THE CONGRESSIONAL OVERSIGHT PANEL REPORT ON AUTO BAILOUTS: DEALER CLOSURES

I'm reading the Congressional Oversight Panel's report on the auto bailouts (COP is the oversight entity headed by Elizabeth Warren). I'll have more to say in a bit, but I did want to point to one of the most coherent explanations for why the manufacturers had to shut down so many dealers.

First, the Chrysler details (footnotes removed):

> Chrysler announced that it would retain an "overwhelming majority" of its suppliers and would close 789 of its nearly 3,200 U.S. dealerships. These dealerships employed more than 40,000 people. State governments heavily regulate the relationship between dealerships and automotive companies, usually claiming that close oversight is necessary to equalize the bargaining power of dealerships and automakers. Generally, states only allow an automotive manufacturer to terminate a dealer contract if it has good cause. However, the bankruptcy process provided the automotive manufacturers with greater flexibility in terminating dealership contracts. Congress is currently considering a number of bills to restore the terminated dealers‟ contracts.
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> Both Chrysler and GM maintain that their dealer networks were oversized and that downsizing was necessary to regain viability. Domestic brands in 2008 accounted for about two thirds of U.S.

> dealerships, but only 48 percent of new vehicle sales. Chrysler, for example, has less domestic market share than Toyota, but even after its intended closings will have many more dealers [Toyota has 1502 dealers].
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> In 2008, Chrysler‟s dealers lost on average $3,431. By consolidating dealerships, the companies argue, they can drive more sales through more profitable businesses that can afford to invest in their businesses. The remaining dealers may also be able to negotiate more favorable terms with their floor-plan financers. This may in turn help dealers acquire more stock and sell it to consumers at lower prices, thereby increasing sales and profits for the dealers and for Chrysler and GM.

And here are the GM details:

> GM subsequently notified 1,300 of its approximate 6,000 U.S. dealers that they would be closing by year end 2010, aiming eventually to trim its total to about 4,000. GM provided approximately $600 million in financial assistance in return for the dealers‟ selling down their existing inventory over the subsequent twelve months. These payments could vary widely based on each dealer’s situation.

Now, the report misses one key element—the one that dealers complained about constantly when I was doing a US dealer consulting project for an American manufacturer in 2007. If you’ve got a GM dealer on Main Street and another GM dealer two miles away on Auto Parkway—and they can get the same product with little time lag (they do this through dealer trades)—then only two things separate those dealers: customer service, and price. This forces dealers into cannibalizing the sales of dealers of the same brand, driving down the price and with it, the profit margins of each dealer.

Not only does this make each of the dealers less viable, but it contributes to the cheapening of the brand overall. So to the extent you can cut down on these kinds of cannibalizing sales on price, you improve the overall health of the brand.

And, as this report notes, you can increase the overall sales of dealers that can invest in their businesses.

I suspect GM and Chrysler will have to continue to shed dealers over time (and I know Ford realizes it need to do the same to remain competitive). But within the context of the restructuring through bankruptcy described here, the report gives a fair explanation of the need.