AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

# SUBMISSION TO THE INQUIRY INTO PROMOTING ECONOMIC DYNAMISM, COMPETITION AND BUSINESS FORMATION

MARCH 2023

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Section 1

# FOREWORD

The AADA welcomes the opportunity to make a submission in response to the House of Representatives Standing Committee on Economics inquiry into promoting economic dynamism, competition and business formation.

The AADA is the peak automotive industry body which represents Australia's franchised new car Dealers. There are approximately 1,500 new car Dealers in Australia that operate over 3,000 new vehicle dealerships. Franchised new car Dealers employ more than 59,000 people directly and generate $59 billion in turnover and sales with a total economic contribution of over $14 billion.

Australia's automotive industry is in a state of profound change. Electrification and changing consumer habits bring with them many opportunities for Australia's new car retailers. A trend that is emerging is the intent from some manufacturers to move from the traditional model of retailing vehicles through dealerships to a new model in which vehicles are sold at a fixed price through a network of agents.

Franchised new car Dealers accept that manufacturers have the right to distribute their product through the model of their choosing. However, Dealers invest significant capital, time and effort in bringing customers to a brand. Significant changes to distribution arrangements should afford Dealers sufficient notice, maximum transparency and should be accompanied by compensation when appropriate.

There are several risks to competition and productivity that stem from the agency model. The AADA believes that regulatory protections in markets like the US, the EU and Canada better ensure that distribution changes made by manufacturers are fairer and ensure better outcomes for Dealers and their customers.

**James Voortman**
**Chief Executive Officer**

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# AADA KEY POINTS

1. Australian franchised New Car Dealers operate in one of the most competitive and deregulated car markets in the world.

2. Some manufacturers are moving from the traditional model of retailing vehicles through Dealerships to a new ‘Agency Model’ in which vehicles are sold at a fixed price through a network of agents.

3. Agency Models have eroded intra-brand competition, led to higher vehicle prices, stifled productivity, and lowered sales volumes and profitability.

4. Regulatory regimes in the US, EU and Canada ensure that Dealers and consumers are protected when significant distribution changes are made.

5. Current automotive protections should be extended to truck, motorcycle and farm machinery Dealers.

6. Access to justice for franchisees in disputes with franchisors needs to be improved.

7. Unfair Contract Term protections should be expanded to all Australian franchisees.

8. A post-implementation review of the automotive part of the Franchising Code is due by mid-2023.

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# AUSTRALIAN AUTOMOTIVE INDUSTRY

The Australian automotive new car retailing industry can be broadly defined into two categories. Vehicle manufacturers, which are largely multinational businesses which supply vehicles into the Australian market. Car Dealers, which are generally Australian privately owned or family businesses who enter franchise agreements to purchase vehicles from these manufacturers to retail into the Australian market. This system is known as the franchising model and underpins around 1,500 members which operate approximately 3,100 individual new car dealerships.

The new car market in Australia is one of the most competitive and deregulated car markets in the world and contains 68 brands and 380 models. The competitive nature of the industry within Australia drives good consumer outcomes through increased inter and intra brand competition.

## Franchising in Australia

Over the last few years, some manufacturers have begun to explore alternative ways to distribute and sell their vehicles in a more direct to consumer way, known as the agency model. The agency model of new car sales enables direct sales of new cars from manufacturers to customers while still utilising traditional dealerships but to a reduced extent. In an agency model, the role of car Dealers is transformed to that of 'agents' who act on behalf of the manufacturer and are remunerated through a fee paid to dealerships on each vehicle that is delivered.

Honda Australia and Mercedes-Benz Australia are two manufacturers that have adopted the agency model in recent years. Some manufacturers see the agency model as the optimal model for vehicle sales as it provides the manufacturer with the ability to introduce a fixed price model, gain greater access to customer and vehicle data, and provide greater control over sales activities. However, the AADA considers that the adoption of this model can have detrimental effects on the overall automotive industry, including but not limited to, increased prices, reduced competition, loss of jobs, employee remuneration, dealership viability and industry productivity.

When Dealers enter into agreements with manufacturers they are generally required to make substantial capital investments in real estate and assets like showrooms and service facilities and equipment. These investments have meant that dealerships

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have taken on the bulk of the risk in this relationship, but they are also subject to a large variety of prescriptive and onerous performance measures.

The relationship can be characterised by a great deal of uncertainty for dealerships in terms of their viability into the future and ability to make a return on their investments and in some cases, manufacturers have pulled out of the Australian market with little to no notice to Australian dealerships, as seen with the removal of the Holden brand, by General Motors in 2020.

This highlights the power imbalance that exists between car manufacturers and franchised new car Dealers that disadvantages both dealership businesses and consumers who purchase new vehicles from Dealers. Many Dealers enjoy good relations with their respective manufacturers and work in a mutually beneficial partnership, but there remain many instances where Dealers are subjected to unfair treatment.

In recent years, the Government has introduced various automotive-specific protections into the Franchising Code. While this is a very welcome development, the AADA remains concerned that the protections do not apply to truck Dealers, motorcycle Dealers, or farm machinery Dealers, all of whom face the same power imbalance. Furthermore, it has become apparent that manufacturers have significant legal resources which are skilled at finding ways to circumvent such regulations. Dealers do not have the same level of protection compared to their counterparts in the US and Europe.

### The Economic Contribution of the Automotive Dealer Industry

The Australian automotive Dealer industry generates $14.12 billion in direct economic activity and supports almost 60,000 jobs generating $5.38 billion in wages. Dealers operate in every Australian State and Territory with over 1,780 dealerships located in regional and rural areas.

In Australia, franchised new car Dealers provide a unique service to consumers, providing them with the full service of retailing a car, finance and insurance services, and after-purchase care such as servicing and repairs. Dealers are a mainstay in the local communities they operate in, making significant contributions to a range of local charitable, community and sporting organisations. They employ individuals within their local communities, including apprentices and make a strong direct and indirect economic contribution to these communities.

# Australia

## 3,026 Dealerships

## Economic Contribution

**59,669**
Dealer Employees

**$5.38 billion**
Dealer Wages

**$2.74 billion**
Tax Contribution

**$14.12 billion**
Total Economic Contribution

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# RESPONSES TO THE TERMS OF REFERENCE

## A) THE EFFECT OF A DIVERSE AND DYNAMIC BUSINESS ENVIRONMENT ON:

- **PRODUCTIVITY, PRICES AND BETTER-PAID JOBS**
- **OUR SUPPLY CHAIN RESILIENCE TO DISRUPTION**

Franchised new car Dealers are dynamic and agile businesses with a deep understanding of the markets they operate in and the business of retailing vehicles to consumers. Intra-brand competition, excellent customer relationships and the ability of Dealers to make independent decisions about their businesses drive productivity within the sector. However, recent moves towards the agency model by some brands risks fundamentally changing the way in which Dealers operate and minimise the value they bring to the table in the new car retail space.

This recent change in the business distribution model whereby Dealers are considered to be agents of the manufacturer, and their place in the supply chain is limited to just delivery of the vehicle to the consumer, has the potential to drastically change the way in which the new car retailing industry in Australia works and potentially to the detriment of consumer outcomes.

- **Productivity**

Under the traditional dealership model, Dealers take on the lion's share of the risk, but are also able to exercise control of their businesses by making key decisions such as the ordering, marketing and pricing of products. When moving to an agency model, manufacturers take responsibility for the marketing, administration, ownership of vehicle stock, insurance and transport costs, and technology investments/improvements. As a result of this, agents have little to no ability to influence vehicle sales outcomes and are less agile in their operations.

Examples of this are, extended timeframes for consumers to receive pricing information on vehicles. If a consumer attends a dealership looking to purchase a vehicle, the sales agent is no longer selling the vehicle to the customer, rather they are acting as a facilitator for the sale between the brand and the customer. This means that on occasion the sales agent is not able to provide on-the-spot pricing information and there are reports that on occasion it has taken more than 24 hours for a customer to receive this information.

Another example is if a customer has ordered a vehicle and has subsequently decided they would like to amend the contract for example to either add on or remove accessories, or modify the finance contract. Reports have suggested that it can take weeks for these contracts to be updated and if they are amended, consumers are put back to the end of the queue and the contract is effectively restarted from the day of the amendment.

Dealers understand the local markets they operate in very well, they know the type of stock customers are seeking, colours, vehicle types etc. In an agency model, the brand has primary responsibility for the decisions related to stock ordering and geographical allocation of stock. There are reports that this has led to a mismatch between stock in particular dealerships and consumer preferences in those particular regions. For example, manufacturers ordering black or dark-coloured vehicles in warmer climates.

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The above examples reinforce how the agency model can lead to reduced productivity within the sector and would have much less intuitive and flexible sales capabilities than that of Dealers that have refined their capabilities over long periods of time in a competitive industry.

- **Prices**

One main feature of the agency model is the ability for manufacturers to introduce a fixed pricing model. This means that new vehicles have a standard price that is set across the board and removes a consumer's ability to negotiate on price for new vehicles. There are examples where this model has led to higher prices as it removes intra-brand competition between Dealers as the manufacturer can manage or more likely remove, customer discounts, in this way achieving price consistency and avoiding competition between Dealers of the same brand.

For example, if a consumer is looking for a specific vehicle within a brand, under a franchising model the consumer is able to shop around at different Dealers to negotiate on price and or extras included with the sale to ultimately get the best deal for their circumstances. However, under an agency model, the consumer is subject to the fixed price set by the manufacturer and has no negotiating power within the transaction.

This could lead to a scenario where all customers end up paying higher transaction prices as the Dealer does not own the stock they are selling and as such, are unable to provide discounts to consumers as a means to achieving a sale. If a Dealer is the owner of the stock, they will be more motivated to move the product and reach deals with customers. Dealers understand their customer base and are more agile in adapting to changing consumer needs, preferences or external market forces.

This move to a fixed pricing model appears to contradict consumer preferences. AADA research conducted by Zing Insights canvassed views of Australian new car buyers and intended buyers across particular areas relating to their vehicle purchase behaviours. The research showed that "91% say that the ability to negotiate price of a vehicle is 'very or quite' important to them in context of the purchase process overall".

- **Better-paid jobs**

As mentioned above, under the agency model the Dealer would no longer purchase stock from a manufacturer or supplier to resell onto consumers, the stock is solely owned by the manufacturer. The earning potential for dealership businesses is much reduced as is the earning potential for certain professions within dealerships. Recent industry anecdotes suggest that brands that have switched to an agency model have found that high achieving sales personnel have left to take up positions in other brands due to the reduced ability to make commissions on sales, particularly when sales volumes have fallen.

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### B) THE EXTENT TO WHICH ANTI-COMPETITIVE BEHAVIOUR AND CHANGES IN INDUSTRY STRUCTURES HAVE CONTRIBUTED TO RISING MARKET CONCENTRATION IN AUSTRALIA

The AADA considers that consumers benefit when businesses are in competition, as detailed above, the nature of the agency model and fixed pricing makes the purchase of vehicles whose brands operate under this model, inherently less competitive. Intra-brand competition is completely removed and consumers lose the ability to negotiate on price between dealerships. Prices are more likely to be set in boardrooms in Stuttgart, Tokyo or Detroit using an algorithm which tries to maximise profits.

### C) THE EXTENT TO WHICH ECONOMIC BARRIERS—SUCH AS REGULATORY COSTS AND BARRIERS TO FINANCE, INFRASTRUCTURE, SUPPLIERS, CUSTOMERS AND WORKERS—CONTRIBUTE TO RISING MARKET CONCENTRATION AND SLOWING BUSINESS FORMATION RATES IN AUSTRALIA

The AADA has no comment.

### D) THE EXTENT TO WHICH BUSINESSES CONSOLIDATING THEIR MARKET POWER HAS UNDERMINED PRODUCTIVITY, STIFLED WAGES, MADE MARKETS MORE FRAGILE AND LED TO HIGHER MARK-UPS

The AADA is concerned that moves to more centralised distribution strategies by automotive manufacturers will abolish intra-brand competition and serve to enhance the market power of these multinational companies.

Covid-19 had significant effects on the new car industry, supply chain disruptions caused by semiconductor shortages, border closures and lockdowns all contributed to new car supply shortages. Even recently, disruptions to supply chains which meant that new vehicles were stored in source countries has meant that new vehicles are arriving in Australia with biosecurity risk material which has caused further disruptions and delays at Australian ports. This supply squeeze has meant that consumers are waiting extended periods for delivery and have reduced ability to negotiate on price, due to high demand and low supply.

As these pressures relax, more supply will come into the market which will allow a transition back to the market experiences pre-Covid. However, some brands which have moved to an agency model have stated that in order to protect the high prices experienced over the last few years, they will be seeking to limit supply.

According to automotive analysts *"Mercedes is putting value over volume and planning with flat volumes in 2023 to protect pricing"* .[1]

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This has already been seen with the two brands which have moved to the agency model, Honda Australia and Mercedes-Benz Australia. For example, Mercedes-Benz Australia's first new model to be launched since the move to the agency model had a $12,000 price increase, while other new models have increased by over $15,000.[2]

Honda has also admitted that the retail prices for most of its new cars increased since switching to a fixed price business model, stating that the recommended retail prices for 16 of its 18 models increased by between $100 and $300.[3] However, research by automotive analysts - *Drive* has found that Honda Australia has dramatically downplayed the true scope of the price rises.

*"Honda Australia's drive-away prices have in fact increased by between $2700 and $5300 compared to their lowest point in the year prior to the switch to non-negotiable sales."* [4]

Honda has also had a large reduction in sales volumes since moving to the agency model, with Honda Australia stating that its plan was to make more profit from each vehicle while selling fewer cars.[5]

The AADA acknowledges that manufacturers should have the ability to move to an agency model and make business decisions that they see fit, however, this should not be at the expense of competition and consumer outcomes. The AADA also considers that where a brand moves to agency model, Dealers who have made significant capital investments, as detailed above, should be fairly compensated.

### E) DRAWING ON INTERNATIONAL EXAMPLES, HOW AUSTRALIA COULD LOWER ECONOMIC BARRIERS TO COMPETITION AND BUSINESS FORMATION, FURTHER LIMIT ANTI-COMPETITIVE BEHAVIOUR, AND BETTER MANAGE CHANGES IN INDUSTRY STRUCTURE THAT WOULD ENTRENCH, INCREASE OR EXTEND MARKET POWER

The AADA considers that Australia is currently lagging behind other jurisdictions in terms of protections for Dealers in order to promote better consumer outcomes. In other international markets such as the US, governments have introduced automotive franchising protections which have had the effect of empowering local Dealers and addressing the power imbalance that exists between Dealer and manufacturer.

Almost all states in the US have strong Dealer protections, requiring manufacturers to sell new vehicles through local franchised Dealers, protections from competition in particular market areas, and restrictions around the termination of agreements with existing Dealers, requiring good cause to do so.

In the EU, antitrust laws prevent 'non-genuine' agency Dealer contracts between manufacturers and Dealers. Manufacturers are still free to move to an agency model if they choose, however, they must comply with the obligations of their chosen model, agency or franchise. They are not able to blur the lines between agency and franchise and reap the benefits from each model. This means that in an agency model, agents must act on behalf of the manufacturer and assumes no risk for the ownership of stock, the manufacturer sets a fixed retail price for the stock and the agent does not act independently of the manufacturer, in order to be considered a genuine agent. Further, franchisors must be upfront and transparent with franchisees when changing the distribution model of their brand.

In Canada, most franchise agreements include specific provisions related to dispute resolution through arbitration or mediation. A number of Canadian Provinces also have adopted franchise legislation which includes detailed provisions allowing either party to a franchise agreement to require any dispute between them to be submitted to mediation.

The international examples above highlight regulations to ensure that where major changes are undertaken in the distribution model of a franchise, that the changes are undertaken in a way that maximises transparency, provides appropriate lead time for franchisees, and provides stringent guidelines in the establishment of a new distribution model.

AADA notes and is supportive of recent moves to better regulate this market in Australia and correct the power imbalance between manufacturers and dealers such as the various automotive-specific protections in the Franchising Code. However more needs to be done to better protect Australian businesses and the benefits they bring to the communities they operate in. AADA considers that it is in the best interests of consumers and Australian-owned Dealers that the regulations around vehicle franchising in Australia are strengthened to put us in line with the US, EU and Canada.

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# RELATED MATTERS

## Tax Implications

A move to an agency model also presents questions related to tax avoidance. In the franchised model, Australian-owned Dealers purchase the stock and on sell, as such, business income tax is tracked and monitored and these Dealers pay their fair share of tax, to the tune of around $2.74 billion. The AADA considers that it is increasingly likely that in circumstances where large multinational brands are responsible for importing cars to Australia and retailing these to customers through an agent or an online service, this tax revenue could end up going overseas.

## Expansion of Franchising Protections to Trucks, Motorcycles and Farm Machinery

AADA considers that other franchisees such as those that operate in the truck, motorcycle and farm machinery sectors also experience the issues outlined in this submission. Some brands that manufacture cars for the Australian market, also manufacture trucks and or motorcycles, as such, the franchise agreements for these other types of vehicles are structured in the same way and many of the risks carried by car Dealers are carried by truck, motorcycle, and farm machinery Dealers. AADA considers that automotive-specific protections should be extended to cover Dealers which distribute vehicles such as trucks, motorcycles and farm machinery.

The previous Government considered expanding the franchising protections to truck, farm machinery and motorcycle Dealers in an Automotive Franchising discussion paper in August 2021, but the consultation did not progress. A post-implementation review of the most recent amendments to the automotive part of the Franchising Code must be completed by mid-2023 and the AADA strongly suggests that these automotive Dealers should have access to these critical protections.

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### Access to Justice

The AADA considers that more needs to be done to give franchised new car Dealers access to justice that doesn't involve litigation, which can be time consuming and costly. Alternative dispute resolution mechanisms such as arbitration are a more effective, expedited, personalised and cost-effective way to manage disputes within the automotive industry.

The AADA is encouraged by the recent automotive industry Memorandum of Understanding (MoU) reached by automotive industry associations, to adopt better dispute resolution practices through the arbitration provisions, however, this MoU will rely on the OEMs and Dealer Councils to include these provisions in their Dealer Agreements and will only apply to a very narrow set of dispute criteria. This means that there are a number of franchise agreements that do not contain arbitration provisions and a potential reluctance by franchisees to request these provisions to be included in agreements due to the power imbalance and reliance on the manufacturer to continue the franchise agreement.

The previous Government considered alternative approaches to dispute resolution in an Automotive Franchising discussion paper in August 2021, but the consultation did not progress. A post-implementation review of the most recent amendments to the automotive part of the Franchising Code must be completed by mid-2023 and the AADA strongly suggests the issue of access to justice should be considered.

### Unfair Contract Terms

The AADA is encouraged by and welcomes the recent changes to Unfair Contract Terms (UCT) laws which take effect from 9 November 2023. These changes will strengthen protections for small businesses from unfair terms in standard-form contracts and provide increased protections for Dealers who qualify under the new thresholds. However, AADA considers that all franchise agreements should qualify for UCT protections, irrespective of the number of employees or annual turnover. The AADA highlights that return on investment for car Dealers takes many years and often spans multiple terms of agreements. This makes negotiating more balanced commercial terms extremely difficult for car Dealers renewing contracts after making the initial investment in the franchise. Also, the comparative size difference between the manufacturer and the Dealer creates a power imbalance when entering into a franchise agreement. The AADA considers that car Dealers are therefore at greater risk of being subjected to UCT.

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# CONCLUSION

We would be happy to meet with you to discuss our submission and participate in any further consultation. If you require further information or clarification in respect of any matters raised, please do not hesitate to contact me.

**James Voortman**
Chief Executive Officer

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# REFERENCES

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