

# Minimizing the Negative Consequences of Rationalizing the General Motors and Chrysler Dealer Networks

*A Report to the Presidential Task Force  
on the Auto Industry*

*Submitted April 21, 2009 by:*

*InnovAuto Group, LLC*

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## Executive Summary

InnovAuto Group, LLC is an independent team of auto industry experts, covering all sectors of the industry and not affiliated with any manufacturer or interest. InnovAuto is currently studying initiatives to aid the Obama Administration and the President's Automotive Task Force in generating optimum returns from the planned restructuring of Chrysler and General Motors.

InnovAuto supports the conclusions of the Task Force that the GM and Chrysler Viability plans of February 17, 2009 did not go far enough in planning for sustainable futures. However it is our group's conclusion that current GM and Chrysler dealership rationalization plans will not contribute to the financial and operational viability of either manufacturer because:

- GM's and Chrysler's estimates for shrinking their dealer counts underestimate the level of rationalization needed to give GM and Chrysler a fighting chance to compete
- Previous dealership rationalization efforts—like most mergers and acquisitions—have turned out differently from expected (or hoped):
  - Costs have been significantly higher than estimated
  - Target operational cost reductions and market share increases were not achieved
- Reducing GM and Chrysler dealer counts in no way assures the ability of surviving dealerships to compete effectively with other automakers for vehicle sales or with aftermarket repair facilities for service and parts business

Real opportunities for achieving Chrysler and GM viability may be missed should the Automotive Task Force and OEMs continue to address the retail networks as secondary. Dealerships must sell the vehicles produced by Chrysler and GM plants in order for those plants to increase utilization and generate profitability for the OEMs. Enabling surviving dealerships to generate these sales requires:

- Identifying the markets, dealerships, and operators with the greatest potential for enabling OEM turnaround success
- Preparing these same dealerships to sell more vehicles in the near, medium, and long terms so that plant utilization remains high and the OEMs have both the time and capital to develop innovative and attractive new vehicles
- Increasing dealership profitability so they can survive the low-priced competition of Chinese and Indian automakers expected to enter the U.S. market
- Avoiding process-intensive statutes governing dealer terminations in order to mitigate significant additional cost and distraction

Finally, InnovAuto proposes to deliver the Automotive Task Force at its convenience a briefing on:

- Optimum brand, model, and dealership rationalization
- The relative price and market share impacts of network changes
- How to ensure that surviving dealerships are able to generate sufficient sales and profitability to turn around the OEMs
- How to address the constraints posed by myriad state laws governing OEM and dealership interactions
- How to assist communities in:
  - Preparing for the unemployment and lost tax revenues resulting from dealership closures
  - Finding alternative uses for closed dealerships



## Who We Are

InnovAuto Group, LLC is a team of industry professionals whose **mission is to aid the century-old North American automobile industry in attending to the realities of both the present and future.** Our 20 + members include former auto company executives and distribution network planners; former dealership owners and operators; dealership accountants and attorneys; auto industry business start-up and equity advisors; and automotive industry consultants specializing in branding, management, process efficiency, and business turnarounds. We do not represent any auto industry group or constituency. **Our sole focus at this point in time is to offer our assistance to the Presidential Task Force on the Auto Industry in realizing the maximum return on the investments and commitment of the Obama Administration.**

## Purpose of this Report

To that end we have been closely monitoring the efforts of the Task Force; conferring daily with auto company industry executives and retailers, financial services, accounting, legal, and retail management specialists; and reviewing amongst ourselves alternatives for producing optimum results for the industry, government, and American taxpayer. While the Task Force is making many necessary and correct decisions, **we are concerned that the planned restructuring of General Motors and Chrysler dealership networks appears inadequate to enable either organization to succeed without continued financial support from the Federal Government. InnovAuto therefore wishes to provide the Task Force necessary dealership network, consumer, and local community solutions** in order to assist it in achieving the President's goals to, "...help America's automakers prepare for the future," (1.29.2009) and ensure long-term viability, rather than, "...kicking the can down the road" (2.11.2009).



## Strategic Realities

InnovAuto supports the conclusions of the Task Force that the GM and Chrysler restructuring plans did not go far enough in planning for viable futures. In fact, we would go further and say these plans failed to sufficiently address the role of dealer networks in successful restructuring. InnovAuto therefore wishes to bring several key issues to the attention of the Automotive Task Force:

1. GM's and Chrysler's **estimates for shrinking their dealer counts underestimate the level of consolidation needed** to give GM and Chrysler a fighting chance to compete. Specifically, we highlight here the distinctions between *stores* and *franchises*:

- GM has proposed shrinking its dealer network by 2,100 dealerships from 6,200 to 4,100 over the next 5 years (including severing GM responsibility for approximately 777 Saturn, Saab, and Hummer dealerships.)

This 6,200 refers to physical locations with multiple GM brands. In reality General Motors had 13,132 individual brand franchises as of 1.1.2009 (*Automotive News*)

- Chrysler's "Genesis" dealership rationalization plan has been suspended by Cerberus Capital Management. But numerous reports in the past 12 to 18 months suggest that Chrysler LLC has been considering reducing its year 2007 dealer count of 3,700 by 1,000 stores. Since then Chrysler's dealer count has dropped to 3,250 stores.

Again, the reality is that Chrysler was carrying 7,819 Chrysler, Dodge, and Jeep franchises in 3,250 store fronts as of 1.1.2009 (*Automotive News*)

How do these dealer counts (current and planned) compare with the competition? In the first quarter of 2009 **Toyota/Scion/Lexus relied on 1,461 franchises to sell 31,951 more vehicles than GM's 13,132 franchises**, while **Honda/Acura's 1,299 franchises sold 73,789 more vehicles than Chrysler's 7,819 brand outlets** (*J.D. Power and Associates*).

"Sales per dealership" make an enormous difference in individual dealership and brand success. Toyota and Honda dealership throughput enables them to invest in facilities, employees, and customers at levels building additional competitive advantage in brand strength, customer experience, and profit margins. Given the GM and Chrysler "slices of the consumer pie" are only so big, continuing to slice those pies into far more pieces than appropriate will render the **surviving dealerships unable to make the investments needed to attract, sell, and retain skeptical consumers.**



## Strategic Realities (continued)

2. **The impact of broad-scale dealership closings on local communities can be as significant as major plant closings.** Based on average dealership data provided by the National Automobile Dealers Association, **every 1,000 dealerships closed means** the loss of:
  - 54,000 dealership jobs and annual payroll of \$2.6 billion
  - Similar losses to dealership suppliers and local retailers relying on dealership employees and customers for business totaling \$33.4 billion in local sales
  - Sales, corporate, property and payroll tax revenue in all 50 states where sales of vehicles, financing, service, and parts represent 18% of each state's retail sales
  
3. **Costs associated with previous dealership rationalization have been significantly underestimated while having limited or no positive impact on the OEM.** We need look no further than GM's shuttering of Oldsmobile (approximate restructuring costs: \$1 billion over 5 years) for expensive consequences of dealership rationalization.

Since 2000—when the Oldsmobile shutdown and Buick-Pontiac-GMC consolidation processes began—GM market share has declined from 29% to 22% and profit margin from 2.7% to -11.3% (General Motors corporate 4<sup>th</sup> quarter earnings releases 1.17.2001 and 2.26.2009). Other factors have certainly contributed to GM's slide in the marketplace, but it is clear that network actions taken were inadequate to stem the flow of red ink. In addition, reorganizing brands (past and future) carries significant costs, both predictable and unpredictable:

- **Predictable restructuring costs**
  - Compensation of dealers for parts, signage, tools, and equipment plus costs related to relocating vehicles and customers are estimated by InnovAuto at **\$.5 million per dealership**



## Strategic Realities (continued)

### 3. Costs associated with previous dealership rationalization have been significantly underestimated (continued)

#### – Unpredictable restructuring costs

- Dealer lawsuits represent a significant unpredictable cost, based on GM history:

- "Tim Kelly, a Hummer dealer in Chattanooga, Tenn., told Automotive News **GM is 'tiptoeing through a legal minefield' by trying to shed Hummer, trying to avoid the lawsuits that ensued when it killed Oldsmobile.**" (*Hummer: bonuses, buyouts*; Automotive News 7.28.2008)
- "**In eight states, including Virginia and Indiana, dealers have a strong chance to get legislation that would give them more compensation if an automaker kills a brand.** The state proposals, which share key provisions, seek higher factory payments to dealers for: vehicle inventory buybacks, reimbursement for dealership rent; and other damages when a car company kills a brand." (*Dealers lobby statehouses for beefier franchise laws*; Automotive News, 2.23.2009)
- "GM won't say what that [Oldsmobile] buyout cost, but some estimates put that figure at more than **\$800,000 per dealer.**" (*NPR* 5.21.2007)

Some of these costs might be mitigated in a bankruptcy action, but the time and financial costs are still up to the courts.

- Vehicle buybacks represent another significant OEM/taxpayer investment, with average **dealership inventory approaching \$4 million in wholesale value.** Precise buyback costs are certainly known within GM and Chrysler, although we note that as of March 31, 2009 neither company is including 2008 model year vehicles in their reported dealership days' supply figures.

What this means for the eventual vehicle buybacks moves this particular cost into the "unpredictable" category. Specifically, the impact on new GM and Chrysler vehicle selling prices as these "remarketed" 2008 model year units are released to the public.

- Based on automotive inventory and pricing history we expect that as many as **100,000 or more 2009 model-year-vehicles repurchased by the OEMs from shuttered dealerships will be released into the marketplace at the same time 2010-model-year vehicles start to become available.** This in turn reduces the value of the entire OEM inventory, 2009 and 2010...



## Strategic Realities (continued)

4. Reducing GM and Chrysler dealer counts—even to competitive levels—**in no way assures the ability of surviving dealerships to succeed.** In reality the greatest impact of **network restructuring lies not in out-of-pocket costs** but, if the restructuring is mismanaged, in the detrimental impact on remaining dealers and OEMs who—due to inadequate preparation and skeptical consumers—are **unable to improve price retention or profitability, create actual operational economies, or enhance brand image and customer satisfaction.** Sales per outlet and corporate profitability do not improve, thereby “kicking the can down the road” for continued Federal Government involvement.

Dealers who are merely “left standing” as opposed to “strengthened” will be unable to:

- **Compete effectively** with Toyota, Honda, Ford, and others in order to sell GM and Chrysler vehicles profitably
- **Provide adequate warranty and customer service** to existing and new GM and Chrysler vehicle buyers while staving off the encroachment of aggressive aftermarket part and service providers

Our assessment, then, is that while GM, Chrysler, and the Task Force are effectively addressing Suppliers, Manufacturers, Labor, the Financial Industry, and Federal Taxpayers at necessary strategic levels, the effort does not sufficiently consider the specific effects of broad and sudden dealership reduction on local employment, economies, customers, and the ability of surviving dealerships to effectively represent their brands. **We fear that GM, Chrysler, the Task Force, and collective advisors may be making an “8 foot jump across a 10 foot gap.”**

## Tactical Challenges

InnovAuto anticipates a number of tactical challenges at the point where dealerships and consumers meet:

1. **“Running the numbers” to identify dealerships for closure will scoop up good operators along with weaker ones.** A dealership currently experiencing low sales and financial losses due to unemployment and tight credit may actually have excellent long term prospects due to the quality of its local brand, management team, location, facilities, and material assets. The streamlined GM and Chrysler dealer networks must be comprised of the cream of the crop in order for the Treasury Department’s investments to pay off.



## Tactical Challenges (continued)

2. **Allowing the process to continue to work itself out in Darwinian fashion could very well end up in the courts, take 4 to 5 years per store, and generate significant additional costs and distraction** for all parties (except the attorneys).
3. **Should the approach to dealer reduction be more proactive, the Task Force, GM, and Chrysler will be faced with process-intensive statutes** governing dealer terminations. Not only will the dealers, state automotive trade associations (ATAEs), and their respective attorneys fight the terminations tooth and nail, individual state laws specifying how dealership inventories and other assets are to be disposed of will inject significantly more dealership closure costs into the process, thus placing additional financial stress on GM, Chrysler, and their remaining dealers.
4. As GM, Chrysler, and the Task Force well know, the service business—and the OEM parts used in maintaining and repairing vehicles—are mainstays of dealer profitability and vital sources of income for the highly-stressed domestic OEMs. Every dealership going out of business carries with it the **risk of lost service business for surviving same-brand dealerships and lost part sales for the manufacturer**. We do not want to see GM and Chrysler service business appropriated by Jiffy Lube, Pep Boys, AAMCO, and independent garages as this will decrease customer confidence and satisfaction with the brand, erode factory profitability, and further devalue the investment made by the U.S. taxpayer. **Service and part business from closed dealerships will be a significant aid to both surviving dealerships and their OEMs** if transferred properly to well-prepared dealerships and accompanied by effective consumer education and promotion.
5. During the restructuring process **foreign automakers**—including expected Chinese entrants such as Chery, FAW, Geely, BYD (also a major battery manufacturer) and others—**will attempt to take advantage by capturing their initial market share from weakened Detroit 3 dealers**, and put the Treasury Department's recovery plan at further risk.
6. The restructuring plans as written focus almost exclusively on the cost side of the profitability equation. The fact is that **most domestic vehicles sell at painful discounts to their foreign rivals**. Thus, even heroic cost reduction efforts can lead to OEMs whose profitability still lags that of their foreign competition. In the long run GM and Chrysler must rebuild brand premiums through innovative, attractive, high-value products, but in the shorter term dealers play a key role in the automaker turnarounds via the experience they can give their customers. **Explicitly taking these effects into account in strengthening the dealership networks will help GM and Chrysler through the next several years** when many consumers will be skeptical about buying their products.



## Tactical Challenges (continued)

GM, Chrysler, and Task Force leadership cannot be everywhere at once, and this challenge is exacerbated by the nature of the auto industry, which simultaneously combines all the greatest complexities of long-term forecasting, advanced technology R&D, engineering, manufacturing, finance, fashion, international currency management, retailing, and after-sale service. Given its main priorities lie with such issues as capital structure adjustment, labor cost equilibration, plant closings, supplier viability, credit availability, and union and bond-holder negotiations it is not surprising—and completely understandable—that the Task Force has left distribution and dealership issues to GM and Chrysler to handle. But **whatever improvements are made at the beginning of the value chain—clean balance sheet, right-sized organization, etc.—must be carried all the way through to the consumer for the recovery effort to work as intended.**

## An Offer to Help

InnovAuto can be a useful resource for the Auto Industry Task Force. As such **we propose a discussion with appropriate Task Force members and/or Official Designees on the issues highlighted in this report:**

- 1. Optimum brand, model, and dealership rationalization**
- 2. Ensuring that surviving brands and dealership networks are effective in generating sufficient sales and profitability to enable their OEMs to deliver the new products they will need to become competitive again**
- 3. Determining the relative price and market share impacts of network changes for input into the Task Force's economic and financial models**
- 4. Addressing the constraints on OEM dealership rationalization caused by the myriad state franchise laws**
- 5. Developing, implementing and facilitating local community and regional development activities to contend with employment and tax revenue losses while supporting the development of locally funded efforts to find and implement new uses for closed dealerships**



# InnovAuto Group, LLC

**Beyond our professional qualifications we want to emphasize our neutrality, eagerness to be of service, and ability to work quickly.** We are ready to help and look forward to meeting with you very soon. We have designated the founder of InnovAuto **Mr. Mark Rikess as our point of contact.** He can be reached at the contact information provided below.

With respect,

## *InnovAuto Committee on the Presidential Task Force on the Auto Industry*

### **Brad Bowers, CPA**

Former VP - CarOrder.com  
Former VP - Volvo Cars, N.A. Franchise Development

### **Alan E. Cabito**

Former Group VP - Toyota Motor Sales, U.S.A.

### **Larry Cummings**

Former General Motors Dealer Principal  
Former President/CEO of National Automotive Education Foundation

### **William Ewing**

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### **Jay M. Ferriero**

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### **James Hoostal**

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