Porter & Company, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

241 Summit Avenue, Suite 100
Post Office Box 4112
Greensboro, North Carolina 27401 / 27404-4112
Office: (336) 370-1000
Telefax: (336) 275-1337
www.porterandco.com

March 4, 2016

Federal Trade Commission
Office of the Secretary
Constitution Center
400 Seventh Street, SW
Room 5610
Washington, DC 20024

RE: Comments on Automobile Distribution Workshop: Current Issues and Future Trends
Project No P131202

Dear Sir/Madam:

I am a Certified Public Accountant (CPA) located in Greensboro, North Carolina and a shareholder in Porter & Company, P.C. CPA's. I have worked with automobile and other motor vehicle dealers located primarily in the Southeastern United States for over thirty years as their primary financial and tax advisor. I have personally worked with at least one hundred dealerships during my career helping with the complex task of operating a successful dealership. I believe I am qualified to offer credible insight concerning the retail sale and servicing of vehicles in the United States through a dealership distribution model.

The vast majority of our dealer clients have one or two dealership locations representing one or two manufacturers sometimes with multiple franchises (e.g. Chrysler Dodge Jeep Ram) in the same facility. Our clients are representative of most dealerships in the United States. While most of the press and attention focus on the large dealership groups and large transactions made by those groups (e.g. Warren Buffet's recent investment), collectively those large groups represent only a tiny fraction (less than 9%) of the dealerships in this country. The vast majority of dealerships are considered small businesses employing less than fifty people.

Some of the workshop speakers stated that dealerships generate millions of dollars in business with the implication that this is in some way harmful to consumers. While dollar sales volumes in dealerships may seem high on a relative basis versus other industries, these sales are generated through the sale of a relatively small number of very large ticket items (vehicles). A dealership selling only 100 vehicles a month (about three or four vehicles per day) at an average sales price of $20,000 per vehicle would generate $24 million in vehicle sales not including service, parts, or other sales. It takes only a small volume of transactions to generate exceptional dollar sales volumes.

The cost of the products sold (i.e. vehicles and parts) purchased by dealers from the manufacturers was not addressed during the workshop. The cost of products is extremely high and payments to the manufacturer comprise a majority of a dealership's annual expenditures. Average gross margins on new vehicle sales are generally less than 8% of sales, meaning that approximately ninety-two cents of every sales dollar in sales goes to the manufacturer of the product (General Motors, Ford, etc.). This margin is before paying for very expensive real estate in prime locations on which the dealership operates, personnel costs for sales and support of the vehicles, advertising, computer systems, customer goodwill, and other costs of operating any business.

The net profit margin of a typical dealership is around three dollars of every one hundred dollars in sales before income taxes are paid. If the retail distribution system was changed without dealers to sell and service products, a majority of the costs incurred by dealers would be transferred to the manufacturer. For instance the delivery of a vehicle from the factory to the dealership is paid by the dealer, the marketing cost for the product in the local market is paid by the dealer, the cost of storing and maintaining products available for sale are paid by the dealer, along with real estate, personnel, etc. and this is only a partial list. If the current vehicle distribution system were changed, these costs would not go away, they would simply be absorbed by the manufacturers. If and only if, the manufacturers could market, distribute, sell, finance, service, and protect consumers more effectible and efficiently than the current franchise system, would consumers potentially benefit from disrupting the current system. Manufacturers have failed miserably in every past attempt where they have tried (and there have been many occasions where they have tried) to distribute product directly to consumers. Every time the current system has been changed, the manufacturers quickly exit the retail sale of vehicles and return to the franchise method of distributing their products.

Manufacturers are very, very powerful entities that carry a very big stick with dealers. The manufacturers have direct access to the dealership's bank accounts to put or take away funds. They have the power to perform subjective and random audits of dealership operations including warranty and incentive audits which can be capricious, vindictive and expensive with limited appeal rights to the dealer. In some cases, manufacturers practically force dealers to report sales prematurely and then later penalize the dealer having done exactly what they were told to do. In addition, the manufacturer can use various schemes including forcing large injections of capital, require large capital outlays to build large, expensive new facilities at the dealer's expense (not the manufacturer), and take other measures that put the dealership in a position of not being economically viable or risk losing their ability to sell vehicles for the manufacturer. These measures and others are frequently used to penalize dealers the manufacturers do not like or want to keep. Without the protections afforded by the state franchise laws, dealers would be even more vulnerable to the whims of the manufacturers than any dealer, even large publicly traded ones. This is not meant to imply that manufacturers are inherently bad actors, however dealers are in an unfair bargaining position in dealing with large organizations that have objectives not always aligned with those of dealers which the franchise laws help make more equitable.

It is important to understand that the dealership is the manufacturer's customer, not the retail consumer. The dealership orders (or in some cases is allocated) product manufactured by the manufacturer and pays the manufacturer for the product when it leaves the factory or port. The dealer uses its own combination of cash and financing to pay for these vehicles before they leave the factory. Once the dealer is shipped the vehicle, the manufacturer records a sale regardless of how long it takes the dealer to sell the vehicle to a retail consumer. If the product is not a desirable model or does not have the correct features (e.g. air-conditioning in the South), the loss for this mistake is the dealer's not the manufacturer. In many cases (most cases for smaller dealers), the dealer must personally guaranty the financing the dealership uses to pay for the vehicles it purchases from the manufacturer and also personally guarantees large real estate mortgages for the expensive property on which the dealership operates. The capital needs of a dealership are huge and far in excess of that in most other businesses. All of this capital must be supplied by the dealer not the manufacturer. The dealer is "all in" to use a popular vernacular term.

No other party involved in the sale of the vehicle to the consumer is similarly at risk. At worst, an employee of a manufacturer might lose his or her job for an egregious mistake and need to find another, but the dealer puts at risk everything he or she owns to make the dealership successful and take care of the consumer. If they fail, the dealer goes broke. If they operate unscrupulously or unethically, the dealer goes broke. If some governmental agency puts them out of business, the dealer goes broke. If laws that protect the huge investment they have made change they can go broke, if the manufacturer changes the design of a key high volume vehicle to one consumers no longer want, the dealer goes broke. The risks are huge and seemingly unending. The dealer truly puts his own money at risk and has more incentive than anyone else involved in the sale of a vehicle to a consumer to make certain that each and every customer is satisfied and receives the best possible value. Satisfied customers return to purchase additional vehicles and have their vehicles serviced at the dealership. Dissatisfied ones do not and the dealers have a strong incentive to try and satisfy each and every customer of the manufacturer's products.

The average dealer lives where his customers live, goes to church (synagogue, etc.) with his customers, is in Rotary with his customers, has kids on sports teams with his customers, donates money to various civic and charitable organizations for customers, sees customers at dinner and in the grocery store. The dealer knows the consumers in the local market better than anyone and far better than any economist, analyst, or accountant in a back office or ivory tower could ever know the customer. The dealer knows how to help a struggling customer trade out of a car they can no longer afford when a life event happens and they can no longer to make the payment, the dealer helps customers purchase a vehicle after a nasty divorce and their credit is ruined, sometimes the dealer even finances the vehicle for a customer who is struggling and cannot get credit otherwise. Our average dealer is a pillar of their community and many, many people come to them for help which is gladly offered. The dealer serves a purpose for the manufacturers that is rarely recognized or appreciated and serves as a bridge between the consumer and the manufacturer in many, many ways.

While in my personal opinion it would be preferable to have a consistent set of franchise laws across all states, the reality is that this has never been feasible due to the wide differences between markets, manufacturer needs, and dealer sizes in different parts of the country. A dealership in New York City is very different than one in a rural market, luxury import brands have different customers and needs than domestics selling pickup trucks. Some overarching needs are the same for all dealerships, and protection from the capricious actions of the manufacturers is universal. Even the biggest public dealership groups can only own a small number of dealerships from each brand due to framework and other agreements imposed by the manufacturers solely to limit the dealership's bargaining power and influence over the manufacturer. It has never been a level playing field between dealer and manufacturer and this remains the case today. However the state franchise laws which have developed over time to accommodate the needs and priorities of each state and its government and citizens are still relevant and needed to keep the imbalance of power between manufacturers and dealers in check.

Without legal protections afforded by the dealer franchise laws, if the manufacturer suddenly decided they wanted representation in another part of the dealer's market, the manufacturer could simply tell the dealer to move and build another multi-million dollar facility at the dealer's expense or risk losing the franchise. With dealership real estate costing millions of dollars for even a small dealership this is no easy accomplishment. The franchise laws afford a mechanism whereby if the market has shifted to another area of the market and representation is needed, an adequate amount of time is allowed for the dealer to identify potential sites, handle zoning issues, develop plans and drawings, obtain manufacturer and governmental approvals, dispose of existing property, build a new facility and relocate the dealership. This is a huge and complex undertaking which takes years of planning and execution. The franchise laws facilitate this process for both the manufacturer and the dealer. Without the certainty allowed by the franchise laws, it would be impossible to attract the capital and talent needed for this to happen.

The current distribution system also protects consumers because it insures someone local is available to take care of their problems and concerns and to advocate on their behalf to the manufacturer. Manufacturers come and go. Fiat went away, now they are back. Suzuki came and went, Daewoo and Yugo the same. General Motors shuttered nearly half their brands in the past couple of decades, and recently even mighty Toyota eliminated the Scion brand. Under the current model, even if the manufacturer shuts down, the local dealer is still available to service and support the consumer.

If a manufacturer were able to eliminate its dealer base, the supply of vehicles would still need to be maintained and sold using some other method but the local economic effects would be hugely disruptive. Dealership facility locations would no longer be valuable thereby harming the surrounding real estate values, unemployment in the local area would be adversely impacted due to the direct and indirect loss of local jobs. In addition whole new channels would need to be established for the disposal of used vehicles that customers no longer wanted or need to trade to supply the down payment for the purchase of a new vehicle, service and repair of existing vehicles could require long commutes by customers to far-away locations causing disruptions in the lives of consumers, and other unintended consequences. Reliable, affordable transportation and the delivery and maintenance of that transportation is the backbone of this country and helps sustain a vibrant economy.

Tesla was presented as an alternative model for the future. It sold about one-tenth of one percent of the vehicles sold in the United State in 2015. Tesla sold about twice as many vehicles in 2015 as did Maserati and about half as many as Porsche. All three brands serve the same customers – movie stars, billionaires, and other wealthy individuals who can afford vehicles costing as much as a small house in many locales. Tesla's total sales in the whole United States in 2015 was less than one larger dealership in a major metro market. Tesla has only one product to sell which costs about $120,000 and has only been selling vehicles for a few years. Tesla is not representative of the automobile industry and serves only a very tiny sliver of the upper end of the car buying public. It remains to be seen if Tesla will ever sustain profitability and become a mainstream viable business or whether it will be more than a toy for rich people. To base any substantive changes in the automobile retail distribution system on Tesla's unproven business model would be a huge mistake. Tesla has acknowledged that if it ever produces and sells a significant volume of product, it will need to revisit its distribution model and consider a franchise framework due to the capital intensive nature of the retail distribution system.

Elio has never produced or sold a vehicle to a consumer. Ever. Whether their manufacturing, distribution and repair model will work remains to be seen. There are serious doubts about whether they will ever pull it off. Many similar companies have tried and failed. No credibility should be placed on Elio or their proposed distribution strategy until they can actually produce and sell a vehicle and prove their business model works for an extended period of time.

In most vehicle dealerships, approximately two out of every three (and possibly three out of four) customers who visit the dealership lot have some type of impaired credit. About half have very bad credit. A large part of a dealership's work is not only helping customers choose a vehicle they like and want to drive, but also finding a method for the customer to pay for the vehicle. Dealerships have become experts in finding credit sources for credit challenged customers and supplying products these customers can afford. No mention has been made about how a different distribution system would address credit challenged customers who are often not knowledgeable about credit options which a dealership is expert in finding and matching to a consumer's specific circumstances. Consumers would be harmed if these resources provided by dealers were not available.

A customer with a high credit score could easily buy any vehicle from any manufacturer in any retail distribution system, franchised or otherwise. These are the customers that every dealership covets but many rarely see. Many customers would be severely disenfranchised by not having access to retail dealerships to facilitate the car purchasing and financing experience. By helping to provide reliable transportation in a safe vehicle to a family who would otherwise not be able to purchase, the dealer dramatically improves the lives of that family and helps them become (or remain) gainfully employed. Owning a reliable vehicle significantly reduces the commute times for consumers in most areas of the country versus using public transportation. In many areas of the country employment is virtually impossible without access to a vehicle which dealers help average and below average customers acquire.

Almost every vehicle purchase is different and unique. The credit worthiness of the buyer, the cost of the vehicle, down payment, trade-in equity, financing alternatives, incentives, rebates, and a myriad of other factors must be analyzed and fit together correctly to effect a vehicle purchase in the best interest of the customer. A dealership is expert in these matters for its specific customer base and has the unique combination of products, financing and features to meet the customer needs through the current distribution model. A "one-size fits all" approach cannot and will not work. Well trained knowledgeable professionals are needed to craft each purchase to the unique needs of each customer.

A dealer accepts this responsibility and is willing to invest large amounts of personal capital and work countless hours to make this happen for the manufacturer's consumers. Often a dealer's whole family is involved in this process along with employees, local merchants, lenders, and others in the community. Any significant change in the automotive distribution system in this country would have far reaching consequences throughout the whole United States affecting thousands of families, employees, and communities. Such unintended consequences and the damage any change in the current distribution system may inflict on our country and our economy should be carefully measured and considered.

It is easy for academics and economists to say to let the chips fall where they may and let market forces act to create efficiencies in the retail distribution system. However lives and livelihoods are at stake for millions of people in this country that depend on the process working effectively and efficiently. The consumers, dealers, employees, manufacturers, and local and national economy would suffer the impact of disruption that changing the existing system would cause. This is not an intellectual academic exercise, it could seriously disrupt the United States economy and one of its largest industry sectors. While academics may assert that as a matter of public policy such disruption would be good for our country and our economy, I posit that it is not.

I appreciate this opportunity to provide my comments and look forward to answering any questions.

Respectfully submitted,

C. Gregory Porter, CPA
Porter & Company, P.C. CPA's