The Anticompetitive Effects of Direct Distribution Prohibitions in the Automobile Industry

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Roadmap

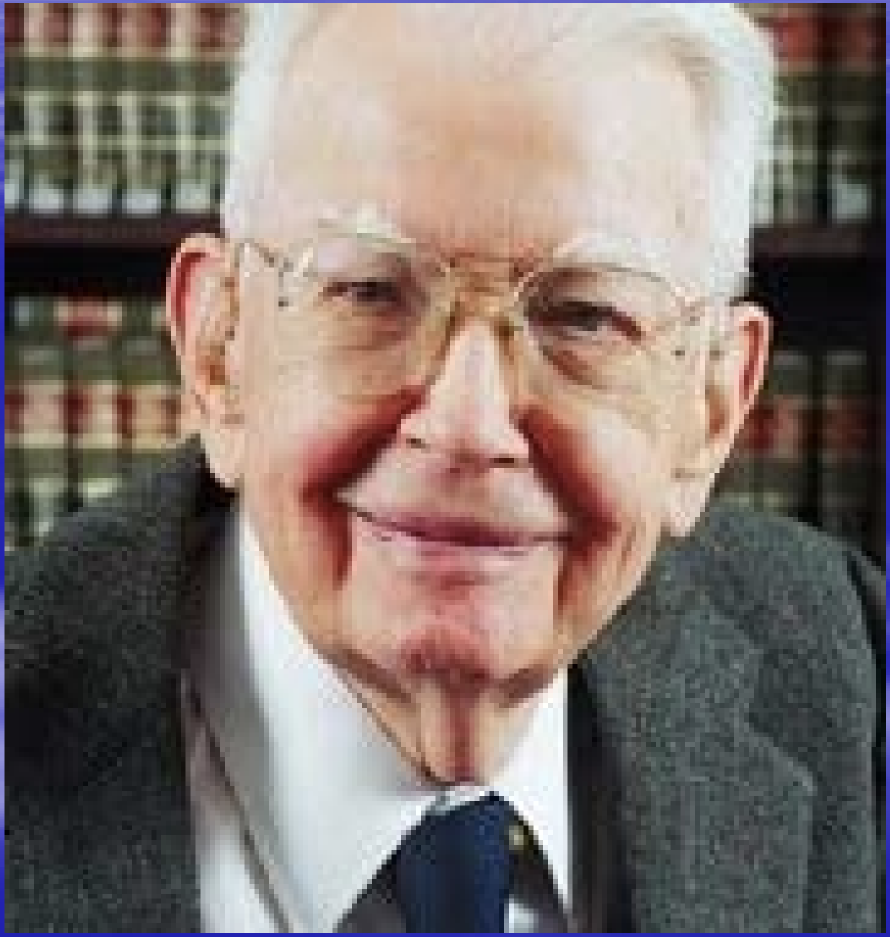
- Choice of direct, franchised, or mixed distribution method is a question of transactions costs and firm-specific circumstances.
- The choice of distribution method is an important component of competition.
- Emerging technologies often must be distributed innovatively, hence laws that entrench incumbent distribution methods chill innovation.
- The existing direct distribution prohibitions were motivated by dealer protection, not consumer protection.
- Efforts to redefine these laws in consumer protection terms are frivolous.

Variety of Distribution Strategies

Dual distribution

Direct-to-Consumer Only

Economic considerations



- Advantages to dealer distribution
  - Local market knowledge
  - Focus on core competencies (R&D, manufacturing
  - Economies of scale
  - Capital limitations
- Advantages to direct distribution
  - Cost savings to vertical integration
  - Superior product knowledge
  - Stronger brand promotion incentives

Economic bottom line

- No *a priori* reason for public policy to favor any particular mode of distribution.
- Consumers are best off when manufacturers are free to choose the distribution method that works best for them in their particular market circumstance.
- The choice of distribution methods is itself an important dimension of competition.

Effects of banning direct distribution

- New market entrants, particularly those with disruptive technologies, often must use innovative distribution methods to reach the market.
- Laws that entrench incumbent distribution methods harm innovation.

Historical Pedigree of Dealer Laws

- 1930s-50s
  - Market entirely dominated by Big Three
  - Concern with manufacturers exploiting dealers through superior bargaining power.
  - Package of dealer protections, including direct distribution prohibition
  - 1977 Michigan statute, House Legislative Analysis: "the unequal power balance between dealers and manufacturers leaves a great potential for arbitrary and unilateral decisions by manufacturers about contract arrangements," therefore manufacturers should not be allowed "to compete with franchised dealers by offering the same services."

Relevance?

- Dealer protection, not consumer protection.
- Big Three no longer dominate—manufacturer market much more competitive.
- Dealer protection has no relevance to pure direct distribution.

Dealer Lobbyist Arguments

- If it’s consumer protection, where are the consumer organizations supporting the dealers?
  - Consumer Federation of America, Consumer Action, Consumers for Automobile Reliability and Safety, American Antitrust Institute
- March 26, 2014 letter to Chris Christie from 72 economists and law professors:
  - “There is no justification on any rational economic or public policy grounds for such a restraint of commerce. . . . It is protectionism for auto dealers, pure and simple.”

Argument 1

- Claim: Direct distribution allows manufacturer a "monopoly" over retail sales; competition among dealers lowers prices to consumers.
- Facts:
  - As a matter of economics, a manufacturer cannot increase its profits by charging a monopoly mark-up at retail.
  - If anything, vertical integration lowers prices to consumers by eliminating double marginalization.
  - 2009 Justice Department study: $2,200 in cost savings to consumer per vehicle.
  - Dealers admit it: Direct distribution leads to "inequitable pricing," meaning pricing that is *too low.*

Argument 2

- Claim: Manufacturers won't provide adequate levels of after-market service.
- Facts:
  - Manufacturers can't recover their large investments in their brand if they obtain a poor reputation for service.
  - Manufacturers can go out of business, but so can dealers. (Fisker example).

Argument 3

- Claim: Direct distribution leads to unsafe cars on the road.
- Facts:
  - Safety issues (GM, Volkswagen) arose in the context of *franchised distribution.*
  - Dealers don’t make recall decisions.

Argument 4

- Claim: Direct distribution is bad for local economies and small business.
- Facts:
  - Direct distribution means *more* local jobs.
  - Dealers are not primarily “small business.”
    - Top 10 dealer groups in U.S. have annual revenue of $80 billion!
    - 100th largest dealer group revenues > $300 million

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