The automotive market has never been so good . . . and yet so bad. Demand for new and used vehicles are at all time highs, but that's not due to technology break-throughs or deft executive moves. Supply chain bottlenecks and a strong desire to travel again after being couped up for months and months do wonders to spark demand. Add in some of the highest gas prices at the pump in decades, and US consumers interest in buying an EV (electric vehicle) is at a peak.

While these issues are integral to EV demand, this report is not about battery costs or materials shortages. Instead, we want to focus on what it will take for automotive companies to win the hearts and minds of customers. **We are going to look at a classic challenge in a highly competitive market, and one that most CEOs struggle with regardless of industry: How to shift customers to a new way of delivering value**.

Today, electric vehicles (EVs) represent only about 5% of overall US sales. But more and more these days, customers are looking to scrap their internal combustion engine (ICE) vehicles. To best illustrate competitive interactions in a market, we'll use the EV leader, Tesla (TSLA), as the industry challenger and Ford (F) as an industry standard for the ICE market.

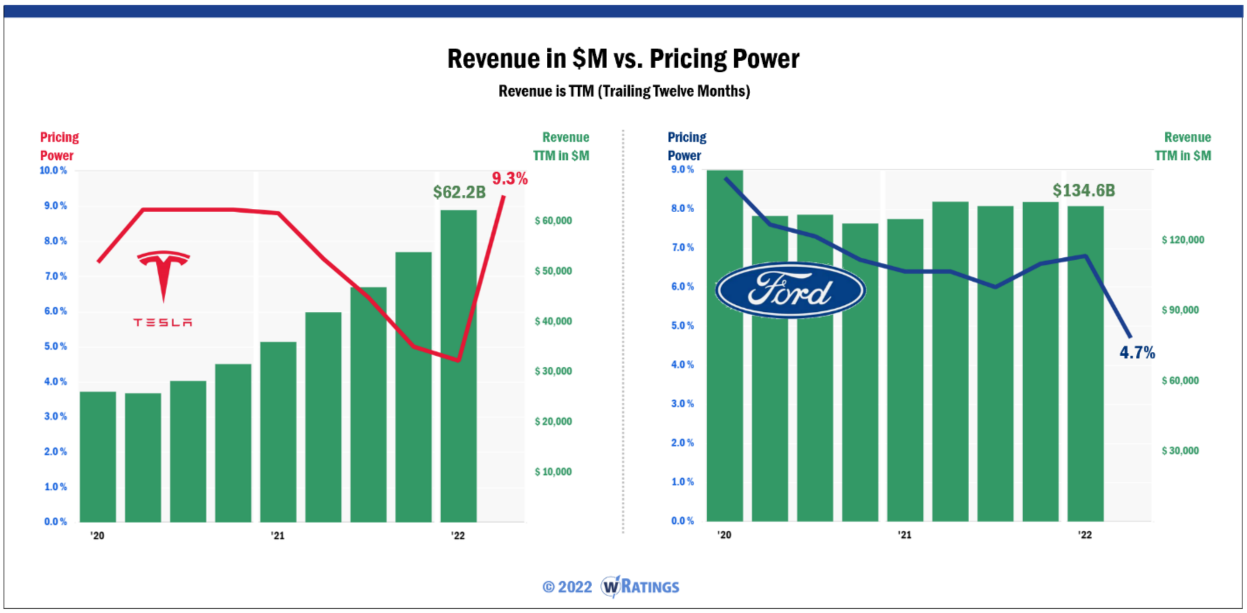
Challenger vs. Standard Market Value

Tesla generates less than half the revenue of Ford ($62.2B vs. $134.6B), yet has over 15X the market capitalization ($761.5B vs. $48.4B) currently.

Until just recently, pricing power with customers was in a downward trend with Ford settling at 4.7%. Pricing power is the amount more that customers are willing to pay a company if they could meet their ideal (i.e. expectations). Today's Tesla customers are willing to pay 9.3% more for their vehicles, indicating a strong desire for Tesla to be their preferred choice.

This difference indicates that Tesla has the ability to raise prices with less resistance than Ford.

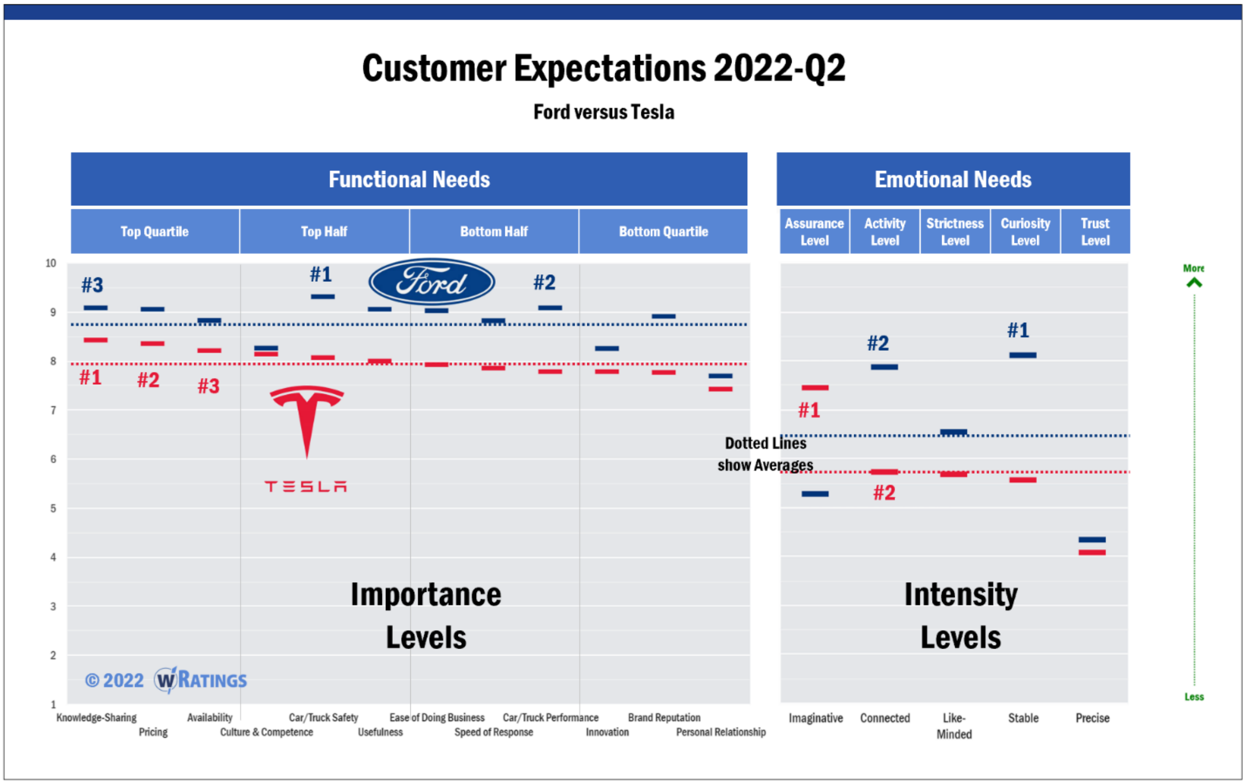
The Wall Street Journal reports that EV prices are up 22% straight off the lot in the last year, a larger increase than for ICE vehicles. And given that both companies plan to continue raising prices, Tesla holds the advantage with its customers to accept the increases. Sticker shock is coming everywhere now, whether at the gas pump or the car lot.



The Power of Expectations

To figure out why Tesla (or any company) has more pricing power, one of first places to look is at what customers expect. What Tesla/EV customers need and what Ford/ICE customers need are quite stark (see Customer Expectations 2022-Q2 chart). On average, Ford customers rate their functional and emotional needs as ~0.80 points higher in importance and intensity. **This makes delivering on customer expectations, in general, easier for Tesla**.

But the priorities of how customers make decisions for Ford & Tesla shows the reason why **this is not a seamless transition from ICE to EV**. First, let's look at Ford customers that place a substantial importance on #1 Car/Truck Safety and #2 Car/Truck Performance, followed by #3 Knowledge-Sharing. Tesla customers have a different priority set that starts with #1 Knowledge-Sharing, followed by #2 Pricing and #3 Availability.

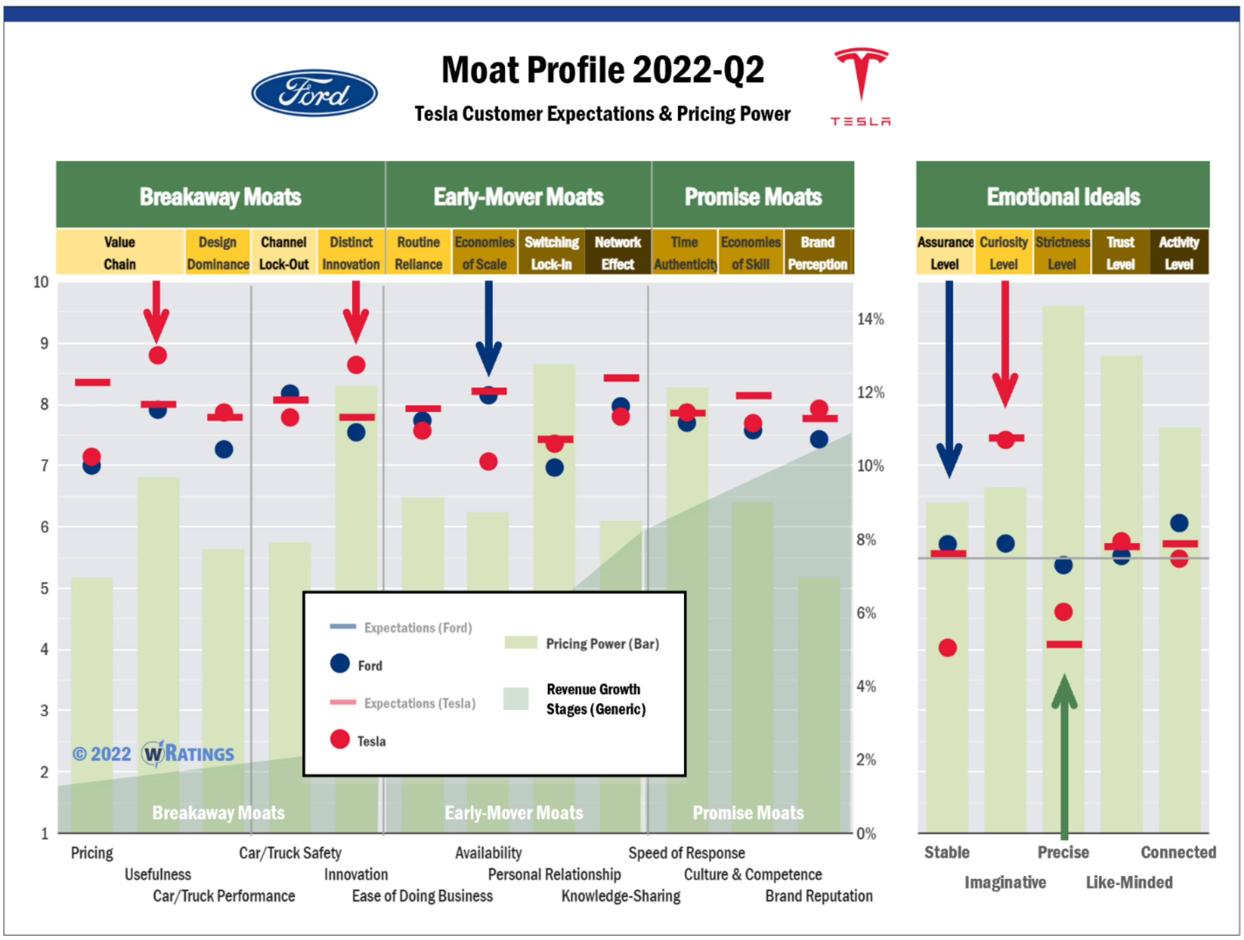


How customers want to feel when buying a vehicle is where the differences become even more extreme. Ford customers place emphasis on #1 Stability whereas Tesla customers value #1 Imagination. Most interesting is how Tesla customers do not desire stability and Ford customers do not desire imagination. In both instances, the differences are actually on the other side of the spectrum (bottom-half). Both customer sets want their ideal automotive company to be active with them, but Ford customers desire more connection while Tesla customers still prefer some connection but also want to be left alone.

Managing expectations is critical to growing revenue and attracting new customers. **Companies have two ways to better meet expectations: 1) Improve your performance/delivery, 2) Alter the customer's perception of what to expect**. Based on our experience, a lot incumbents/standards (e.g. Ford) spend the vast majority of their time on performance improvement while challengers (e.g. Tesla) focus on shifting customer expectations to the new sources of value.

Growing the EV Customers through Value

Moat Profile charts show multiple ways to look at value and growth within one view. In addition to Tesla/EV customer expectations, this profile adds in customer perception of how well Tesla and Ford perform. Data order follows the sequence of revenue growth, where customer needs furthest to the left must be addressed before companies can breakaway into future competitive advantages. When a company delivers value (usefulness for a price) or performance within an acceptable range (not necessarily the leader), customers then move into other areas of need to evaluate the company.



The Moat Framework allows executives to fully grasp what a company must do to meet customer expectations. For example, Channel Lock-Outs provide a powerful way for a company to reduce rivals from distributing your offerings, whether through patents, partnerships and/or geographic limitations. Distinct Innovation requires a company to fully redesign the status quo in an industry, essentially forming a new foundation for how to compete (e.g. Apple, Tesla).

In this Moat Profile, Tesla has met or exceeded all the customer expectations in the first four moats, with their pricing in an acceptable range compared to Ford. **The dilemma for Tesla is that they have not been able to capitalize on other moats**. Scaling has proven difficult as product availability has suffered even more than usual during the pandemic, and it already was prior to it. With its ICE vehicles, Ford has been able to satisfy availability superior.

Where Tesla really shines in delivering what EV customers really want with imagination. But for all that success, Tesla struggles to meet customers perception of stability. In laymen terms, customers view Tesla as high-risk which increases their concern levels about buying from Tesla. Along with availability, stability is a critical area for Tesla to improve.

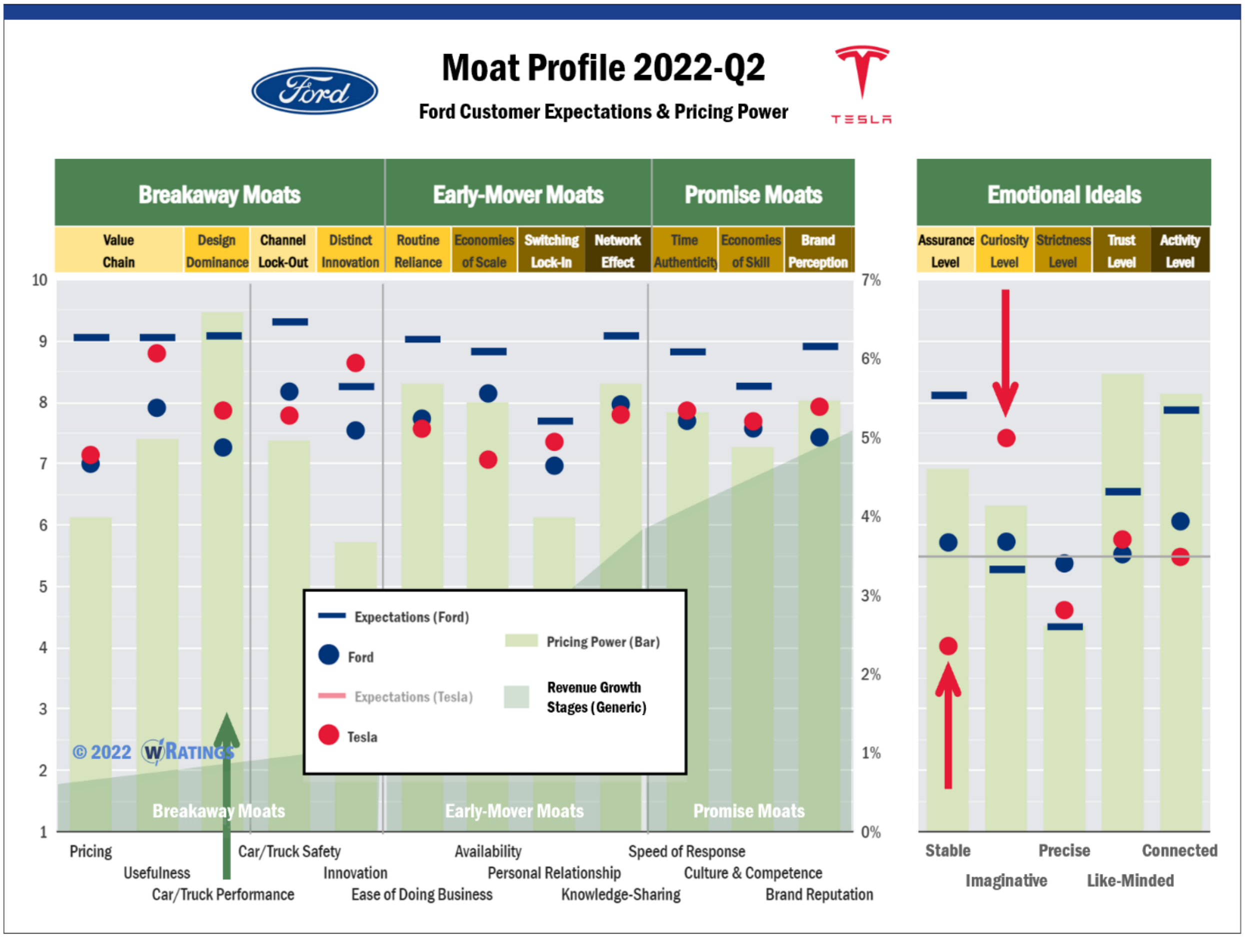
The last area of a Moat Profile to examine is pricing power (light green columns). Today, Tesla customers value the lack of strictness in their EV vehicle experience. Flexibility is often key in the pandemic environment, and Tesla's processes have adapted to better meet customer needs than Ford has. Customers value flexibility the most of all functional and emotional needs based on the highest pricing power (14+%).

When looking at EV customer expectations and current Ford performance, the Ford team is in excellent shape except for two areas: Car/Truck Performance and Imagination. While Tesla customers see them as possessing more innovation, Ford customers are already meeting EV Innovation expectations. But the clear issue Ford must resolve is how EV customers feel about the lack of imagination. Ford products are seen as too routine-oriented, although being less imaginative is actually a plus with ICE customers.

How ICE Customers view Value Differently

This Moat Profile replaces the Tesla expectation levels with Ford expectation levels and pricing power, giving a much different look at how ICE customers view value. The first and most critical observation is that customer expectations for ICE vehicles are higher than for EVs. This makes it inherently more difficult for EV manufacturers like Tesla to "cross the chasm" and convert ICE customers to the new world.

In particular, the need for Tesla to become more stable is essential for them to attract more customers. And while Tesla customers value innovation and imagination, Elon Musk has his work cut out to shift ICE customer expectations to value imagination and become more care-free (less stability).



The ICE customer has the most willingness to pay for Car/Truck Performance at over 6% pricing power. Surprisingly, customers are more satisfied with Tesla's performance than Ford's but neither is close to meeting what customers expect. Improvement here, which is often the easiest to measure & manage, will favor the next big winner.

Ford's competitive profile favors their ability to scale their customers in the EV market. Improving the usefulness of their EV offering along with assuring customers of their commitment will be critical to future success.

To win more ICE customers over to the EV market, Tesla needs to reshape what customers need and want in their vehicle experience: More imagination with a more care-free attitude. Similar to a Steve Jobs or Howard Schultz, this is a core strength for Elon Musk.

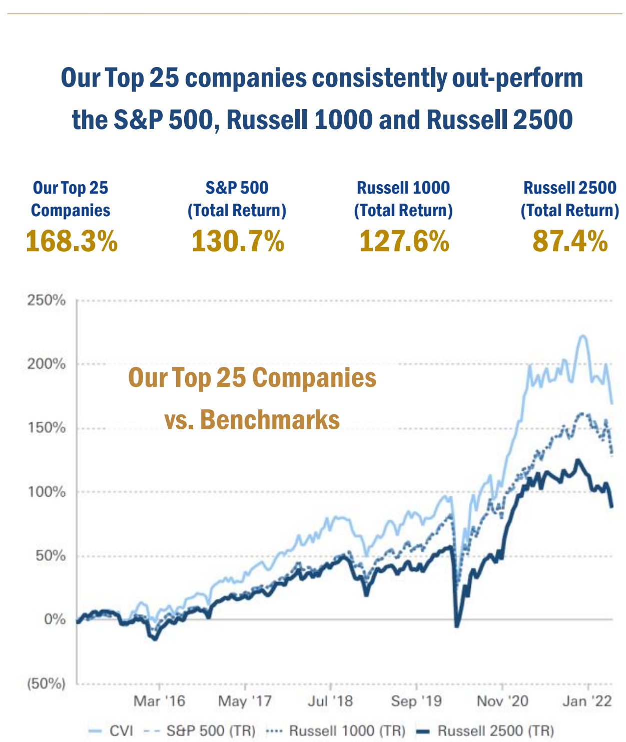
About The W Report™

The W Report™ provides a proven, innovative way to see what contributes to a company's revenue growth today, and predictive power of where to focus efforts that will drive future revenue. Created by **Harvard Business Review** author Gary A. Williams, the patented wRatings system provides fresh, forward-looking data and analytics that cannot be found anywhere else.

Our competitive strength research requires a number of fixed investments to help executives make decisions about how to drive organic revenue growth. Basic economic theory shows that in a highly competitive market, returns will be driven down to essentially no economic profit as rivals imitate any known advantage. To achieve a durable advantage, executives must find ways to defy this very powerful force of competition.

Since starting a fund on January 1st, 2015, the Top 25 Companies in our rankings have outperformed the S&P 500, the Russell 1000 and Russell 2500 by double-digits. Our research was featured as the May 2002 cover article in Harvard Business Review.

The wRatings Corporation provides CEOs, their executive teams and PE Firms & Hedge Funds with subscriptions to our independent competitive research analytics.



Source: Concentus Wealth Advisors, May 1st, 2022