# New motor cars

A report on the supply of new motor cars within the United Kingdom

**VOLUME 1**

MONOPOLIES AND MERGERS COMMISSION

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**Presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty**
**February 1992**

## Members of the Monopolies and Mergers Commission as at 31 October 1991

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[1]These members formed the group which was responsible for this report under the chairmanship of Sir Sydney Lipworth.

## Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests. The omission is indicated by a note in the text.

# Volume 1 contents

# 1 Summary

1.1. We have been asked to investigate and report on whether a monopoly situation within the meaning of section 6 of the Fair Trading Act 1973 (the Act) exists in relation to the supply of new cars in the United Kingdom and, if so, on whether any of the facts found operate or might be expected to operate against the public interest.

## Background

1.2. In 1990 2 million new cars were sold in the United Kingdom, for £19 billion; the car industry accounted for about 3.5 per cent of gross domestic product and employed about half a million people. There are over 40 different suppliers to the United Kingdom market, 16 of which each have more than 1 per cent of the market. Most of the major suppliers are multinational companies which supply cars throughout the world. Virtually all use a distribution system under which selected dealers are given exclusive territories, within which they are responsible for selling and providing full after-sales service for the suppliers' cars. The dealer obtains cars at a price which allows him a standard margin from the list price set by the supplier and sets his own price to the customer. In the United Kingdom most customers receive substantial discounts from the list price.

## The monopoly situations

1.3. We found two monopoly situations: a scale monopoly situation in favour of Ford, together with its wholly-owned subsidiary Jaguar, by reason of their 25 per cent share of United Kingdom supply; and a complex monopoly situation arising from the selective and exclusive distribution (SED) system used by most car suppliers in the United Kingdom, including Ford. It should be noted that these findings do not, of themselves, connote that the suppliers are acting against the public interest.

1.4. We also considered whether the voluntary restriction by Japanese car manufacturers of their exports of new cars to the United Kingdom gave rise to a complex monopoly situation involving the respective United Kingdom and Japanese trade associations, the Society of Motor Manufacturers and Traders (SMMT) and the Japan Association of Automobile Manufacturers (JAMA), and the SMMT's members. After much consideration we found that these voluntary export restraints (VERs) did not give rise to a complex monopoly situation, within the meaning of section 6 of the Act. They do, however, have a major effect on competition in the new car market and therefore require detailed consideration in that context.

## Market distortions and their effects

### *VERs*

1.5. VERs date from 1975 in the United Kingdom. During the first half of the 1970s Japanese exports to the United Kingdom increased from less than 1 per cent to nearly 10 per cent of the market in 1975. Following a meeting between the then Secretary of State for Trade and his Japanese counterpart, the Japanese manufacturers undertook to exercise voluntary restraint in their car exports to the United Kingdom. These have been held to less than 12 per cent of the number of United Kingdom cars sold each year since then, with the SMMT and JAMA meeting regularly to discuss forecast demand and ensure a smooth flow of deliveries. The individual Japanese manufacturers restrain their respective shares within this overall limit. In the EC some other member states, France, Italy, Spain and Portugal, also have restraints on the numbers of Japanese car imports.

1.6. The object of VERs in this country was and is to protect the United Kingdom car industry, which has a history of low productivity and high costs, from competition from Japanese manufacturers. Other EC producers, however, increased their share of the United Kingdom market, at prices that reflected the restriction of Japanese competition. VERs clearly restrict competition in the United Kingdom and in the EC generally. They keep down the share (by volume of cars) of the market by Japanese producers, as a group; and they sharply reduce competition between individual Japanese suppliers and limit their ability to expand. Recent studies have demonstrated Japanese car makers to be the most efficient and productive in the world, and a comparative study carried out for us of prices of Japanese cars in the United Kingdom, Japan and the United States indicated that United Kingdom prices were significantly higher than those in the other markets. Choice is restricted, simply by reason of the limitation in the numbers of imports, and also because, as the restriction is on volume and not value, there is every incentive on the part of the Japanese to import the more expensive and more highly specified models rather than the smaller, cheaper vehicles on which there is less margin. The distorting effects of VERs are reinforced by the 10 per cent Common External Tariff.

### *Company cars*

1.7. Another distortion of the United Kingdom market is the company car, particularly when given wholly or partly as a benefit or `perk'. The impetus in this sector came in the mid-1970s with the policy of income restraint, coupled with high personal taxation, and the sector has continued to grow through the 1980s. The company car buyer is far more significant in the United Kingdom than in the rest of Europe. This has a distorting effect on the market in that it encourages high specifications (and is one of the main reasons why United Kingdom cars are so much more richly specified than their continental equivalents), and has created a class of professional buyers who are able to secure greater discounts than are generally available to private buyers. The present system thus disadvantages the private buyer and screens out a large part of the market from consumer choice based on personal economic considerations. Furthermore, car suppliers give substantial additional discounts to the larger fleet buyers. The higher prices paid by the private consumer finance the discounts given to company car buyers since the major suppliers have to retrieve from other buyers the revenues foregone by offering extra discounts on these substantial sales if they are to keep their United Kingdom operations viable over time.

### *Right-hand drive (RHD)*

1.8. The fact that the United Kingdom is an RHD market unlike the rest of Europe (except Ireland) also has a distorting effect in that it facilitates its segmentation within the EC and makes it more difficult to import cars from the Continent to take advantage of any price differentials that may arise between the United Kingdom and these markets. Similarly, differing type approval requirements in EC countries have segmented the EC market. The EC Commission has recently stated, however, that a common EC-wide type approval regime will be introduced at the end of 1992, but the RHD differentiation will obviously still remain.

## Competition within the United Kingdom

1.9. Within the constraints of VERs there is active inter-brand competition among the car suppliers. Competition for market share is driven by the economics of manufacturing-high investment costs, high break-even point and low incremental costs thereafter. In 1990 the top three suppliers, Ford, Vauxhall and Rover, had 54 per cent of the market, with 25 per cent, 16 per cent and 13 per cent respectively. Five other suppliers had between 3 and 10 per cent of the market. United Kingdom market shares have changed significantly over recent years, and are still changing. The most dramatic example is the decline of the leading British-owned supplier (the British Motor Corporation (BMC)) from a market share of 38 per cent in 1970 to Rover's present share of 13 per cent. There is heavy promotion and advertising as companies strive for an increase in market share. There is a vast range of models and variants, giving a great deal of choice, and good availability. Over recent years several new suppliers, albeit relatively small, have successfully entered the market.

1.10. All the leading companies in the United Kingdom adopt virtually the same method of distribution, through independent dealers who are franchised to sell the supplier's marque under SED arrangements which benefit until 1995 from a ten-year block exemption, under EC Regulation 123/85. Substantially the same system is used throughout the EC as well as in the USA and Japan. Under these arrangements dealers selected by the supplier are allocated territories as their areas of responsibility and are given protection from other dealers within the same franchise network setting up in competition in their areas. They are allowed to sell only to final customers or other dealers within the same network. The SED arrangements require the dealers to provide full servicing and repair facilities. While the arrangements restrict the dealers' independence and freedom of action (and these restrictions formed the basis of the complex monopoly finding), they encourage inter-brand competition, allow some intra-brand competition, and provide consumers with after-sales repair and service facilities that they can be confident are backed by the car suppliers. However, some of the restrictions have adverse effects on competition and prices, as we set out in our conclusions.

1.11. In most car markets discounts are regularly given by dealers to customers. The size of these discounts is a notable feature of the United Kingdom market, so that the published list price is little guide to actual transaction prices and is used mainly by the supplier as a bench-mark to establish its position in the market. Cars are supplied to the dealer at a price allowing him a margin of about 14 to 18 per cent, depending on the car model. The size of discount the dealer then offers the customer out of this margin is influenced by such factors as the state of trade and, on individual models, by the pattern of additional support from suppliers. Discounts vary from dealer to dealer but our investigations suggested that the average discount offered by dealers in 1990 was over 10 per cent. Fleet buyers (with fleets of 25 or more cars) get larger discounts from dealers than private customers, and buyers with large fleets can expect further discounts direct from the major suppliers. Information on discounts is not published; private customers may be aware that discounts are available but will have to search to find out what is actually on offer at a particular time.

## EC price comparisons

1.12. When the reference was made by the Director General of Fair Trading (DGFT) he drew our attention in particular to the widely publicised claims that United Kingdom prices for new cars were higher than those in other parts of the EC. We recognised that an analysis of price differences was an important task in our inquiry.

1.13. Over recent years several surveys by the Consumers' Association (CA) and the Bureau Européan des Unions de Consommateurs (BEUC), taken up in numerous articles in the media and trade press, have claimed that United Kingdom prices are substantially higher than those for comparable cars in some other EC countries. The car suppliers have consistently challenged these findings. We therefore commissioned our own independent survey through Ludvigsen Associates Ltd (LAL) as a basis for our own assessment. The methodology and findings of the survey were checked as fully as possible with the relevant suppliers. In the following paragraphs we set out an outline of the survey, our own work on price differentials and our assessment.

1.14. The survey found that list price differences between the United Kingdom and other EC markets were indeed wide, and even wider in smaller markets like Belgium and the Netherlands. Cars in the United Kingdom, however, have more lavish specifications (partly as a result of the company car and the way the benefit is taxed, partly general consumer preferences in the United Kingdom). We have taken into account all but the smallest differences of specification. Agreement on virtually all these specification adjustments was reached with the suppliers and we believe that they present a fair picture. After adjustment for these specification differences the list price differentials narrowed considerably.

1.15. List price specification adjustments are not sufficient for a valid price comparison. Some estimation of actual transaction prices is essential. We ourselves were not able to collect information on actual transactions in other EC countries or the discounts actually given there. A telephone survey was carried out by the Harris Research Centre (Harris) which sought price quotations for the model variants in our survey in the EC markets selected. This is adequate as an indication of possible discounts, but the results are obviously not the same as those in actual transactions. Some suppliers also gave us evidence on discounts (which showed discounts higher than those indicated by the telephone survey, both in the United Kingdom and other EC countries) and on other financial benefits they offered to buyers.

1.16. Discounts depend on the state of the economy generally and of the car market, and on the knowledge and persistence of consumers. Similarly, financial benefits come and go and are only for limited periods. Exchange rate fluctuations also have a major impact on price differences at any point in time. Our price quotation survey was conducted in October 1990, when the United Kingdom had only just entered the Exchange Rate Mechanism (ERM); most of the car suppliers' price information was for the early part of 1990 when the exchange rate was substantially lower than in October. Taking account of all these sources of variation we have expressed our price comparisons in terms of ranges within which we think the price differences lay.

1.17. A comparison of the price ranges in the United Kingdom with those in France and Germany, the two markets studied most similar to the United Kingdom in size and both with substantial indigenous manufacturing capacity, does not indicate a significant difference in general price levels. However, there are a number of model variants in the two countries, particularly in the smaller segments, whose adjusted prices appear on any of our assumptions to be considerably lower than those in the United Kingdom. Prices in Belgium and the Netherlands tend to be below those in the other markets in all segments. Differences are particularly noticeable in the small segment. These smaller markets, however, are affected by a number of factors, including the Belgian price control system and the absence in both countries of a major indigenous manufacturer. Prices in markets of this nature are necessarily less reliable guides to the potential level of prices in the United Kingdom.

1.18. The results of our work on relative prices do not lead us to expect significant differences in the general level of prices between the United Kingdom and France or Germany in the future. We think it reasonable to assume, however, that for individual models, particularly in the smaller car segment, prices to private customers in the United Kingdom will be higher than those available in other EC countries, and especially in Belgium and the Netherlands, and that from time to time even the general level of prices may be expected to diverge.

## Assessment

### *VERs*

1.19. Although, in the absence of a monopoly finding related to VERs, it would be inappropriate to make any statutory finding or recommendation we consider it would be wrong to avoid expressing views on such an important feature of the market, where change is needed. VERs on imports of Japanese cars are the principal restriction of competition in new car sales in the United Kingdom, and the main factor in prices being higher than they otherwise would be, through reduced competition and because there is less incentive for Japanese suppliers to cut prices or sell cheaper models as the number of cars they can export is restricted.

1.20. In July 1991 the EC Commission and the Japanese Government reached an understanding on future VERs. While the precise arrangements have not been spelled out publicly, the aims are that nationally-negotiated VERs should be superseded by an EC-wide restraint at the end of 1992, that this EC-wide VER should continue until the end of 1999, that there should be no restrictions on Japanese cars produced within the EC and that from the year 2000 there should be no restrictions at all. While the announcements are silent on what happens between 1993 and 1999, the EC Commission's forecasts are that by the end of 1999 Japanese exports to the EC as a whole will be 8 per cent of the market (with Japanese exports to the United Kingdom constituting 7 per cent of the United Kingdom market) and imply that at that stage about one-half of all Japanese cars sold in the EC would have been locally produced and one-half imported.

1.21. There are many unknown factors in considering the precise effects of these arrangements on the United Kingdom market over the period. The planned increase in Japanese-owned EC production is bound to have strong effects on competition and price, but it is impossible to predict with any certainty exactly how Japanese suppliers will react individually either in the United Kingdom or in other EC markets. Clearly the situation could develop in ways which left VERs as a serious constraint. In evidence to us the Department of Trade and Industry (DTI) indicated that if Her Majesty's Government (HMG) does not wish VERs to remain in the United Kingdom there is nothing in the EC arrangements that would prevent this. We think that on purely competition grounds the removal as quickly as possible of restrictions in the United Kingdom would be desirable. There are of course wider considerations to be taken into account but we hope that the Secretary of State, in assessing the many factors involved, will give full weight to the competition arguments.

### *Company cars*

1.22. We have pointed out the distorting effects of the company car on specification and prices. Over recent years changes in taxation treatment have lessened but not removed the financial benefits of private use of a company car, but we recognise that even their complete removal will not easily change the company car culture. We consider, however, that the system of banding the charge by engine size and price has led to more highly specified cars geared particularly to the engine capacity and price thresholds, and we suggest that the basis of charge be kept under review with a view to avoiding this bunching. We think that the introduction of a single percentage charge based on list price or cost would remove the distortion.

### *RHD*

1.23. We have identified the need for RHD cars as an obstacle to the smooth working of parallel importing or arbitrage into the United Kingdom and an important factor that will continue to prevent United Kingdom consumers from taking advantage of EC price differences when these occur. It is over 20 years since the feasibility of moving in the United Kingdom to driving on the right was reviewed; imports then were of much less significance, and we suggest the costs and benefits of such a change should now be reassessed.

### *Parallel importing*

1.24. Parallel importing procedures were introduced by the EC Commission as part of the block exemption to enable consumers to take advantage of significant price differences between EC countries. The procedures ought to be of particular advantage to United Kingdom customers who are uniquely handicapped by RHD, while continental buyers, who have left-hand drive (LHD) cars, can take advantage of cheaper prices where they occur. These procedures have not been working as smoothly as they should. We suggest that the Secretary of State should draw to the attention of the EC Commission our suggestion for review of the operation of parallel importing under the block exemption.

## Conclusions

1.25. We have noted earlier the benefits provided by the SED system. We consider, however, that some of the restrictions on dealers imposed within the system have adverse effects on competition. We have mentioned that United Kingdom prices, and especially those for the private buyer, are higher than would obtain in a more competitive market. The main causes of this are VERs, which raise the general level of United Kingdom prices, the company car and the deep discounts that large fleet owners obtain from the suppliers, which together distort the price structure for other buyers. Greater competition between dealers, both inter- and intra-brand, would restrain these higher prices. Restrictions on dealers' promoting sales outside their designated territories, limits on the total volume of cars sold through a single dealer or dealer group, limits on the number and location of other suppliers' dealerships held by a dealer, and limits on sales of other car-related goods and services all weaken competition both intra-brand and inter-brand. They restrict new suppliers' entry and restrain the emergence of larger and more efficient dealers who would be in a position to offer lower prices, especially to their private customers.

1.26. We considered whether any developments in the market were likely to alter our assessment. Even while we have been carrying out our investigation there have been significant changes in the industry and we have no doubt that change will continue. The gradual elimination of VERs, increased Japanese car production within the United Kingdom and greater productivity from United Kingdom car manufacturing all point in the direction of greater competition. Nissan is already producing over 100,000 cars a year in the United Kingdom and the start-up of Toyota and Honda will add to the competitive pressures on the United Kingdom car industry, which have already started to take effect. Both Ford and Rover have announced their urgent need to negotiate new manning practices and levels to compete with Japanese-owned production.

Technological developments in manufacturing and performance will also be agents of change. By 1993 there are to be common type-approval standards throughout the EC but these will not markedly reduce the United Kingdom segmentation within the EC market.

1.27. The car market is at present depressed and conditions are not normal. There is greater awareness by United Kingdom consumers, partly as a result of the depressed market, of the fact that transaction prices and discounts vary widely and of the need to bargain and to shop around. We would hope this awareness will continue, and indeed be heightened by our report. However, as the market recovers, discounts are likely to be harder to secure.

1.28. While we see strong influences for change we do not expect these developments to remove the adverse effects on competition we have identified from certain aspects of the distribution system.

1.29. We have concluded therefore that the restrictions identified in paragraph 1.25 operate and may be expected to operate against the public interest.

## Recommendations

1.30. We do not propose fundamental change to an established system, but we recommend the removal from distribution arrangements of provisions that:

*(a)* limit the dealer's freedom to advertise outside his territory;

*(b)* limit the dealer's freedom to hold or acquire dealerships outside that territory from other suppliers;

*(c)* prevent a dealer holding or acquiring competing dealerships within his territory; provided that the supplier may be entitled to require that any other dealership acquired be on a distinct and separate site and a reasonable distance away from his dealership;

*(d)* restrict the extent to which a dealer can sell car-related goods or services, eg car hire, second-hand car sales, fast-fit or multi-brand servicing, outside his territory; and

*(e)* limit the total number of the supplier's cars that any dealer or dealer group may sell during any given period, or the proportion of the total sales of its cars that may be made by any dealer or dealer group.

1.31. In considering these recommendations the Secretary of State will doubtless take into consideration the provisions of EC Regulation 123/85 including Recital 29 and will note the views of Directorate General IV of the EC Commission, which have been challenged by some suppliers, on the interpretation of the Regulation. In making our recommendations we do not regard it as necessary for us to reach a view on the correct interpretation of the Regulation. One of our members, however, has made suggestions for amending the Regulation when it comes to be reviewed.

1.32. In addition to our recommendations there are a number of other matters, not covered by our findings, on which we have made suggestions for review of existing policies. These are:

- VERs in respect of the United Kingdom;
- the structure and level of company car taxation;
- the requirement to drive on the left; and
- parallel importing procedures.