

# Networks as Barriers to Innovators

-the case of car distribution in the European Union

by

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## Abstract

Both from inside the industry and from outside actors, there is a high pressure for major innovations in the Sales & Distribution system for cars. But so far only minor changes can be found. Why? In our analysis of the European situation we have found that OEMs, importers and dealers traditionally co-operate for maintaining status quo. IT-based middlemen started an innovative process in 1999. The IT crisis came while they were attacking the barriers of entry. They lost their financial power and had to partly withdraw from the marketplace. Another important issue is that customers obviously are not yet ready for changing their behaviour - they prefer to kick the tires instead of clicking the (Internet) button. For the incumbents, the trade-off between the possible benefits from a more cost efficient S&D system and the risks of changing something that works but is costly is negative. In our opinion, future innovations will therefore take place stepwise or evolutionary rather than revolutionary.

**Keywords:** Innovations, Sales and Distribution of Cars, Automotive

## 1. Introduction

'Dell Direct' is a successful innovation in the sales and distribution (S&D) of computers. In the sales and distribution of private cars similar models have failed. In the period 1999-2000 direct distribution of cars was growing to more than 10 per cent of the total sales in the US. In the automotive industry a majority of the actors were convinced that direct distribution would continue to grow.

However, during 2001-2002 the Internet-based sale of cars has decreased. More efficient distribution of cars is a major issue for the whole industry. While the development and production of cars have changed dramatically, the distribution system is basically the same as in the 1970s. Why? This is the starting point of our study. We will discuss driving factors both from inside the car industry and from the outside, e.g. EU deregulation that could open for new members and new models of S&D.

Effective business development involves all parts of a company and influences external business partners/actors and other stakeholders. In our studies of supply chain management (SCM) in the automotive industry, we have identified dramatic changes in the car manufacturer - supplier relationship during the last decade (Brandes *et al*, 1999). Financial goals and changes in technology are the two most powerful drivers in this change process aiming at more efficient SCM. The pattern is very much the same in industries such as the aerospace, automotive and communications. OEMs are outsourcing non-core components and materials in order to reduce the capital employed.

The issue of building sustainable competitive advantage is not only about in-house development of core competence, but also about the dynamic processes in the cross-section between the members in the total supply chain. One of the main enablers of this development is the information and communication technology that has opened for innovations like E-business. E-business development is involving the interfaces between customers and other stakeholders.

During the 1990s there has been a remarkable increase in productivity in the product development, purchasing and production functions in the industries mentioned. Lean

production, lean management and global purchasing are programs that have increased the efficiency of these functions, each supported by improvements in information and communication technology. However, there is not any corresponding development in the S&D. This part of the supply chain is not as efficient as the upstream activities and therefore it is the major target for innovations. Both the car manufacturers, dealers and new actors, without any tradition in car distribution, have initiated a process of change. The outcome is not significant so far.

## **2. Aim and structure**

Our aim is to analyse the driving forces affecting the S&D innovations and increase the understanding of supply chain management innovations in delivering customer satisfaction. What does the network of relations mean in this system? Which are the major actors and core relations? Which power do they exercise? Who are the winners and the losers so far?

In section 3 and 4 we are developing a model for the analysis of our case. In section 5 we are presenting the case which is analysed in section 6. In section 7 we are looking for a pattern of change, the managerial implications and policy issues of the deregulation process going on in the EU.

## **3. Theory: Competitiveness, competencies and networks**

There is an interesting imbalance between different theoretical aspects of this field and also between theories and best practice. More general research approaches of interest here are found in the fields of industrial organisation, e.g. Porter (1980; 1985; 1990) and transaction cost economics (TCE) (Williamson, 1999). In the automotive industry, one of the most competitive of the major, mature industries, competitiveness and performance are key concepts for the understanding of the innovative process. However, Porter/Competitive Strategies and Williamson/TCE can only offer partial explanations for the understanding of the automotive channels development. Their major weakness is that both approaches are very cost focused. There are no concepts for the understanding of the dynamics, value creation and other processes that are generating income. We need other references for these aspects.

The resource-based theory of strategic management (Wernerfelt, 1984; 1995) and the concept of core competence (Prahalad and Hamel, 1990) offer a framework for analysing and understanding why the intellectual capital and knowledge are factors of great importance for the understanding of competitive power. Teece *et al* (1997) have made an interesting contribution by suggesting the concept of 'dynamic capabilities', defined as:

“the ability to sense and to seize new opportunities, and to reconfigure and protect knowledge assets, competencies, and complementary assets and technologies to achieve sustainable competitive advantage.

It is relatively easy to define dynamic capabilities, quite another to explain how they are built. Part of the answer lies with the choice of organisational form, and part lies with the ability to strategize”. (Teece, 1998 p 72).

Firstly, this reference opens for a deeper analysis of the recent development in the automotive industry with partnership or core relationships working as if the buying firms have created a partial and virtual reality merger with some of their suppliers without any ownership at all. In an industry with overcapacity the sales and distribution relationship increase in importance and become an important strategic issue.

Secondly, Teece (1998) developed the concept of dynamic capabilities to a model for capturing value from knowledge assets. His major point is that

“the key sources of wealth creation at the dawn of the new millennium will lie in the new enterprise formation; the renewal of incumbents; the exploitation of technological know-how, intellectual property, and brands; and the successful development and commercialisation of new products and skills” (p 74).

Finally, network and interaction approaches (Håkansson *et al.*, 1982; Ford (ed.), 1990; Anderson *et al*, 1994) are conceptual models for other relationships than those in the traditional consumer marketing model. The network approach is promising for the understanding of how long term relationships and networks are built up, but limited when it comes to breaking relationships. In most cases the economic performance is the main reason (Lilliecreutz, 1998). In the network approach social factors and non-economic variables are in focus, but economic performance is not an integrated part of the approach. The network and interaction approach is relevant for the indirect effects in a supply chain. OEMs actions are of great importance not only for

the next link, the dealers, but also for the final buyers. The dealers' actions affect the OEMs as well as the final buyers. And the new middlemen are trying to find a position where they can change the rules of the game for the four other channel members mentioned.

To summarise, these approaches and theories are not consistent in the sense that they can be freely combined in one framework for the planning and analysis of empirical studies. They offer both competing and complementary tools for the analysis of business development. There are two major theoretical problems to be solved. First, theoretical approaches that are realistic in terms of considering opportunism as a risk and a dynamic force in the development of new products and processes in industrial networks where trust and co-operation are the opportunities, Foss and Koch, 1996). This means that there must be performance criteria for the understanding of the efficiency and key financial measures. Second, theories that can explain the dynamics of the whole value chain i.e. why the dramatic changes in the division of work and boundaries of the firms are leading to changes in the competitive situation in terms of market shares and financial performance (Cox, 1996).

#### **4. Managing innovations in sales and distribution**

In the development of a model for the understanding of the innovation process we are using some relevant concepts and a process model from the literature. For each phase in the model we are discussing our empirical case in the light of the model. Finally, we will analyse the case and discuss how the innovation process could be improved.

In the search for competitive advantage there is a tension between the need of creativity and stability in the firm (Trott 2002). The management have to provide a balance in the internal environment. If an organisation emphasises the exploration of new ideas, while neglecting the exploitation of internal activities and routines, the organisation may experience a decrease in internal stability, which will increase uncertainty and create turbulence (March (1996). Consequently, the future competitive advantages will be lost since employee's turnover is high and the company's culture is unstable.

One major innovation process started in the late 1990s when many companies embraced the Internet for starting E-business. In the most spectacular applications, E-business meant eliminating the intermediaries. Business should go directly from producers to customer in order to increase efficiency. But in many industries, like the automotive, the traditional middlemen have survived. One reason could be that third party suppliers have often developed the innovations. Obviously, the understanding of how to manage innovations in the S&D is still lacking, and the efficiency of the system is still lagging behind other industries.

Van de Ven (1986) discusses four central problems in the management of innovations, which originates from four central factors in the development of innovations. These factors are *ideas*, *people*, *transactions* and *context*, and are denoted in his definition of innovations:

“Innovation is defined as the development and implementation of new ideas by people who over time engage in transactions with others within an institutional order” (Van de Ven, 1986, p590).

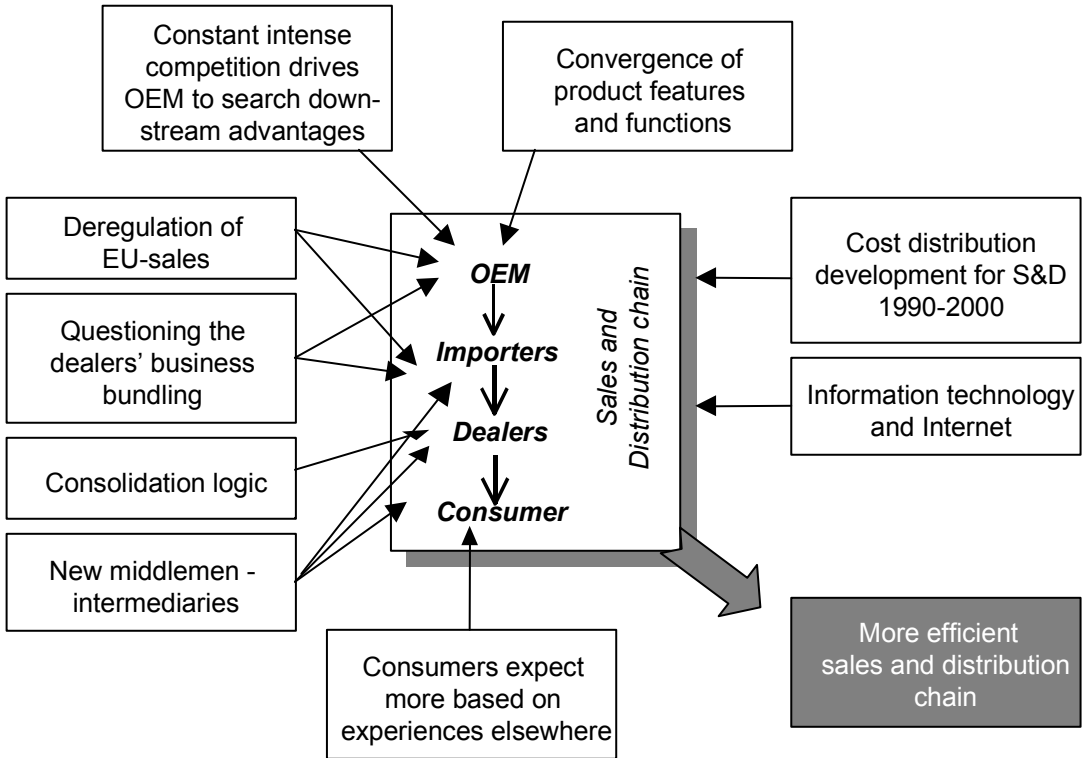
The managerial problems associated with the process of innovation are identified as (1) the human problem of managing attention, (2) the process problem of managing ideas into good currency, (3) the structural problem of managing part-whole relationships, and (4) the strategic problem of institutional leadership. After a presentation of the empirical setting, we are taking these four steps for the analysis of the failures of innovation in the automotive S&D system.

## **5. Empirical setting**

The major members in the automotive industry supply chain are traditionally the car manufacturers and their suppliers, especially the first tier suppliers, the dealers and the final consumers. During the last few years a new group of members has appeared namely the Internet-based intermediaries (new middlemen). Our analysis of the distribution and sales part of the supply chain is taking the driving forces including the new members and catalysts into account (Figure 1).

In a market with transparent prices the OEMs' interest in the S&D part of the supply chain is related to a belief their brands need a sales process that is more profiled and independent of the geographical area. Another important aspect is the convergence of product features and functions between different brands. First tier suppliers are taking a larger responsibility of developing and producing modules that can be used in a slightly modified version in another product. For OEMs the product offering must be included in a package of services that can create loyal customers during the ownership of the present car as well as future cars.

The incumbent dealership structure with mainly independent dealers, exclusive districts and high fixed cost has been a financial advantage for the OEMs. During the 1990s the economics of the six different dealership businesses (new cars, used cars, financing and insurance, workshop, service, and accessories) have changed significantly. The new middlemen have challenged the bundled offer of these businesses.



**Figure 1 Driving forces and catalysts for change in the S&D of prestige cars**

In the upstream relationships (OEM and first tier suppliers) service and satisfaction are built upon very open information exchange e.g. in the product development. This has been recognised by the Internet-based intermediaries that entered the sales and distribution process. During the last decade larger dealer chains spanning larger geographical areas have acquired smaller, family-owned dealers. These “megadealers” are also challenging the OEMs in the S&D system. Existing dealers in Europe have largely driven the consolidation logic whereas in the US outsiders without dealer history have established dealer chains of up to 400 dealership outlets.

Consumer expectations are constantly evolving. Experiences from buying and owning other products drive the individuals in their evaluation of the dealers and the OEM sales process. Information technology has made information assessable through all computers with Internet access. This information is not only “selling the product”, it is also comparing its price/performance characteristics with other products in similar segments.

## **6. Analysis**

In order to analyse the development of automotive industry sales and distribution we are applying the four different aspects of the management of innovations presented by Van de Ven (1986). First, we are discussing how the market channel members have managed peoples’ attention to new ideas. In the following sections, the management of ideas into good currency, and the part-whole relationships and the management of innovation context are depicted.

- **Managing attention: recognising the need of renewal, communicating the need of renewal, and understanding double-loop learning**

The human problem of managing attention involves the tension between stability and creativity in the initial phase of the innovation process. The problem is how to trigger people to pay attention to new ideas and concepts. Van de Ven means that successful organisations experience more difficulties in changing peoples’ attention from daily activities and routines to new ideas, opportunities and needs. According to Schroeder et al (1989), innovations are often triggered by internal or external shocks, e.g. business cycles or internal organisational crisis (King and Anderson 1995).



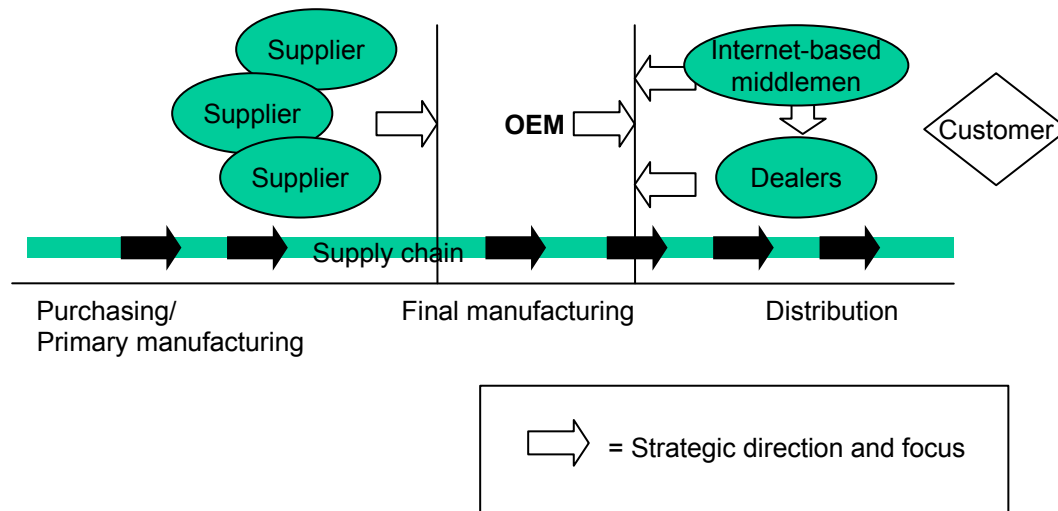
Van de Ven (1986) also discusses the importance of motivating people to change by direct confrontations with problem sources. The pressure from the most demanding customer may lead to a product innovation by triggering employees to overcome the threshold of taking action. However, using customer needs as a way of managing peoples' attention may also create stress in the innovation process. The idea of single loop and double loop learning introduced by (Argyris and Schön, 1996) may further improve the management of attention in the innovation process. Single loop learning deals with actions based on normal daily activities, while in the double loop learning the daily, monitoring activities are questioned.

According to Van de Ven, successful organisations experience more difficulties in triggering people to pay attention to new ideas. Consequently, organisations experiencing deep crisis and economic decline may have greater prerequisites of changing peoples' attention to innovative ideas, since there is a need of renewal in the organisation. In the late 1990s, sales and distribution were mentioned in several consultant reports as an area in which we could expect significant changes. But the triggers have obviously not been strong enough.

The relative cost for S&D compared to the other main functions product development, purchasing and production have increased between 1990 and 1997. The data of the S&D costs presented by the EC commission (EC, 2000) for 1998 indicate that it in the EU were approx. 30 per cent, in the US 25-27 and in Japan 29-31. In relation to the other components of the total sales price of each sold car S&D is the second largest part (Materials and components 44 per cent, Production and assembly 15 per cent, Product development 5 per cent, Margin and administration 3 per cent).

In the strategic analysis of the development of more efficient S&D, we must consider the roles of the members. The OEMs or primes own the product brands that are the basis for all businesses in the supply chain. Therefore they have to focus upon the management of the interfaces, relationships and contracts from the suppliers all the way to the final customer. At the same time OEMs' control over the operational part of the value-adding supply chain is decreasing as suppliers are taking over a larger

share of operational activities. Cross-functional and organisational integration is increasing. The complexity of the system is growing (Figure 2):



**Figure 2 The channel members current strategic position, direction and focus in the supply chain**

According to an EC Report (EC, 2000), the dealers' margins for new car sales are low. The average margin for traditional dealers on new car sales in Sweden in 1999 was 7% (Sundé, 2000). From this margin the new Internet-based middlemen are trying to take a part for establishing a unique position. In a system where law is still protecting the exclusive distribution, the new middlemen have to buy via the traditional dealers. In a future deregulated system they will also attack the OEMs margins.

- **Managing ideas into good currency and the part-whole relationships: Dynamic Capabilities - A Quasi-Resolution to Conflict**

The process problem of managing ideas into good currency relates to the difficulties in implementing and institutionalising innovative ideas in the organisation. While individuals provide the invention and the initial idea, the implementation of the invention involves the whole organisation. This process of transforming the idea into good currency is primarily influenced by social-political dynamics within the organisation, and is controlled by the existing system as long as the critical debate of problems continues (Van de Ven 1986). Thereafter, new ideas are initiated and the political debate can go on. A political tension in the organisation can move the idea forward. When this tension decreases other ideas are initiated and thus the political problems related to

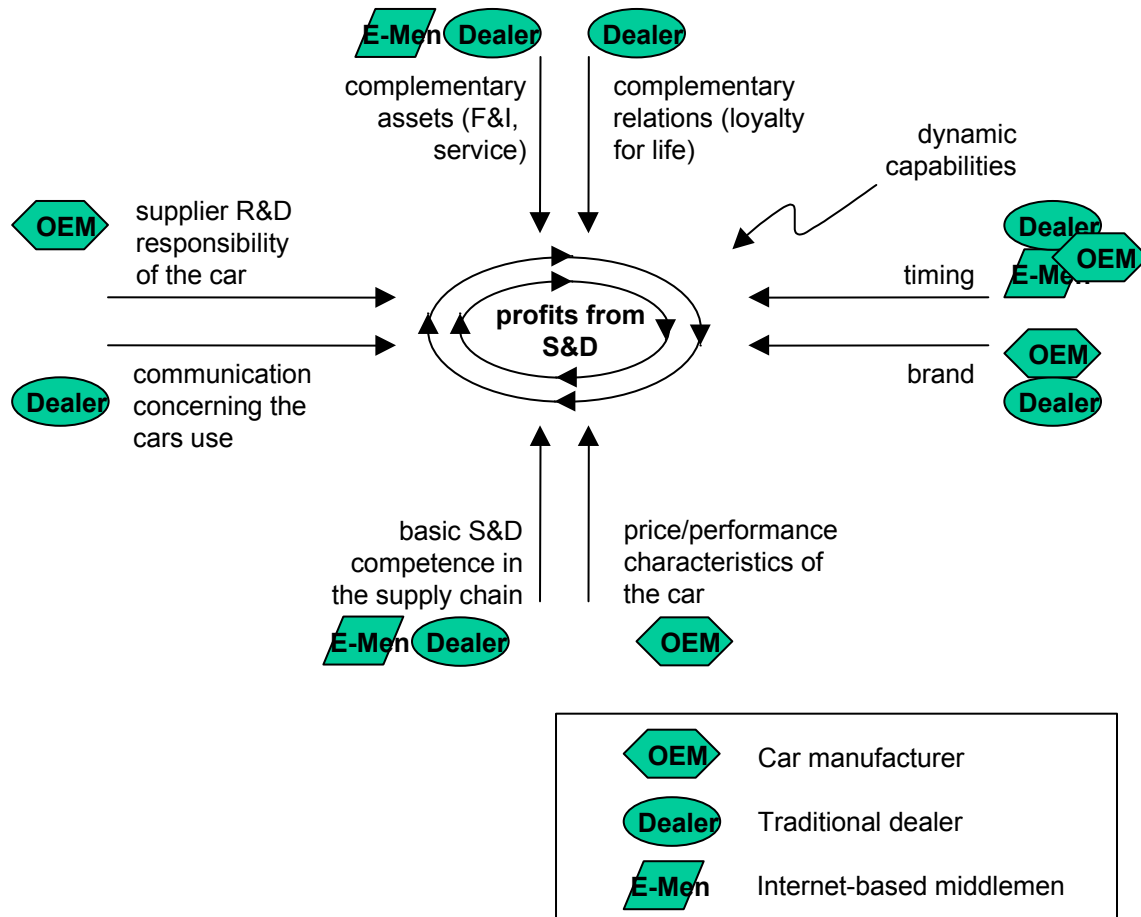
the new idea are debated. Viewing the implementation process of ideas as social-politically controlled implies a perception of individuals and organisations as short-term problem oriented (Van de Ven 1986), thus people need new goals and motivation for progressing and developing new ideas. If the current problem has not been solved, it is rather relabelled to become a new problem. Managing new ideas thus means dealing with the need of progression by providing the organisation with long-term goals and visions as well as short-term objectives regarding new ideas.

The process problem of managing part-whole relationships deals with the proliferation of individual ideas into collective thinking (Van de Ven 1986). Since innovation is a collective achievement, rather than an individual activity, the management of innovation encompasses the handling of the transaction of ideas in the organisation. When a single idea is communicated to others, it proliferates into different ideas due to peoples' interpretations of that idea. The multiple perceptions are influenced by peoples' diverse frame of references, backgrounds and interpretation schemes. The relationships between people contribute to amplified perception among people. Thus, an innovative idea may from the beginning seem as the perfect solution, but as it proliferates over time it becomes complex and hard to realise in the whole organisation.

Managing part-whole relationships requires an increased understanding of the organisation as a whole. Integration of specialists into cross-functional groups may contribute to an understanding of different parts of the organisation and thus to increased communication and transactions between different professions, units and divisions. Autonomous work groups that are self-organised may also increase the understanding of the whole. The groups may be allowed to develop their own goals and action plans to solve their problems within the frame of the over-all vision and strategies (Van de Ven 1986).

Based on our analysis we can draw the conclusion that no single channel member has the power of imposing or getting acceptance for their own ideal SCM structure in the automotive industry. Even the most powerful channel member, the OEM, would be taking too high risks by breaking up or taking conflicts with the established dealers in a direct sales strategy (the "Dell Direct" model). The only exemption might be a new brand with no or a low market share in a specific geographical market. The core

relationships in the total supply chain is considering all long term, knowledge-based relationships from the suppliers to the OEM and from the final assembly to the end-user. The strategic issue in S&D is the role of the dealer in a future, more cost efficient system that is also value-creating. Based on Teece (1998) Figure 3 explains our conclusions for the S&D of cars.



**Figure 3 Value creation in car S&D relationships and the members' main focus** (adapted from Teece, 1998, p.73)

The members' main focus is earmarked in Figure 3. OEM and the traditional dealers are focusing on all major value-creating functions. The new Internet-based middlemen are trying to apply their knowledge of S&D from other industries to create value by timing and complementary assets. In order to meet the new members, the traditional dealers have to shift focus from sales of the individual car to the exchange process in order to develop a service/distribution centre of the lifestyles that the brands

brands and customers are representing. Some dealers are already working with this concept.

Price/performance characteristics of the products, complementary assets and technologies are the main sources of value creation behind the knowledge assets in the interorganisational relationship, not the physical product in itself.

Creation of value and personal contacts are necessary ingredients for the efficient communication with the prospective buyers. The business is local and there are considerable emotional arguments to consider.

A compromise must be found in a stepwise introduction of change in the S&D system. There will always be different interests between the OEMs and the dealers on the division of the total sales margin but the cost pressure for change in the present system will increase both from the inside members and from the new middlemen. However, the OEMs and the dealers' different interests will never be finally resolved. The concept of "quasi-resolution to conflict" (Cyert and March, 1963) is generative in this context. The negotiations will serve as a learning process in the development of a more efficient S&D system.

In a customer-driven S&D system a hybrid channel structure is preferable for private owners (except for the fleet owners that already have direct relationships with the OEMs). The hybrid channel designs combine offline (personal) and online (Internet) advantages. This strategy for serving the different customers requires changes in the roles of the upstream members in order to exploring the possibilities to cost reduction and service improvement in the S&D.

Obviously, the transaction costs must be reduced in a more competitive S&D system for prestige cars. But we do not expect a straightforward lean distribution approach after a lean production process in the automotive industry. OEM-controlled Internet communication and direct logistics from OEM to final consumer should imply a lean distribution system with significantly lower transaction costs. The ideas have been presented without getting any serious attention from the S&D members. In an industry characterised by similar strategic developing revolutionary ideas has problem get-

ting attention if no one wants to be the leading innovator. An exception is Toyota that for example not has outsourced and modularised as much as all other manufacturers but in terms of S&D they follows the others.

For the creation of dynamic capabilities, a rethinking of the division of functions between the parties in the S&D channel has to be considered. The direct contact-based knowledge about customers changing preferences is the source of profit both for the dealer and the OEM. This knowledge has to be shared through information networks giving all channel members a sensing of the dynamic and complex nature of their customers. The relationships between the dealers and OEMs must also be differentiated. Why is it not already implemented to a much greater extent?

- **Managing innovation context: Core competencies and core relationships as strategies for sales and distribution innovation**

The structural problem of institutional leadership concerns the creation of an infrastructure that is conducive to innovation. Innovations are not only adapting to the existing organisational arrangements and policies, but they are also transforming the practices of the organisational context. Van de Ven (1986) advocates the importance of an institutional leadership in order to create a culture context that fosters innovation and establishes strategy structures, and systems that enable creative thinking. The creation of an innovative culture may be carried out through four factors, namely definition of the organisation's mission, embodying purpose into the organisation's structure and systems, defending the institution's integrity, and ordering internal conflict (Van de Ven 1986). If institutional leaders fail in these factors, the organisation may drift and lose focus, which may lead to loss in competence and organisational integrity.

However, as pointed out by Trott (2002), there is a balance between preserving institutional values and exploring new ideas. As an institutional leader, it is important to understand the value of double-loop learning (Argyris and Schön, 1996). Debating, communicating and conflicting are leading to the reconsideration of existing rules, norms and values, and thus bring the innovation forward. Institutional leadership implies creating a climate for innovation through plainness in goals, rules and mission,

but accepting the uncertainty and tension that is promoting a creative and innovative behaviour.

The concepts of dynamic capabilities and core competence are highly relevant in periods of expected change in technology and environmental factors. What is behind these concepts in this specific context? Hard-to-imitate skills, tacit knowledge and the ability to change the market are the basic issues that make a brand specific to the customers. Less emphasis on selling and more on the creating of life-long relationships should be the expected new strategy that is also a necessary complement to the inner Internet communications. This is where the dealers' role is growing in importance. The OEMs cannot establish the personal contacts with the prospects but they can promote and co-ordinate the personal communication. The traditional dealers are experts on personal contacts with the car owners and the prospects. This is one of the dealers' core competencies.

Trends in the USA indicate that the number of dealers is expected to decrease in the deregulation of the franchising system also within the EU. The Internet development is working in the same direction. Therefore, each dealership outlet will be more important for the OEM. Our conclusion is that the OEMs will search for a compromise where they can co-ordinate their S&D with dealers that can be competitive enough for the new situation.

We define a core relationship as an intentionally long-term, knowledge-based relationship between a buyer and a seller who are aiming at close co-operation. Together the parties should be able to take advantages of both being close-to-customer in the relatively small and flexible firm and to have access to economies of scale and scope in the large firm. The development of core relationships between OEMs and their dealers would strengthen the competitiveness of the S&D system.

In the S&D the meaning of core relationship is that the OEM cannot come close to the customer without personal contacts via full-service dealers (with all six businesses). To live up to the concept of core relationships, OEMs and dealers must develop their communication of knowledge. Especially, the OEMs have more to learn about local markets for better product development, brand image building and new

media communication. More attention to core relationships by all channel members should open for expanding their business in good times and to be less vulnerable in hard times.

If the incumbents, i.e. OEMs and their dealer network, cannot cut transaction costs and develop core relationships, it will open for the new Internet-based middlemen. Until now the final buyers have preferred kicking the tires to clicking the button in their buying behaviour.

## **7. Conclusions: Looking for a pattern of change.**

There was a quasi-crisis in the car industry during 2000-2001, before the European Commission released the new Block Exemption rules in September 2002. The management of attention was verified in an intensive debate in the European automotive industry about alternative scenarios ([www.acea.be](http://www.acea.be)). In our interviews we found that the OEMs were prepared for more dramatic changes than the EC compromise implied.

From our analysis we conclude that changes in the S&D system will take place step-wise or evolutionary rather than revolutionary. This conclusion does not exclude rapid and rather dramatic changes for individual members. There will be important differences between countries and regions (urban, rural etc). Internationally, the USA is leading the process of change so far and the expected deregulation of EU markets is one catalyst for similar developments in Europe. In the fastest growing markets for new cars, e.g. China and South America we can expect new business models to be tested.

There is little doubt that there will be considerable differences between very established, strong brands that sell many cars per year in a market and those that are selling relatively few new cars. The latter group will be more inclined to use a variety of distribution solutions, including Internet-based middlemen and sales through wholesaler chains, because they have less sunk costs in the S&D system. These members might be the leaders of the change process to a new and more efficient S&D. In the new Block Exemption the EU is unbundling new car sales and workshop operations.



In the future OEMs have to handle them as two independent businesses. Based on our analysis of each member's contribution to the S&D process (Figure 3) this deregulation will open for innovations similar to what we have already seen in the US market, namely niche players focusing on either new car sales or workshop operations.

***Transaction cost focus is not enough.***

In the management of ideas into good currency the European OEMs have obviously come to the conclusion that the traditional system is more profitable than any new and risky alternative that the EC had announced before the compromise decision. The OEMs together with the traditional dealers have a very strong power position in the European system. These OEMs have been able to manage the part-whole relationship in order to keep new members out. A common enemy has strengthened the OEM-dealer relationship.

In order to increase the supply chain efficiency, the OEMs have focused on lean production that means cost cutting and reduction of the balance sheet, increasing the quality and reducing the time of the assembly process. These programs have led to important effects upstream in the supplier relationship. The developments of information and communication networks have been the main enabler for OEMs achievements. Their focus upon cost, quality and lead-time for the car is still important but only one part of the value creation of the customer. Traditionally, the other parts are the dealer's responsibility. In an industry with over-capacity this tradition can be expected to change since the S&D is too important to leave to dealers handling it according to their own ideas.

The cost efficiency criterion in the supply chain transactions is based on the minimization of the transaction cost of an individual player, in this case the OEM. This is not enough for developing a more efficient S&D. If the value of the expected future exchanges and relationships is the common goal, also the final customers and the interdependence between the exchange partners have to be taken into account.

A change from transaction costs to value-creating relationships also directs our interest to the interaction process between the channel members. By looking at the process from different members' perspective new, more competitive models can be iden-

tified. New models for value creation must be better adapted to the customer preferences.

### ***Unbundling through information networks.***

In the management of the innovation context the OEM should be the institutional leader in the structural change process. In the debate on deregulation of the European S&D system, the OEMs have been advocating for status quo. They have been successful in defending the integrity of the system and ordering of internal conflicts. But they have not been instrumental in the creation of the organisation's mission or embodying purpose into the structure and systems. As we have shown above, there are strong indications of the need for change. But short-term economic goals and risk avoidance is more important issues for the industry than the long-term innovation. In total the incumbents have preferred their vested interest to risky innovations. As long as the customers are conservative as well, the push for change is too weak.

From the OEMs' point of view, Internet has broken the geographical boundaries and their ability to handle each market separately. Transparent prices, competing brands that use generic modules from similar suppliers, and the lack of sensing of the customers changing attitudes and demands are restrictions on the OEMs' ability to customer adaptation.

We can conclude that in this situation, the OEMs with their financial power are the strongest actors in the supply chain (The old concept of channel captain is adequate). Together with the dealers they are powerful enough to stop innovations leading to more price competition in the system. The final customers in a market economy should be able to push for lower prices in a more competitive system. But the final customers are obviously not powerful enough. Therefore, the legislators (the EC in Europe) will act on behalf of the consumers. The dealers will be squeezed between the the OEMs and the final consumers. From October 2003 there will be a deregulation in Europe. The OEMs will not be able to franchise dealerships or after sales services. The single market will be realised in EU.

One of OEMs core capabilities has been to unbundling the physical and information flows upstream through information networks. In this process the efficiency of the

logistic systems has been increased. The present lack of unbundling downstream is due to the traditional S&D channel member's different focuses. Many dealers are transaction oriented on selling the car without systematically processing customer preferences back to the OEM. All partners are important, but they should focus on various functions. Communication with the customer is the prime concern of one partner whereas logistics the prime for another. Information technology is an enabler for questioning and redefining previous roles since the knowledge and information can be distributed among the channel members without adding costs. The result is that messages to customers become clearer which strengthens the chain competitiveness. Focusing also means that economies of scale are likely to be gained. These questions are of major strategic importance and they have a long tradition. For new actors like the Internet -based middlemen with experiences from industries e.g. computer, this is an opening for new business models.

#### ***Internet-based actors as a driving force.....***

The new Internet-based middlemen are customer-oriented (e.g. Autobytel, CarsDirect). They have developed a package of all necessary services of comparable brands on the market to enable the customer to evaluate the purchase cost, the ownership cost, and the brands support to the lifestyle of the customer before the decisions are made. The traditional dealers offer the same service but are biased in their communication since they are focused on selling what a specific OEM has assembled.

The new Internet-based middlemen are unbundling the value creation. But they cannot control the repair and service programs without investing heavily in real estate and expensive electronic equipment. Test drive and delivery of the new car are services that the pure Internet-based middleman cannot easily handle. But for this service, the dealers' brick and mortar facilities are not necessarily required. It can be handled at the customers' office or at the buyers' home at more convenient hours. For the dealer there is a risk of losing control over a part of the new car business. In that case they would become more dependent on the service and repair businesses.

In the prestige car market the personal interaction is still an important aspect (Pine and Gilmore, 1998) as well as the possibility to reveal the S&D experience over time.

From the Internet-based middleman perspective the upstream channel members, OEMs, are weak in handling the final customer values. Each partner in the chain has knowledge that they can utilise to adjust the chain to future requirements. But for tailoring the customer offerings their co-operation is essential, the network is not stronger than its weakest part.

**.....and the incumbents.**

Traditional dealers' major strength is the six integrated businesses of which sales of new cars is one. Compared to the new middlemen, these dealers can offer financing (where the customer's used car is often about 50 per cent of the new car price), insurance and information services like cost comparisons between brands. The single business focus of the new middlemen is competing with the dealers' all-inclusive offer. In this situation the car's cost/quality and brand is the foundation upon which customer values are created during the car ownership.

From our analysis we can conclude that there is a high pressure for major innovations in the S&D system for cars. But so far only minor changes can be found. Why? One reason could be the IT crisis starting in 2000 just when the new Internet-based middlemen were attacking the barriers of entry. They lost their financial power and had to withdraw from the marketplace. Second, the customers are not yet ready for changing their behaviour - they prefer to kick the tires instead of clicking the (Internet) button. Third, the incumbents in the supply chain have intensified their co-operation in order to keep the newcomers out. The OEMs have taken the higher costs in order to keep control over the system. One policy implication is that the European Commission is the only powerful actor that could open for innovations in the S&D system. In a market economy we can ask if there is need for political decisions as long as the parties in the market place are satisfied with the traditional system.

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