The Competitive Position of New Vehicle Dealerships and Their Value to Consumers

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In 2015, the four largest automakers (GM, Ford, Toyota, FCA) took 59.7 percent of total sales in the U.S. light vehicle market. The combined U.S. light vehicle market shares of the eight largest automakers totaled 88.5 percent. The average level of unit sales for the four biggest firms was 2.61 million vehicles, and for the eight biggest, 1.94 million.[i] North American operating profit per vehicle for the four largest automakers last year was a sales weighted $2,374 per vehicle. Two automakers earned just over $3,000 per vehicle sold. It must be said that 2015 was a good year in the U.S. vehicle market for almost all automakers, a development celebrated in remarks by President Barack Obama when he recently visited the North American International Automotive Show in Detroit.

The industry is actually even more concentrated at the vehicle producer level than the percentages shown above indicate when major vehicle segments are considered. Just three automakers take more than 80 percent of pickup truck sales. Asian brands similarly dominate compact and intermediate passenger car sales and German automakers have a commanding position in the luxury segments. If there is a major factor in the comeback success of automakers in the U.S. automotive market in the last six years it is "price discipline," and low incentive levels and rising prices for much of the period prove this.

If there is a segment of the long automotive value chain that remains fiercely competitive it is new vehicle dealerships. In contrast to the vehicle manufacturers, the 16,545 "rooftop" dealers[ii] who own 30,397 franchises and who sell an average of about 1,100 new vehicles a year per dealership earned a final profit of only $49 per new vehicle sold in 2015. This is a margin so thin compared to the automakers it belies any claim of "double marginalization." In fact, dealers spend about $143 per vehicle just to finance their inventory to provide consumer choice to the over 80 percent of buyers who buy off the lot. The dealers even spend over $600 in advertising per new vehicle sold. Why are dealers willing to accept such a low profit from selling an average of $30 million in new vehicles a year? Because they make reasonable profits on the sale of largely same brand used vehicles and the provision and sale of services and parts. This can raise the average overall profit of a dealership to $1,100 per new vehicle sold or so but even here automakers are largely in control of the business.

Dealers cannot sell new vehicles except those supplied by automakers through franchise agreements and they only have access to new vehicle parts in a similar way. Even the supply of relatively new used vehicles is allocated by the automakers since off-lease cars return to the ownership of the automakers and leasing is now at a record level. Automakers are also in control of vehicle allocation, most incentives, and even dealer investment requirements in buildings and equipment upgrades. In fact, dealers are not allowed independently to even to sell their business without automaker approval. Finally, the bill is due to the automaker for new vehicles at the dealer, not when they are sold to a buyer, but when they are delivered to the dealer.

Dealerships today do face strong competition from other franchisees who sell the same vehicles and also from other dealers with very similar products in close proximity. Most franchise agreements, it is true, define a geographic distance from other franchisees for the same brand. But distances between same brand franchisees aren't great enough to prevent severe price competition between same brand dealers as was shown in a recent econometric analysis of Texas dealers and vehicle prices by the Phoenix Center for Advanced Legal and Economic Public Policy Studies (March 2015).[iii] In fact, such intra-brand competition can produce greater price effects than inter-brand competition in the same auto mall (dealerships of different brands now commonly co-locate in "auto malls" or the same territory. Such co-location of dealers provides buyers with the convenience of low-cost shopping). The increasing use by buyers of information on the inter-net, however, may be seriously reduce the cost of shopping same brand dealers across distances within a region or a sort of a virtual automotive mall.

Non-price elements of the new vehicle sale have never been more competitively important. Any dealer sales manager will tell you that the trade-in value is part of the final vehicle price. J.D. Power's Sales Satisfaction Index underlines the critical importance of superior service especially in repeat sales. And finally, it is the acutely competitive duty of the dealership to find the best possible finance rate- if not from automaker captive finance companies like FMC – then from automotive loan services of banks like Chase Auto – or even hundreds of credit unions that supply 39 percent of the trillion-dollar market in vehicles loans. The competition on any one of these items is across the street or at a same brand dealership less than 30 miles away at most and very often the surcharge on these loan rates should be seen as a finder's and search fee that benefits the automotive consumer.

Finally, is an interesting question to ask what the automakers would do without their dealership franchisee partners? Would they hire 1,110,000 replacement employees with an annual payroll of $62.8 billion? CAR studied the economic contribution of new vehicle dealerships to the U.S. economy and the fifty states in 2014. Our results showed that at that time the 1,056,000 direct jobs at dealerships produced an additional 310,000 supplier jobs in the economy and the spending of these combined 1,366,000 employees produced an additional 870,600 jobs throughout the economy for a total impact of 2,236,600 U.S. jobs or a jobs multiplier of 2.1.[iv] Total personal income contributed to the economy by the 2.23 million jobs was $143.8 billion.

Also, would the automakers lay down another $210.9 billion in facility, working capital, and inventory investments as the dealerships have? This is an amount greater than the equity value of the Detroit Three! And would they know the names of the customers, their families, and even their pets?

The answer is fairly obvious: the automakers would severely consolidate the dealership/franchisee network and pocket the savings as monopolists. They would also then be in a position to raise prices because independent dealers that used to compete within a brand on the same models would now be replaced by automaker sales centers that offer one, set monopolist price for each model by the automaker. And America would lose.

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[i] Vehicle sales and market share figures taken from various issues of Automotive News.
[ii] All dealership data provided by NADA, 2016
[iii] Beard, T. Randolph, George S. Ford, Lawrence J. Spiwak, **The Price Effects of Intra-Brand Competition in the automobile Industry: An Econometric Analysis**. Phoenix Center Policy Paper Number 48, Phoenix Center for Advanced Legal & Economic Public Policy Studies. March 2015.
[iv] Menk, Debra Maranger, Joshua Cregger, **Contribution of New-Car Dealerships to the Economies of All 50 States and the United States.** Center for Automotive Research, Ann Arbor, September, 2015.