

vAuto Venture Strategy

by Riley Lind



Organization Overview

The company was founded by Dale Pollak, an industry expert, in 2005 under the name mPower Auto, Inc. as an attempt to indicate the mobile applications of the product. However, due to the shortcomings of mobile platforms in the mid-2000s, the name was changed to vAuto, Inc. in 2007. It is headquartered in Oak Brook, Illinois with an R&D center in Austin, TX.

Growth was rapid in the first 3 years, increasing revenue 2044% from \$1.4 to 30.3 mm in 2009. Because of this stellar growth and future potential, it was ranked as the 11th best software company in the 2010 INC 500 (125th overall).

However, that same year vAuto was purchased by Autotrader.com, Inc. and now is run as a subsidiary. Despite the buy-out, Mr. Pollak remains in charge of strategic planning and development. He is also vAuto's spokesperson and remains a key figure in customer relations.

KEY EXECUTIVES

- Mr. Keith Jezeck**
Chief Executive Officer and President
- Mr. Dale Pollak**
Founder and Chairman
- Mr. Michael Chiovari**
Co-Founder and Chief Technology Officer
- Mr. Thomas Jung**
Chief Marketing Officer
- Mr. Morrie Eisenberg**
Vice President of Corporate Development

1: Key executives from vAuto, now a subsidiary of AutoTrader.

Technology / Product Assessment

In order to understand the technology, it helps to understand a bit about the retail automotive business. Despite the common public perception that dealers are making money hand-over-fist by fleecing customers, the margins in this industry are typically quite low.

Table 1: Average Margins across industries in the US. Source: IBISworld reports 2011.

Industry	Margins	Industry	Margins
Handbag Store	9.9%	Home Improvement Stores	4.3%
Funeral Homes	9.0%	Car wash	4.0%
Liquor Store	8.5%	Shoe Sales	3.9%
Real Estate Sales	8.5%	Sheep farming	3.8%
Fitness Clubs	8.1%	Lingerie, Swimwear, Bridal	2.8%
Jewelry Stores	7.9%	Consumer Electronics	2.6%
Hotels & Motels	6.0%	Hospitals	2.4%
Women's Clothing	5.7%	Auto financing	2.3%
Men's Clothing	5.0%	New Car Sales	2.1%
Used Car Sales	4.4%	Grocery Stores	2.0%

Table 1 shows that despite popular opinion, dealers are doing just okay. This is heavily impacted by the large overheads, especially for those retailers who also sell new cars. First of all, most dealers still rely on drive-bys to create showroom traffic, and thus occupy expensive buildings on expensive land. Next, as each marque tries to ensure brand consistency across the country, it is not uncommon for dealers to spend tens of thousands of dollars on showroom remodeling every few years.

On top of this, most dealers finance the huge cost of their inventory using what is known as floorplan financing. In order to afford an inventory with enough variety to satisfy customer demands, the dealership borrows short-term money from a bank. Because of this, the entire time a unit is on the lot it is costing the dealer money. The longer the vehicle stays, the more money is tied up into that unit. This creates the inherent incentive for dealers to shift away from holding out for higher margins and instead focus on inventory turns.

This is where Dale Pollak and vAuto come in. A longtime advocate of velocity, he has stressed a high-turn low-margin strategy. The typical problem for dealers in this strategy is that as margins get thinner, the risk of them selling at a loss increases. Thus, there was a great need in the marketplace to help dealers perfect this art.

From the “good old days” well into the Internet age, car dealers relied on monthly or weekly NADA price guides combined with their own personal experiences to price a car on a hunch. For example, if the last black '07 Audi A4 sold quickly, the appraiser would look at the NADA regional price guide and maybe add a few hundred dollars.

vAuto changes the decision-making information from history to the present. The simplest description for the service that vAuto provides is to give car dealers live market information. Now with vAuto, the dealer can look at what other dealers are currently priced and use that to inform their decision. In essence, it is adding a dose of science to the black art of pricing.

More specifically, vAuto offers the following services. Descriptions are sourced from the vAuto website.

Stocking

With this real-time view of the fastest moving vehicles in your market, you can align your inventory to the demands of actual buyers — everyday. No matter where market preferences shift, you'll know first. And the more you beat your competition to the cars people want, the less you'll have to beat them on price.

Appraising

Know the real value of any car by seeing what identical vehicles are selling for in your live retail market. Car-to-car. Trim-to-trim. Equipment-to-equipment. Get into more cars right, and see how much more aggressively you can price while still making a profit.

Pricing

See exactly where you rank against actual competing vehicles in your market. Price every vehicle to maximize your turn while also maximizing your profits. Drive more traffic to your showroom by competing effectively for the top spots on customers' shopping lists.

Merchandising

Make sure your cars look as attractive online as they do on your lot. Great pictures. Compelling descriptions. Consistent pricing. See every one of your placements, all from one screen. Whether you want a car to be “a great deal” or “worth every penny”, the better your presentation, the better your chances for success.

RealDeal

RealDeal is the industry's first third party price validation and delivery system that allows you to show your buyers how your price competes against the prices of matching vehicles for sale in your area. RealDeal is powered by vAuto and uses the same Live Market technology that brought transparency to the way you price, stock, appraise and merchandise your used inventory. With RealDeal, vAuto empowers you to promote that sense of transparency – and fairness – to individual buyers or the whole marketplace.

When purchased together, this suite costs about \$1,595 per month is able to give dealerships analytics and resources that they typically wouldn't be able to afford. It has disrupted the playing field and now allows new managers to compete effectively with those who have been doing it for a lifetime. Now the successful dealers are those who will be able to adapt to this new reality.

Industry Competitive analysis

The main competitors for vAuto are QuickTurn and Auto Exchange (AAX). They have many of the same features as vAuto, save a few. One of these unique features is vRank, which ranks inventory on several factors instead of just price. Since no two used vehicles will ever be exactly the same mileage and condition, this allows a potentially more accurate ranking system. In addition to this feature, vAuto also offers AutoMatch, which is unique in the industry in that it allows dealers to directly compare similarly-equipped used vehicles in their market.

Another unique facet of these competitors is that they require dealers to commit for a time period. vAuto is a no-commitment no-contract service, so the dealer is able to drop the service if they ever find anything they perceive to be a better product.

vAuto currently enjoys the position of market leader with nearly three times the subscriber base as their competitors. Mr. Pollak has contributed this to vAuto's successful use of the low-margin, high turn philosophy while the competitors stuck with the old ways. Now that they have seen vAuto's success, they have shifted their philosophies and are now positioning themselves as the value alternative, doing the same thing at a lower price. Average prices as given by vAuto are listed below.

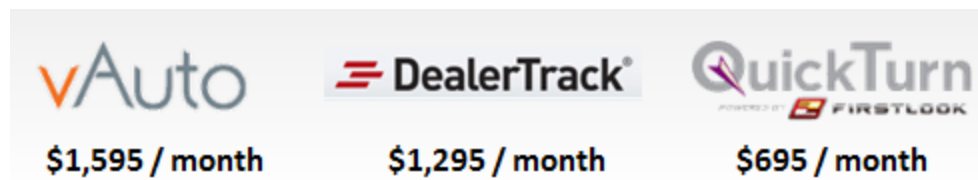


Figure 2: Average monthly prices for the industry.

Despite their price premium, vAuto maintains nearly three times the subscribers of either of their competitors.

Organizational strategies / opportunities analysis

Like many successful companies, much of vAuto's success is attributed to its people. Early in the development of the product, vAuto used contract programmers to develop the software. However, after some non-compete agreements expired from one of Mr. Pollak's previous ventures, he was able to hire on software developers he had worked with in the past. This is where the organization really took off. These people understood the business and Mr. Pollak's vision as well. As he described, he could suggest an idea and 3-weeks later have a nearly-finished interpretation of his vision. This synergy between innovator and developers has helped vAuto bring features to market quickly and efficiently, and will continue to be an advantage for the firm.

Also key to vAuto's success is the support that they offer. When a dealer first contacts them, they offer a live demo, explaining both their methodology and product. Being able to explain the concept of velocity while showing at the same time how the tool can make it work has been very effective. For a used-car manager used to the old ways of working off hunches and personal experience, this demo can be typically eye-opening and little disconcerting. That is why their 24/7 service and training have become such a huge factor to their success.

Another huge advantage for vAuto has been their recent purchase by AutoTrader.com. In addition to the funding and support of a large organization, they are now given complete access to the website's data. This allows for a complete integration with one of the most popular vehicle shopping websites in the country. vAuto can now seamlessly access the postings from dealers all across the country and use it in their analytics. While the service can download info from other popular sites, this integration with autotrader.com to inform the dealer if pictures or descriptions are missing from a post, making both services better. It also allows dealers to see how many page views each car has, allowing them to readjust their pricing strategy to fit.

Beyond the standard customer service, Mr. Pollak continues to serve as the ambassador for the product. He has written successful books, blogs frequently about problems facing dealers, and still speaks one-on-one with customers. He is well-known amongst his potential customers and is seen as very successful. He has positioned

himself (and vAuto) as partner or enabler in success rather than a software salesman. This positioning has helped and will continue to help the company for the foreseeable future.

In the long-term, Mr. Pollak's vision of the used-car industry is a move towards commoditization. The Internet has leveled the information playing field between consumer and dealer, making the markets more efficient. Customers can already play dealers off of each other, putting a downward pressure on margins. As this continues, the massive overhead that most dealers carry will become unsustainable. Combining this with Gen-Y's comfort level of buying lifestyle items (clothes, shoes, etc.) online, he believes that the only future for the business is the e-commerce model, where efficient dealers ditch their expensive lots to sell their used cars online out of a warehouse.

Long-run potential

As stated above, vAuto is currently the leader in the industry. While this is great in the fact that they currently have high margins, it also puts a target on their back. Competitors have shifted strategies to become the cheaper alternative. In order to maintain the margins they currently enjoy in the short- to medium-term, they will have to remain differentiated. They are currently achieving this through their excellent customer service and positioning as the marketplace thought leader.

In the long-term though, the only way to protect your margins is through innovation. vAuto is aware of this and has plans to launch an entirely new product in November 2011. This will support their position as the innovator as well as provide a unique product that the fast-followers haven't yet copied.

Overall though, vAuto is in good shape no matter what comes. They have a strong, satisfied customer base that is ever-expanding. What is unique about this service though, is that the more it is used, the more it's needed. As this product makes the market for used cars more efficient and lowers margins, it will be even more critical to have a product like this.

They are well aware of this and know that they need to innovate to stay ahead of the curve. Their success now has afforded them the cash and time to invest in this innovation process. They have the innovator in Mr. Pollak and his core group of developers to bring the products to market. When they do come to market with this new product, they have a solid reputation that would give them the benefit of the doubt with the customers.

Interview with Dale Pollak, founder of vAuto.

Notes from a phone interview on 9/15/2011 at 10AM

How would you describe your business in 1-3 sentences?

It's decision-making software with a philosophical bend to it. It leverages the shift in the market due to the Internet transparency.

Describe your "a-ha" moment when you came up with the idea. How long ago was it? How did it start?

There was no serendipitous moment. I began to suspect the old rules didn't apply so much. I read a book called "Money Ball" by Michael Lewis. It was very inspirational for me and read it around 2002-2003. How could the A's compete with the Yankees despite having the lowest payroll? He met a kid who displayed what really mattered in baseball wasn't ERAs, batting average, etc. You really needed to analyze the data to see what really won games. This did not match what the industry valued, such as the ability to get a walk. I was inspired by that story and connected the dots. If I show the new rules and things that matters, then maybe they'll adopt them.

I recognized the old rules didn't apply, but dealers were still operating by the old rules. I created the software with decision making to new metrics the industry hadn't used before. They were using old assumptions, so I'd have to teach them first. You need to inspire them to change. Early adopters were taking a risk because the assumptions were opposed to the old industry.

How long did it take to get from your idea to company?

2003-2005. The business was resistant to it. This resistance was what led me to writing the book. What gave me the edge was that the new car business went into the tank. Overproduction, huge incentives, etc. Dealers needed to turn their attention to used cars to stay alive when the new car bubble burst. I was there with this book and software say "You see?!" What used to be second fiddle (used cars) to dealers suddenly became first fiddle.

Do you think that the new car business will come back and dealers will lose focus?

Yes. I have seen diversion of focus back to new cars and it has affected my business. But it doesn't disprove the effectiveness of this method and product.

Underlying the success is the change. Any time you have change it is disruptive, but it almost always signals opportunity. If you can be at the right spot at the right time, it's a little bit of luck, a little anticipation.

How did you get from idea to a full-functioning program? Did you hire programmers or just sell the idea?

I started with a partner to flush out the idea. When we realized that the program was beyond his skillset, we hired contractors to write the software. Eventually, a group of coders from one of my previous ventures came off their non-compete, so we were able to hire them on. That's when it really took off.

It's important to have both coders who "get it" and me as the innovator. You need guys that "get it" to be successful because they understood me. I would get on the phone with my people with an idea and a few weeks later he would present me something that was 85% done. That is magical when you can avoid the middle men, stepping from idea to business specs to technical specs, and so on.

How did you get the buy-in from the Auto-trader, etc. at first to pull their data?

I knew all the data I needed was out there on the Internet. We had the technical ability to go out there and grab it. They all had “click-wrap” agreements or terms of use. It says you can use this data for this purpose, but can’t scrape through automated interface. Those have held to be binding in court. I knew the data was out there but didn’t have permission to access. I went out and got it anyhow. It was a difficult decision, but most of them didn’t care because I wasn’t doing them damage. I knew some did care. In the initial days I used the data from two who did care: cars.com and AutoTrader. Eventually, I showed them that I was using it was to teach their customers how to be more effective on their platforms. They ultimately gave me permission and I had to pay them until AutoTrader acquired me. If I asked for permission from them at the beginning, I would’ve been shut down. I took an entrepreneurial risk and turned out to be proved right. It really kept me up at night though.

What were your biggest mistakes, or biggest wastes of time/money?

Being too early is exactly like being wrong. I changed my name from mPower to vAuto. I had a vision that dealers would price, etc. on their mobile phone. I insisted every bit of application was available on mobile phones. Back then though, the browsers were clunky and unsophisticated. I spent a fortune building for every hardware provider. I spent 2/3 more than I needed to make this thing mobile and nobody used it. Seeing what’s needed in the future is easier than seeing the time until it will arrive in a commercially viable manner. Getting the timing right is harder than creating the solutions. The landscape is littered with solutions that came and died before their time.

You focus on velocity rather than margins. Do you think that will ever change or will

Floorplanning costs keep velocity #1 forever?

My underlying assumption is (if I’ve got this wrong, I’m in trouble) as the market gets more efficient, cars will become more like commodities. In every commodity market, despite of the low margins, there are winners and losers. Two characteristics: equilibrium price. Winners are sellers that can see margin price and move to it right away. The ability to perceive this price and willingness to move forces out the least-efficient operators. As they move out on the way to the bottom, the margins come back up. Those super-efficient operators will then make more money and the cycle will start over again as people flock back to the market.

All of us still have an emotional aspect to buying a car. But many of us are getting more accustomed to buying merchandise without trying on. Clothes, shoes, etc. Maybe you can get a test drive fix at the Hertz or mall. The one thing that will constrain the evolution of the dealers is the state laws in franchise agreements.

What would you say is your sustainable advantage?

Firstlook Quickturn & AAX owned by dealertrak. Both were there first. I saw them out there while I was reading Money Ball. It perpetuated the old model. That gave me the confidence that I could come in. I have overtaken them in penetration despite selling at more than double their price. I have 3 times the subscribers. Now everyone is copying me. They have re-casted and reformulated their software to follow me. Now we are recognized as the thought leaders and premium in the market. However, if we don’t continue to innovate and anticipate, we’ll lose that premium edge that we have. Those companies are run by people who don’t have the experience and people that we have. I can see the future better than anyone else in the space.

We are worried and trying to anticipate the next problem for the dealers that I can solve more than the competitors. I’m about to do the next big thing. On 11/11/11 the search for used vehicles will change again when I launch it.

Info Sources

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