



Unintended Consequences of Image Requirements By John J. Pico, JD

Perspective

Prosperous years can conceal obligations that become dangerous when a market turns.

In 1980, the prime interest rate exceeded twenty percent and banks were dropping dealers faster than a cowboy would drop a rattlesnake.

In 1990, we were going through an “attack the rich” phase and I could not give away a Porsche, BMW or Mercedes-Benz dealership. It was a time when Mercedes hood ornaments made great peace symbols for the youth to wear on a chain around their necks.

Conversely, today’s dealer is experiencing the longest economic expansion in our history. With the exception of a hiccup during the COVID-19 crisis, the economy has been on a roll since the Great Recession, which lasted from December 2007 to June 2009.

The COVID-19 recession was unusual because the federal government provided extraordinary assistance through the Paycheck Protection Program. When all was said and done, the government doled out over \$800 BILLION in loans, most of which was eventually forgiven.

It is highly unlikely dealers will receive the same assistance in the next recession, for “COVID” was a unique period in both world and American history.

Operating Dealerships

As every dealer knows, there are costs that can be controlled, and ones that cannot. The latter include expenses such as rent, mortgage payments, real estate taxes, insurance, and loan repayments – all items which must be paid in order for a dealership to survive.

These are the costs that can bankrupt a dealership during a recession.

For years, manufacturers have not only been bleeding dealers of profits that could have been used as a cushion for those downturns, but they have unwittingly had their dealers dig deeper holes from which to emerge in order to secure their existence during a major downturn.

We may not speak about it, but we all know every day that passes brings us closer to the day of reckoning when dealerships will have to rely upon those cushions in order to secure their existence.

We just do not know when the next recession will happen, or what will cause it.

To dealers, the cause is irrelevant. The only thing that matters is recessions occur – and that is when the impact of the factory image programs will be felt and some dealerships will needlessly fail.

Why Needlessly?

As Joe Putnam once told me, “**The fuel in a new car dealership is new car sales.** If you want more parts business, sell more new cars. If you want more service business, sell more new cars. If you want more used car business, finance business, insurance business, warranty business, you sell new cars. We are a new car dealership and our lifeblood is selling new cars.”

Available studies have repeatedly questioned whether image programs sell additional vehicles.

Consider, for example, the National Automobile Dealers Association’s (NADA) two studies of factory image programs. Phase 1 concluded that the economic value of OEM facility programs was only weakly demonstrated while their costs were excessively high.

Phase 2 went further and essentially reconfirmed the earlier finding that standardization beyond logos and signage did not produce sufficient economic benefit.

See: <https://www.nada.org/media/3262/download?inline>

The question is not whether dealers should maintain adequate, modern facilities. They should.

The questions are whether mandatory standardization justifies its cost—and whether the debt it creates will affect a dealer’s chances of surviving the next downturn.

I have been in this business over half a century and have yet to meet the person who purchased a new Honda because a blue oil can was built into the dealership's superstructure, or because they could watch their car being repaired through a glass window, or who bought a car because he or she admired flooring selected by the factory.

With all due respect to both NADA and the factories, one does not need a survey to reach that conclusion – just look around.

Two highly successful retailers are Costco and Sam's Club. Both function from cinderblock buildings, with no windows, interiors with naked cement floors and, to add insult to injury, if customers want to carry products to their cars they either have to bring their own bags, or use boxes that would otherwise have to be disposed of as garbage.

How important are images?

Consider this. Tesla is currently ranked third in sales volume in California and, according to Dominion's Cross-Sell Reports, is ranked ninth in vehicle sales in Texas.

It doesn't matter if Tesla is not in the top ten in every state. What we are measuring is the effectiveness of dealership facility image programs and California and Texas (two national leaders in new car sales) provide real-world evidence that elaborate factory-standardized dealership facilities are not necessary to achieve substantial vehicle sales.

Additional Unintended Consequences

In addition to decreasing working capital, **factory image programs are eliminating good dealer candidates** because, for

example, many exceptional general managers*, long a source of future outstanding dealers, are eliminated from the mix because they cannot afford to meet factory requirements to “upgrade” facilities in order to obtain factory approval for a purchase.

A good survey would be to ask how many successful dealers were able to purchase a store in the past decade, without being required to expend substantial funds in order to meet a factory’s image requirements.

In addition, image programs may also be contributing to the growth of ‘too big to fail’ groups by favoring mega-dealers that can readily produce the capital necessary to satisfy the manufacturers’ increasingly expensive facility requirements.

The Evolution

In the 1920s factories and dealers would collaborate to grow the industry. It was a time when dealership networks became central to the growth of Ford, General Motors and Chrysler and to increasing their reach nationwide.

During the beginning years, agreements between dealers and manufacturers concerned themselves only with the distribution of vehicles.

Subsequently, those agreements were expanded to include facilities, but only to the extent of providing adequate space for sales and service and requiring the factory sign be displayed.

During the 1930s and 1940s, facility requirements helped standardize dealership operations, ensuring a consistent customer experience.

The original requirements were simple. They were designed merely to ensure dealerships operated from legitimate and accessible locations.

The key elements were:

1. Dealers were required to maintain a permanent structure for conducting business.
2. They had to have a car lot—a designated area for displaying vehicles.
3. They had to have a sign that visibly displayed the factory's name.

In 1972, when I began representing dealers, **all Sales and Services Agreements** I read contained practically identical verbiage when it came to facilities.

Dealers were required to have adequate space in service and parts to service their customers and in showrooms and on their lots display new and used vehicles.

With respect to the facilities, they were to be built so as to resemble other facilities in the area and the décor of the city or town in which they resided.

In 1985, when I sold my law firm and moved to Aspen to raise my family, factories had begun requiring “lookalike” facilities and colors.

Subsequently, in the 1990s factories began experimenting with standardized designs, and by the mid-2000s some (Hyundai, Mercedes-Benz and Nissan, for example) were well on the way to mandated dealer designs.

If, one day, an otherwise viable dealership fails because it cannot carry the debt incurred to satisfy an image program or another Rick Hendrick* or Roger Penske* is precluded from becoming a dealer because of the costs involved in meeting current facility

requirements, would those results really be the intended consequences of their actions?

The irony of it all is illustrated in the February 8, 2010, edition of *Automotive News*, where Arlena Sawyers reported that GM would take five to ten years to reimburse dealers for required facility upgrades—**and the reimbursement would be based on vehicle sales**, not the cost of the upgrades.

We are talking about new car dealerships. Their lifeblood is the sale of new cars.

When capital stops serving sales, you're spending money in the wrong place.

Keep your eye on the donut, not the hole.

**Roger Penske started in the car business by working as a sales engineer for Alcoa after college. He eventually became the general manager of a Chevrolet dealership in Philadelphia, and later (1965) purchased the dealership with a loan from his father and--the rest is history.*

Rick Hendrick, who today has over 100 dealerships, got his start in the car business when he opened a small used-car lot with Mike Leith, an established new-car dealer. Hendrick became the general sales manager of the dealership and, at 23 sold his assets to purchase a Chevrolet dealership and thus became the youngest Chevrolet dealer in the country.

John Pico is a retired attorney and founder of Advising Automobile Dealers, LLC and has been consulting with automobile dealers and lenders for over fifty years. For more articles about dealerships and dealers, visit our website at www.advisingdealers.com

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