

Bankruptcy Court Decisions

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Recession or not, this time is different

Discover's U.S. Spending Monitor, a monthly poll gauging consumer spending intentions, recorded its third consecutive decline in January.

Waning confidence in the U.S. economy, combined with higher household costs, led half of the consumers surveyed to say they intend to cut back on discretionary purchases in February. That's nearly five points higher than December and a full 10 points more than September 2007.

Aggressive responses by the Federal Reserve and a stimulus package had no immediate effect on consumer pessimism.

We've been in recessions or economic slowdowns before, but this one is different. Chuck Tatelbaum, National Chair of the Bankruptcy Litigation and Secured Transaction Practice at Adorno & Yoss, explains why, by sharing with us what he sees when he holds the magnifying glass to just one often ignored industry.

Automotive industry suffers in economic downturn

In every economic slowdown, consumer discretionary spending wanes, and the businesses that rely on that spending suffer. But Chuck Tatelbaum, National Chair of the Bankruptcy Litigation and Secured Transaction Practice at Adorno & Yoss, who's watched the effects of economic slowdowns on businesses over the course of his 42-year-career, sees evidence that the damage being done this time around is of a far greater magnitude than in recessions and slowdowns past.

Consumer spending is only part of the puzzle. As consumers skimped on savings and racked up easy credit card debt on everything from \$10-a-day Starbucks habits to regular maintenance on their cars, businesses proliferated, as if the cycle would never end.

It's reminiscent of musical chairs, Tatelbaum said. "So long as the music is playing, no one cares how many chairs are there. Everyone who was opening stores didn't worry so long as people were coming. But what happens when the music stops and the chairs have all been pulled away?"

Now that the music does seem to have at least faded, one industry Tatelbaum thinks you should expect to hear from is the automotive service industry — dealerships with service arms, and minor service quick lube chains.

Consumers, faced with increasing mortgage payments, reduced credit availability, increased household expenses, and higher food and gas costs, are deferring their regular automobile maintenance. Statistics show that a 20 percent drop in volume has occurred in businesses that perform oil changes and minor preventative maintenance on vehicles.

For the dealerships with maintenance arms, a ploy to boost new car sales some years ago by offering zero down, zero percent interest rates is both exacerbating and highlighting the problems. People who ordinarily could only afford used cars, bought new cars instead. That was nice for new car sales numbers, but it took its toll on the used car industry, once a major profit center for dealerships.

Those offers are now coming back to haunt the dealerships in a new way. Non-warranty repair work for dealerships is critical. While manufacturers pay them a discounted rate for warranty repair work, they pay the full rate for non-warranty work. Now that those new cars have reached the end of their warranty period, and dealerships should be performing non-warranty repair work on them for the first time, discretionary spending concerns have caused consumers to forgo all but the most crucial maintenance on their vehicles.

Considering that the other business dealerships are in the selling of new cars, it comes as no surprise that many manufacturers have announced plans to close unprofitable franchises.

The problems don't end with the minor repair shops and the dealerships, and they don't just impact major chains, but mom and pop franchise owners as well. And as these businesses struggle under reduced demand for their services, their problems spill over into the petroleum products industry and the replacement auto parts business.

What are they to do?

Since what these businesses really need is customers, there's little they can do. Labor costs, service hours, and rent often can't be cut. Worse yet, unlike many businesses, you can't expand sales, because you can't expand the service line.

"When Kmart went into Chapter 11, they had a plan to bring more people in by, say, emphasizing their Martha Stewart line. But if you are a Chrysler Jeep dealer, you can only be a Chrysler Jeep dealer. And that's the problem — just like a Starbucks or

a Carvel can't suddenly change their product line, neither can these companies. The only thing you can do is lower your prices — and that may be counterproductive."

So when these businesses or their creditors start calling you, expect a challenge. "All you can really do is try to figure out how to cut expenses, but at the same time not cut them so much that you deteriorate the service that you provide," Tatelbaum said. Chapter 11 may help chains by allowing them to get out of leases, but industrywide, the problems are likely to only be alleviated by customers' return.

Not going away

Tatelbaum estimates that the industry is going to have to tread water for at least a few years, since neither interest rate cuts, nor \$600 cash from the government are likely to help. As a case in point, Wal-Mart recently reported that gift cards sold during the holidays aren't helping the company's sales, because customers are using them to buy food.

The bankruptcy courts aren't structured to alleviate the problems either, Tatelbaum said. "It's not about pointing a finger as to whether the credit card industry extended too much credit, or credit was too cheap. Clearly blame goes there, but the blame is also on the consumer who thought they could spend and never have to worry about it. The problem is that the 2005 amendments were so concerned about consumer abuse that the pendulum has swung so far to the other side that consumers who really need a fresh start won't get one, and that's only going to prolong the difficulties." ■