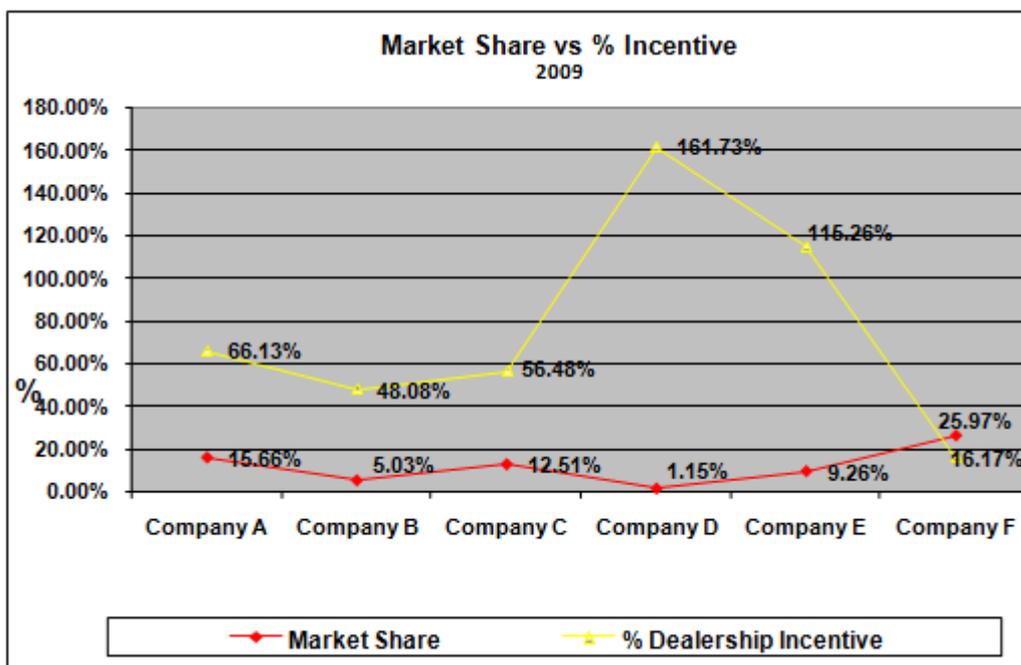


Figure 6.10: Market share vs percentage incentive (2009)



The above results from Chapter 5 show that Company F is an apparent outlier: over the four-year period under review, the brand earned the lowest manufacturer incentive, but held the highest market share percentage. All the other companies received higher incentives in comparison to their market share.

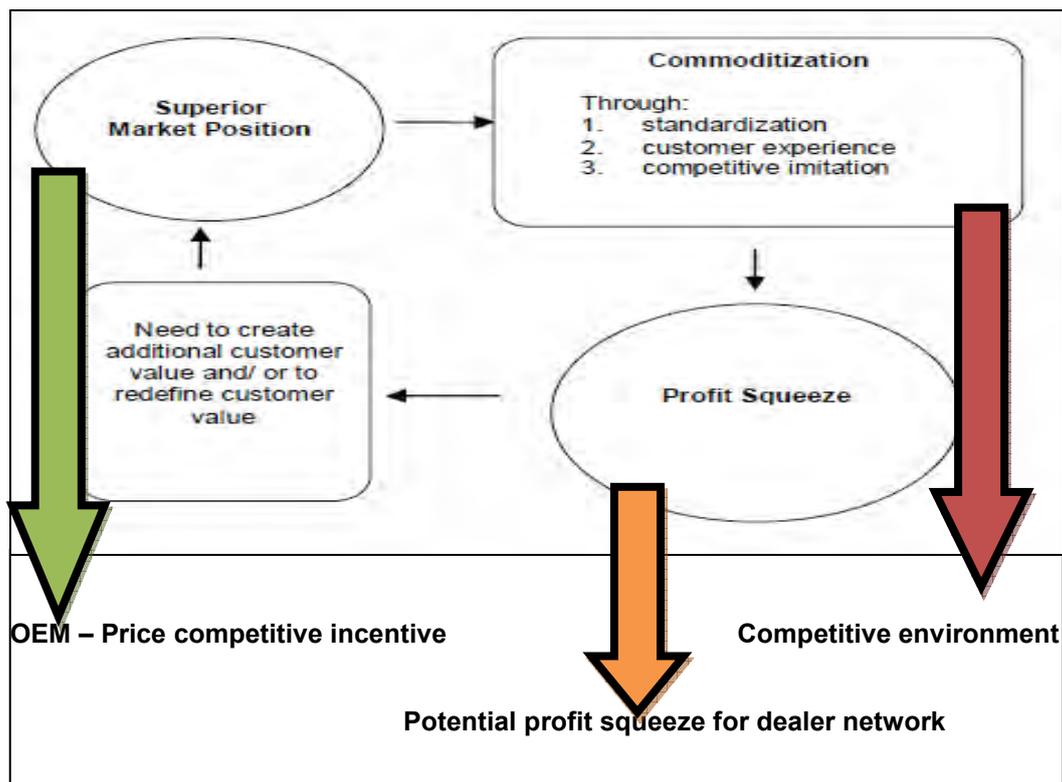
The analysis using the Spearman Rank Order Correlation (see Chapter 5) between the percentage market share and the dealership/brand incentives could not confirm that the OEMs to a great extent control the market share figures through incentives. The confidence level was 0.05. In addition, the correlations were significant at the 5% level of significance, meaning that there is 95% certainty that the relationship does exist and is not due to change.

As has already been explained, a correlation coefficient indicates both the magnitude of the linear relationship and the direction of the relationship (Zikmund, 2003). Correlations can be very useful, but have an important limitation: they can only measure the strengths of a linear relationship (Albright *et al.*, 2006). The implication hereof is that further independent research will have to be done to ensure accuracy in the results. Therefore the recommendation is that an independent investigation should look at the different operations in their individual capacity to identify the relationship between the different revenue streams that drive performance.

One must take into consideration that various factors with regard to the product lifecycle and customised value pack to the customer were not

included when analysing the data. Therefore, the central theme for an independent dealer network analysis should be different competitive strategies to ensure operational excellence and fair value for both the buyer and seller (Matthyssens & Vandenbempt, 2008).

Figure 6.11: Drivers and effects



Source: Adapted from Matthyssens and Vandenbempt (2008:317)

The results indicate that with most of the companies in the sample, the manufacturers implemented possible strategies in line with some or all of the following strategies suggested by Matthyssens and Vandenbempt (2008):

- a value-added strategy to the dealer network through incentives;
- a process innovation strategy referring to dealer incentives to decrease pricing and cost to serve;

- a market focus strategy focusing on a high value niche; and/or
- a service innovation strategy pinpointing the decrease of cost to serve.

The level of competition between the respective brands clearly indicates that the manufacturers influence the behaviour of the dealers through incentives models (Eggert *et al.*, 2006). The different incentive models depend on the product lifecycle and market demand, which implies that different brands introduce different models to the market place (Buzzavo & Pizzi, 2005). However, the incentives model used may change when new models are introduced, which may explain why Company F displayed a high market share with a low contributing incentive. The product lifecycle versus market demand at the time can also determine the incentives model available from the manufacturer (Spring & Araujo, 2009).

In conclusion, there is not enough evidence to confirm that there is a relationship between the market share and dealer incentives. However, one can say that this is one of the many control mechanisms the manufacturers implement to exercise control over their products and brand in their respective markets. Hypothesis 2's null hypothesis, H_0 ('Vehicle manufacturers in South Africa use incentive models to control their market share in the new vehicle retail market') is therefore accepted.

6.4 Hypothesis 3 – H₀: Through manufacturer incentive models as a control mechanism, manufacturers artificially report additional new vehicle retail sales

There are only a few channels that service the customer segment of the respective brands. In South Africa, the OEMs rely mostly on their respective dealer networks to ensure that they gain most of their market segment (Parment, 2008). The remaining channels are predominantly there to service government contracts. The OEMs normally facilitate these transactions directly, at cost price. Although the reporting of these vehicles forms part of the NAAMSA results according to the reported sales figures, these sales have a small effect relative to the overall reported sales figures on an annual basis.

The strategy of the respective OEMs is always to have the maximum market share and provide a large range of products to end users (Spring & Araujo, 2009). This type of strategy relies on two main factors. The first is producing and selling as many vehicles as possible. The second factor is making the correct models for the current market, with various options available to the end customer to choose from and to deliver on time (Bhoon, 2006).

With reference to the cost of manufacturing and asset management from the OEM side, it has become imperative for the manufacturer to ensure that the focus is on asset return with regard to stock return to the dealer network to ensure profitability at all times (Kabadayi & Ray, 2007). High

investment with regard to the entire supply chain can affect the competitiveness of brands.

The market fit of its products is critical for any company's long-term survival, which implies that the correct fit strategy can provide a platform for performing significantly better to improve a brand's position within the market (Hughes & Morgan, 2008). Therefore, the greater the fit between the strategic resources of organisations and their product-market strategy, the more these organisations can encourage financial success and enhance performance for the customer. This fit is vital for the respective brands to assist with their strategic orientation in defending or analysing their strategic decision-making (Hughes & Morgan, 2008).

The results in Figures 5.12 to 5.15 focus on the Hypothesis 3, which relates to the analysis of whether there is artificial reporting of new vehicle sales and a percentage difference between actual sales and the total reported sales. Hypothesis 3 was the following:

- H₀:** Through manufacturer incentive models as a control mechanism, manufacturers artificially report additional new vehicle retail sales.
- H₁:** Through manufacturer incentive models as a control mechanism, manufacturers do not artificially report additional new vehicle retail sales.

Figure 6.12: Market share vs percentage of registered demonstrator vehicles (2006)

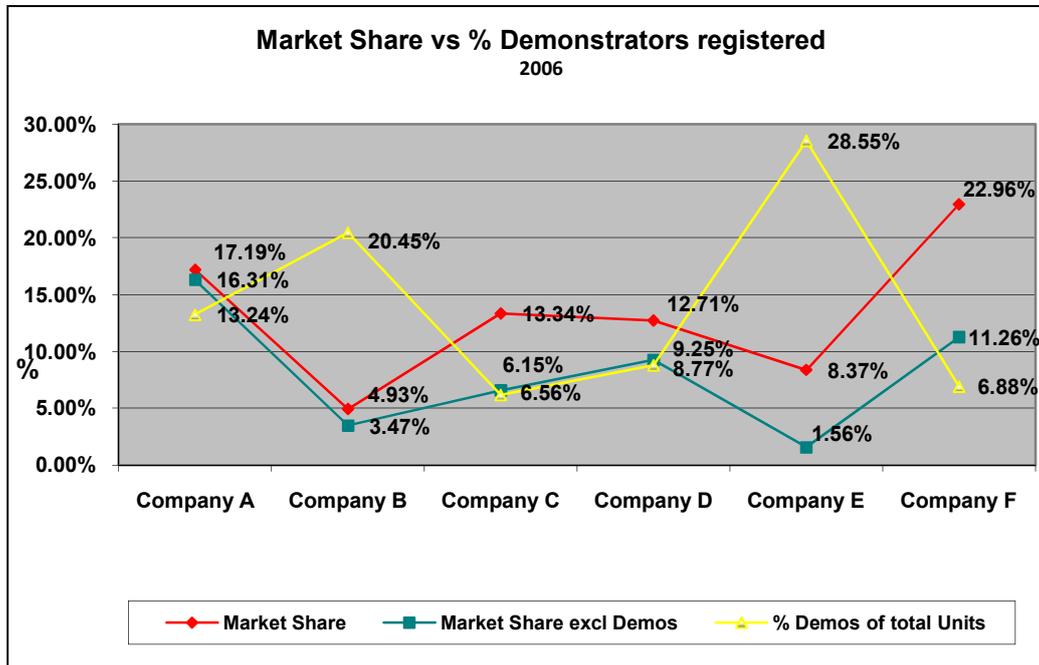


Figure 6.13: Market share vs percentage of registered demonstrator vehicles (2007)

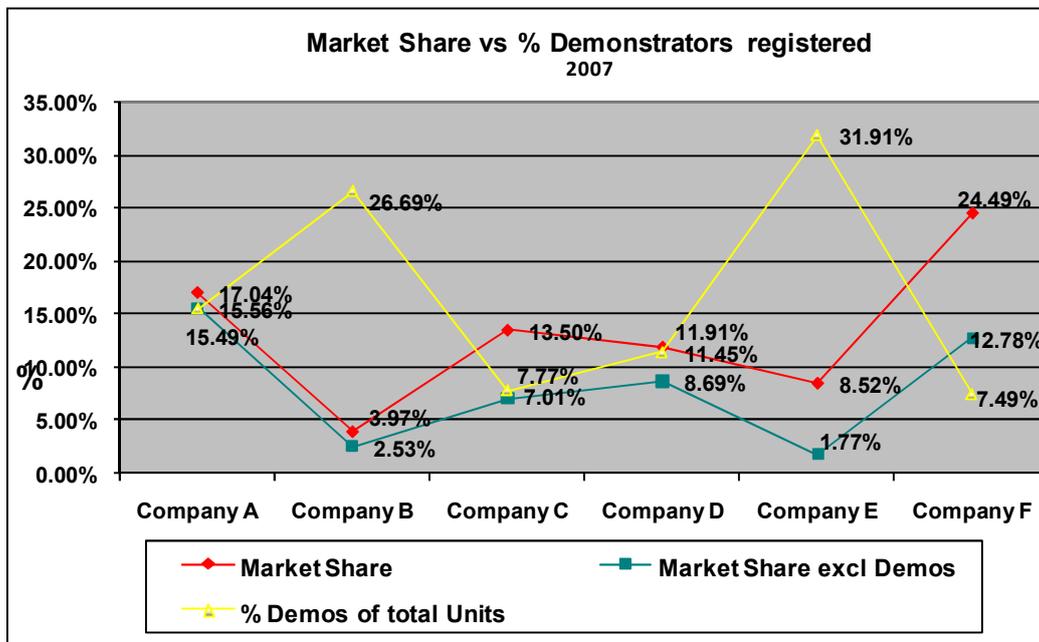


Figure 6.14: Market share vs percentage of registered demonstrator vehicles (2008)

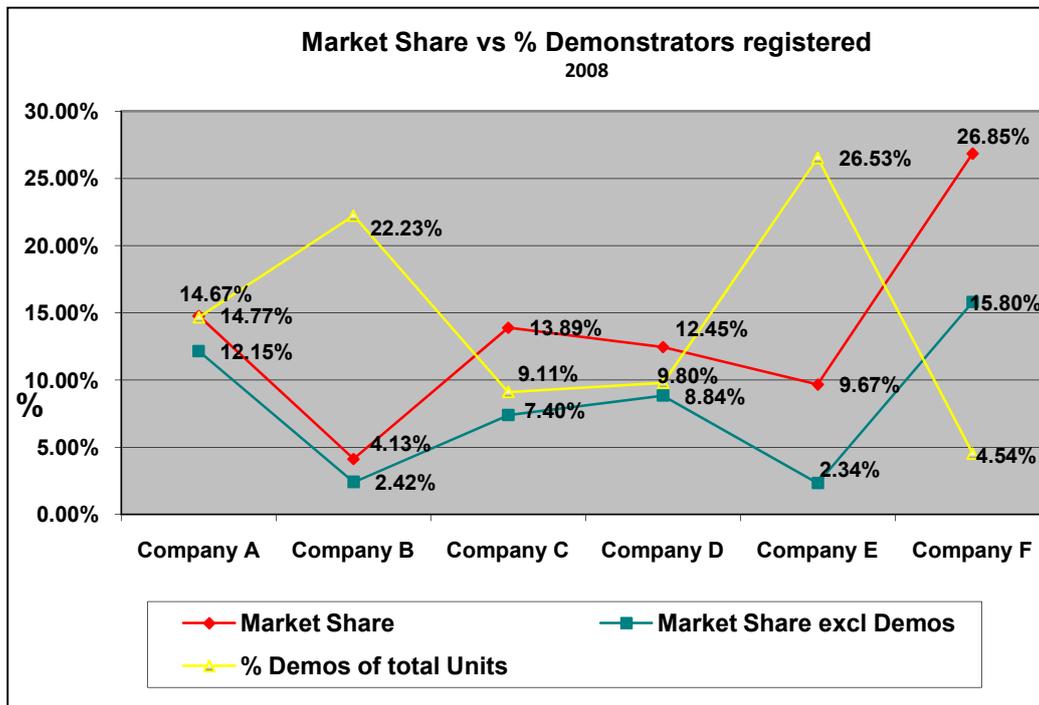
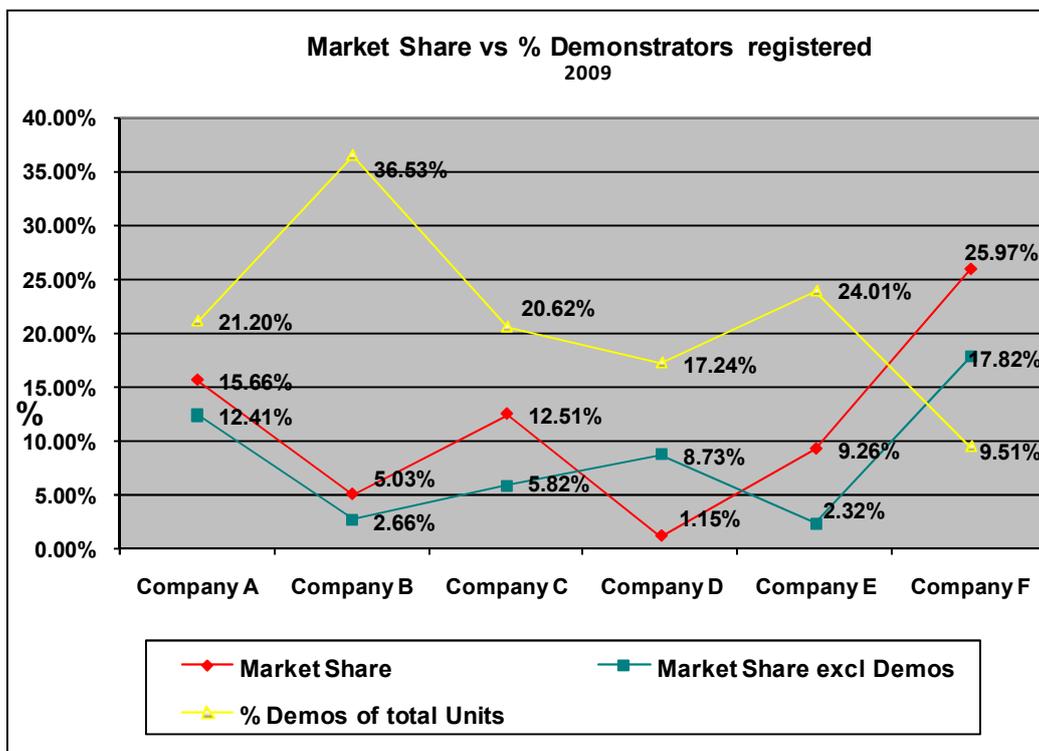


Figure 6.15: Market share vs percentage of registered demonstrator vehicles (2009)



With regard to the results that refer to market share versus demonstrators and actual sales, one needs to clarify why it is important to examine this area. All new vehicles registered in South Africa through the e-natis system are reported and seen as new vehicle sales to the end user/customer by NAAMSA and RGT, which includes demonstrator vehicles.

It is important to note that a demonstrator vehicle forms part of either the OEM's fleet or the dealer network fleet to assist with the potential sales of new vehicles to the market. A particular demonstrator vehicle is normally financed by the respective OEM for a short period, whereafter the respective dealer can either finance the vehicle through its own financial facility or absorb the vehicle into a pre-owned facility of choice to be sold as a pre-owned vehicle at a later stage to an end user or the first customer.

However, when it is registered via the licensing authorities for the first time, the demonstrator vehicle is included in the particular brand's market share as a new vehicle sold to a real-time customer. This is clearly not the case for the demonstrator vehicle, in fact, the vehicle does not really have an end user, and is only being used to facilitate future sales of models of the same brand. Because of the various incentive models from the OEMs and the targets that the dealer networks needs to achieve, retailers are often forced to register these vehicle to ensure incentive earnings

(Arrunada *et al.*, 2001). This in turn has a negative impact on the overall profitability of the individual business unit as a result of its direct impact on asset management and business cash flow (Arnold *et al.*, 2009).

Depending on product lifecycle, a dealer network will drive this type operational initiative, based on the potential incentive to be earned (Spring & Araujo, 2009). In relation to this, the OEM will increase the incentive, either to sustain its market share for the brand concerned or to get rid of an end-of-range product.

The manufacturers try to ensure retention of market share and product performance to control risk (Demeter *et al.*, 2006). Through this marketing and product strategy and the various supplier initiatives, the manufacturers controls the dealer networks (Eggert *et al.* 2006).

With regard to the results on the third hypothesis, the results show that a large number of demonstrator vehicles are indeed reported. The analysis of the results indicates that if there is an increase in demonstrator vehicle registrations, the percentage in the market share is lower. This correlation was significant at the 1% level of significance, so the assumption can be made with a 99% certainty that the relationship exists and is not due to change.

Thus, Hypothesis 3's null hypothesis, H_0 ('Through manufacturer incentive models as a control mechanism, manufacturers artificially report additional new vehicle retail sales') is accepted.

With regard to the third hypothesis and the current response in the South African automotive market in respect of relative weakness in new vehicles sales, the results show that, if new vehicle sales keep on declining, the dealer networks will be exposed to an increase in used vehicles, which in turn will definitely be more profitable, as well as more flexible, due to the independent control of the dealer network. The gross profit per pre-owned vehicle sold will be something that the dealer can control, and will therefore not be affected by any manufacturer control or incentive.

If the focus of the dealer networks shifts to pre-owned markets, the problem that the OEMs face is that there will be a further artificial figure with regard to new vehicle reporting, because the dealer network will have to rely on the respective brand image to maintain dealers' exposure to buyer power, as well as the menu of margin offered by the OEMs, for this will ensure the flow of future pre-owned vehicles with regard to the use of incentive models available for trading between the new and the used vehicle segment (Arrunada *et al.*, 2001). The assumption could be made the dealer network will use the new car leverage to build an independent pre-owned vehicle business.

6.6 Conclusion

The research problem has been addressed, and the data was sufficient to do exploratory research and establish certain trends within the automotive retail sector in South Africa.

It is recommended that, in future studies, dealerships within the automotive retail sector in South Africa be researched on an individual basis to increase the sample size, which will in turn assist with the confidence levels of the research. In closing, with a bigger sample with regard to the data and information on independent performance throughout the industry, a superior analysis can be done which will assist with future strategic planning in this complex and integrated industry.

CHAPTER 7

CONCLUSION

7.1 Introduction

The study investigated the role of manufacturer incentives as a control mechanism within the environment of automotive retail in South Africa. The six most prominent OEMs in South Africa and their dealer networks were reviewed. The focus was to determine the impact of the incentive models offered by the OEMs on the sales performance of the dealerships regarding new vehicles. The rationale for the study was assisting the respective dealer networks with data relevant to their strategic planning relating to the viability of the individual enterprise and the independence and long-term sustainability of the franchise. In this chapter, recommendations with regard to future strategic decisions are made.

7.2 Market share and OEM control

There is evidence that the South African automotive dealer network is becoming increasingly (and excessively) dependent on manufacturers' incentive models to ensure profitability. Indeed, two out the six brands that were represented in the research are not profitable if one excludes the incentives earned.

With regard to market share control and retail sales on new vehicles, and based on most current manufacturer incentive structures, the only option in future will be to focus on volume. The question remains whether this is

creating conditions conducive to fair trade, or whether this is creating a long-term constraint. If one argues that it is creating conditions conducive to fair trade, then one could probably also argue that this is counter-competitive and could be construed as collusion, especially if the incentives models are all the same per unit.

However, on the basis of the findings reported in this study, one can argue that the trend analysis shows this strategy will create long-term constraints, because the independent dealers will apply individual short-term strategic decisions to earn incentives, creating a lot of unintended consequences with regard to their long-term sustainability and profitability. Thus, if a dealership is focused on volume, and is waiting for payoff in the form of incentives, the mechanism would create pre-invoicing, the use of more demonstrator vehicles and a tendency to start selling almost new vehicles as pre-owned vehicles. Should this transpire, it would have a severe impact on the pre-owned market in respect of profitability and market demand.

In terms of longevity and sustainability, it is clear that short-sighted OEM incentive structures can potentially drive down the profitability of the respective dealer networks, especially in South Africa, where vehicle sales are used as a barometer to gauge consumer confidence. Understanding that the business models of the different franchises need to be adapted continuously to meet the changing financial models of the banks or monetary policies could provide a competitive edge in the future .

Further research in the form of analyses of independent dealerships will be helpful in determining whether or not there is a direct relationship between the actual market share and incentive models (Eggert *et al.*, 2006). In such research, reference could be made to the number of demonstrators registered per single dealership compared to the actual sales reported. In addition, a qualitative study might be able to determine whether the rationale behind the behaviour of management in the particular business supports the financial decisions of the business. If that is indeed the case, the individual business unit (the franchisee for a particular brand) may not be aligned with the overall strategy of the OEM.

An additional finding from the literature review with regard to the current economic downturn and the impact of the National Credit Act on new vehicle sales was that most of the six brands under review protected their market share in terms of overall market share versus the respective brand's market share in the automotive retail sector in South Africa (Arrunada *et al.*, 2001).

There is definitely a clear trend with regard to increasing manufacturer control in respect of the percentage incentive contribution compared to other gross profit of the different brands (Black & Mitchell, 2002), based on the 'car wars' to ensure market retention and gain buyer power, making the brands more competitive. There needs to be continuous focus to improve the profitability and ensure long-term independence of the

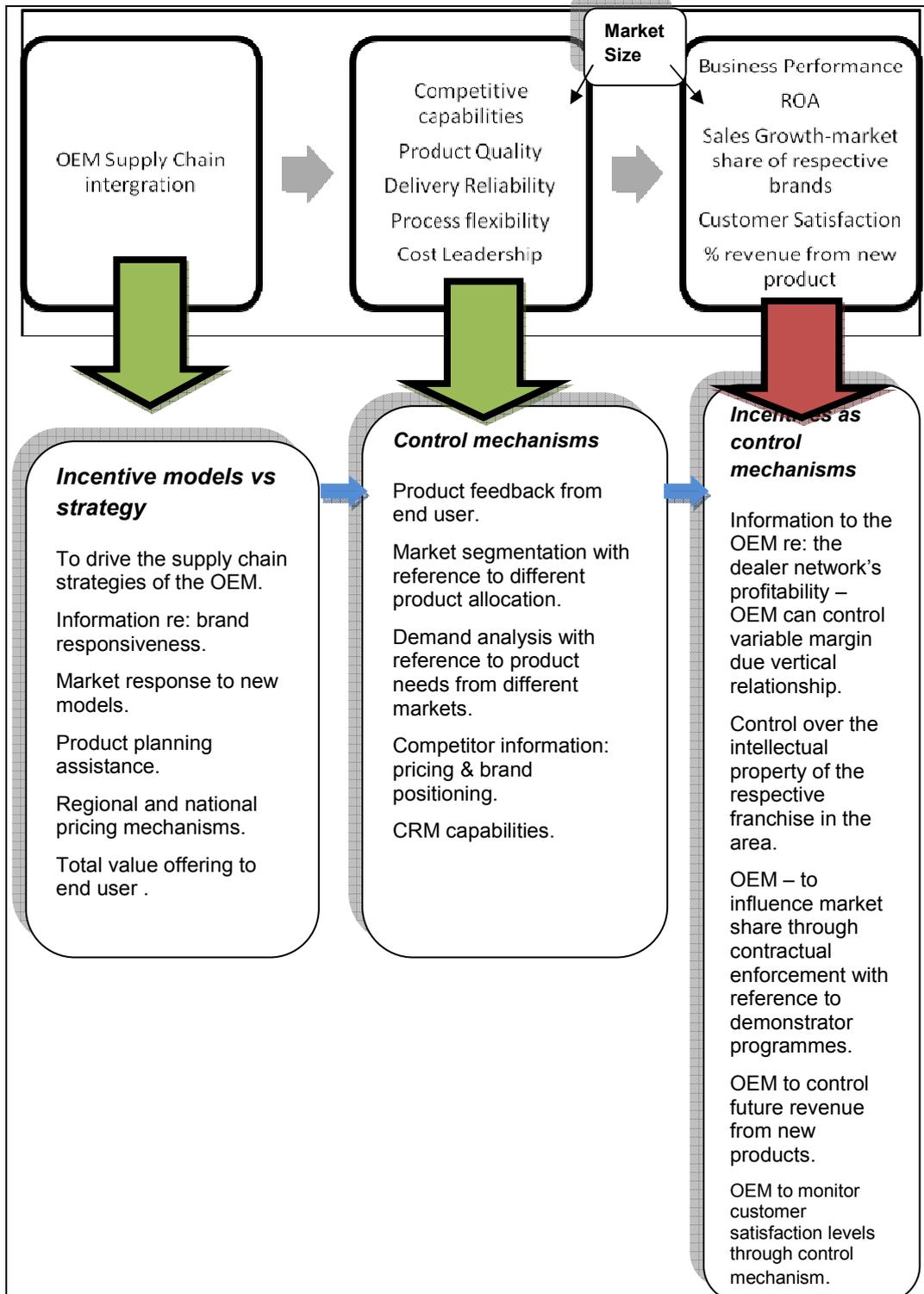
individual dealers, and the dealer network strategy should be aligned with the OEM's strategy for particular regional markets (Spring & Araujo, 2009).

7.3 Integration strategy compared to competitive capabilities and business performance

The franchise dealer model is an integrated model, with multiple revenue streams and potential profit streams. Dealers focus on selling new vehicles, selling pre-owned vehicles, and earning additional profits on finance and insurance agreements. In addition, they have to provide a range of OEM products that relate to performance in the after-sales and customer service and parts business.

The integration in the sector is illustrated in Figure 7.1, in which additional strategic models and process decisions are integrated in the original model by Rosenzweig *et al.* (2003) with regard to various control mechanisms controlled through incentives.

Figure 7.1: Model integration on competitive capabilities and business performance



Source: Adapted from Rosenzweig *et al.* (2003:439)

The above model, which has been adapted to assist the dealer network with its future strategic planning, shows that the strategy should include developing objectives and making decisions that can assist with creating future independence and sustainability.

7.4 OEM and dealer network alignment

The alignment of the individual dealer's operational strategy with the OEM's strategy should be one of most important considerations in all the dealer networks in the automotive retail sector in South Africa. This means that dealers need to ensure a full understanding of the objectives the OEMs want to achieve. A clear understanding of the particular incentive models and their purpose must be obtained and included in the medium- and long-term financial planning of businesses. No incentives earned should be included in the operational earnings of the business. Additional OEM incentive models must be reported separately from the operational margin. This will help create a form of independence with regard to the vertical relationship put in place by the OEM-dealer agreement.

The focus should be on building a dealer brand within the respective OEM brand through customer service and excellence programmes. If this can be achieved over the medium or long term, then the individual business enterprises will be able to create a form of financial security and independence.

To guard against the threat of full control being seized by the OEMs through incentive models, the dealer networks should independently focus

on their internal resources and strengths, which should form the cornerstones of their internal strategies. The OEMs' strategies (incentive sales models) will always make a demand on the weaker areas.

In the light of the findings of the research project, it seems that when vehicle sales are declining, the focus should be diverted to other stronger revenue streams within each particular dealer network to assist with building an internal support structure to enhance sales. This, in turn, will put the particular dealer networks in a stronger position to negotiate better incentive structures aligned with achievable sales volumes. As discussed in Chapters 5 and 6, the number of demonstrator vehicles registered in comparison to real end vehicle sales should be negotiated with the OEMs to ensure that future registrations and demonstrator vehicles are solely supplied by and absorbed into the OEM's costs.

7.5 Strategic supply chain management

There is a collection of activities that support the end product or service. All these activities, which both the OEMs and dealers perform, assist with the creation of the value chain. It is the intention of both the OEM and the dealer to ensure that total value is created for the buyer. The dealer network should bear in mind that its value chain also allows for an independent profit to the respective business and that therefore the dealers must be in a position to identify the two categories of activity that construct the value chain, namely primary activities (providing value to the particular business customer through service delivery and commitment)

and support activities (these facilitate primary brand activities, creating value not only for the business, but also for the respective OEM).

Supply chain management is a very important activity for any OEM , but it is usually not that important for the dealer network. This implies that a dealer network should differentiate between its primary and support activities and should focus only on those activities that form important components of the business cost structure (see Table 7.1).

Table 7.1: Primary and support activities

PRIMARY ACTIVITIES	SUPPORT ACTIVITIES
(related more to OEM, but integration with the dealer network is possible)	both OEM and dealer network
Supply chain management – OEM components, parts and manufacturer relationships	R&D – new technology – OEM Equipment design – OEM
Operations – assistance associated with converting inputs into a final products	Human resources development – responsibility of both the OEM and dealer network
Distribution – distributing the product to retailers for introduction to buyers	General administration – OEM and dealer network
Sales and marketing – generic advertising and brand awareness to public buyers	Data base capabilities – OEM and dealer network
Service – technical assistance to dealer network through training programmes and support with regard to buyer complaints	Strategic alliances and collaborating with strategic partners – OEM and dealer network.

Source: Adapted from Porter (1980)

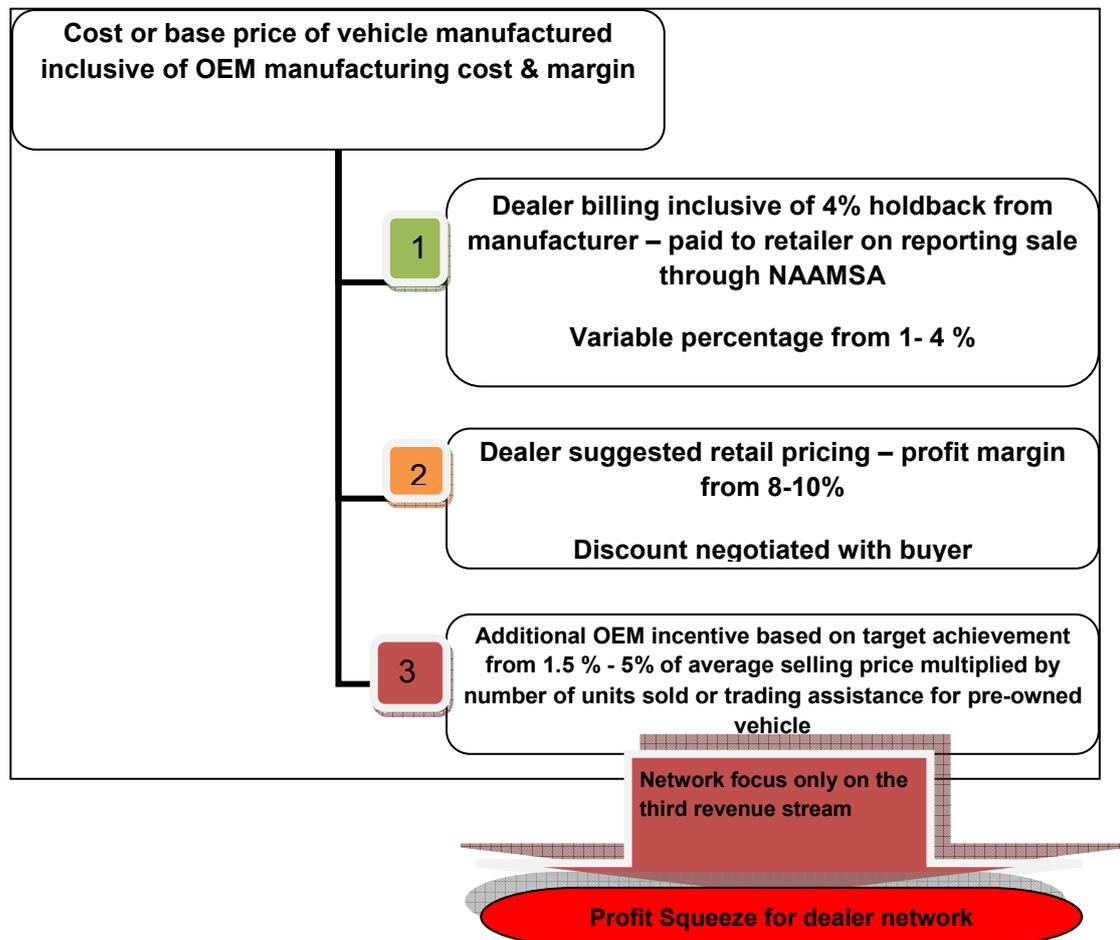
The combined cost of all the above-mentioned activities in the value chain will assist in defining the cost structure. The purpose of the analysis would

be to identify the internal activities that can be a cost advantage or disadvantage. Once a company's cost position is known, a benchmark can be set in the particular dealer network to assist with future profitability strategy and with absorbing manufacturer incentives in the operational cost.

7.6 Strategic decision-making regarding sales incentives from the manufacturer

Strategic decisions have to be made regarding sales incentives from manufacturers (see Figure 7.2).

Figure 7.2: Strategic decision-making:



The concern that arises from the research findings is that, although the different dealer networks in the South African automotive sector do have control over a certain percentage of the variable margin with regard to the first and second margin available in the sale of a new vehicle, due to market competition and manufacturer involvement, the different dealer networks tend to rely solely on the third margin contributor to ensure overall profitability. They tend to lose sight of the fact that this is purely a mechanism to enhance OEM sales and market share retention from the OEM's side.

Therefore, it is recommended that dealer networks should exclude the entire OEM incentive from their planning and should instead use their internal resources and appropriate marketing tactics to capture the respective market share required in terms of the OEM-dealer agreement.

Porter's (1980) five forces model should be applied to analyse the dealers' areas of responsibility and to independently build a marketing and sales strategy which relies on differentiating the individual business enterprise from the rest of the competitors. Thus, dealers should look at the following steps to identify strength and weaknesses within the business in order to take functional decisive action:

- identify the landscape of your market;
- familiarise your sales environment with the needs of the landscape;
- adapt your marketing and sales strategy around the needs of your customers;

- exclude additional incentive earning based on future performance from the financial planning;
- create a superior ability in the business to serve your market niche or buyers;
- be in a position to respond and react to changing conditions within an emerging economy like that in South Africa;
- be proactive with OEM alignment;
- create strategic alliances and partnerships with other dealer networks within the area of responsibility;
- align internal resources with external market trends; and
- benchmark your margins against the market share of the competitors.

7.7 Concluding remarks

Having an independent strategy means that there is a pattern of decisions that are connected. Alignment of these decisions with internal and external resources will reveal the goals and objectives of the dealer network, as well as those of the OEM or brand represented.

Dealers should focus on creating future readiness with regard to the current economic crisis – this means that they should create predictive awareness and develop the capacity to see what may happen next. They can prepare themselves better by monitoring trends within the industry. They should take to heart the motto ‘exploit the trend and not the fad’, and should ensure that their strategy rests on the latest trend. A trend is

something that persists over time, whereas a fad tends not to last. Allocating resources to following a trend will ensure future profitability.

For future research, it is recommended that the strategic approach of the different OEMs in South Africa be investigated. Such future research would support the retail environment, enabling retailers to secure a more favourable vertical relationship than the franchisee-franchisor agreements that are currently in place. This, in turn, if it is successful, will change the game plan from OEM control to retail control. Thereby the dealer networks in the South African automotive industry can place themselves in a position to negotiate margins and control their market share.

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