

**Proposal to: Mr. Damon Lester, President & CEO
National Association of Minority Automobile Dealers (NAMAD)**

**Proposal Title "A Market Based Economic Rational for Increasing the Number of Minority Owned
Automobile Dealerships in the U.S."**

In the United States, most new cars are sold through automobile dealers who are among this country's most dedicated and successful entrepreneurs. Automobile dealers operate under a franchise system, where the manufacturer has the exclusive rights to select a dealer based on some well-defined criteria. The manufacturer exerts considerable influence over the dealer, with the potential of cancelling the franchise if the dealer does not live up to the manufacturer's expectation. The manufacturer also exerts considerable control over the dealers through its determination of the number of dealers that it extends franchises to within a certain geographic region. The manufacturer must pay attention to the need to protect the market of a given dealer and ensure the dealer's sustainability both in the short and in the long run. Once awarded a franchise the dealer then becomes part of the automobile eco-system, where both the manufacturer and the dealer aggressively seek to create and expand their market share depending on each other for their successes. Thus while the manufacturer is solely responsible for producing the cars, the dealers are primarily responsible for selling the cars. While the manufacturers are keenly aware of what drives the national market, the dealers are aware of what drives the local market. Thus while manufacturers strive to create a national presence and acceptability for the product, dealers are responsible for transforming that national recognition to local sales. There is thus a mutual dependence between the dealer and the manufacturer, where the manufacturer is expected to provide a high quality product, and the dealer is expected to provide a high quality distribution service for that product.

The consumer also benefits from this franchise relationship, because the consumer is assured of a good service from the dealership (mandated and monitored by the manufacturer) and have access to

all the products made by the manufacturer. Thus under the franchise system, although the dealer is not legally an agent of the company, yet he is perceived to be one by the consumer. The manufacturer, in its choice of dealers, sends an unmistakable signal about the commitment it has on the community and the geographical region the dealer is supposed to represent. Thus, the success that the manufacturer enjoys in any given market is often contingent upon how successful the dealer has been able to reinforce the mission and vision of the manufacturer. Thus the manufacturer- dealership relationship is crucial to the success to any given brand in the automobile market. The manufacturer has to carefully balance and nurture the relationship it has with the dealers. On one hand the manufacturer has to make a quality commitment to help dealers sell cars and also restrict the number of dealership it assigns in a given geographical area to sustain the dealer profitability. On the other hand the manufacturer must make sure that it is not over-protective since dealers sheltered by too much restriction on the number of dealers may cease to exert the aggressiveness needed to protect or expand the market. In short the manufacturer has to be both selective about the choice of dealers, but selected dealers must be afforded enough care and protection that ensure their success.

The choice of both the quality and the quantity of the dealers is critical given the structure of the present manufacturer-dealership relationship in the United States and the importance of the role of dealers behind the success of the manufacturer. It is in this context that we must examine the issue of diversity in auto dealership in the United States. Mandating diversity is often inefficient and superfluous since, market signals are enough to alert manufactures about the importance of diversity. In other word, only an efficiency argument (not a fairness argument) is often enough to illustrate the role and importance of diversity. At present, of the roughly 18,000 dealerships currently in the U.S., only 5 percent are owned by minority groups, which include African-Americans, Latinos, Asian-Pacific Islanders, and Native Americans. Almost all manufacturers have diversity programs to attract minority owners. The role of National Association of Minority Auto Dealers (NAMAD) has also been critical in this area. They

and other interested groups have made a compelling case for diversity. However, mandating a strict quota may not help increase the proportion of dealerships owned by minorities. What is important is to make an efficiency argument for expanding minority owned dealership. The efficiency argument requires that the ethnic composition of the dealer ownership should reflect the trend in the racial diversity of the American population. American consumers are very diverse, with about 24% of the consumers belonging to minority communities (excluding non-minority females). No manufacturer who wants to be economically viable in the long run can or should ignore this trend. With increasing proportion of consumers who are minorities, it only makes economic sense to have increasing proportions of dealers coming from the minority population. Thus having more minority owned dealership does not just seem fair but makes good business sense. The buying power of all minorities will inevitably be the driving force behind the efforts to diversify their dealer networks. All manufacturer, both domestic and international has come to recognize that the consumer buying base is changing and changing very fast. Thus, as an example, in 2012, the Hispanic buying power in the US was roughly to the tune of \$1.2 trillion. This growth in Hispanic buying power was followed by the rise of the Hispanic owned dealership, and their growth outpaced growth in other minority owned dealership in the United States. This growth was not mandated by any government agencies, but simply reflected the change in market reality and businesses responded to that market reality.

Increase in the number of minority owned dealership lends **four** immediate benefits to the auto industry:

1. It allows for more control over the market since diversity of dealership allows for additional **product differentiation**. Although the auto industry is characterized by an oligopolistic market structure with few sellers, but given the market for any given automobile, diversity allows for some serious opportunity for market concentration. For example, selling Toyota Camry, is selling a brand that in itself has a certain defined market. However, that market power can be

enhanced when a dealership owned by a black is selling to a black community, or a Hispanic dealership is selling to a Hispanic community. It is known that people most often buy from people they know, like, and trust, and that usually happens when the buyers and the seller are from the same community. This type of familiarity only end up increasing the market penetration of dealers and helps in the growth of the auto industry. National product presence created by the manufacturer can be transformed into sales relatively easier in the local market by a dealer who knows the community well and knows what it takes to sell.

2. More minority owned dealership increases the economic strength of the community they are representing, minority based or not, thereby increasing the size of the auto market. One demonstrated successful way to increase minority ownership is to identify capable and talented minority general managers for a dealership and giving them equity ownership. That provides them with an opportunity to learn the entire business without making a substantial investment. This makes these competent, motivated minority executives a part of the process, allows them to own the process and expand their influence among other minorities to follow a similar path. This enriches the minority community and makes them effective market participant. This helps in the growth of the automobile industry.
3. Increase in minority ownership also enhances the diversity of feedbacks that manufacturers receive about their product. That helps them build a better product and increase market share. In the absence of such diversity, feedbacks are scarce and feedbacks may not be relevant. Minority dealers are more effective in soliciting feedback from minority buyers and more effective about transmitting those feedback to the manufactures. A black or Hispanic buyer may be less open to a white dealer with their feedback, and even if they are, a white dealer may have a harder time appreciating the importance of those feedback and transmitting them expeditiously to the manufacturer.

4. A rise in the minority owned dealership will help create better service to consumers due to rise in the competition. Since the number of minority owners are very limited, the probability of a new minority owners having a generational capital and expertise is low. This makes the dealership network more responsive to market changes due to two specific reasons: (1) new minority owners are less likely to be part of a well-established dealership family, making it behave more like a competitor(with the associated benefits to customers) rather than a monopolist, traits often exhibited by multi-product large dealerships, (2) minority owners without the protection of family wealth are often more innovative and efficient, and respond to market needs more promptly compared to multi-product large dealerships.

The Study

We will use the following economic data: A) per capita GDP by state, B) per capita national GDP, C) overall GDP by state, D) average individual income by state, E) average household income by state, F) average national income, G) average national median household income, H) population growth by state, I) population growth by country, J) breakdown of previous data by ethnic codes, and K) forecast income and population growth by ethnic codes.

As discussed, we will need NAMAD to provide us with the breakdown of data for the number of manufactures and new car dealers in the United States broken down by state, manufacturer's brand and the ethnic code of the dealer. We also request sales data by dealer and brand, as well. Ideally, we would like data from 2000-2014 or 2011-2015. We already have all of the necessary data for previously mentioned. Once all data is in our possession we will run a series of simple and multiple regressions on the data to find and validate changes and trend lines related to population growth, income growth and automotive sales growth. We will conduct an extensive review of the literature, on-going trends related to minority customers and their ever increasing purchasing power, as well

as, the growing percentage of minority entrepreneurs in the United States. Based on the review of the literature to date and trend analysis, we believe there is a strong case for expanding minority owned dealerships in minority and non-minority neighborhoods due to changing demographics and market demand. The study, once we have receive the aforementioned data from NAMAD, will be completed in 3 months. The study will contain a thesis statement, review of the literature, a statistical analysis section and a conclusion section. We expect the study to be between 75-125 pages in length which will include appendices.

Deliverables

In addition to the comprehensive study, the authors will deliver three op-eds for the popular press to NAMAD and be available at a press conference announcing the study.

Study Cost: \$20,000

This figure includes 10 bound copies of the study, writing of op-eds, travel costs, materials, and researcher's fees.