

ECO 201: Final Project

ECO 201 Final Project – Microeconomic Analysis for Tesla

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**Contents**

Introduction..... 4

    Purpose..... 4

    Tesla’s History and Overview ..... 4

Tesla’s Supply and Demand Conditions..... 6

    Tesla’s Impact..... 6

    Tesla’s Actions..... 7

Tesla’s Price Elasticity of Demand..... 10

    Tesla’s Analysis ..... 10

    Tesla’s Consumer Responsiveness ..... 11

    Tesla’s Pricing Decisions..... 12

Tesla’s Costs of Production ..... 12

    Tesla’s Profitability..... 12

    Tesla’s Output Decisions ..... 14

Tesla’s Overall Market ..... 15

    Tesla’s Market Share ..... 15

    Tesla’s Barriers to Entry ..... 16

    Tesla’s Market Structure..... 17

Tesla’s Recommendation..... 18

Tesla’s Future Production .....	18
Tesla’s Recommended Action .....	18
How Tesla Can Sustain its Success .....	19
References .....	20

## Microeconomic Analysis for Tesla

### **Introduction**

#### **Purpose**

Tesla specializes in the design and sale of electric cars, and its goal is to ensure that the consumer is not forced to compromise style for sustainable energy. The purpose of this paper is to enable Tesla to meet this goal by providing a thorough and thoughtful analysis of Tesla's past, present, and future goals. Currently, Tesla is focusing its efforts on making their products more accessible and affordable to the public. Tesla is reimagining their business model and has begun focusing on economic efficiency by producing similar products (renewable energy generation products) which are compliments to their main products and are designed for homeowners and businesses alike (About Tesla, n.d.).

At this time, we feel a normative economic analysis of Tesla may be helpful in planning and implementing a more efficient way to advance Tesla's business due to this type of analysis being "concerned with what ought to be". Our objective, through this analysis, is to enhance the business so that it can meet the needs of the consumers and the organization by helping the firm interact appropriately within the government. This analysis hopes to determine what steps should be taken to attain appropriate support for economic incentives that might grow Tesla's business in a more positive direction (Hubbard, 2014, p. 13).

#### **Tesla's History and Overview**

Tesla, a business founded in 2003 and named after inventor Nikola Tesla, designed their factories with safety and productivity in mind, while they designed product to focus on performance and efficiency. In 2008, Tesla unveiled the Roadster which contained some notable technological advances such as a lithium-ion battery technology that could last for 250 miles on

a single charge, and electric powertrain. Customers could recharge Roadsters in a standard wall outlet but doing so would take between 24 to 48 hours. Initially, the \$100k cost of this product placed Tesla's demand curve asking price at far too great a price point for most consumers to be able to afford (Reed, 2020).

While consumers may have been willing to buy Tesla's products, most of them certainly were not able to. At the time, Tesla was only able to sell their products to consumers who were most willing and able to afford them. Eventually the law of supply kicked in and as the later Model S sedan prices dropped to a lower starting price of \$76k, and the lower price allowed for greater interest in the product to develop, and the demand curve shifted. Eventually, the Model 3 sedan was released as the "first car targeted at a mainstream market, with a price point below [\$70k]" and later, the Model Y was released below a \$45k starting point which is signaling that the price has reached an equilibrium that will allow even more people to be able to afford Tesla's products (Reed, 2020, para. 23).

Today, Tesla seeks to acquire an even greater market share by building its most affordable car that its ever built. Tesla ultimately desires to make its products even more affordable and accessible so that it can accelerate, "... the advent of clean transport and clean energy production." Tesla's range of products now include Electric cars, batteries, renewable energy generation, and storage, and Tesla has expressed interest in making these products available to an even greater consumer base (About Tesla, n.d., para. 5).

## **Tesla's Supply and Demand Conditions**

### **Tesla's Impact**

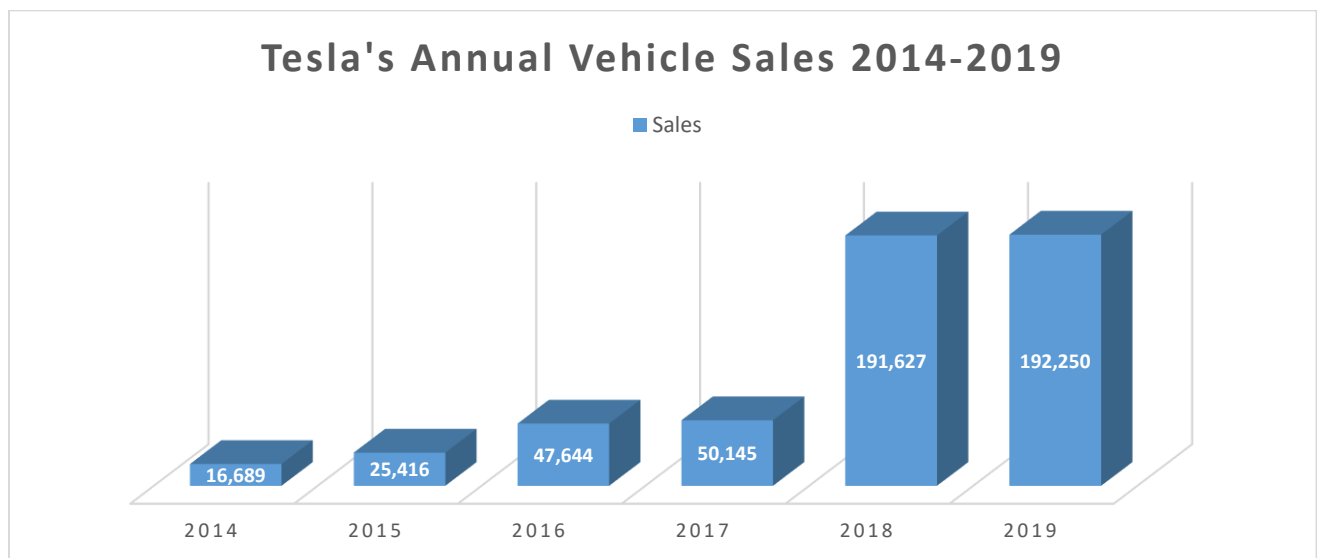
Electric vehicles are a normal good, and because of this one of the variables that have shifted the demand for Tesla's vehicles includes consumer income. Consumer income affects a consumer's, "willingness and ability to buy a good". As a consumer's income rises so does their willingness and ability to purchase an electric vehicle. Price of related goods is another variable that has shifted demand for Tesla's vehicles. As Tesla's competitors' price their vehicles consumers will often compare prices to shop around for the best vehicle that meets their needs and budget (Hubbard, 2014, p. 72).

Tastes is another variable that has shifted demand for Tesla's vehicles. As consumers taste for a product rises, so does the demand for that product. When a consumer's taste for a product falls, so does the demand for the product. Population and demographics are another variable that has shifted demand for Tesla's vehicles. As the population becomes larger and more diverse the range of potential consumers broadens and this allows Tesla to have a broader range clientele. Expected future prices is another variable that has shifted demand for Tesla's vehicles (Hubbard, 2014).

Tesla's five largest competitors in the Auto Industry include Honda, Nissan, BMW, Chevrolet, and Toyota. A few examples of their vehicles and prices are the Honda Clarity PHEV (\$33.4k MSRP), Nissan LEAF (\$31.6k MSRP), BMW 530e (\$53.9k MSRP), Chevrolet Bolt EV (\$36.6k MSRP), and Toyota Prius Prime (\$27.9k MSRP), as compared to Tesla's Model 3 (\$33.6k MSRP). Will the price for electric vehicles go up in the future, or will it decline? Our best guess is that as newer and more efficient production methods are utilized the price will drop. However, an important factor surrounding price is the resale of a three-year-old Tesla vehicle.

When reviewing Tesla’s Model S resale value, I found that a typical Model S will retain up to 72% of its original value, partly due to the limited quantity of Model S vehicles Tesla had produced (Evannex, 2018).

As seen in Figure 1 below, Tesla’s annual sales have increased drastically from 2014 through 2019. Tesla has outperformed itself year over year. In 2015, Tesla experienced 52.29% growth, in 2016 it experienced 87.46% growth, in 2017 it experienced 5.25% growth, in 2018 it experienced 282.15% growth, and in 2019 it experienced 0.33% growth. What this tells us is that the demand for Tesla’s products are only increasing as the variables mentioned above continue to influence the demand for Tesla’s vehicles (Wozniak, 2020).



*Figure 1.* Tesla’s Annual Vehicle Sales 2014-2019. Data retrieved from “Tesla Sales Data & Trends for the U.S Automotive Market,” by K. Wozniak, 2020, Car Sales Base.

### **Tesla’s Actions**

Elon Musk once stated, “The Tesla strategy has been the same from the beginning, which is to start out initially with a car that was expensive but low volume. It’s the only car that we

could have really made and that was the Roadster sports car”. Looking back at Tesla’s humble Roadster beginnings, Tesla started out producing a single model electric vehicle. Tesla now produces four models of electric vehicles and produces solar panels & solar roofs. Today Tesla dominates the U.S. electric vehicle market and had sold more than 192k electric vehicles in 2019, as seen in Figure 2. For a better perspective, Toyota, which sold the second largest quantity of electric vehicles in 2019 had only sold a little over 31.5k electric vehicles, and Toyota’s sales represented roughly 16% of the total sales Tesla made within the 2019 year (Stringham, 2015, p. 89).

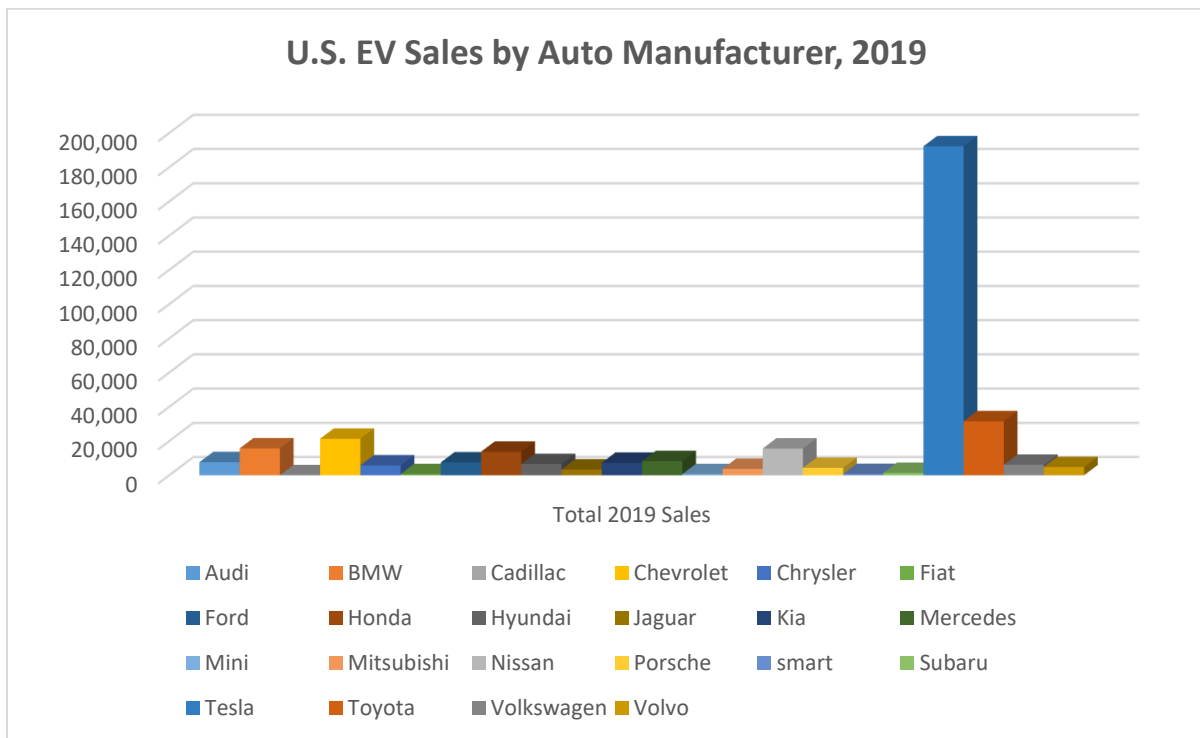


Figure 2. U.S. EV Sales by Auto Manufacturer, 2019. Data retrieved from “Final Update: Quarterly Plug-In EV Sales Scorecard,” by S. Loveday, 2020, InsideEVs.

Tesla’s Model S also led the full-size luxury Sedan sales in the U.S. during 2019 and sold more than 14k Model S vehicles, as seen in Figure 3 below. It is worth mentioning that Tesla’s

closest competitor, Mercedes-Benz only sold 12.5k S-Class vehicles. Let us review how the annual sales data has changed over time for Tesla. When we looked back at Tesla’s humble beginnings in 2014, we saw that Tesla had only sold a mere 16.6k electric vehicles, and in 2019 it sold 192.2k vehicles. That is a huge jump in demand to have experienced in merely 5 years (Wozniak, 2020).

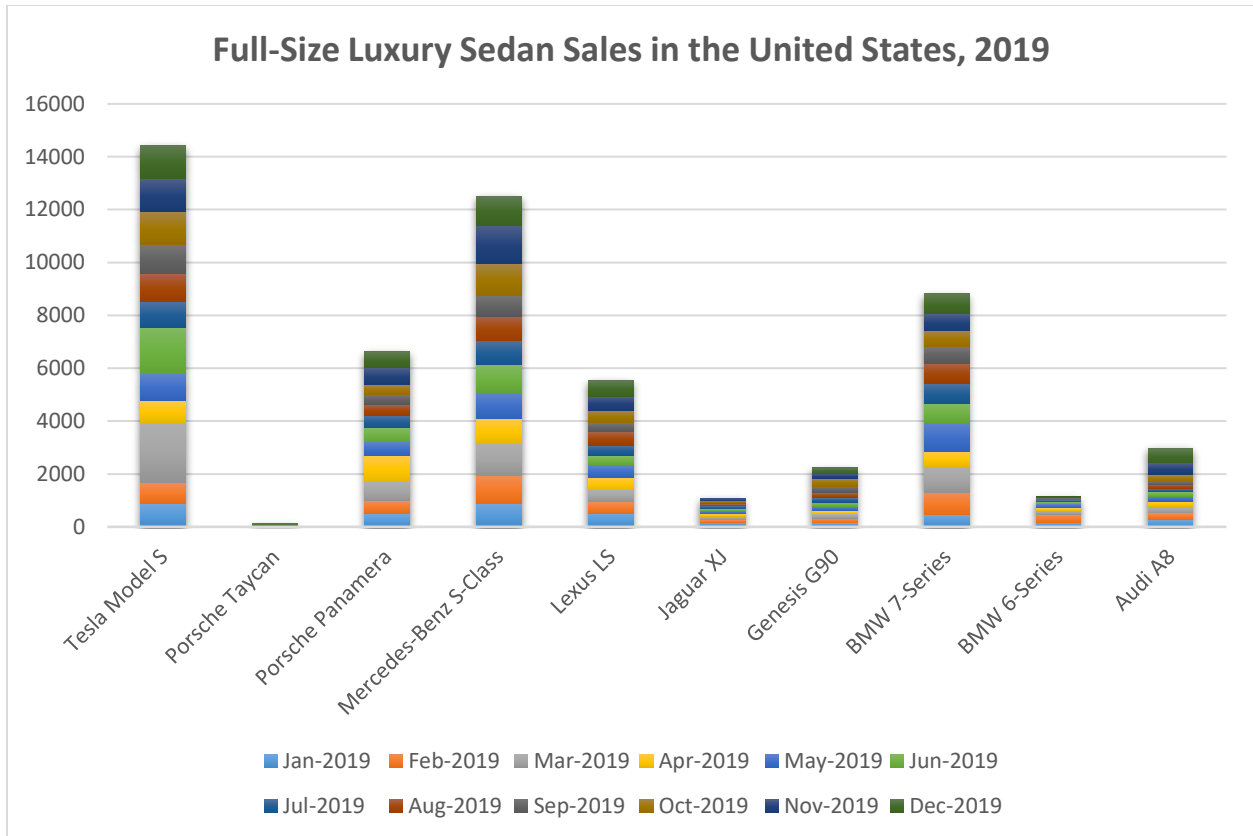


Figure 3. Full-Size Luxury Sedan Sales in the United States, 2019. Data retrieved from “2019 U.S Large Luxury Car Sales Analysis,” by C. Tulumba, 2020, Good Car Bad Car.

More importantly, Tesla’s revenue during this time has changed from \$15 million in 2008 to over \$24,578 million in 2019, as seen below in Figure 4. The kind of growth associated with sort of revenue is astounding considering Tesla’s starting point. This just goes to show us how drastically the demand for this product has changed since the inception of the company in 2008.

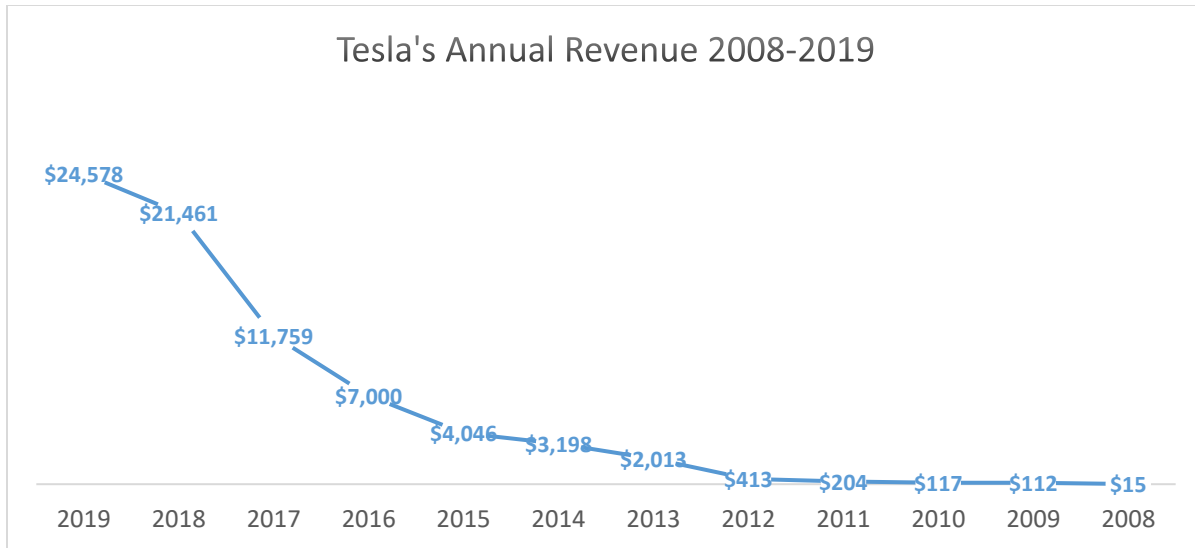


Figure 4. Tesla’s Annual Revenue 2008-2019. Data retrieved from “Tesla Revenue 2009-2020 | TSLA,” by Author Unknown, n.d., Macrotrends.

To encourage additional growth, I believe Tesla should consider branding itself as a global leader in the auto industry instead of limiting itself to the United States. I believe the potential to expand Tesla’s consumer base has been justified by the phenomenal growth that has been experienced since the inception of the company in 2008. The only way for Tesla to grow beyond its current scope is to extend its reach to a more global scale.

### Tesla’s Price Elasticity of Demand

#### Tesla’s Analysis

When compared to BMW’s 530e with a \$53.9k MSRP Tesla’s price point is in alignment with many of its top competitors. Due to the high demand for Tesla’s products it is currently dominating the electric vehicle market. Expected future prices, which is controlled by factors such as resale value were mentioned under the section on Tesla’s Impact. As shown, Tesla’s Model S will retain up to 72% of its original value. This is due, in part, to the limited product run

and the high demand for the product. Currently Tesla's products have an elastic demand due to factors such as pricing and the availability of substitutes. These two factors have increased Tesla's price elasticity of demand for its electric vehicles (Loveday, 2020).

Some of the determinants of supply that have affected Tesla's elasticity of demand are input costs such as the costs associated with creating Tesla's products. Technological improvement can be affected by the scaling up Tesla's production of its products. However, this is also affected by the technology that goes into Tesla's products. As better and more efficient technologies are created it impacts the cost as well as the components that are installed within Tesla's electric vehicles. Prices of substitutes such as Toyota Prius Prime which has a \$27.9k MSRP can also affect Tesla's elasticity of demand. Toyota's price point is slightly lower than the Tesla's Model 3 which is \$33.6k MSRP. However, it was substantially lower than the BMW 530e, which was priced at \$53.9k MSRP. Tesla has 21 major competitors so there are many suitable substitutes currently on the market and having this many alternative firms with close substitutes available will also affect elasticity of demand (Loveday, 2020).

### **Tesla's Consumer Responsiveness**

Some of the factors that affect consumer responsiveness to price changes of Tesla's vehicles are availability of substitutes, which can be determined by looking at the 21 major competitors that were presented in Figure 2. Passage of time also affects consumer responsiveness to price changes of Tesla's vehicles. One question that poses itself is that as time goes on, how do these vehicles hold up regarding their resale value? Luxury or necessity also affects consumer responsiveness to price changes. As fuel has become even more expensive the value perceived from Tesla's products has increased the perceived need for the product from being defined as a luxury to a necessity. Definition of the market also affects consumer

responsiveness to price changes. Tesla is currently dominating the electric vehicle portion of the auto industry. Share of budget also affects consumer responsiveness to price changes. As the price of Tesla's vehicles has fallen the cost of the product as compared to consumers budget or income has also fallen. All these factors will affect a consumer responsiveness to price changes for Tesla's electric vehicles and cause the consumer responsiveness to price changes to increase in elasticity (Loveday, 2020).

### **Tesla's Pricing Decisions**

Tesla sells electric vehicles with a very elastic demand, and customers are extremely responsive to its price changes. In Figure 4 above, we saw that as Tesla's prices for its vehicles have decreased from \$100k to \$33.6k the demand for Tesla's vehicles has grown from \$15 million to \$24,578 million. This change has drastically affected Tesla's Total Revenue as seen in Figure 4 above. As mentioned in the introduction Tesla is focusing its efforts on making their products more accessible and affordable to the public. As Tesla puts out more and more affordable vehicles it stands to reason that the demand for their vehicles will only increase. I feel that if their price were to increase, we could certainly expect their total revenue will decrease. However, Tesla's long-term goal is to make electric vehicles even more affordable, so I do not see this happening to them any time soon as the price elasticity of demand impacts the firm's pricing decisions and revenue growth (About Tesla, n.d.).

### **Tesla's Costs of Production**

#### **Tesla's Profitability**

Tesla's Profitability is determined by both cost of goods sold (COGS) as well as operating expenses. When reviewing Tesla's annual financial statements, it became apparent that Tesla has

experienced increasing costs associated with both variables. Within Figure 5, we can see that in 2013 Tesla’s costs of goods sold was \$1,557 million as compared to 2019 where Tesla’s costs of goods sold was \$20,509 million. During this timeframe, Tesla began expanding its production and its costs of goods sold now include the variable costs surrounding inputs such as lithium, steel, technology, assembly line workers, and robots. This increase represents nearly a 1217.21% increase in Tesla’s costs of goods sold within the past 6 years.

As Tesla’s production grew throughout this timeframe, Tesla’s operating expenses show these additional costs as well. These costs include fixed costs surrounding inputs such as rent, maintenance, advertising, insurance, marketing, and other indirect expenses. When we investigate these costs, we can see that in 2013 Tesla’s operating expenses were \$2,075 million as compared to 2019 where Tesla’s operating expenses were \$24,647 million. This increase represents nearly a 1087.81% increase in Tesla’s operating expenses within the past 6 years.

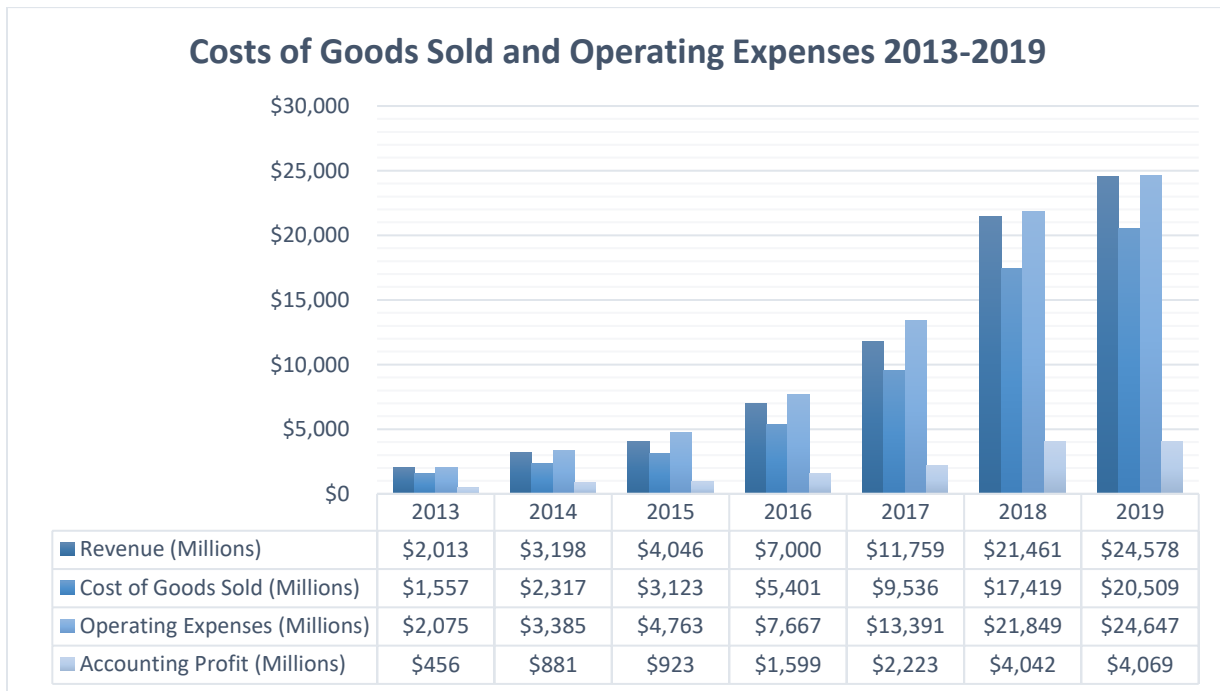


Figure 5. Tesla’s Costs of Goods Sold and Operating Expenses 2013-2019. Data retrieved from “Tesla Financial Statements 2008-2020 | TSLA,” by Author Unknown, n.d., Macrotrends.

### **Tesla's Output Decisions**

In 2012 Tesla introduced the Model S, which was Tesla's first entry into the mainstream consumer market, and in 2013 Tesla produced its first quarterly profit. This progress was followed in 2014 by Tesla's Gigafactory in Nevada, which produces all the rechargeable batteries for its products. In 2015 Tesla entered the solar power market using the rechargeable batteries it was producing in the Gigafactory. In 2016 Tesla announced the Model 3 sedan, which it overestimated production on. Originally Tesla anticipated producing four times the amount it could produce by year's end. In 2018, the company again overestimated its capabilities and when it targeted 5000 cars per week but delivered only 2400 within a three-month span (Reed, 2020).

These production limitations that were experienced were mainly due to an inefficient supply chain spread throughout the globe. However, Musk later tweets that he is taking the company private, and the price of the stock nearly doubles. This later led to the SEC charging Musk with securities fraud. Finally, in 2019, Tesla unveils the CyberTruck, which is a pickup truck that seats six (Reed, 2020).

The way these milestones played out within Tesla's accounting profits, seen in Figure 6, below, was that in 2013 we can see the 1<sup>st</sup> profit being shown. In 2014 we can see that profit nearly double as the Gigafactory is introduced. In 2015, we can see the profit climb slightly after entering the solar energy market. In 2016, profits nearly double again after announcing the Model 3 sedan. In 2018, profits again rose nearly double what they were in 2017 after Musk's tweet of taking the company private. However, in 2019 there was only slight growth following Musk's securities fraud charges, coupled with the introduction of the CyberTruck (Reed, 2020).

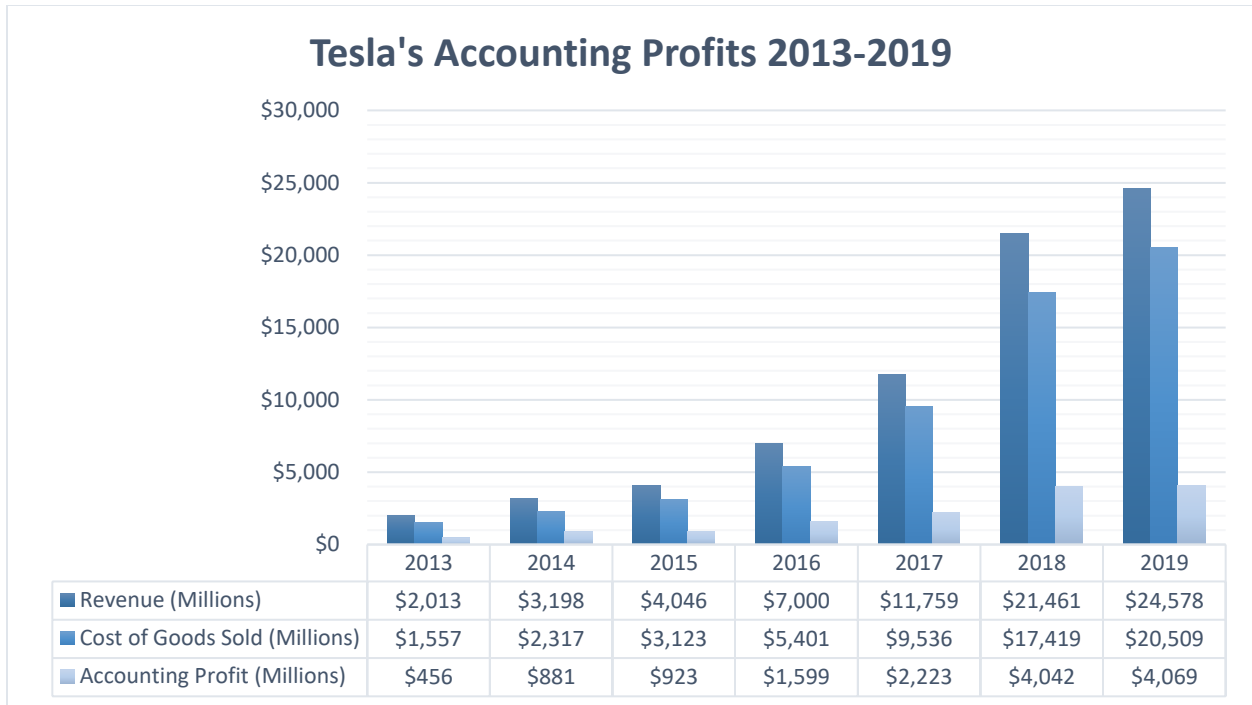


Figure 6. Tesla’s Accounting Profits 2013-2019. Data retrieved from “Tesla Financial Statements 2008-2020 | TSLA,” by Author Unknown, n.d., Macrotrends.

## Tesla’s Overall Market

### Tesla’s Market Share

Tesla is a leader in the electric vehicle automotive market, as seen below in Figure 7, Tesla holds 58.34% of the 2019 market share for the electric vehicle automotive market. Looking back at Tesla’s previous market shares we can see that Tesla has significantly increased its market share dating back to 2014 when it held a mere 13.63% of the 2014 market share for the electric vehicle automotive market. For comparison, Tesla’s top competitor, Toyota, holds less than 10% of the 2019 market share for the electric vehicle automotive market. Tesla’s second top competitor, Chevrolet, holds less than 7% of the 2019 market share for the electric vehicle

automotive market. While Tesla’s other two competitors, BMW and Nissan, each hold less than 5% of the 2019 market share for the electric vehicle automotive market.

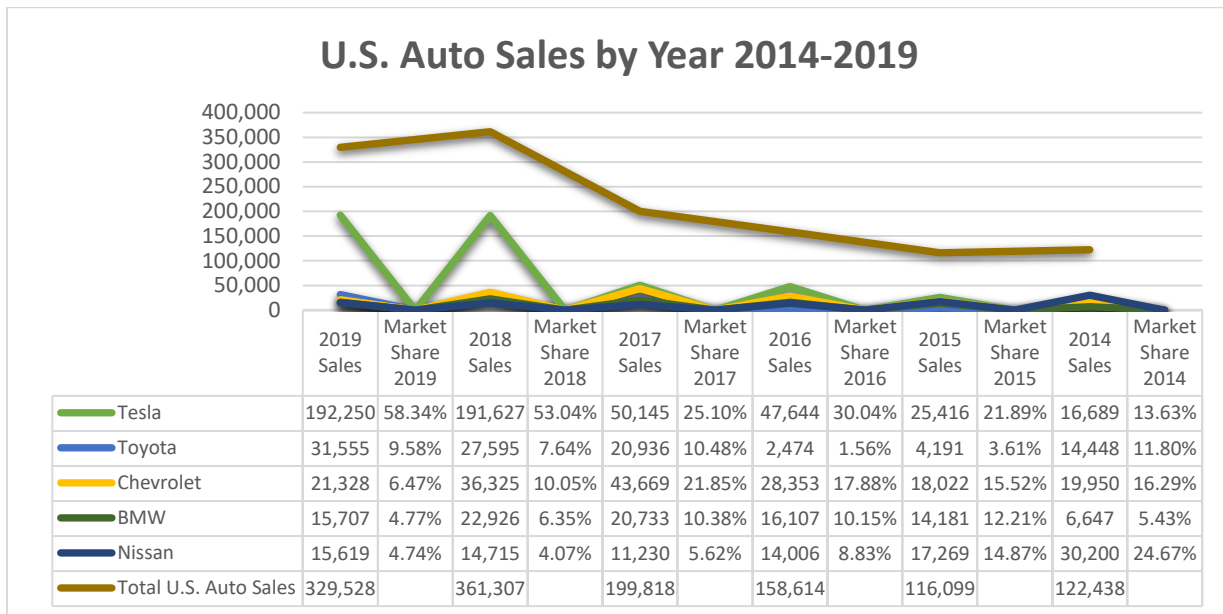


Figure 7. U.S. Auto Sales by Year 2014-2019. Data retrieved from “Monthly Plug-In EV Sales Scorecard: Historical Charts,” by S. Loveday, 2018, InsideEVs.

**Tesla’s Barriers to Entry**

One of the barriers to entering the electric vehicle automotive market that Tesla had faced was economies of scale. As a new auto manufacturer Tesla simply was not large enough to be able to produce its chosen product. Tesla initially lacked the funds, facilities, staff, and skills necessary to design or produce the product themselves. To navigate around this issue, Tesla worked smarter by outsourcing the work needed to take their technology to the market in a timely fashion. In doing so, Tesla was able to provide proof of concept and break through their barriers to entry by partnering with other companies (Dobrinova, 2016).

Tesla initially partnered with an auto manufacturer by the name of Lotus. Lotus helped Tesla design, engineer, and create Tesla’s first minimum viable product, the Roadster. As Tesla

grew, so did its partnerships and it began partnering with firms like Daimler, Panasonic, and Toyota. In 2010, Toyota was so impressed with Tesla that it invested \$50 million for a 3% stake in Tesla and sold the company an assembly plant in Fremont, California (Dobrinova, 2016).

Another barrier Tesla faced was state dealership franchise laws, like the ones in Texas, which prohibited direct sales to consumers by auto manufacturers. These dealership franchise laws were initially designed to protect existing dealerships from a manufacturer directly competing with them after the dealership had already invested the energy, money, and time necessary to start and promote their business. To work around this, Tesla hired lobbyists to circumvent these laws by asking for an exception to be made to allow Tesla to bypass the franchise laws and sell directly to consumers (Loyola, 2015).

### **Tesla's Market Structure**

Tesla's Market structure is an oligopolistic market structure because the concentration ratio of the top four firms account for more than 40% of the industry's sales. The oligopolistic market structure affects Tesla's ability to influence the market because Tesla's sales account for 58.34% of the overall market. This large a percentage means that Tesla is the leader in the industry even though Tesla has many competitors. Tesla's top competitors are Toyota, Chevrolet, BMW, Nissan (Loveday, 2020).

We should note that while Tesla mainly targets the electric vehicle automotive market, many of its competitors simply target the entire automotive market. This market is comprised of both electric vehicles as well as vehicles with combustible engines. By targeting only one segment of the automotive market, Tesla has focused its efforts and distinguished itself as a leader in the EV automotive market. Doing so has allowed Tesla to acquire the largest market share of this niche in the market (Hubbard, 2014).

## **Tesla's Recommendation**

### **Tesla's Future Production**

My recommendation for how Tesla can manage its future production is to continue to expand and innovate. Tesla experienced its largest growth in revenue during 2018 just following the increase in production for the Model 3 sedan and the announcement that Tesla would take its company private. Utilizing this historical data, it stands to reason that if Tesla were to create a similar demand for a new product it was launching, to build awareness through a marketing campaign, and to consider taking the company private again it might create similar conditions that would allow it to generate a huge demand for their vehicles. However, to avoid the demand problems faced during the release of the Model 3 sedan, Tesla should consider expanding its production capabilities beforehand, so it does not disappoint its customers like it did between 2018 and 2019 (Reed, 2020).

### **Tesla's Recommended Action**

The best course of action for Tesla to follow, while expanding its business, is by procuring additional resources and facilities needed to compete within the electric vehicle automotive market. Tesla should consider product demands, facilities, and investing in scalable and/or movable assembly lines that can be increased or decreased as needed. Tesla should also be careful not to commit itself to producing a higher quantity of vehicles than it possibly can during any given time frame. Making these changes will help Tesla expand its business by building trust within its consumer base and this will help Tesla further differentiate itself from its competitors (Reed, 2020).

**How Tesla Can Sustain its Success**

A few ways Tesla can sustain its success going forward is through both product differentiation and by building trust with its consumers. Mean what you say, and say what you mean, is the idea that is going to set Tesla apart from the version of Tesla that its consumers currently know. Regardless of any supply chain challenges experienced in the past, Tesla needs to set itself apart through thoughtful leadership and mindful expansion. If Tesla can do this it will ultimately become the company that its consumers need it to be. Product differentiation can be achieved if Tesla considers creating an electric SUV to expand its current product line. Tesla already has a sports car, sedan, and truck. An electric SUV is an untapped alternative to the traditional combustible engine or hybrid models its competitors currently produce (Reed, 2020).

Following the recommended actions above and generating awareness of Tesla's new line of vehicles can easily allow Tesla to expand its operations. However, accomplishing this will take time, effort, and careful planning to avoid experiencing the same challenges Tesla has experienced in the past. These challenges have caused some consumers to lose faith in Tesla's integrity and it's important not to have to repeat this lesson with consumers. If Tesla can accomplish this goal it may once again find itself owning yet another segment of the electric vehicle automotive market. However, it's Tesla's consumers who will experience the marginal benefit and they will be the ones to be made all the better for it.

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