

New cars

A report on the supply of new motor cars within the UK



COMPETITION COMMISSION

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A report on the supply of new motor cars within the UK

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

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The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

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Part I

Summary and Conclusions

1 Summary

1.1. On 17 March 1999 the Director General of Fair Trading sent us a monopoly reference under the Fair Trading Act 1973 (FTA) on the supply of new cars within the UK by manufacturers and importers (the suppliers: see Appendix 1.1).

1.2. This is the Commission's second report on such a reference. Since the first report,¹ there have been notable developments of an economic, technological and regulatory nature affecting the supply of new cars within the UK. One such development was the expiry of EC Regulation 123/85, which exempted, for ten years, specified categories of motor vehicle distribution agreements which otherwise would be illegal under EC competition law. It was replaced by EC Regulation 1475/95 (the Block Exemption, itself currently being evaluated by the European Commission) which introduced modifications intended to stimulate competition, improve the functioning of the single market and rebalance the interests of manufacturers, dealers and consumers. Given developments since the 1992 report we have looked at all relevant matters afresh.

Monopoly findings

1.3. We identified a complex monopoly situation resulting from suppliers' practices in distributing new cars in the UK. Most of these practices relate to suppliers' operation of the selective and exclusive distribution (SED) system permitted by the Block Exemption. The 17 suppliers with 1 per cent or more of the total supply of new cars in the UK in whose favour we found the complex monopoly situation to operate together accounted for 94 per cent of the total number of new cars registered in the UK in 1999.

Market definition

1.4. We take the view that the geographical market should be defined as the UK. The product market, in our judgment, comprises all new cars and is separate from the market for used cars of all ages.

The UK car market

1.5. New car registrations in the UK rose steadily from 1.6 million in 1992 to 2.25 million in 1998 before falling back slightly to 2.2 million in 1999. Shares of supply may be calculated at the level either of individual brands or of supplying groups. The brand leaders are Ford, Vauxhall, Peugeot, Renault, Volkswagen and Rover; the main additional brands in these supplier groups are Volvo, Mazda, Citroën, Nissan, BMW, Land Rover, Skoda and Audi. The combined UK market share of the top six supplier groups in 1999 was 79 per cent. Most of the

¹*New Motor Cars: a report on the supply of new motor cars within the United Kingdom*, HMSO, Cm 1808. The inquiry was carried out between May 1990 and October 1991, and the report was published in February 1992. We refer to this inquiry as the 1990/91 inquiry, and to the report as the 1992 report.

20 or so other suppliers are relatively small in global terms but Fiat, Toyota, DaimlerChrysler and Honda are substantial players in the world motor industry.

1.6. The automotive industry in the UK—which includes the production of commercial vehicles, parts and other products besides cars—employs some 225,000 people and accounts for 1.5 per cent of gross domestic product. A further 570,000 people are employed in the sale, maintenance and repair of motor vehicles. Of the top ten suppliers all but Renault, Volkswagen, Fiat and DaimlerChrysler have car assembly plants in the UK. Suppliers' declared profit margins are low but because transfer prices affect the profitability of their imports and exports in transactions with other group companies we cannot say whether these margins fairly reflect the profitability of their respective groups on UK operations. The franchised dealer sector is highly fragmented and no group holds a major share.

Factors influencing competition

1.7. At the core of the SED system lie the suppliers' refusal to supply new cars to retailers other than their franchised dealers; the associated prohibition on dealers from reselling except to final customers and other dealers in the manufacturer's network; the granting of exclusive territories to dealers; and the requirement that dealers sell exclusively one brand of new car. Dealers are required to provide servicing and repair services. Dealer agreements typically impose many additional restrictions and obligations on dealers, covering such matters as sales targets (often for each model range), standards of showrooms and other facilities, stock levels, organization and staffing, training, customer service, advertising and promotion, accounting systems and the provision of detailed business information to the supplier. Dealer margins have been reduced since the previous inquiry but dealers may earn bonuses for meeting sales targets and a variety of other objectives. On the other hand, dealers are now required to keep few cars in stock and in general do not have to pay for them before they are sold.

1.8. Suppliers also use the SED system to segment the market and to offer preferential discounts to certain fleet customers. As a condition of purchase, cars sold to such customers must normally be retained for a specified minimum period, usually six or twelve months. Dealers frequently pre-register cars which have not been sold to customers in order to meet sales targets and earn bonuses.

1.9. Imports of Japanese cars into the UK were subject to voluntary export restraints (VERs) between 1975 and the end of 1999 (as were Japanese imports into the EC as a whole between 1991 and 1999). With the ending of VERs there will now be some increase in competition but we do not expect this development of itself to have a major impact on the overall price level, especially in the context of the SED system.

Prices

1.10. For all suppliers, the prices and specifications of their competitors' models emerged as the most important factors in setting their list prices (recommended retail prices—RRPs). In general, suppliers appear to set their list prices at about the same level as their competitors, for equivalent cars, and seek to compete through other means such as marketing, product quality, specifications and temporary offers.

1.11. Most customers receive a discount off the RRP. Private customers may also receive financial benefits (for example, free or low-cost finance or insurance) and in most cases the amount paid is affected by the amount allowed against a used car offered in part-exchange. Our analysis showed an overall average discount for private customers of 7.5 to 8 per cent in 1997/98, as compared with 11 per cent found in the 1990/91 inquiry. Average discounts to fleet customers are considerably higher, ranging from around 17 to 35 per cent for individual

suppliers. In general, fleet customers do not receive financial benefits but some sell their cars back to the supplier at a pre-arranged, favourable price.

Price comparisons between the UK and other EC countries

1.12. We used the price surveys carried out by the European Commission every six months since May 1993 to see how new car prices in the UK compared with those elsewhere in the EC. First, we studied price differences between the UK and the lowest-priced EC country, at contemporaneous exchange rates, in order to show the full extent of the potential for arbitrage; secondly, we looked at price differences between the UK and France, Germany and Italy, using four different exchange rate bases and two different methodologies. We also examined the arguments put forward by the suppliers that the price differences shown in the surveys were affected by exchange rates; differences in taxation between countries; relative levels of discounts and financial benefits (such as free credit); differences in specifications; and differences in the prevalence of trade-ins and in residual values of used cars.

1.13. We found that, on the longer-term basis (where the data cover the six years from 1993 to 1999), UK prices were higher than those of France, Germany and Italy by a margin of between 3.5 and 7.1 per cent. Following the appreciation of sterling in 1996/97 the gap has widened in the second half of the period to between 10.1 and 12.6 per cent (using three-month forward exchange rates). These figures, however, understate the extent of the opportunities currently available to UK consumers for buying cheaply abroad. Taking the May 1999 survey (the most recent available at the time of our report), for 58 of the 71 models we analysed the UK price was at least 20 per cent higher than in the cheapest country even when the three countries with the highest levels of car tax (Denmark, Finland and Greece) were excluded from the comparison. When those three countries were included, the UK price was at least 40 per cent higher for 49 of the 71 models analysed. In sum, prices in the UK have been higher on a long-term basis and a wide gap has developed—and persisted—over the last few years.

Assessment

1.14. Although the UK car market is relatively unconcentrated, almost all sales fall within the vertical restraints imposed under the SED system. Nearly all suppliers control the entry, growth and exit of franchised dealers in their respective networks. Moreover, dealer agreements are subject to termination by suppliers under provisions which in our view do not reflect the significant investments that dealers have to make. Under such arrangements dealers are reluctant to do things which might displease their suppliers and intra-brand competition at the retail level is muted. Some suppliers accepted that prices might be lower in the absence of SED but contended that the possibility of any gain for consumers would be offset by the loss of other benefits which the system brought.

1.15. The weakness of the dealers' position vis-à-vis the suppliers is reflected in the fact that the wholesale price paid by dealers is higher than the retail price paid by the larger fleet customers. Prices in the fleet segment are generally at a competitive level, whereas all dealers, large and small, acquire cars at similar prices regardless of the volume bought. We consider that the absence of volume discounts to dealers has the effect of raising both wholesale and retail prices. Because of changes in dealer margins, bonuses and suppliers' marketing activities, suppliers are now exercising greater influence over the retail prices of their new cars. Moreover, some suppliers appear to exercise control over the prices which their dealers advertise. We consider that the costs imposed on dealers to achieve specified showroom and operational standards, to stock models for display and demonstration and to offer the full range of their supplier's new cars contribute to higher prices; as also do the suppliers' exercise of selectivity; the allocation of exclusive territories; the tying of sales and servicing; showroom brand

exclusivity; and the deterrence of dealers from buying new cars from their counterparts in other EC countries.

1.16. Furthermore, suppliers' widespread adoption of the SED system, coupled with their reluctance to compete on RRP, have contributed to their lack of price-responsiveness to the persistent favourable exchange rate movements in recent years. The suppliers' selling practices, centred on RRP, together with discounts, financial benefits and pre-registrations, inhibit transparency. We believe that some consumers are misled and pay higher prices as a result. Pre-registrations are used to enable suppliers to achieve sales targets without setting a true market-clearing price for their new cars, thus helping to sustain high wholesale prices.

1.17. The overall effect of the suppliers' practices has thus been to raise the UK price of new cars sold to private customers. How far prices may currently exceed the competitive level is difficult to estimate. The responses of suppliers and dealers to changes in costs, input prices and exchange rates have become ossified by the SED system (which itself also adds costs). We are, however, able to draw on the evidence of the differences in discounts between private and fleet customers as well as our international price comparisons. On this basis we believe that prices paid by UK private customers are currently likely to be, on average, about 10 per cent too high even after taking account of discounts, trade-in allowances and financial benefits. This amounts to some £1,100 for the average car.

Conclusions on the public interest

1.18. After taking account of the benefits resulting from the suppliers' SED practices and also of possible employment and environmental effects, we conclude that the adverse effects on the prices of new cars to private customers, and the similar effects of the suppliers' practices of publishing RRP and of pre-registering new cars (or encouraging dealers to do so), operate against the public interest. Some of the practices permitted by the Block Exemption also restrict innovation and reduce the choice of type of retailer from which customers may buy new cars. We consider that the adverse effects resulting from the cumulation of the practices specified are greater than the sum of adverse effects from each of the practices individually.

Recommendations

Practices covered by the Block Exemption

1.19. We believe substantial changes are necessary to remedy these adverse effects. We consider that suppliers should be prohibited from refusing to supply, on normal commercial terms, any party wishing to retail the supplier's new cars. Retailers should be free to sell the supplier's brand of cars to resellers. Suppliers should not be allowed to withhold supplies on grounds relating, for example, to the retailer's standards of presentation or facilities, the model ranges it is willing to sell, the provision of servicing or repair services and the selling of other makes of new car. Suppliers should not be allowed to grant exclusive territories.

1.20. About half of the practices which we find to be against the public interest are explicitly allowed by the Block Exemption. In order for them to be prohibited or constrained, therefore, one of three routes would have to be taken:

- (a) the benefit of the Block Exemption would have to be unilaterally withdrawn in the case of individual agreements in the UK; or
- (b) a decision would have to be taken to prohibit acts which are permitted by the Block Exemption; or
- (c) the Block Exemption itself would have to be changed or allowed to expire.

The Block Exemption is not due to expire until 30 September 2002. Having concluded that the core practices which it allows operate against the public interest in the UK, we consider that action to remedy their adverse effects should be taken without delay. It must be for the Secretary of State, however, to decide what action to take in the light of our report and taking account of EC law.

Remedies not subject to the Block Exemption

1.21. We regard substantial change as essential but there are other measures which would go some way to remedy the adverse effects and on which action might be taken quickly. Accordingly we recommend that the Secretary of State should make an order under the FTA to prohibit suppliers (pending abolition of the SED system) from discriminating by price between fleet customers and dealers which are willing to buy a stock of new cars outright; and from discriminating in the terms on which new cars are supplied to contract hire companies according to whether the companies' end-customers are fleet or private customers. In order to mitigate the adverse effects of RRPs, suppliers should be prohibited from seeking to control the prices at which dealers may advertise new cars. Finally suppliers should be prevented from making agreements which cause dealers to pre-register cars and should publish information about the supply of cars which they themselves have pre-registered.

1.22. We would emphasize, however, that we do not see these remedies as a substitute for the abolition of the SED system.