The Ruggles Report™

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The Ruggles' Report is an ongoing, independently published report with insights, reflections and opinions from noted vehicle expert David Ruggles.

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I Was Wrong!

(But don't tell my wife I admitted it!)

I predicted that Chapter 11 bankruptcy for Chrysler and GM would cause chaos and linger for years. Well, I was right about the chaos part. Little did I know what can happen when the government is the driving force behind a Section 363 sale in a Chapter 11, and how much influence the provider of Debtor in Possession financing has - especially when they also happen to be the government.

I do, however, remain dead set against the arbitrary termination of Dealers. Let's hope there is a favorable result from the House Resolution currently pending in Congress to reinstate Dealer's rights under state franchise law. It's probably too late for rejected Chrysler Dealers but GM Dealers may have a chance.

The recently published photo of Greg Mauro in Automotive News standing in front of his newly completed Chrysler – Jeep store should be evidence to all how arbitrary and counter productive the Dealer terminations are. The Mauro family does things one way: First Class. The idea that Chrysler would terminate a proven, profitable and successful dealer is still a shock. Particularly since they had just completed a $6MM plus new facility at the behest of the OEM.

Further, the idea the Task Force would mandate leaving an entire town like Ames, Iowa, a major university town, without representation is another shock. The examples go on and on. With such geniuses running these companies why would anyone want to own their stock? I won't even start on GM in this column although they have officially been approved for their own Section 363 sale and have their own inane closings to account for.

Unintended Consequences

I find it curious why is no one is talking about safety issues associated with Dealer terminations. The Ames, Iowa vacuum provides just one example. Chrysler owners in this Midwestern community must now either take their vehicles to independent service centers for routine maintenance or drive MANY miles to an authorized Dealer. To my knowledge, Jiffy Lube and other independents don't have access to information regarding safety recalls on new vehicles. Or if they do, it doesn't seem like it fits their agenda since they can't do the work anyway.

So we now have thousands of orphaned owners turned over to independent shops instead of being serviced by factory trained technicians. The safety recalls are only one reason this is important. Factory trained technicians also know where to look for other problems. Often these are little problems that turn into bigger problems if they are not addressed. For example, it came to my attention in the 1990's Ford had an issue when they started putting cabin pollen filters into Taurus and F150. I f the filters weren't changed at proper intervals they would clog and burn out HVAC blower motors.

Steve Finley from *Ward's Auto World* recently "outed" Steve Girsky as the man behind the arbitrary Dealer terminations. Girsky is a former GM employee and Wall Street analyst who is now a member of GM's board of Directors representing the UAW's Voluntary Employee Beneficiary Association (VEBA) interest. According to Mr. Finley Girsky gave an address at a recent NADA convention where he said he thought the domestic auto makers should reduce their dealer counts by 70%.

The question in my mind is how Girsky came into such a position of influence. To my knowledge true visionaries like Maryann Keller and/or James Womack, and even the retired Lee Iacocca, were available and were not consulted. For those who haven't read it, *The Machine that Changed the World* by James P. Womack, Daniel T. Jones and Daniel Roos is a must read. It was fascinating to read in the early 90's and even more so now that many of their predictions have come true. And anything by Maryann Keller is on target and fascinating.

The Task Force selected a guy like Steve Girsky for advice and failed to bring in more proven voices. It seems the people making the decision to cut Dealers weren't aware of the cost transfers to the Dealers made by the OEMs over the years. Their calculations of per Dealer marketing costs neglected the fact that the OEM's own over production caused them to spend wildly on incentives. It had nothing to do with the number of Dealers. If anything, their Dealer coverage was an asset, something well recognized by Ford and anyone knowledgeable in the industry.

Yet, for all the chaos and the counter productive termination of thousands of Dealer franchise agreements, the two OEM's appear "saved" for now. Time will tell how decimating their distribution network will benefit them.

It is important to note the U. S. Government Task Force has taken a different road than European governments. In exchange for bridge loans and other contributions, the European countries have chosen to exact employment commitments, as if employment guarantees are the answer to a bloated OEM's problems. Dealer closings weren't a part of any European plans. At least the U.S. government has mandated draconian job, pay, benefit, and work rule concessions to give Chrysler and GM a fighting chance.

Imagine if the Task Force had taken the European approach. We might have saved our Dealers but the companies would have been stuck with keeping non productive assembly plants and a bloated work force.

What's Next? More Chaos.

Ford is making progress in terms of market share. They sure look better off on the surface than GM and Chrysler. But Ford is having trouble negotiating GM/Chrysler level labor parity with the UAW, who now owns significant positions in the competition. The UAW is playing hard ball with Ford as it knows Ford will do almost anything to avoid going to the government. The Ford family isn't willing to take a chance on losing its special category of voting stock. They would most certainly lose that status in a Chapter 11 filing.

In addition, Ford borrowed a LOT of money to be able to dodge the fate that befell Chrysler and GM. And unlike their Detroit competitors, they have to service the totality of their debt! It's great to be perceived as the superior company, but they just cannot afford to give up a major per vehicle competitive disadvantage. But the UAW believes they have Ford at a negotiating disadvantage and will work it for all its worth.

Long term, how do the Detroit 3 compete with Toyota, Honda, Nissan and other Japanese manufacturers? Honda just raised capital in Japan paying less that 1 percent interest. Toyota and Nissan also have access to cheap capital. Money owed to the U.S. Federal government and U.S. banks commands at least interest rates typical of corporate America while Ford is paying whatever rates were agreed to when they retrenched in 2006-07.

The Road to Recovery

Chrysler is trying to restart production. Most major suppliers are in Chapter 11, with the exception of Magna who just purchased Opel, GM's European subsidiary. Ford, Toyota, Honda and the other U.S. manufacturers are watching their own suppliers closely. Not commonly known is the OEM's all use the same suppliers. If a major supplier goes down, it shuts down production for everyone.

Moreover, many surviving Chrysler Dealers are having trouble obtaining essential financing and floor plan arrangements through GMAC It seems Chrysler terminated a significant number of Dealers who were financially sound and would have qualified for GMAC floor plan, or already had their own set up through local banks. Instead, they kept many who don't have floor plan and can't qualify through GMAC. What were they thinking?

The New GM Small Car

In the meantime, GM has now committed to build a small car in Michigan. Small cars have traditionally provided little to no profit for GM in the past. I wonder why Michigan, a stronghold of the UAW, was selected as the site to build this "important" and symbolic small vehicle?

GM will lean on everyone possible for tax abatement, free land, and whatever else they can think to ask for. How else can they hope to make money on this small car even after the cost reductions they've made in bankruptcy?

As the world languishes in recession, the recent uptick in oil prices is probably not the short term trend. I expect to see downward pressure on fuel prices toward the end of the summer driving season. Who knows what oil prices will look like when the new GM small car hits the market? Most assuredly, GM will not sell in enough small cars to make any real difference in the face of cheap fuel prices. And in Michigan, they will also incur significant labor and production costs compared to say Mexico, Brazil, China or even Canada. The same goes for their Hybrid and Plug-In-Electric offerings. Are we to believe that GM's future depends on high oil prices?

Ruggles on Government Intervention

Lastly, a few words on the controversial tactics employed in Washington. I find it difficult to say government is inherently bad or government is good. It's usually a mixed bag. Ronald Reagan was fond of saying, "Government is not the solution, it is the problem," but I find that too simplistic a take.

The government just saved GM and Chrysler from liquidation. Whether that is good or bad is open for debate but they certainly did it imperfectly. In my mind, the Chrysler bailout of the early 80's was a lot cleaner deal but times and circumstances are much different today.

I view CAFÉ is having been truly bad program from its inception. It is a result of the government not possessing the political will to do what the rest of the industrialized world has done regarding a fuel tax. The European/Japanese model has worked for them. On the other hand, our own dependence on foreign oil has more than doubled since the first oil crisis in 1973, even with the adoption of CAFE.

And now we have "Cash for Clunkers," or "Cash for Guzzlers" - now officially designated the Car Allowance Rebate System (CARS). CARS has noble intentions, but as my father is fond of saying, "A camel is a horse designed by committee."

With CARS, the Government has indeed created a "camel." It currently has the entire new vehicle market temporarily "on hold" while everyone waits for the final details of the program. Consumers will end up frustrated over these details and will probably direct their ire at Dealers, rather than the Government. While the European C for C programs have worked well, I have my doubts for ours. Too many objectives were targeted and the plan lacks focus.

Speaking of Japan, I just returned after a 3 week visit. The Japanese government came up with their own program to try to boost sales of new vehicles. Their program is based on emissions, so hybrids get a huge tax break. The result? Everyone is rushing to buy a hybrid to get the tax breaks. Honda Insights and Toyota Priuses are oversold for months.

Absolutely everything else the industry needs to sell and can deliver NOW isn't selling. Imagine trying to pay your overhead out of the dribbles and drabs of production you get for one model. The Japanese situation is another example of when government has all the right intentions but doesn't account for unintended consequences.

The One Thing I Do Know!

There are a LOT of quality Dealers looking for a new franchise to replace the ones that were yanked. More importantly, these Dealers are motivated to take a big chunk out of the backside of the OEMs who jilted them. Import OEM's are already taking a look at them.

Many rejected Dealers were axed for doing TOO GOOD of a job with CPO and pre-owned vehicles. In other words, their profit or loss was NOT dependent on new vehicle sales and that unfortunately spelled their doom.

Clearly, these Dealers are smarter and more successful than many of the Dealers being retained. The history books will tell the story of how GM and Chrysler are ultimately impacted by cutting their Dealer body. I'm anxious to hear about the success stories of the guys who were jilted, survived, and came back with new franchises to kick GM and Chrysler's ass!

About Dave Ruggles

Dave Ruggles is a widely known, auto industry veteran with more than three decades' worth of experience. His self-titled Ruggles Report *is a highly acclaimed industry insider brief detailing the latest hot-button topics in automotive sales, training, recruiting, finance and service.*

Ruggles has sold cars, managed, owned and trained dealerships literally across the world. For the last seventeen years, he has spent a month each summer consulting with the world's largest privately owned Toyota dealership group in Nagano, Japan.

He lives in Las Vegas, Nevada.

Follow his blog "Autos and Economics" at http://autosandeconomics.blogspot.com/

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