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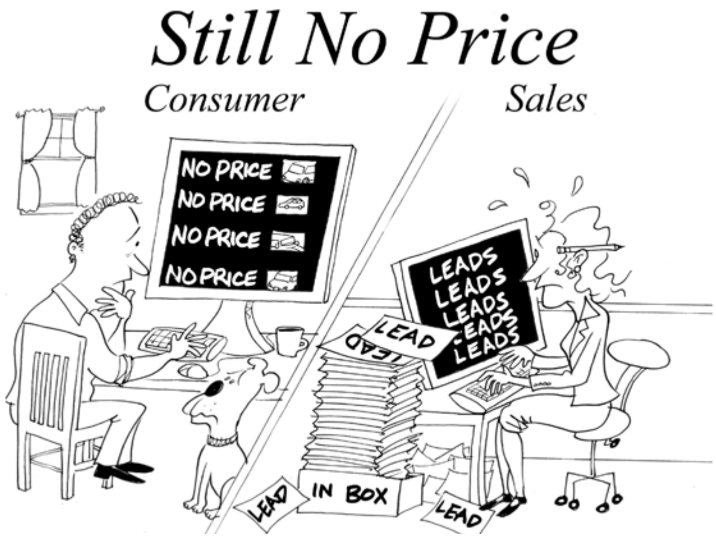
Whitepaper 01

Lead Generation Is Broken for Dealers and Customers

Dealers Should Pay for Sales, Not Leads



Executive Summary

The automobile has arguably done as much to change modern life as any invention in human history. And while the car has only been with us for little more than a century, it has profoundly affected the way we live, and it has fueled one of the largest industries the world has ever seen – with more than 16 million[1] new vehicles sold in 2007 in the United States alone. Yet in a century that saw remarkable changes in the car itself, there has been relatively little change in the way that cars are sold.

The Internet was expected to dramatically change car buying – by offering consumers better information, which the Web has done excellently, and the opportunity to be in control of the process, and by extension giving dealers a more effective, targeted channel for finding buyers. But what's emerged instead is quite different. It's a deficient system based on selling to dealers the names of consumers researching car purchases online. This system, known as "lead generation," revolves around simply monetizing a consumer's desire to get a price quote on a particular car, and a dealer's desire to know who's looking.

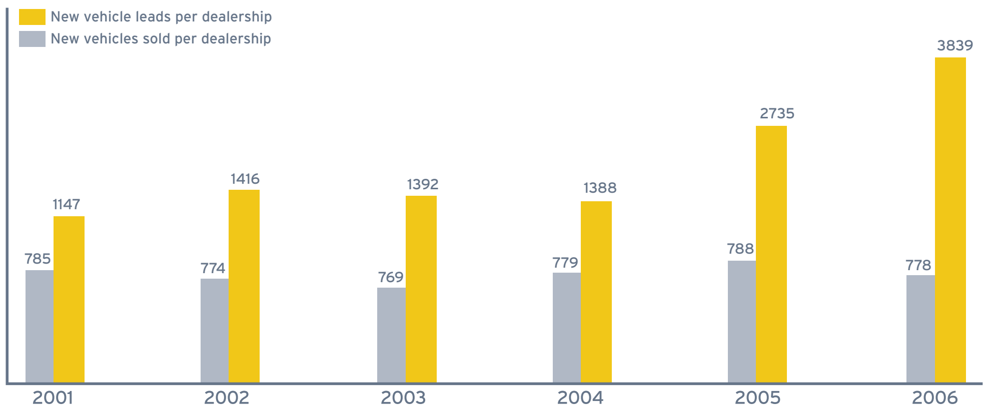
Consumers now have access to robust, anonymous, almost perfect product information online. But, in most cases, to get a price quote – or, more accurately, the promise of a price quote – they're forced to submit their contact information to lead generation websites, which turn around and sell it to multiple dealers. And in some cases, they're also selling consumer information to other websites that then sell it to dealers themselves or to other businesses related to the auto industry – with the end result that consumer trust around submitting a name to a website is further eroded upon receipt of solicitations from a wide spectrum of lead purchasers. So, in the end, consumers must relinquish control over the transaction to a traditional salesperson.

Lead generation is flawed for dealers, as well. Dealers understandably like to spend their marketing dollars on leads that are addressable – that is, leads that come with the prospective customer's name, phone and email – versus traditional, less trackable forms of advertising. So it's natural that they would buy these online leads. In fact, many believe that lead generation has replaced the walk-in. Consequently, dealers theoretically have an insatiable demand for more leads, to the extent that with leads comes the ability to sell more cars. But, addressable as they are, those leads still aren't helping dealers reduce marketing expenses on a per-car-sold basis. In fact, lead generation in this form is economically broken for dealers. And a key reason is a direct result of the sheer popularity of the Internet: given that nearly all car shoppers are using the Web to gain access to product information, the mere fact that someone asks for a price is no longer a leading indicator of who's actually in the market to purchase a car soon.

The problem is that the Internet as it relates to automotive is currently focused on delivering leads, not sales – resulting in a model that fails to facilitate the sales process for dealers or to enhance the customer experience. The solution is a performance-based model wherein dealers pay for sales, not leads, in such a way that aligns incentives and works for both the consumer and dealer.

1. National Automobile Dealers Association Industry Analysis Division, NADA Data, *"Economic Impact of America's New-Car and New-Truck Dealers"*, www.nada.org, 2008.

Lead Sales vs. Car Sales[2]



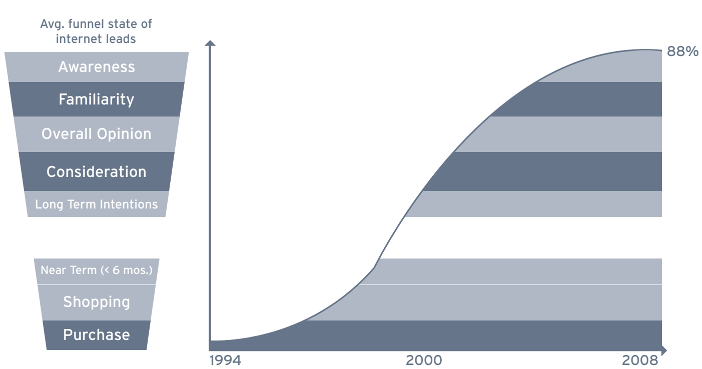
While automotive lead sales have grown significantly since 2001, new car sales have remained flat and even begun to decline in recent years

The Business of Lead Generation Is Fundamentally Bankrupt

Over the past decade there's been a fundamental sea change in how people shop for cars, because of the evolution of the product itself and the Internet's ability to provide anonymous access to robust product information. Customers, as a general rule, simply do not walk into the local dealership asking for a brochure anymore. The "walk-in" was the entire foundation upon which the franchise system was premised – dealers pay for geographic exclusivity under the assumption that they'll gain a built-in customer base of everyone in that area. But things are changing.

According to the 2007 Dealer eBusiness Performance Study, 83 percent of consumers use the Web for research before visiting a dealership[4]. In fact, there's reason to expect that number will be close to full penetration in the near future, given that the anonymous access to product information is so compelling for buyers looking for new cars.

Auto-Buying Conceptual Graph[3]



Since 1997 there has been a rapid increase in the percentage of auto buyers using the Internet. By the nature of product adoption, the early visitors were further down the automotive purchase funnel. Today's Internet users are satisfying their pricing curiosity, no longer making the Internet a good indicator of who is ready to buy.

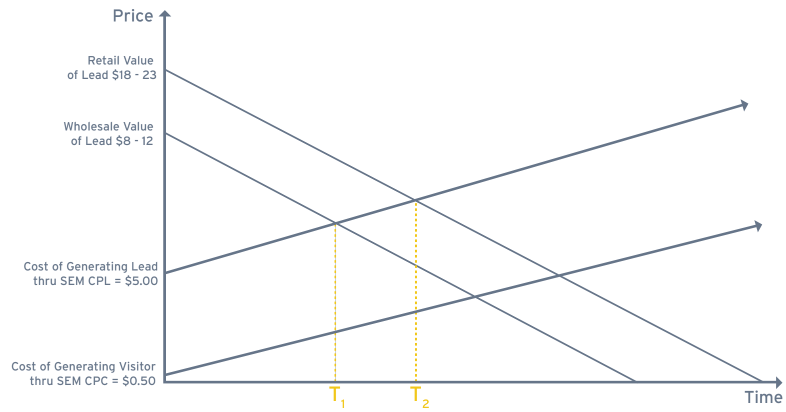
To complete their research and get a price quote from a dealer, shoppers are asked to offer up a name and contact information. This exchange reveals just how badly consumers want to know price – to the point that they'll surrender their online anonymity to get it, and they'll seek out what they dread: an introduction to a salesperson. As with any commodity, searching for a new car without being told the price is akin to going to Amazon.com and being referred to a local bookstore. Without a price attached to the shopping experience, the system sets up a natural need for the consumer to be connected to a dealer – giving leverage to the lead generators that are paid to make that connection.

This is the first place the lead generation system breaks down since a request for a price quote doesn't necessarily translate into sincere interest on the part of the buyer to buy a car[5]. **Because the Internet makes car research so easy that anyone can do it at any time, the Internet is no longer a good indicator of who's ready to buy.**

At last count, there were more than 50 companies in the business of automotive lead generation. They buy the clicks and sell them to aggregators, such as Dealix, Autobytel.com, and AutoUSA.com. The aggregators then sell those leads to any one or a number of the 39,708 new car franchised dealers in the United States[6]. Dealers currently spend $18-23 per lead[7], and online leads convert to sales roughly 2-5 percent of the time[8]. The graph on the following page puts these numbers into perspective:

2. NADA, "Web-Site-Generated, Unsolicited Prospects According to U.S. Automobile Dealers, 2001-2006", *2006 Dealership Internet Survey*, as cited by eMarketer, "Automotive Marketing Online: Negotiating the Curves," June 2008. National Automobile Dealers Association Industry Analysis Division, NADA Data, "Dealership Financial Trends,"NADA's *AutoExec,* May 2008.
3. 2008 Zag Curve Estimate
4. The Cobalt Group, in partnership with Yahoo! and R.L. Polk & Co, *Dealer eBusiness Performance Study: The New Buying Influences,* 2007.
5. "83 percent of visitors to third party automotive shopping sites do not intend to purchase a vehicle within the next three months." J.D. Power and Associates, *Online Cross-Shopping Study*, 2006.
6. Automotive News
7-8. Zag Data

Lead Pricing Trends



In this conceptual graph, we see the general trends of downward pressure on both wholesale lead costs and retail lead costs, and the upward pressure on click costs and the corresponding costs of generating leads by wholesalers. At T_1 it is no longer profitable for the wholesalers to generate and sell leads, at T_2, it is no longer profitable for the lead retailers to sell leads. These market pressures have led to a downward spiral of lead quality.

If the lead generators pay a cost-per-click of 50 cents each, as noted in the graph, and if they're able to convert 10 percent of those clicks into leads that they can sell to the aggregators, then their cost per lead is $5. They're able to sell those leads to the aggregators for $8-12[9], which the aggregators turn around and sell to dealers for $18-23. Over the last several years, the cost-per-click and the cost-per-lead have been rising, while the price at which they can sell those leads has been falling. This white paper will examine in detail why those values are slipping.

In the graph, Time 1 (T_1) represents the point at which the lead generator's customer acquisition costs meet its sale price – it can no longer make any money on the leads. The lead costs more than it's worth. Time 2 (T_2) is the point at which cost-per-click meets the retail value of the lead. This represents the end of lead generation – no business can survive if the cost of its product (the lead) exceeds the value of what that product is worth in the marketplace.

To put that in context: last year 16 million new cars were sold nationwide. After eliminating the fleets from the equation, it's roughly 12-13 million new cars for the year, or about 1.1 million per month. Considering just one of the major infomediaries selling leads processes 12 million price reports per month[10], it's clear the lead generation business is predicated on driving the highest quantity of leads into dealerships without regard for whether or not those leads become sales. Given the great disparity that exists between the number of leads requested and the number of cars purchased, that value proposition to dealers is nearly at a breaking point.

Lead generators have a natural bias toward quantity, because it's the surest way to drive their own revenue growth. They use basic website economics to increase quantity: remove "friction" to obtain higher adoption rates. Friction on a website is anything that distracts the visitor from taking a desired action. In the case of automotive websites, friction would be the in-depth product information – because the more a website tells a customer about the product, the more likely the consumer will feel he doesn't want it.

Some sites have become so optimized around the goal of removing friction that they ask the consumer to submit a name for a price quote right on the landing page. While this results in high click-to-conversion rates and more leads, it also results in low close rates for dealers trying to turn those leads into sales. Because those consumers are the least committed – they haven't demonstrated interest by spending time on the site, for example – they represent the least qualified leads. They have simply chosen to surrender their anonymity in exchange for a price. What dealers and consumers truly need is *quality* – a connection between a ready buyer and a qualified dealer.

The lead generator's incentives are not aligned with those of either the dealers or the buyers.

Increasing the Chaff, Not the Wheat: What This Means for Lead Generation

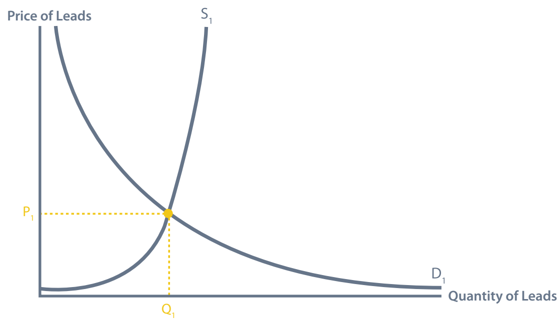
Lead generation, in its current state, diminishes the customer's experience because the entire model is structured around selling more leads, rather than improving the customer experience and facilitating a sale for the dealer. It's increasing the chaff, not the wheat – when the Internet's very promise was to do the opposite.

As lead generators' costs go up, they protect their own profits using three primary strategies: selling the same leads to multiple dealers, finding consumers higher up in the sales

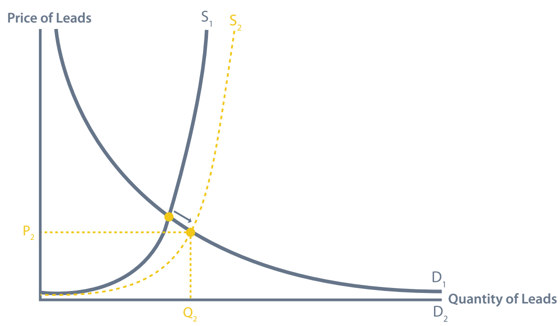
9. Zag Data

10. Kelley Blue Book; www.kbb.com.

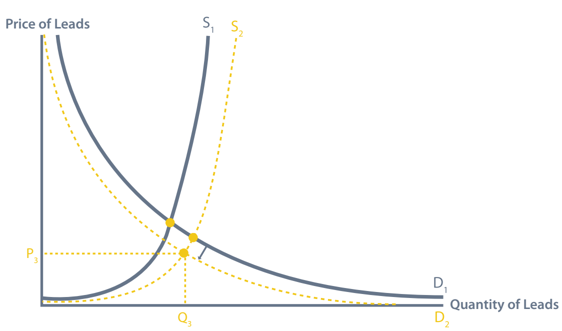
Increasing the Chaff. As lead generators determine ways to increase their yield of leads from their site visitors and the revenue from those leads, they decrease the quality of those leads and ultimately reduce dealer demand for those leads.



An approximated supply and demand curve for automotive leads. Such a market quickly reaches equilibrium at a price of P_1 and quantity of Q_1.



In order for lead generators to increase their revenues, they find ways to extract additional yield from their sites and revenue from their leads by activities like selling leads multiple times, or reducing site friction so that users are filling out lead forms from the outset of the site experience. This shifts the supply curve, causing a slight decrease in lead price (P_2) that is more than offset by a significant increase in quantity (Q_2).



Over time, dealers realize that the quality of leads they are receiving has decreased. As a result, dealers shift their demand curve, reducing prices(P_3) and quantity(Q_3). This cycle will continue until leads are a fraction of their original value.

process, or doing anything possible to improve website conversion by removing friction on the sites.

These tactics devalue the leads, because each dealer has to compete harder just to make a sale – and ends up buying more leads that don't convert. Dealers pay an average of $600 in advertising costs per car sold[11]. As dealers' close rates go down and as they put more manpower on following up those Internet leads, they're willing to pay less and less for the leads themselves – creating downward pressure on the entire system.

The industry is already seeing a softening of the cost-per-click prices for some automotive keywords. But unless the lead generation websites can maintain their conversion rates, their cost-per-lead won't necessarily follow the click prices down.

The lead generator has been forced into a financial Catch-22: it must sell more leads to more dealers to make money – but that's also what's devaluing the leads and driving down prices (and profits). The dubious business practice of shotgunning leads has resulted in conversion and close rates that no longer work for dealers.

While the numbers behind lead generation point to some very real inadequacies in the business model, it's the sub-standard *experience* that the system inevitably creates for both buyer and seller that is its ultimate failure. The next sections will examine how online lead generation affects both sides of the transaction.

Lead Generation Almost Never Results in a Better Customer Experience

A lead generator's incentive is, naturally, to generate more leads – which is not in-line with an online shopper's goal to remain anonymous, conduct research and get a price. This misalignment of incentives often frustrates potential buyers.

As outlined above, these sites are removing friction to create better conversion and sell more leads. In order to be successful, these companies are not optimizing their sites to be consumer-friendly – they must optimize their sites to obtain a consumer's email address or other contact information as soon as possible, often on the home page or within one click. Such sites remove friction between the consumer and their request for a price quote. The friction they're removing is the *qualifying shopping process* that would otherwise be a filter for identifying who is likely to buy and

11. National Automobile Dealers Association Industry Analysis Division, NADA Data, "Advertising and the Dealership," NADA's *AutoExec*, May 2008.

when. In fact, the reason lead generation is so prolific online is that as a business model it's very efficient and the "easy" standard, since most portals and search engines are driven by the bottom line, not the value proposition or user experience.

The bargain that consumers are making when they sign up for lead generation is that they will surrender their anonymity in exchange for a price quote. But there's no contract between the seller of a lead (lead generator) and the buyer of that lead (the dealer) that forces the fulfillment of the consumer's expectation. Most dealers are reluctant to give a price in that return phone call or email, because it's intuitively a weak negotiating position to surrender price before getting the buyer into the dealership. In fact, that's how they're trained to technology to empower and inform them.

The No. 1 frustration people generally have when shopping at the dealership is the pressure they feel from the salesperson. Lead generation magnifies that problem in every case because the very thing that customers are looking to avoid, or to at least gain an advantage over – the salesperson – not only still has the advantage, but now has their personal contact information and can pursue them at home. The very thing they're fearful of or frustrated by has now been invited to chase them in larger numbers.

The faulty logic here is the assumption that a request for a price quote means the consumer is a serious buyer. In fact,

The assumption with lead-gen is that a request for a price quote means the customer is a serious buyer. In fact, the numbers say differently.

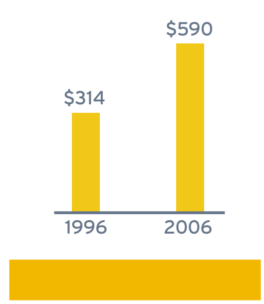
respond – conventional wisdom says "get the customer in the store." As a result, only 38 percent of dealers say they provide a price quote in the first email response[12]. The motivations of the dealer are so clearly focused on getting customers into the showrooms that dealers will only surrender price when truly forced to do so by the customer. This tug of war adds to consumer distrust of dealers.

Consumers ultimately just want access to a real price quote in that moment. They want it so badly they're willing to share their email address or phone number to get it. They think they're getting a quote, but they're actually being sold to the highest bidders. This is not in the best interest of the consumer – the "highest bidder" doesn't necessarily have the best price or offer the best experience. So, the system itself fails to reinforce the best outcome for the consumer. What's more, the consumer's contact information is often sold to between three to seven separate competing car dealers. The consumer, who probably went online to avoid the salesperson at this stage of the game, has just invited multiple dealers into his or her *home*.

The Internet, which was supposed to help shift the information balance of power from dealers to buyers, has, in fact, facilitated the loss of consumer anonymity – the very dynamic that once made it such a powerful tool. This process is in direct conflict with the psychology of people relying on as mentioned earlier, the numbers say differently: there is a massive disparity between the number of consumers requesting price quotes and those who are actually in the market to buy in the next 30-60 days.

The problem with giving a dealer a consumer's name before providing the would-be car buyer with a price quote is that the buyer then becomes the target of the dealer's sales efforts, instead of being in control of the transaction or the discussion. But giving consumers the price *first* – while they're still online and able to maintain anonymity – helps bridge that gap of trust by providing the shopper with an upfront price and, if it's not good enough, the ability to walk away. (See Zag's white paper, "The Case for Upfront Pricing" for an examination of upfront pricing and the psychology of the Internet shopper.)

Increase in advertising expenses per car sold (1996 vs. 2006)[13]



12. J.D. Power and Associates, *2007 Dealer Satisfaction with Online Buying Services Study.*

13. National Automobile Dealers Association and AutoExec, *Automotive eCommerce: Best Practices, Technologies and Strategies to Master Online Success.*

For Dealers, Lead Generation Creates More Work for Less Return Over Time

For dealers, one of the promises of the Internet was precision targeting – a way to capture the attention of serious buyers who are searching for the specific cars a dealer has on the lot. But as our examination of the current state of lead generation suggests, a request for a price quote is not an accurate predictor that someone is in-market and ready to buy.

Dealers know that consumers are online, and they know that's where they need to be, as well. NADA reports that 96 percent of franchised U.S. dealerships had websites in 2007[14]. According to a study conducted in February 2008 by The Kelsey Group, auto dealers are shifting more of their media mix online – with 62 percent planning to increase online media spending throughout 2008, and 46 percent saying they will decrease spending on traditional media[15]. But dealers' advertising expenses per new car sold have actually moved upward since the Internet has taken over as a primary marketing channel – going from $314 in 1996 to $590 in 2006[16].

It's true that dealers will continue to buy Internet leads – they know that the more leads they buy, the more cars they'll sell (and the more chance they'll have of keeping those buyers from their competition). In most cases, however, they're paying good money for low-quality leads – leads that someone at the dealership will spend valuable time tracking down. To their own disadvantage, dealers have not been diligent about holding lead generators and aggregators accountable to a high-quality lead standard. Add to this the fact that most dealerships aren't sufficiently staffed to handle the large influx of Internet leads they receive at such low close rates, and what's left is a business model that is a losing proposition for dealers. As lead quality diminishes, what dealers are willing to pay for those leads will decrease accordingly.

In one sense, the shift from traditional marketing and advertising to the Internet has been a burden for many dealers. Dealers are generally reluctant to reduce, offset or eliminate other traditional marketing expenses. Consequently, the Internet and buying leads truly becomes an incremental cost. What's more, it has created additional cost centers and function at the dealership, without yet delivering on its promise of efficiently identifying in-market customers. Lead generation is a failing business model because it doesn't set the customer up to be a likely buyer, and therefore its own value as a source of leads will continue to erode over time. But, clearly, the genie is out of the bottle. Given that this modality – the Internet – is here to stay, the challenge is now to efficiently identify who is in-market and use that information to reduce costs. (For a more detailed discussion of how to identify in-market customers online, see Zag's white paper, "Long Live New-Car Profitability.")

This Faulty Approach Negatively Affects the Consumer/Dealer Relationship

The relationship between consumer and salesperson at the dealership is arguably one of the most contentious in all retail transactions. For all the strides the industry has made – empowering consumers with product information online, for example – the shortcomings of the lead generation business model keep both parties at odds and, in some ways, even make the situation worse.

Consumers, who now expect to get whatever they want online, are often flustered to learn that price is out of their control. They have to wait to be contacted, even waiting sometimes until they get to the dealership. To their great dissatisfaction, consumers have to come to terms with the fact their online research has not been instrumental in reducing the time spent at the dealership, an issue about which they're particularly sensitive[17]. The reason for that is you cannot make an informed decision without first understanding price; it's fundamentally impossible as a consumer.

Dealers – not the lead generators – take the blame for this unsatisfactory experience, further exacerbating how broken the system is for dealers. Even though it's the lead generator that has sent out the buyer's information to several dealers, it's the dealers themselves who are on the front lines trying to turn a price request into a sale – making the calls and sending the emails without price. The fact that five different salespeople are now calling a buyer at home simply reinforces that buyer's distrust for dealers.

For the dealers' part, since following up on Internet leads can be time-consuming, they sometimes assign that job to the low man on the totem pole. It's an understandable reaction – they can't have their highest-paid salespeople on leads with low close rates. This generally means that the least-qualified salespersons are tasked with following up on Internet leads – a terrible strategy for the dealership, but a natural one given that it's harder than ever to determine which customers are actually in-market.

14. NADA survey, as cited by Donna Harris, "e-Commerce Alters How Dealers Do Business," *Automotive News*, February 4, 2008.
15. Steve Marshall, "New Research on Media Spending by Auto Dealers," *The Kelsey Group*, March 2008.
16. National Automobile Dealers Association and AutoExec, *Automotive eCommerce: Best Practices, Technologies and Strategies to Master Online Success*.
17. "Customers are particularly sensitive to time-related issues when purchasing a new vehicle." J.D. Power and Associates, *2006 Sales Satisfaction Index (SSI) Study.*

Is Lead Generation Dead?

As a business model, lead generation is profitable for a number of players – the major search engines like Google and Yahoo, which are selling the clicks, and "infomediary" websites that attract consumers turning to them for objective product information, like Kelley Blue Book, Edmunds and others. Both consumers and dealers are going online in droves, and they'll continue to do so.

But, as this paper outlines, the lead generation *experience* for both consumers and dealers is broken. It will likely only get worse, and it will affect the business overall. Two trends are already in motion that will ultimately kill lead generation as a viable business model:

Upfront pricing: The underlying bargain in lead generation is that a consumer trades his or her anonymity in exchange for the promise of a price. What ultimately changes the power in that equation is getting an upfront price with no strings attached – no bargain necessary. Some dealers are already offering upfront prices, and the industry is fast approaching a tipping point. Once that happens, consumers will no longer need to rely on lead generators as an intermediary for getting a price quote. (For a more in-depth discussion of upfront pricing, see Zag's white paper, "The Case for Upfront Pricing.")

Dealers will demand a shift to paying for sales and not leads: The interesting dynamic here is that the lead generation system is incrementally working itself out of business. Because the system is designed around quantity, not quality, the value of its own product is diminishing. Lead generators have to sell more leads to more dealers, thereby decreasing the quality of each lead they sell. The economics of this will only survive to a certain point – why should dealers pay good money for diluted leads? Dealers will look for more efficient ways of finding buyers online and elsewhere, and a performance-based (a.k.a., cost-per-sale model) is an increasingly viable option.

Performance-Based Marketing Aligns Incentives – Everyone Wins

Performance-based marketing is an emerging business model that is based on the philosophy that dealers should only pay when a sale closes. This approach has emerged as a response to the realities of the marketplace – that only when incentives are aligned among buyer, seller and intermediary can a system emerge that truly changes the game to benefit everyone.

With a cost-per-sale model, the dealer only pays a lead generator if a sale occurs. The alignment of incentives in this model motivates the lead generator to deliver the highest-quality leads possible – consumers who are ready to buy. In order to accomplish this, the lead generator is encouraged to give as much information to the consumer upfront as possible, including vehicle price. This allows the lead generator to know that if a consumer requests a contact, he or she is serious about purchasing a car.

To the extent that dealers are truly introduced to in-market customers who end up buying cars a higher percentage of the time, they'll treat those consumers with special care, thus building customer loyalty. Consumers who receive upfront pricing and, as a consequence have a haggle-free experience at the dealership, are more likely to buy and to be repeat customers[18].

Conclusion

Lead generation has become an end in itself. It doesn't work for consumers, and it doesn't work for the dealers investing their highly-coveted advertising dollars. It ignores the consumer's demand for a true informational advantage through upfront pricing, and convolutes the online information-gathering process by making promises on which it doesn't deliver.

Lead generation doesn't earn customers' trust, nor does it make them more likely to purchase a vehicle from the dealer. It is only good for one thing – monetizing consumer interest in getting price quotes. It does not facilitate the sales process for dealers or enhance the customer experience. Plain and simple, lead generation is about monetizing the consumer's desire to acquire information.

The performance-based model aligns incentives and works for both the consumer and dealer. As such, it's the model most likely to move things forward in a positive direction, by making the car buying process more enjoyable for consumers and more effective, efficient and productive for car dealerships – a win-win situation for all involved.

18. "Consumers who understand car prices are happier with their vehicles and their dealers. Price knowledge impacts dealer loyalty." Forrester Research, *Auto Site Designers Must Rethink Price Info*, June 19, 2006.