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Completing Contracts Ex Post: How Car Manufacturers Manage Car Dealers

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Published/Copyright: April 1, 2005

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From the journal
Review of Law & Economics
Volume 1 Issue 1

Article

This article illustrates how contracts are completed ex post in practice and, in so doing, indirectly suggests what the real function of contracts may be. Our evidence comes from the contracts between automobile manufacturers and their dealers in 23 dealership networks in Spain. Franchising dominates automobile distribution because of the need to decentralize pricing and control of service decisions. It motivates local managers to undertake these activities at minimum cost for the manufacturer. However, it creates incentive conflicts, both between manufacturers and dealers and among dealers themselves, concerning the level of sales and service provided. It also holds potential for expropriation of specific investments. Contracts deal with these conflicts by restricting dealers' decision rights and granting manufacturers extensive completion, monitoring and enforcement powers. The main mechanism that may prevent abuse of these powers is the manufacturers' reputational capital.

Published Online: 2005-4-1

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https://doi.org/10.2202/1555-5879.1002

Downloaded on 8.10.2026 from https://www.degruyterbrill.com/document/doi/10.2202/1555-5879.1002/html?lang=en