

Los Angeles Times

Thinning dealer ranks is key to reducing GM and Chrysler's costs

But contracts make it nearly impossible for the automakers to simply put these independent business owners out of commission, the way they can lay off employees.

By Ken Bensinger
April 13, 2009

Car dealers -- sponsors of Little League, fixtures of Main Street, vibrant symbols of the American entrepreneurial dream -- could now prove to be the biggest threat to the future of the very industry they built.

For much of the last century, in exchange for selling Detroit's new models and providing a public face to distant industrial giants, dealers were richly rewarded with a steady, lucrative business and received community respect.

Now, with the industry in crisis, it's clear that there are too many outlets for the two most desperate carmakers, General Motors Corp. and Chrysler, economists and industry analysts agree.

Thinning the dealer ranks -- there are now about 9,500 locations combined for the two companies -- is key to cutting the two automakers' costs, helping to ensure that those dealers that do survive are more profitable and provide better service.

Car manufacturers don't own their dealerships. Instead, they grant franchises to businesses that buy vehicles at wholesale prices and mark them up for sale to the public, keeping the difference.

Although even some dealers concede that there are too many car lots, the trade has been profitable enough over the years that few are willing to give up their own franchises.

Contracts with dealers, meanwhile, make it nearly impossible for automakers to simply put these independent business owners out of commission, the way they can lay off employees.

"We think the marketplace should determine which dealers stay in business," said John McEleney, chairman of the national dealers association and owner of GM, Toyota and Hyundai dealerships in Iowa.

In fact, the market is forcing some contraction. The National Automobile Dealers Assn. said this week that 271 dealerships closed up shop in the first quarter alone, victims of the brutal slump in car sales. But experts say attrition isn't happening fast enough.

"A lot more people are going to have to pay this price," said Tom Marx, a business professor at Lawrence Technical Institute and former GM economist.

Last year, roughly 1,000 dealerships closed nationwide, about 680 of which were under GM or Chrysler flags. The national dealers group expects an additional 900 dealerships to close by year-end.

Toyota Motor Corp. has only about 1,400 dealers nationwide, compared with about 6,200 for GM, despite the fact that the Japanese automaker sells nearly the same number of cars. Honda Motor Co., with sales rivaling Chrysler's, has fewer than half as many dealers.

That means the average GM and Chrysler dealership sells fewer cars, has smaller profit margins and can't afford to invest as much in showrooms and customer service as its Japanese rivals, which experts say leaves a bad impression about the American brands on consumers.

GM, in the restructuring plan submitted to the government in February, said it hoped to reduce to 5,750 dealers by year's end and 4,100 by 2014. Chrysler, which has about 3,300 dealers, said it too planned to reduce the number, though it did not specify by how much. Its plan said 27% of its dealers were in financial distress.

Ford Motor Co., the third of Detroit's Big Three is also working to reduce its roughly 4,000 dealers, but it has not received a U.S. bailout and is not under pressure to make such cuts.

The possibility of bankruptcy looms for GM and Chrysler after President Obama rejected their latest financing requests last month and sent them back to the negotiating table. Reducing billions of dollars in obligations to debt holders and unions was singled out as the most immediate goal, and the administration has been working intensively with the automakers to help work out a deal.

Yet the administration has also strongly urged the automakers to come to terms with dealers. And with their coffers all but drained, they have never been less prepared to make their most loyal partners a reasonable offer to get out of the business of selling cars.

State franchise laws make it difficult and expensive for a carmaker to shut down dealers unless they fold on their own -- or the carmaker files for bankruptcy protection. With little leverage and the clock ticking, GM and Chrysler must find a way to navigate the complicated economics of the American car dealer.

"GM and Chrysler have this mandate to get rid of dealers, but the costs and complexity involved are mind-boggling," said Randy Berlin, practice director at Urban Science, which tracks auto dealers. "Bankruptcy might be the only way."

In its assessment of the automakers' situation, the Obama administration's autos task force said that "pruning" of dealers by GM and Chrysler wasn't going far enough. The administration didn't give specific targets, but GM Interim Chairman Kent Kresa said the message was clear: "The government wants it to happen faster than we had planned."

Kresa said in an interview that GM was working to "rationalize" dealers, but he declined to provide details. Chrysler also demurred, saying in a statement that it was "committed to working closely with all constituents . . . to reach a successful conclusion."

A Treasury spokesman declined to provide specifics about its plans for dealers.

Unlike with the United Auto Workers union or holders of \$27 billion in GM bonds, negotiating with dealers must be done on a franchise-by-franchise basis. That's what happened when GM shut down its Oldsmobile brand earlier this decade. The company offered Olds dealers cash to give up their contracts, costing GM more than \$1 billion in payouts.

GM made a similar proposition to Howard Drake a year ago, persuading him to close his Hummer dealership in Sherman Oaks. But there's not a lot of green to go around these days. When GM said in December that it would sell or eliminate its Saab marque, Drake asked the company if it would help him close his showroom dedicated to that brand as well. The response: silence.

"If they don't come clean on my Saab store, it's really going to hurt," said Drake, who also owns the Casa de Cadillac dealership in Sherman Oaks.

Short on cash, automakers would appear to have few bargaining chips. Aaron Jacoby, head of the automotive practice at law firm Venable, said franchise laws were so strong that only a bankruptcy judge could break them. "If they go into bankruptcy, you just break the contracts and say, 'You're done,' " he said.

For dealers, that's the nuclear option. But with both GM and Chrysler giving increasing signs that a Chapter 11 filing is on the table, there's even more tension.

"In the last eight months, there have been a lot of things that have been hard to swallow," said Jim Arrigo, owner of two Florida Chrysler dealerships and chairman of the national Chrysler dealer council.

Manufacturers contribute more than cars to their dealers. They provide financing for consumers to buy vehicles and for dealers to fill their lots. They also pay dealers to perform warranty service. Throw in sales of extended warranties, undercoating, used cars and parts, and being a car dealer can be quite profitable.

But not lately. With demand for autos at its lowest level in a quarter-century, dealers suffered the largest drop in sales revenue of any retail category last year, according to research firm Sageworks Inc. The average profit per dealership employee dropped 92%.

Arrigo and other dealers point to efforts by GM and Chrysler to force more inventory on unwilling dealers, as well as big increases in costs of the financing that the automakers' lending arms, GMAC and Chrysler Financial, provide to dealers for inventory.

A recent study by the California New Car Dealers Assn. found that 54 dealers had received notice they would lose their wholesale financing altogether -- amounting to a fatal blow -- while an additional 131 were concerned that they would go out of business in the next six months because of tightened access to credit.

That has prompted some dealers to worry that the automakers are using their finance arms to selectively weed out dealers, a move that might violate franchise agreements.

Scott Silverman, who represents dealers for Boston law firm McCarter & English, said several of his clients were considering legal options over changes in their financing terms. "The carmakers want to put these people on the street," he said. "The dealers may no longer be their fair-haired boys, but they need to offer them something."

ken.bensinger@latimes.com