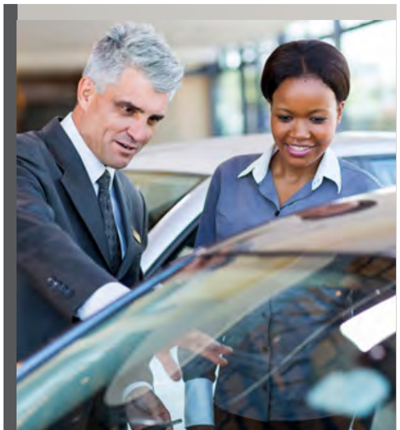
WHY DEALER FRANCHISE LAWS?

WHY STATES PROMOTE THE BUYING AND SELLING OF CARS THROUGH LOCAL DEALERSHIPS



Consumers have bought automobiles from local franchised new-car dealers for decades. Why don't factories sell directly to consumers, or online through websites like Amazon? Why is the buying and selling of automobiles regulated at all? State policymakers deal with this question from time to time—often when a new trend hits the automotive market, in an economic downturn like the recession of 2008-2009 or when new technologies change other industries.

In the end, automobiles are sold through franchised dealers because that business model is a good deal for everyone. Consumers are given extra protection in the marketplace, local communities benefit when local businesses compete to sell and service great products, and manufacturers get to invest their capital into designing, engineering and marketing great products in lieu of low-margin retailing. For these and other reasons, state legislatures have passed laws that promote the buying, selling and servicing of cars through local franchised dealers.

Q

ARE THE LAWS NECESSARY?

A Some who are approaching the issue for the first time in a policy context have questioned the need for dealer franchise laws at all, while others have even questioned whether states have the constitutional right to regulate the buying and selling of cars.

Here, it is critical to remember that cars are different from other products bought online, like books, clothing or computers. Cars are durable goods that are highly regulated at nearly every step of manufacturing, buying, operating, servicing and repairing—unlike virtually any other product in the marketplace.

Consider how different cars are from other products:

- To operate a car, a consumer must have a license issued by a state government agency.
- Before driving a car off a lot, a customer must have insurance that is regulated by a state government agency.
- Some 85 percent of car sales require financing, which is regulated by state and federal government agencies to help ensure that credit is given fairly.
- A full 60 percent of car sales involve trade-ins, and some of these are highly complex transactions that require lenders to pay off liens on other automobiles—sometimes out-of-state liens.
- Cars are expensive goods that require maintenance by technicians, who are often licensed by state government agencies because of the safety implications of their work.
- Cars contain hazardous materials—from gasoline to batteries to other fluids—that must be properly handled by technicians.
- Unlike virtually any other product, if a car is operated incorrectly, people can be hurt or killed.

Given the unique safety, financing and environmental issues with automobiles, states are well within their right to regulate the buying and selling of cars. And federal courts have repeatedly upheld the validity of states to regulate the buying and selling of cars through dealer franchise laws. In fact, the U.S. Supreme Court ruled eight to one to uphold a state dealer franchise law in California, stating that the legislature was "constitutionally empowered" to enact regulations in that area.

Q: BUT WHY ARE DEALERS NEEDED?

A Dealer franchises are beneficial to consumers and manufacturers alike, for a number of reasons:

- The ability of consumers to choose to comparison shop between different dealerships in selling the same brand keeps prices competitive and low. A Ford dealer's biggest competitor is the Ford dealer down the street or in the next town. Because of broad access to vehicle pricing, consumers can bargain with multiple dealers to get a great deal.
- Some people assume that franchised dealers are "middlemen" who add an extra layer of costs to the process. This is nonsense. As long as cars are retailed, there will be costs of retailing, and those costs will be incurred by whichever entity does the retailing, be it a factory or dealer. But when local dealers compete against one another, there are great incentives to minimize those costs as much as possible.
- Franchised dealers also create extra accountability for consumers, with warranties and safety recalls. When a customer has a warranty or recall issue, dealers are incentivized to act on behalf of the consumer because they are paid by the factory to do the work. If manufacturers retailed their cars, they would be incentivized to reduce warranty and recall work—where dealers are incentivized to take the side of the customer.
- Meanwhile, manufacturers broadly support dealer franchises. Franchised dealers invest billions of dollars of private capital into retail outlets to provide top sales and services experiences—allowing auto manufacturers to concentrate their capital into their core areas: designing, building, and marketing vehicles. Throughout the history of the auto industry, manufacturers have experimented with selling directly to consumers—but have inevitably gravitated back to the franchise model because of its efficiencies and effectiveness.

Q: DO THESE LAWS ONLY PROTECT DEALERS?

A Franchise laws actually level the playing field between large automakers and small local dealers.

Currently, more than 95 percent of local dealerships are privately owned businesses, while nearly 40 percent of dealerships sell fewer than 300 new cars per year. Meanwhile, large automobile manufacturers are some of the biggest corporations in the world. Because of the disparity in size and power between individual dealers and manufacturers, states have enacted provisions of their franchise laws to level the playing field between dealers and factories. For example, some franchise law regulations ensure that manufacturers cannot simply open another store next to an existing dealership. Often, provisions in state franchise laws provide the guidelines for the entities that retail automobiles—requiring that they are bonded, for example—to ensure that customers are dealt with fairly.

It is also critical to note that franchise laws effectively remedy antitrust prohibitions against dealers. Local franchised dealers are prohibited by federal antitrust laws from banding together to negotiate their franchise contracts with automakers. Because of these antitrust provisions, individual dealers are forced to negotiate contracts with massive multinational corporations by themselves. State franchise laws have the effect of remedying the impact of federal antitrust provisions against dealers.

Q: DO THESE LAWS STIFLE INNOVATION—IN MANUFACTURING OR MARKETING?

A Not at all. Local franchised dealers sell tens of thousands of cars with new technology and spend roughly one-third of their advertising budgets online—a number far higher than many other industries. And the auto-retailing business is fiercely competitive, which drives innovation at every level. Dealers now sell cars over the Internet and are even able to market their cars to customers in different states. Competition between dealers drives innovation in the sales and retail experience, while lowering prices and creating great deals for consumers.

Q: DO FRANCHISE LAWS BENEFIT LOCAL COMMUNITIES?

A The positive impact of franchise laws is felt in every local community in America. Locally owned and operated dealers employ more than 1 million people in well-paying jobs with benefits, and which can often provide upward mobility. Dealerships often anchor local economies, paying billions in state and local taxes, and funding local services—from schools to police to firefighters. Local dealerships also generate more than 15 percent of state and local tax revenue and invest in their communities in ways that large, out-of-state or multinational companies would not.