

The Benefits of the Franchised Dealer Network: The Economic and Statutory Framework Executive Summary - November 24, 2008

The automobile manufacturers established the dealer network comprised of independent entrepreneurs to outsource the costs associated with the distribution, sales, and service of their products, and they have achieved this goal through the use of contracts of adhesion called sales and service agreements or franchise agreements. The complex interaction between an auto manufacturer and a franchised new car or truck dealer is unlike any other business relationship in America. While the manufacturer assumes the economic risk attendant to designing and producing vehicles, the dealer assumes the economic risk of retailing those big-ticket items. Franchised dealerships are independently owned businesses, not the “company owned” stores used by many other industries to distribute their products. As such, it is the dealer – and not the manufacturer – that invests in the land, buildings, facility upgrades, personnel, advertising and equipment necessary to sell and service vehicles. Because of these multi-million dollar dealer investments, manufacturers receive a national retail distribution network at no capital expense and are able to externalize most of the costs associated with the establishment and maintenance of a national retail distribution network for their products. Similarly, customers enjoy a competitive market in local communities throughout the nation in which to purchase and service vehicles and convenient locations to respond to safety recalls.

Absent the independent entrepreneurs who assume the costs and the risks of the retail network, a manufacturer would have to invest billions of dollars to replicate the existing facilities, employees, and retail presence. The operational costs incurred by the manufacturers related to maintaining the dealer network are immaterial. Moreover, objective observers have called the U.S. franchised system the most efficient motor vehicle distribution network in the world.

All 50 states have enacted motor vehicle franchise laws to inject balance in the inherently one-sided economic relationship between a dealer and the manufacturer and to provide consumers a reliable, convenient, and competitive retail network for automobiles sales and service. The state franchise laws guard against a manufacturer unilaterally terminating a dealership without cause and unilaterally threatening to put the same brand on every corner. A typical state franchise law requires a manufacturer to show good cause in order to terminate a dealer agreement, provides a framework for determining a fair value of the franchise terminated, establishes basic rights of succession from generation to generation, and sets out a definition of relevant market area to preclude unfair proliferation of dealerships. Numerous courts, even the United States Supreme Court, have upheld the constitutionality of various state franchise laws.

The state franchise laws have provided a rational framework for consolidation and reduction of dealerships. Within the past sixty years, the number of dealerships has declined steadily from almost 50,000 in 1949 to 19,700 today. Even with the state franchise laws in full effect, the manufacturers have combined brands under one roof at the dealership level via channeling agreements, eliminated brands all together, and terminated individual dealers.

A strong dealer network is part of the solution to the current crisis rather than part of the problem. The pre-emption or suspension of state franchise laws would further threaten the economic stability of Main Street and further erode the national infrastructure essential to the recovery of troubled manufacturers. The manufacturers, dealers, and other stakeholders should work together to design a solution that makes economic sense for all involved, thereby enhancing the political viability of the legislation.