

10 Financial information on the industry

Contents	<i>Page</i>
Introduction	163
Structure of the industry	163
Characteristics of the industry	164
Method and approach	165
Overall results of manufacturers and importers in the United Kingdom	166
—Total business of manufacturers and importers	167
—Profitability of the 17 major suppliers	169
Comparative rates of return	173
Funds flow and investments	176
Costs and profitability of manufacturing and wholesaling	178
—Transfer prices from manufacturing to wholesaling	178
—Analysis of the main activities of the 17 major suppliers	179
Profitability of manufacturing	182
Profitability of wholesaling	182
Summary	187
Profitability of retailing new cars	188
—Trade publications	188
—MMC retailers' financial questionnaire	190

Introduction

10.1. In this chapter we summarise the financial information we obtained on the supply of new cars in the United Kingdom. The reference is concerned with the supply of new cars in the United Kingdom. Since those suppliers which also manufacture cars in the United Kingdom treat their operations as integrated businesses, it was necessary to segment their results into manufacturing, wholesaling and, where appropriate, retailing. This information was derived from the following sources:

- (a) published accounts;
- (b) responses to MMC questionnaires on manufacturing, wholesaling and retailing;
- (c) information supplied by individual firms and consultants; and
- (d) the comments of individual firms on our material.

10.2. The results for parts will be dealt with in detail in our report on the supply of parts and reference is made to parts in this chapter only where it is relevant to measuring the performance of the car sector.

Structure of the industry

10.3. There are over 40 suppliers of new cars in the United Kingdom. We sought financial information from 37, which represented over 99 per cent of the market by number of new car registrations in 1990.

10.4. For our analysis we divided suppliers into four groups:

- (a) The five major companies (‘the manufacturers’) with manufacturing plants in the United Kingdom (Ford, Vauxhall, Rover, Peugeot and NMUK). Of these companies, Ford, Vauxhall and Peugeot import significant numbers of cars as well as manufacturing them in the United Kingdom.
- (b) The six importers of new cars into the United Kingdom each of which held more than 1 per cent of the market (measured by number of new cars registered) in 1990 and was owned by its supplier (Renault, Fiat, Citroën, BMW, Mercedes-Benz and Honda) (‘the tied importers’).
- (c) The six importers of new cars into the United Kingdom each of which held more than 1 per cent of the market (measured by number of new cars registered) in 1990 and was financially independent of its supplier (Nissan UK, VAG (UK), Volvo Concessionaires, Toyota (GB), MVI (the importer of Lada cars) and Mazda) (‘the independent importers’).
- (d) Those importers of new cars into the United Kingdom, or manufacturers based in the United Kingdom, which each held less than 1 per cent of the market (measured by number of new cars registered) in 1990.

As the first three groups accounted for almost 95 per cent of the market we decided to concentrate our examination on them. They are referred to as the 17 major suppliers.

10.5. We also sought financial information from the franchised dealers of 15 of the 17 major suppliers for our review of the retailing of new cars. The results of this review are set out in paragraphs 10.75 to 10.93.

Characteristics of the industry

10.6. There are a number of characteristics of this industry which need to be borne in mind when considering the material set out in this chapter. These are as follows:

- (a) Three of the manufacturers (Ford, Vauxhall and Peugeot) import substantial numbers of finished cars from associated companies within the same group. Two of these manufacturers import their cars at transfer prices set in negotiation with their parent companies or a European umbrella organisation or under a formula agreed with them. The result of these agreements is the setting of the transfer price of imported cars on a basis referred to as ‘net back’. Under this method, the imported car is priced by reference to the list price (excluding all taxes) less the agreed margin to the importing supplier (ie the transfer price is ‘netted back’ from the list price). The third manufacturer informed us that its transfer prices are set in arm's length negotiations with the supplying associated company and that there is no involvement by its parent company, except in the case of deadlock. This manufacturer stated that the prices set reflect the purchasing company's own ability to price in the United Kingdom market. Although we have been told that the transfer prices adopted are, or are generally intended to be, representative of market prices, we have not been able to examine the costs and profit margins which underlie them.
- (b) Four of the manufacturers (Ford, Vauxhall, Peugeot and Rover) operate in the United Kingdom as integrated businesses as far as their manufacturing and wholesaling operations are concerned. In accounting terms, therefore, for cars which are both manufactured and sold in the United Kingdom, no invoicing takes place until the cars pass from the United Kingdom company to the dealer. This contrasts with the position in respect of imported cars which, as explained above, are invoiced at a transfer price from the manufacturing company abroad to the wholesaling arm of the United Kingdom company. In order to overcome this different treatment, so far as is possible, and to separate manufacturing from wholesaling, we asked those companies which undertake both manufacturing and wholesaling in the United Kingdom to impute transfer prices (as explained more fully in paragraphs 10.48 to 10.53) for cars manufactured in the United Kingdom on a comparable basis to the transfer prices which apply to cars manufactured abroad.

- (c) All of the tied importers are supplied with cars by associated companies at transfer prices which are controlled by the parent companies concerned. Once again, the responses to our inquiries indicate that most of the tied importers' transfer prices are set by a process of 'net back' from the United Kingdom list prices. Here, too, we have not been able to examine the costs and profit margins underlying these transfer prices.

10.7. It follows, therefore, that the segmented financial results presented in this chapter are substantially dependent upon internal transfer prices determined within multinational groups of companies. To illustrate the scale of this issue, our figures show that 44 per cent of the aggregate cost of sales for cars of four of the manufacturers (Ford, Vauxhall, Peugeot and NMUK) over the five years studied is represented by transfer prices for cars supplied by associated companies. Similarly 92 per cent of the aggregate cost of sales for cars of the tied importers over the five years studied is represented by transfer prices. As noted, we have not been able to examine the relationship of transfer prices to costs and to this extent our analysis of the financial situation of the industry in the United Kingdom must be seen as incomplete.

10.8. While we received information on operations in the United Kingdom we were not able to compel the production of information about the manufacturers' and importers' operations outside the United Kingdom. A few companies based outside the United Kingdom made it clear that information would be supplied only by their United Kingdom subsidiaries and about matters within the subsidiaries' direct knowledge. Nevertheless, we requested certain information on the profit margins earned by the wholesaling operations of the 17 major suppliers in selected European countries, to be used for comparison purposes with the information gathered in the United Kingdom. Only one company provided this information.

10.9. Another feature of the industry is that all the manufacturers and importers sell replacement parts, as well as new cars, through their dealer networks. The perception of the manufacturers and importers is that the sale of replacement parts is an integral part of their overall businesses, which they consider to be essential to provide the necessary after-sales support to the end-users of their new cars. For the purposes of this chapter, however, we have sought to distinguish the costs and profits arising on cars from those arising on parts and 'other' activities.

Method and approach

10.10. With these considerations in mind we have proceeded in this chapter to assess financial results at successive levels of disaggregation and from a number of different viewpoints to derive an overview of the United Kingdom industry. First, we examined the total business of each company; next, these results were broken down over the separate activities of cars, parts and other non-reference activities; then the results for cars were analysed between manufacturing, wholesaling and retailing (where applicable); then the wholesaling results were analysed by different trade channels, ie dealers, direct sales, exports and other outlets; and finally, wholesaling results were analysed by model range.

10.11. As this inquiry is concerned with the supply of new cars in the United Kingdom we have aimed to remove the effect of exports of new cars from the results of the cars segment shown in this chapter so that the profitability of supply only to the United Kingdom market may be seen.

10.12. Adjustments have thus been made to the manufacturers' results to exclude the sales and profits made from exports of cars, both from the manufacturing and wholesaling segments. Rover's total export results (including the United Kingdom elements which could not be separately analysed), for both manufacturing and wholesaling, were already excluded from its United Kingdom-only cars analysis. NMUK also provided a separate analysis for its export-related manufacturing operations. For the remaining three manufacturers, we carried out the calculations to exclude sales and profits arising from exported cars from the manufacturing segment, based upon the assumption that the profit margins earned on manufacturing exported cars and United Kingdom market cars would be the same. We sent to each of these three manufacturers a copy of our assumptions and calculations for the exclusion of their exports from their manufacturing segments. We asked them to confirm whether the bases of our calculations were reasonable and, if so, whether they were accurate. Two of the manufacturers accepted our assumptions and confirmed that our calculations were correct. One manufacturer, however, did not accept our assumptions or methodology, but felt unable within the time available to provide any alternative calculations. This

manufacturer's sales amounted to only some 12 per cent by value of the total export sales of the three manufacturers concerned.

10.13. Table 10.1, which presents the overall results for the total industry, includes exports, as do Tables 10.2 and 10.3. Table 10.3 is then adjusted to exclude exports of cars (from the 'cars' category and its inclusion within 'other') and their effect on sales and profitability and the result is presented in Table 10.4. The detailed analysis by segment (manufacturing, wholesaling and retailing) of the profitability of the 17 major suppliers which is considered in paragraph 10.47 *et seq* consequently excludes the exports made by the manufacturers.

10.14. Although both the independent and tied importers do export cars from the United Kingdom the numbers are very small (approximately 21,000 in 1990 and less than 3,500 per annum in earlier years). No adjustment has been made for these exports as they are not considered material in the context of the total United Kingdom supply by these importers.

10.15. In assessing the comparative rates of return on capital employed (ROCE) earned by the 17 major suppliers, we have not considered it necessary to measure the ROCE separately on their manufacturing, wholesaling or retailing operations. Instead, we have measured the ROCE of the cars business (including manufacturing, wholesaling and retailing operations together) of the 17 major suppliers separately from parts and other activities, for which 16 of the 17 major suppliers provided us with allocations of their capital employed. The remaining supplier was unable to provide us with such an allocation, and we estimated the allocation of capital employed of this company based upon an analysis of the allocations of the other importers. It should be noted that the ROCE for cars has been measured inclusive of the profits or losses made on exports as it was not considered practicable, on this occasion, to separate capital employed in exporting in this industry.

10.16. We begin, therefore, by discussing the overall results of the suppliers from all their activities (including exports) in the United Kingdom (paragraphs 10.18 to 10.31), their comparative rates of return on capital employed (paragraphs 10.32 to 10.41) and the funds flowing from their operations (paragraphs 10.42 to 10.46). We go on to consider the costs and profitability of manufacturing, wholesaling and retailing of new cars excluding exports. At each stage we concentrate on the results of the 17 major suppliers which have a share of the market (as measured by new car registrations) in excess of 1 per cent.

10.17. Of the 17 major suppliers, 13 had year ends of 31 December throughout the five-year period studied. The remaining four companies had the following year ends:

- (a) Honda-31 December up to and including the year ending 31 December 1987, after which the accounting reference date was changed to 31 March. Therefore the periods included in the analysis in this chapter are the two years to 31 December 1987, 12 months to 31 March 1989 and the two years ending 31 March 1990 and 1991.
- (b) NMUK-31 March up to and including the year ending 31 March 1990 when the accounting reference date was changed to 31 December.
- (c) Nissan UK-31 July throughout the five-year period.
- (d) VAG (UK)-30 September throughout the five-year period.

These four companies' results were included on the basis of year ends of 31 March being treated as the previous 31 December (ie 31 March 1988 being included in the year to 31 December 1987) and year ends of 31 July and 30 September being treated as the subsequent 31 December. The 1990 year includes a nine-month period for NMUK.

Overall results of manufacturers and importers in the United Kingdom

10.18. We present in this section the overall results of the manufacturers and importers of cars in the United Kingdom, to which the new cars business makes the major contribution.

Total business of manufacturers and importers

10.19. Set out in Table 10.1 are the results for the 35 companies which responded to our questionnaire. Two companies were unable to help us as they went into receivership during the course of our inquiry. We are satisfied that our overall conclusions about the industry would not be materially changed by the inclusion of these companies. The results include turnover, gross profit, net profit before interest and tax, capital employed, gross margin on turnover, net margin on turnover and ROCE. It will be seen that turnover is dominated by cars and, of the profits generated, cars contribute the major part.

TABLE 10.1 Overall results for total industry*—analysis by cars, parts and other†

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
<i>Turnover</i>						
Cars	9,328	11,393	13,879	15,853	15,794	66,247
Parts	1,143	1,352	1,575	1,721	1,866	7,657
Other†	<u>4,502</u>	<u>4,354</u>	<u>4,847</u>	<u>5,670</u>	<u>5,836</u>	<u>25,209</u>
Total	14,973	17,099	20,301	23,244	23,496	99,113
<i>Gross profit</i>						
Cars	920	1,275	1,773	1,958	1,567	7,493
Parts	349	439	533	584	627	2,532
Other†	<u>335</u>	<u>406</u>	<u>601</u>	<u>709</u>	<u>676</u>	<u>2,727</u>
Total	1,604	2,120	2,907	3,251	2,870	12,752
<i>Net profit before interest and tax</i>						
Cars	(8)	339	659	577	146	1,713
Parts	136	205	271	275	282	1,169
Other†	<u>(264)</u>	<u>34</u>	<u>242</u>	<u>258</u>	<u>175</u>	<u>445</u>
Total	(136)	578	1,172	1,110	603	3,327
<i>Capital employed</i>						
Cars	2,238	2,457	2,816	3,622	4,413	15,546
Parts	399	413	442	528	638	2,420
Other†	<u>1,177</u>	<u>974</u>	<u>1,065</u>	<u>1,465</u>	<u>1,978</u>	<u>6,659</u>
Total	3,814	3,844	4,323	5,615	7,029	24,625
<i>per cent</i>						
<i>Gross margin</i>						
Cars	9.9	11.2	12.8	12.4	9.9	11.3
Parts	30.5	32.5	33.8	33.9	33.6	33.1
Other†	<u>7.4</u>	<u>9.3</u>	<u>12.4</u>	<u>12.5</u>	<u>11.6</u>	<u>10.8</u>
Overall margin	10.7	12.4	14.3	14.0	12.2	12.9
<i>Net margin</i>						
Cars	(0.1)	3.0	4.7	3.6	0.9	2.6
Parts	11.9	15.2	17.2	16.0	15.1	15.3
Other†	<u>(5.9)</u>	<u>0.8</u>	<u>5.0</u>	<u>4.5</u>	<u>3.0</u>	<u>1.8</u>
Overall margin	(0.9)	3.4	5.8	4.8	2.6	3.4
<i>ROCE</i>						
Cars	(0.4)	13.8	23.4	15.9	3.3	11.0
Parts	34.1	49.6	61.3	52.1	44.2	48.3
Other†	<u>(22.4)</u>	<u>3.5</u>	<u>22.7</u>	<u>17.6</u>	<u>8.8</u>	<u>6.7</u>
Total	(3.6)	15.0	27.1	19.8	8.6	13.5

Source: MMC from company data.

*This table includes exports of cars under the heading of 'Cars', except for Rover. Rover was unable to provide an analysis of the United Kingdom elements of its export business. Therefore its total export results are included within 'Other'.

†'Other' includes commercial vehicles, agricultural machinery, motor cycles, engines for marine and other non-car purposes, parts and components for car production and other items not related directly to cars and parts for replacement purposes.

10.20. Table 10.2 provides a summary of the overall results of each of the six largest manufacturers and importers of new cars as measured by their share of the total number of cars registered in the United Kingdom in 1990. Each of these companies had a market share in excess of 5 per cent and in aggregate they represented some 73 per cent of 1990 new car registrations.

TABLE 10.2 Summary of the overall results* of the top six suppliers of new cars in the United Kingdom

	<i>£ million</i>				
	1986	1987	1988	1989	1990
<i>Turnover</i>					
Ford	3,939	4,674	5,249	5,930	5,674
Vauxhall	1,499	1,668	2,049	2,533	2,620
Rover†	3,412	3,096	3,224	3,430	3,785
Peugeot	640	740	1,154	1,482	1,596
VAG (UK)	727	850	1,010	1,192	1,175
Nissan UK	<u>532</u>	<u>613</u>	<u>778</u>	<u>947</u>	<u>810</u>
	10,749	11,641	13,464	15,514	15,660
Other companies	<u>4,224</u>	<u>5,458</u>	<u>6,837</u>	<u>7,730</u>	<u>7,836</u>
	14,973	17,099	20,301	23,244	23,496
<i>Gross profit</i>					
Ford	549	771	1,072	1,199	782
Vauxhall	113	170	290	431	405
Rover†	62	181	192	194	187
Peugeot	147	178	284	325	355
VAG (UK)	81	100	122	131	132
Nissan UK	<u>57</u>	<u>68</u>	<u>78</u>	<u>81</u>	<u>94</u>
	1,009	1,468	2,038	2,361	1,955
Other companies	<u>595</u>	<u>652</u>	<u>869</u>	<u>890</u>	<u>915</u>
	1,604	2,120	2,907	3,251	2,870
<i>Net profit before interest and tax</i>					
Ford	(1)	219	500	405	98
Vauxhall	(25)	47	142	225	188
Rover†	(350)	28	70	132	55
Peugeot	(5)	24	93	108	87
VAG (UK)	27	37	47	48	37
Nissan UK	<u>41</u>	<u>51</u>	<u>57</u>	<u>51</u>	<u>62</u>
	(313)	406	909	969	527
Other companies	<u>177</u>	<u>172</u>	<u>263</u>	<u>141</u>	<u>76</u>
	(136)	578	1,172	1,110	603
<i>per cent</i>					
<i>Gross margin</i>					
Ford	13.9	16.5	20.4	20.2	13.8
Vauxhall	7.5	10.2	14.2	17.0	15.5
Rover†	1.8	5.8	6.0	5.7	4.9
Peugeot	23.0	24.1	24.6	21.9	22.2
VAG (UK)	11.1	11.8	12.1	11.0	11.2
Nissan UK	<u>10.7</u>	<u>11.1</u>	<u>10.0</u>	<u>8.6</u>	<u>11.6</u>
	9.4	12.6	15.1	15.2	12.5
Other companies	<u>14.1</u>	<u>11.9</u>	<u>12.7</u>	<u>11.5</u>	<u>11.7</u>
	10.7	12.4	14.3	14.0	12.2
<i>Net margin</i>					
Ford	(0.0)	4.7	9.5	6.8	1.7
Vauxhall	(1.7)	2.8	6.9	8.9	7.2
Rover†	(10.3)	0.9	2.2	3.8	1.5
Peugeot	(0.8)	3.2	8.1	7.3	5.5
VAG (UK)	3.7	4.4	4.7	4.0	3.1
Nissan UK	<u>7.7</u>	<u>8.3</u>	<u>7.3</u>	<u>5.4</u>	<u>7.7</u>
	(2.9)	3.5	6.8	6.2	3.4
Other companies	<u>4.2</u>	<u>3.2</u>	<u>3.8</u>	<u>1.8</u>	<u>1.0</u>
	(0.9)	3.4	5.8	4.8	2.6

Source: MMC from company data.

*The results were provided by the companies in their responses to our financial questionnaire and include all their activities (cars, parts and other). These results have been reconciled to the companies' statutory accounts as set out in Appendix 10.1.

†Following the purchase of Rover by British Aerospace in 1988, Rover no longer publishes separate group accounts. The figures for 1988 to 1990 inclusive were provided by Rover on a basis similar to that for group accounts published in earlier years.

Profitability of the 17 major suppliers

10.21. We present the results, including exports, for the 17 major suppliers in Table 10.3. In a subsequent table (Table 10.5) the results for cars only (excluding exports) are analysed as between the manufacturers, the independent importers and the tied importers. In 1990 turnover for cars (including exports, except for Rover) amounted to £14,056 million and net profits before interest and tax were £221 million. In aggregate over the five-year period 1986 to 1990 the manufacture and distribution of cars represented some 66 per cent of total turnover and contributed 57 per cent of net profits. The weighted average rate of ROCE for cars for the five years in aggregate was 13.0 per cent. The annual rate of return during the period has, however, been volatile and for cars has ranged from (3.7) per cent in 1986 to 27.2 per cent in 1988.

TABLE 10.3 Results for the 17 major suppliers-analysis by cars,* parts and other

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
<i>Turnover</i>						
Cars	8,274	9,999	12,264	14,092	14,056	58,685
Parts	1,077	1,254	1,465	1,593	1,725	7,114
Other†	<u>4,245</u>	<u>4,065</u>	<u>4,517</u>	<u>5,300</u>	<u>5,439</u>	<u>23,566</u>
Total	13,596	15,318	18,246	20,985	21,220	89,365
<i>Gross profit</i>						
Cars	733	1,110	1,594	1,835	1,423	6,695
Parts	325	404	490	531	570	2,320
Other†	<u>279</u>	<u>341</u>	<u>521</u>	<u>627</u>	<u>586</u>	<u>2,354</u>
Total	1,337	1,855	2,605	2,993	2,579	11,369
<i>Net profit before interest and tax</i>						
Cars	(74)	311	660	655	221	1,773
Parts	120	181	241	240	246	1,028
Other†	<u>(286)</u>	<u>8</u>	<u>208</u>	<u>225</u>	<u>146</u>	<u>301</u>
Total	(240)	500	1,109	1,120	613	3,102
<i>Capital employed</i>						
Cars	1,980	2,118	2,428	3,188	3,937	13,651
Parts	379	386	410	494	602	2,271
Other†	<u>1,136</u>	<u>927</u>	<u>1,020</u>	<u>1,420</u>	<u>1,917</u>	<u>6,420</u>
Total	3,495	3,431	3,858	5,102	6,456	22,342
<i>per cent</i>						
<i>Gross margin</i>						
Cars	8.9	11.1	13.0	13.0	10.1	11.4
Parts	30.2	32.2	33.4	33.3	33.0	32.6
Other†	<u>6.6</u>	<u>8.4</u>	<u>11.5</u>	<u>11.8</u>	<u>10.8</u>	<u>10.0</u>
Overall margin	9.8	12.1	14.3	14.3	12.2	12.7
<i>Net margin</i>						
Cars	(0.9)	3.1	5.4	4.6	1.6	3.0
Parts	11.1	14.4	16.5	15.1	14.3	14.5
Other†	<u>(6.7)</u>	<u>0.2</u>	<u>4.6</u>	<u>4.2</u>	<u>2.7</u>	<u>1.3</u>
Overall margin	(1.8)	3.3	6.1	5.3	2.9	3.5
<i>ROCE</i>						
Cars	(3.7)	14.7	27.2	20.5	5.6	13.0
Parts	31.7	46.9	58.8	48.6	40.9	45.3
Other†	<u>(25.2)</u>	<u>0.9</u>	<u>20.4</u>	<u>15.8</u>	<u>7.6</u>	<u>4.7</u>
Total	(6.9)	14.6	28.7	22.0	9.5	13.9

Source: MMC from company data.

*This table includes exports of cars under the heading 'Cars', except for Rover. Rover was unable to provide an analysis of the United Kingdom elements of its export business. Therefore its total export results are included within 'Other'.

†'Other' includes commercial vehicles, agricultural machinery, motor cycles, engines for marine and other non-car purposes, parts and components for car production and other items not related directly to cars and parts for replacement purposes.

10.22. Although the sales of parts for replacement purposes do not represent a significant proportion of the total turnover of the 17 major suppliers, it will be seen from Table 10.3 that the contribution to net profits that parts make is substantial. In aggregate over the five-year period 1986 to 1990 parts for replacement purposes represented some 8 per cent of total turnover and contributed 32.6 per cent of net profits. The weighted average ROCE for parts for the five years was 45.3 per cent, with a range from 31.7 per cent in 1986 to 58.8 per cent in 1988.

10.23. It should be noted that virtually the whole of the replacement parts business of the manufacturers is that of wholesaling. Only a small minority of replacement parts are actually manufactured by the car manufacturers in the United Kingdom, the majority being bought in from other parts or component manufacturers or from the car manufacturers' domestic or overseas affiliates.

10.24. Comparing the results for cars with those for replacement parts shows that the margins earned on parts and the ROCEs for parts are higher than those for cars. Unlike the profits from cars, the profits earned on replacement parts have not suffered such strong cyclical influences during the five years from 1986 to 1990. Parts profits have provided the 17 major suppliers with a stable source of income while the net profits from cars have varied from £660 million in 1988 to losses of £74 million in 1986.

10.25. We asked the 17 major suppliers to explain why there are relatively high margins on parts when compared with cars. The main explanations we received were as follows:

- (a) *The cars and parts operations are integrated businesses.* The supply of cars and the supply of parts are integrated businesses, with the latter being a necessary adjunct to the former. Both the manufacturers and importers stated that they would be unable to sell their cars without providing a full parts service as well. It was put to us that it was necessary to consider the costs of parts and servicing as well as of purchase in assessing the lifetime costs of a car.
- (b) *Allocation of costs.* When segmenting their total operations between cars, parts and other activities the companies encountered difficulties in allocating certain 'shared' costs. As a result, the internal allocation of costs would not necessarily reflect the pattern of benefit to the elements of the business. An example of this would be marketing costs, which often form a significant part of total overhead costs. Marketing costs were generally allocated to cars, as most marketing is for cars. However, the companies put it to us that parts sales benefit directly from marketing of cars and their subsequent sales, but it is very difficult to allocate a part of the cost of the marketing effort. A similar argument was put forward for research and development costs, which were allocated to cars but from which parts must benefit.
- (c) *Level of capital tied up in parts.* One manufacturer put it to us that the ratio of sales to average capital employed is very different for cars and parts operations (in its case between 2 and 2.5 times for cars as compared with parts). This manufacturer stated that it would expect to earn higher margins on parts to compensate for the higher levels of capital (as a proportion of sales) tied up in the parts business.
- (d) *Stockholding.* Cars and parts are businesses which have very different stocking requirements. The cars business is one involving the assembly of cars for rapid sale, while parts involves the car manufacturer in very little direct manufacture, but requires large stockholding over long periods. The patterns of sale to the customer and the customers' requirements lead to the differences in stockholding for cars and parts.

10.26. In Table 10.4 we re-present Table 10.3 after having excluded exports of new cars made by the United Kingdom-based manufacturers from the 'Cars' heading. These exports are included within 'Other' in this table. Capital employed and ROCE have been omitted as it was not considered practicable, on this occasion, to separate capital employed in exporting in this industry.

TABLE 10.4 Results for the 17 major suppliers*-analysis by cars, parts and other, 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
<i>Turnover</i>						
Cars	8,208	9,898	11,998	13,536	13,073	56,713
Parts	1,077	1,254	1,465	1,593	1,725	7,114
Other†	<u>4,311</u>	<u>4,166</u>	<u>4,783</u>	<u>5,856</u>	<u>6,422</u>	<u>25,538</u>
Total	13,596	15,318	18,246	20,985	21,220	89,365
<i>Gross profit</i>						
Cars	721	1,104	1,573	1,775	1,317	6,490
Parts	325	404	490	531	570	2,320
Other†	<u>291</u>	<u>347</u>	<u>542</u>	<u>687</u>	<u>692</u>	<u>2,559</u>
Total	1,337	1,855	2,605	2,993	2,579	11,369
<i>Net profit before interest and tax</i>						
Cars	(78)	315	669	661	208	1,775
Parts	120	181	241	240	246	1,028
Other†	<u>(282)</u>	<u>4</u>	<u>199</u>	<u>219</u>	<u>159</u>	<u>299</u>
Total	(240)	500	1,109	1,120	613	3,102
<i>per cent</i>						
<i>Gross margin</i>						
Cars	8.8	11.2	13.1	13.1	10.1	11.4
Parts	30.2	32.2	33.4	33.3	33.0	32.6
Other†	<u>6.8</u>	<u>8.3</u>	<u>11.3</u>	<u>11.7</u>	<u>10.8</u>	<u>10.0</u>
Overall margin	9.8	12.1	14.3	14.3	12.2	12.7
<i>Net margin</i>						
Cars	(1.0)	3.2	5.6	4.9	1.6	3.1
Parts	11.1	14.4	16.5	15.1	14.3	14.5
Other†	<u>(6.5)</u>	<u>0.1</u>	<u>4.2</u>	<u>3.7</u>	<u>2.5</u>	<u>1.2</u>
Overall margin	(1.8)	3.3	6.1	5.3	2.9	3.5

Source: MMC from company data.

*This table excludes exports of cars from the heading 'Cars' and includes them within 'Other'.

†'Other' includes commercial vehicles, agricultural machinery, motor cycles, engines for marine and other non-car purposes, parts and components for car production and other items not related directly to cars and parts for replacement purposes. Exports of cars are also included under this heading.

10.27. Table 10.5 takes the analysis of Table 10.4 further and looks at the results of cars only (excluding exports), showing the performance of the manufacturers, the independent importers and the tied importers separately.

TABLE 10.5 Results* for the 17 major suppliers: analysis for cars only by manufacturers, independent importers and tied importers, 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
<i>Turnover</i>						
Manufacturers	5,174	6,199	7,359	8,160	7,784	34,676
Independent importers	1,732	2,016	2,512	2,906	2,741	11,907
Tied importers	<u>1,302</u>	<u>1,683</u>	<u>2,127</u>	<u>2,470</u>	<u>2,548</u>	<u>10,130</u>
Total	8,208	9,898	11,998	13,536	13,073	56,713
<i>Gross profit</i>						
Manufacturers	443	786	1,106	1,249	821	4,405
Independent importers	150	180	233	241	234	1,038
Tied importers	<u>128</u>	<u>138</u>	<u>234</u>	<u>285</u>	<u>262</u>	<u>1,047</u>
Total	721	1,104	1,573	1,775	1,317	6,490
<i>Net profit before interest and tax</i>						
Manufacturers	(166)	230	487	492	111	1,154
Independent importers	73	87	118	106	80	464
Tied importers	<u>15</u>	<u>(2)</u>	<u>64</u>	<u>63</u>	<u>17</u>	<u>157</u>
Total	(78)	315	669	661	208	1,775
<i>per cent</i>						
<i>Gross margin</i>						
Manufacturers	8.6	12.7	15.0	15.3	10.5	12.7
Independent importers	8.7	8.9	9.3	8.3	8.5	8.7
Tied importers	<u>9.8</u>	<u>8.2</u>	<u>11.0</u>	<u>11.5</u>	<u>10.3</u>	<u>10.3</u>
Overall margin	8.8	11.2	13.1	13.1	10.1	11.4
<i>Net margin</i>						
Manufacturers	(3.2)	3.7	6.6	6.0	1.4	3.3
Independent importers	4.2	4.3	4.7	3.6	2.9	3.9
Tied importers	<u>1.2</u>	<u>(0.1)</u>	<u>3.0</u>	<u>2.6</u>	<u>0.7</u>	<u>1.5</u>
Overall margin	(1.0)	3.2	5.6	4.9	1.6	3.1

Source: MMC from company data.

*Exports of cars have been excluded from these results.

10.28. The manufacturers represent 61 per cent of the aggregate sales of the 17 major suppliers over the five-year period, with the independent and tied importers being relatively similar in terms of share of the market by value at 21 per cent and 18 per cent respectively. The independent importers' share has remained very stable at 21 per cent of the market while that of tied importers has increased from less than 16 to over 19 per cent at the expense of the manufacturers' share. The gross profits earned by the manufacturers average 68 per cent of the total gross profits of the 17 major suppliers with a range of 62 to 71 per cent. The tied importers have contributed an increasing proportion of total gross profits equalling that of the independent importers in 1988 and subsequently exceeding it.

10.29. Although the tied importers have higher gross margins than the independent importers, they also have a higher overhead cost base which results in lower net margins than the independent importers. The manufacturers have the highest gross margins but these are consistent with their being engaged in both manufacturing and wholesaling, whilst the importers only wholesale and do not employ manufacturing assets.

10.30. The net margins of the three groups vary significantly. The net margins of the manufacturers average 3.3 per cent over the five years, fluctuating between minus 3.2 per cent and plus 6.6 per cent. Those for the independent importers average 3.9 per cent but show a decline from 4.7 to 2.9 per cent from 1988 to 1990. The net margins for the tied importers have been volatile over the five years with a peak of 3 per cent in 1988. Again the higher net margins for the manufacturers would be consistent with their wider span of activities.

10.31. The ROCEs are discussed in the next section, whilst the overall performance of these three groups is further analysed, as appropriate, later in this chapter.

Comparative rates of return

10.32. We have compared the profitability of the 17 major suppliers as measured by their ROCE with figures provided to us during the course of our inquiry by the Bank of England, for all manufacturing companies and all companies. The results of this comparison are set out in Table 10.6. This comparison includes exports of cars from the United Kingdom as it is not practical to identify separately the capital employed on exports as opposed to United Kingdom market only cars. Rover was unable to provide a separate analysis of the United Kingdom elements of its export business and therefore its total export results have been excluded from this analysis. We do not consider that there is a material effect from the exclusion of these results.

TABLE 10.6 Comparison of the ROCEs of the 17 major suppliers, including exports,* with the Bank of England's reported averages, 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
<i>Net profit before interest and tax</i>						
Manufacturers	(163)	227	479	488	124	1,155
Independent importers	74	87	117	105	80	463
Tied importers	15	(3)	64	62	17	155
Total	(74)	311	660	655	221	1,773
<i>Capital employed</i>						
Manufacturers	1,391	1,382	1,558	2,228	2,993	9,552
Independent importers	396	527	616	638	577	2,754
Tied importers	193	209	254	322	367	1,345
Total	1,980	2,118	2,428	3,188	3,937	13,651
<i>per cent</i>						
<i>ROCE</i>						
Manufacturers	(11.7)	16.4	30.7	21.9	4.1	12.1
Independent importers	18.6	16.5	19.0	16.7	13.9	16.9
Tied importers	7.8	(1.3)	25.4	19.6	4.6	11.7
Total	(3.7)	14.7	27.2	20.5	5.6	13.0
<i>Bank of England returns†</i>						
- All manufacturing companies	18.1	19.3	19.4	17.1	16.0	18.0‡
- All companies	17.9	18.7	18.2	16.1	15.1	17.2.2‡

Source: MMC from Bank of England† and company data.

*Rover's export results have been excluded from this table for the reasons set out in paragraph 10.32.

†Bank of England supplied statistics, calculated using the same definition of return on capital employed as used in the Quarterly Bulletin, November 1990: 'Profitability of large companies'.

‡Simple averages only.

10.33. The returns provided by the Bank of England are not calculated on the same basis as our calculations of ROCE. The Bank of England figures are calculated on a basis that includes results from associated companies and investments in liquid and other non-trading assets whereas our calculations of ROCE are based on trading income and trading assets only. However, in the November 1989 edition of the Bank of England's Quarterly Bulletin, figures were published on both the Bank's normal basis and on the basis of trading income and trading assets which is very similar to our basis for ROCE. A comparison of these two bases suggests that if the returns provided to us by the Bank of England for this inquiry were calculated on the basis of trading income and trading assets they could be two to three percentage points higher.

10.34. Set out in Table 10.7 is an analysis of the ROCEs for the cars segment only of the five United Kingdom-based manufacturers over the five years 1986 to 1990. This analysis clearly demonstrates the cyclical nature of the industry and also highlights the wide variations in ROCEs of the individual manufacturers.

TABLE 10.7 The manufacturers' ROCEs for cars segment only,* 1986 to 1990

	<i>per cent</i>					
	1986	1987	1988	1989	1990	<i>Total 1986 to 1990</i>
Ford	(0.1)	24.4	46.5	24.2	(0.6)	15.7
Vauxhall	2.6	15.5	37.8	71.3	46.9	35.4
Rover	(33.9)	12.5	12.7	8.8	(5.6)	(0.8)
Peugeot	4.0	13.4	96.4	70.5	35.4	44.4
NMUK	(35.6)	(7.7)	(15.3)	(19.4)	(12.8)	(15.9)
	(11.7)	16.4	30.7	21.9	4.1	12.1

Source: MMC from company data.

*Including exports except for Rover, which was unable to provide an analysis of United Kingdom-only exporting results.

10.35. The ROCE of NMUK has been consistently negative over the five-year period. During the period the company has been in its starting-up phase and its results cannot therefore be compared with those of the other four manufacturers. Commercial production of cars by NMUK in the United Kingdom only began in 1986 and during the five years to 1990 there has been considerable investment in new plant and machinery and high initial start-up costs. Unlike the other United Kingdom manufacturers, NMUK does not have an established income stream from existing models with which to cover these costs. The inclusion of NMUK's ROCEs does not materially affect the ROCE for the manufacturers in aggregate.

10.36. Rover's returns have been relatively poor in each of the five years 1986 to 1990 when compared with either the returns of its fellow manufacturers or with the all companies index provided by the Bank of England. Although there was a significant improvement in 1987 and 1988, this was not sustained in 1989 and in 1990 Rover's ROCE again became negative.

10.37. So far as the other three manufacturers are concerned, their ROCE returns have fluctuated widely from a low of minus 0.6 per cent by Ford in 1990 to a high of 96.4 per cent by Peugeot in 1988. It is worth noting that the three manufacturers, Ford, Vauxhall and Peugeot, have each earned the highest returns in different years during the period under review. Thus in 1987 Ford earned the highest return, in 1988 Peugeot and in 1990 Vauxhall. On average over the five-year period Peugeot achieved the highest ROCE at 44.4 per cent, followed by Vauxhall at 35.4 per cent and Ford at 15.7 per cent. The five-year average ROCEs of Peugeot and Vauxhall exceed the average of the returns for all companies provided to us by the Bank of England.

10.38. We asked Ford, Vauxhall and Peugeot to explain their relatively high ROCEs in some years. Their responses are summarised in the following comments. We consider that, of the following factors which may influence ROCEs and cause exaggerated peaks and troughs, capacity utilisation is the most significant.

- (a) *Capacity utilisation.* Car manufacturing is a business where much of the cost base is essentially fixed in the short term and therefore ROCE is highly sensitive to changes in capacity utilisation. Thus if the fixed cost base is covered by production at a capacity utilisation of, say, 75 per cent, and capacity utilisation rises to, say, 90 per cent, profits earned will increase disproportionately to the increase in turnover and no new assets may have been required (other than perhaps a small amount of working capital). The same assets are producing a significantly higher output and the contribution from that additional output (ie sales revenue less variable costs) is largely realised in additional profit. As a result the profitability of car manufacturing, and especially the measurement of ROCE, is very sensitive to changes in the sales of the individual manufacturer, capacity utilisation and the overall size of the market.
- (b) *Mix of imported, assembled and exported cars.* The profitability of Ford, Vauxhall and Peugeot is significantly influenced by the mix of cars that are manufactured or assembled in the United Kingdom and sold there, those that are manufactured or assembled in the United Kingdom and exported, and those that are imported. Substantially different profits can be generated from the same assets depending upon this mix. As Ford, Vauxhall and Peugeot are parts of groups with

integrated operations throughout Europe this mix will vary over time with manufacturing and operational circumstances.

- (c) *Asset valuation and depreciation.* Car manufacturers revalue certain fixed assets, such as some property assets. However, not all assets are stated on a basis that fully reflects their real value. For instance, Vauxhall pointed out that as a subsidiary of General Motors it is not sensitive to the perceived strength or weakness of its balance sheet. Accordingly, the value of its property assets is understated in its accounts. If the full revaluation were to be included in its balance sheet, the effect would be to reduce the ROCE substantially. Similar understatements of the value of assets by the other manufacturers would also result in an apparent overstatement of the calculated ROCE.
- (d) *Level of integration.* The manufacturers have stressed the differences that arise between them from the different degrees to which their manufacturing and wholesaling activities are operated on an integrated basis in Europe. Peugeot does not have a stamping plant, nor does it have either engine or gearbox manufacturing operations within the United Kingdom. In addition, Peugeot states that its United Kingdom vehicle assembly operations are not as highly robotised as those of its United Kingdom competitors. These factors reduce the level of capital employed by Peugeot in the United Kingdom to a significant degree without compromising profits and consequently increase the ROCE. Vauxhall also noted that its assembly operations utilise a high level of bought-in components, which in turn leads to a requirement for less capital employed in the United Kingdom than a fully integrated manufacturing operation.
- (e) *Investment timing.* The capital employed at any point in time will vary substantially with the stage of the investment cycle associated with re-equipping and tooling up for new model lines. Even when average capital employed is used as a measure, the lag of profits generated by any capital increases may result in exaggerated peaks and troughs of ROCE as a measure.
- (f) *Working capital.* ROCE is sensitive to changes in working capital. For example, Vauxhall put it to us that it has improved inventory management over the five-year period studied by increasing inventory turns twofold. The result of this is to reduce the amount of working capital required by Vauxhall for the same level of business. This reduces total capital employed and increases ROCE. However, this change has little impact on gross or net margins before interest charges.
- (g) *Cyclical trends.* It has been put to us that due to the cyclical nature of the car market any calculation of ROCE must be carried out over a long time period. The cyclical pattern also tends to deepen the troughs in ROCEs because, during periods of low sales volume, marketing expenditure is often substantially increased as manufacturers attempt to increase sales to fill spare production capacity. This can result in lower profitability, over and above the direct effect of reduced sales volumes.

For the above reasons Vauxhall told us that it does not consider that ROCE is a useful performance measure. It suggested that comparisons on this basis across companies and with industry norms should be treated with caution.

10.39. To look at the cyclical nature of the car industry we reviewed the published results of Ford, Vauxhall and Peugeot for the five years prior to 1986. Set out in Table 10.8 is a summary of the published results of these companies, which includes all their activities and not just cars, for the ten years to 1990.

TABLE 10.8 Profitability of Ford, Vauxhall and Peugeot in the United Kingdom over the ten years to 1990

	Ford*		Vauxhall		Peugeot	
	Profit/ (loss)† £m	Margin‡ %	Profit/ (loss)† £m	Margin‡ %	Profit/ (loss)† £m	Margin‡ %
1981	121	4.0	(55)	(7.2)	(64)	(12.9)
1982	111	3.4	(9)	(0.9)	(26)	(6.1)
1983	82	2.3	(13)	(1.2)	18	3.3
1984	(26)	(0.7)	2	0.1	12	2.5
1985	62	1.6	16	1.0	3	0.5
1986	13	0.3	(15)	(1.0)	(5)	(0.8)
1987	254	5.4	54	3.2	24	3.3
1988	537	10.2	152	7.4	93	8.1
1989	484	8.2	220	8.8	108	7.3
1990	195	3.4	191	7.3	87	5.4

Source: Companies' published accounts.

*Ford Motor Company Ltd only; not including Group results.

†Operating profit/(loss).

‡Operating profit/(loss) as a percentage of turnover.

10.40. During this period both Vauxhall and Peugeot made either very small operating profits or operating losses until 1987. Although these results are for the companies' total businesses and are not for cars only, the effect on a like-with-like basis would be to reduce significantly the average ROCE over a ten-year period.

10.41. So far as Ford's overall results are concerned, it earned operating profits throughout the ten-year period, except in 1984. As with the industry in general its results show a strong cyclical trend. Ford was not able to provide us with financial information segmented by cars and parts for the earlier years and we have, therefore, not been able to calculate the average ROCE for cars only for the ten-year period.

Funds flow and investments

10.42. We have examined the funds flowing from the total operations of the 17 major suppliers and the proportion of these funds reinvested in the business in the form of fixed assets and trade investments. We also consider the dividend payments that have been made in this period. Table 10.9 shows these figures for each of the five years 1986 to 1990.

TABLE 10.9 The 17 major suppliers: funds flow from operations* in the United Kingdom, 1986 to 1990

						£ million	
	1986	1987	1988	1989	1990	Total 1986 to 1990	
Funds generated† from operations	722	917	1,851	3,933	883	8,306	
Purchase of fixed assets	(561)	(421)	(754)	(1,048)	(1,119)	(3,903)	
Trade investments	(60)	(138)	(21)	(1,708)	(306)	(2,233)	
Net funds flow before dividends paid	101	358	1,076	1,177	(542)	2,170	
Dividends paid	(472)	(210)	(907)	(905)	(264)	(2,758)	
Net funds flow after dividends paid	(371)	148	169	272	(806)	(588)	
	per cent						
Capital invested as a percentage of funds generated:							
Fixed assets	77.7	45.9	40.7	26.6	126.7	47.0	
Trade investments	8.3	15.0	1.1	43.4	34.7	26.9	

Source: MMC from company data.

*Including cars, parts, miscellaneous and non-reference activities.

†After taking account of working capital changes.

10.43. On average over the five-year period 1986 to 1990 the 17 major suppliers have invested 47 per cent of funds generated in fixed assets and 26.9 per cent in trade investments. However, this latter figure is heavily influenced by significant investments by Ford in 1989 and 1990, which are discussed further below. Since 1987 the value of fixed assets purchased has increased each year from some £420 million to more than £1,100 million in 1990. Dividends paid by the 17 major suppliers have averaged 33 per cent of funds generated over the five-year period. For three of the five years studied there were positive net funds flows after reinvestment in fixed assets and trade investments and after dividend payments. However, in 1986 and 1990 there were negative net funds flows and in 1990 these amounted to some £800 million.

10.44. Tables 10.10, 10.11 and 10.12 analyse the results of Table 10.9 into the three groups of the manufacturers, the independent importers and the tied importers. Of these three groups the manufacturers are again the most significant, representing some 86 per cent of total funds generated from operations by the 17 major suppliers, some 88 per cent of fixed assets and 99 per cent of trade investments purchased, and 75 per cent of dividends paid.

TABLE 10.10 The manufacturers: funds flow from operations* in the United Kingdom, 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
Funds generated† from operations	567	750	1,593	3,504	721	7,135
Purchase of fixed assets	(456)	(346)	(633)	(963)	(1,040)	(3,438)
Trade investments	(59)	(136)	(12)	(1,703)	(295)	(2,205)
Net funds flow before dividends paid	52	268	948	838	(614)	1,492
Dividends paid	(406)	(105)	(650)	(736)	(184)	(2,081)
Net funds flow after dividends paid	(354)	163	298	102	(798)	(589)
	<i>per cent</i>					
Capital invested as a percentage of funds generated:						
Fixed assets	80.4	46.1	39.7	27.5	144.2	48.2
Trade investments	10.4	18.1	0.8	48.6	40.9	30.9

Source: MMC from company data.

*Including cars, parts, miscellaneous and non-reference activities.

†After taking account of working capital changes.

TABLE 10.11 The independent importers: funds flow from operations* in the United Kingdom, 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
Funds generated† from operations	110	146	211	198	151	816
Purchase of fixed assets	(64)	(50)	(70)	(33)	(28)	(245)
Trade investments	(1)	(2)	(9)	(1)	(10)	(23)
Net funds flow before dividends paid	45	94	132	164	113	548
Dividends paid	(55)	(101)	(255)	(113)	(80)	(604)
Net funds flow after dividends paid	(10)	(7)	(123)	51	33	(56)
	<i>per cent</i>					
Capital invested as a percentage of funds generated:						
Fixed assets	58.2	34.2	33.2	16.7	18.5	30.0
Trade investments	0.9	1.4	4.3	0.5	6.6	2.8

Source: MMC from company data.

*Including cars, parts, miscellaneous and non-reference activities.

†After taking account of working capital changes.

TABLE 10.12 The tied importers: funds flow from operations* in the United Kingdom, 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	<i>Total 1986 to 1990</i>
Funds generated from operations†	45	21	47	231	11	355
Purchase of fixed assets	(41)	(25)	(51)	(52)	(51)	(220)
Trade investments	-	-	-	(4)	(1)	(5)
Net funds flow before dividends paid	4	(4)	(4)	175	(41)	130
Dividends paid	(11)	(4)	(2)	(56)	-	(73)
Net funds flow after dividends paid	(7)	(8)	(6)	119	(41)	57
						<i>per cent</i>
Capital invested as a percentage of funds generated:						
Fixed assets	91.1	119.0	108.5	22.5	463.6	62.0
Trade investments	-	-	-	1.7	9.1	1.4

Source: MMC from company data.

*Including cars, parts, miscellaneous and non-reference activities.

†After taking account of working capital changes.

10.45. A strong cyclical trend in funds flowing from operations is evident amongst the manufacturers, peaking in 1989 with a strong downturn in 1990. This trend is not so clearly evident in either group of importers although 1989 was a particularly good year for the tied importers. The significant increase in funds invested in fixed assets since 1987 has been influenced in 1988, 1989 and 1990 by substantial investments in increasing capacity and improving productivity, as well as by the imminent launches of new models by Ford, Vauxhall and Rover. Also during this five-year period some £380 million has been invested by NMUK in its United Kingdom manufacturing plant. In 1989 the trade investment made by the manufacturers includes the purchase of Jaguar by Ford at a purchase consideration of £1,382 million. This purchase was completed in 1990 at an additional consideration of £176 million.

10.46. As a proportion of funds generated from operations, the tied importers have reinvested the highest amounts in fixed assets at an average of 62 per cent over the five-year period whilst the manufacturers and independent importers have reinvested 48 per cent and 30 per cent respectively. However, as the importers have no manufacturing operations within the United Kingdom the absolute amounts they have reinvested are small in comparison with the United Kingdom-based manufacturers.

Costs and profitability of manufacturing and wholesaling

10.47. We now look in greater detail at the financial results of the 17 major suppliers, concentrating on wholesaling, and in order to do this we identify the separate activities of manufacturing and wholesaling, both of which exclude exports. We first explain how transfer prices between the manufacturing and wholesaling operations of the vertically integrated manufacturers were established for this purpose. Then we go on to consider the profits and margins realised from manufacturing new cars in the United Kingdom. We then consider the profits and margins realised from wholesaling.

Transfer prices from manufacturing to wholesaling

10.48. We were informed by four of the five manufacturers that their operations were vertically integrated within the United Kingdom and that no invoicing took place within the United Kingdom between the manufacturing and wholesaling stages of car production and the ultimate sale to a third party: no internal transfer prices were set and no attempt was made to measure the relative profitability of United Kingdom manufacturing as opposed to wholesaling operations.

10.49. As explained above, however, we have been concerned to achieve, so far as is possible, consistency of treatment as between cars manufactured abroad and imported for sale in the United Kingdom (for which transfer prices are set) and cars made and sold in the United Kingdom. This was particularly important, since otherwise it would not have been possible to attempt to compare the results of the importers, which do not manufacture in the United Kingdom, with the results of the manufacturers, which manufacture cars in the United Kingdom and also (in the case of three of those companies) import them from abroad.

10.50. We therefore asked the manufacturers to impute transfer prices for cars made in the United Kingdom, in the same way as transfer prices are set for the cars they import from abroad, or which they make in the United Kingdom and sell abroad. The imputed price is referred to here as the 'Equivalent Manufactured Price' (EMP) ie the transfer price imputed to a car manufactured in the United Kingdom and passed to the wholesaling operation for onward sale to the dealer network. We asked the manufacturers to calculate sales revenue for the manufacturing segment, under EMPs, on the same criteria as the pricing of finished cars which are imported or exported. EMP is thus intended to represent a proxy arm's length price and is intended to correspond to the landed price of imported cars.

10.51. This issue did not arise in the case of NMUK since this company is, at the time of this report, solely a manufacturer of cars selling its output to an independent wholesaling company (Nissan UK) for distribution to the dealer network.

10.52. Each of the other four manufacturers are exporters of cars and three are major importers of cars (Ford, Vauxhall and Peugeot). The companies informed us that imports and exports were almost all between group companies and were invoiced at intra-group prices, which were determined either in arm's length negotiations or on bases which were intended to be generally representative of market prices negotiated on an arm's length basis. Most of these transfer prices are set by the process of 'net back' (see paragraph 10.6(a)). Therefore, we asked them to apply similar principles in determining EMPs for their domestic production sold in the United Kingdom and this they did.

10.53. Owing to the slightly different bases upon which these companies determine the transfer prices for their imported or exported cars, the EMP calculations by each of them are not completely consistent one with another. Nevertheless, the resultant EMPs appear to us to provide a reasonable basis both for the analysis of the manufacturers' operations as between the separate activities of manufacturing and wholesaling, and for comparison between the manufacturers' wholesaling operations¹ and the operations of the tied and independent importers. Each of the companies concerned emphasised that they do not normally account for their operations in this way. The results for manufacturing activities, presented in the next section, and the wholesaling results of the manufacturers, presented in the following section, are both calculated using EMPs as described.

Analysis of the main activities of the 17 major suppliers

10.54. Table 10.13 looks at the results of the manufacturers only and separately analyses the main activities of these companies as between manufacturing, wholesaling and retailing.

¹ Although at present Ford's operations are fully integrated, it stated that it did not consider the results represented what would happen in negotiations between a separate independent United Kingdom-based manufacturer and a separate independent United Kingdom-based wholesaler.

TABLE 10.13 Results for the manufacturers: analysis for cars only by manufacturing, wholesaling and retailing activities (excluding exports), 1986 to 1990

						<i>£ million</i>
	1986	1987	1988	1989	1990	<i>Total 1986 to 1990</i>
<i>Turnover</i>						
Manufacturing	3,192	4,169	4,705	4,917	4,742	21,725
Wholesaling	5,157	6,049	7,140	7,983	7,686	34,015
Retailing	60	75	117	140	132	524
Consolidation adjustments*	<u>(3,235)</u>	<u>(4,094)</u>	<u>(4,603)</u>	<u>(4,880)</u>	<u>(4,776)</u>	<u>(21,588)</u>
Total	5,174	6,199	7,359	8,160	7,784	34,676
<i>Gross profit</i>						
Manufacturing	218	520	628	613	339	2,318
Wholesaling	243	223	528	644	474	2,112
Retailing	5	7	8	10	9	39
Consolidation adjustments*	<u>(23)</u>	<u>36</u>	<u>(58)</u>	<u>(18)</u>	<u>(1)</u>	<u>(64)</u>
Total	443	786	1,106	1,249	821	4,405
<i>Net profit before interest and tax</i>						
Manufacturing	(56)	335	429	367	171	1,246
Wholesaling	(111)	(126)	116	110	(67)	(78)
Retailing	0	1	2	1	0	4
Consolidation adjustments*	<u>1</u>	<u>20</u>	<u>(60)</u>	<u>14</u>	<u>7</u>	<u>(18)</u>
Total	(166)	230	487	492	111	1,154
<i>per cent</i>						
<i>Gross margin</i>						
Manufacturing	6.8	12.5	13.3	12.5	7.1	10.7
Wholesaling	4.7	3.7	7.4	8.1	6.2	6.2
Retailing	<u>8.3</u>	<u>9.3</u>	<u>6.8</u>	<u>7.1</u>	<u>6.8</u>	<u>7.4</u>
Overall margin after consolidation	8.6	12.7	15.0	15.3	10.5	12.7
<i>Net margin</i>						
Manufacturing	(1.8)	8.0	9.1	7.5	3.6	5.7
Wholesaling	(2.2)	(2.1)	1.6	1.4	(0.9)	(0.2)
Retailing	<u>0.0</u>	<u>1.3</u>	<u>1.7</u>	<u>0.7</u>	<u>0.0</u>	<u>0.8</u>
Overall margin after consolidation	(3.2)	3.7	6.6	6.0	1.4	3.3

Source: MMC from company data.

*The figures shown for consolidation adjustments are intended to eliminate double counting in respect of cars which are both manufactured and sold in the United Kingdom.

10.55. In presenting Table 10.13 it has been necessary to use transfer prices for cars between the manufacturing and wholesaling segments. In turn these internal transfer prices, which are explained in paragraphs 10.48 to 10.53, are eliminated from Table 10.13, and subsequent tables where appropriate, through consolidation adjustments so as to present the actual total sales of the manufacturers to third parties. It has also been necessary to eliminate certain profits and costs which relate to stock movements within the manufacturing and wholesaling segments.

10.56. Retailing by subsidiaries of the manufacturers is a very small part of their overall cars business and has not been considered further in this chapter. The manufacturing and wholesaling activities are dealt with later in the chapter, but, based upon the EMP methodology used, several points emerge from this table and the comparison of these two segments:

- (a) the five-year record shows a cyclical trend in profitability, which the 1991 results are likely to emphasise;
- (b) when segmented using EMPs, manufacturing appears to be the main source of profits for these companies; and
- (c) the wholesaling activity seems to have a high overhead cost base which results in net losses before interest and tax, for the manufacturers in aggregate, except at times of high sales, ie 1988 and 1989.

This result is exaggerated as a result of the anomaly noted in paragraph 10.65 regarding the EMP calculations for Ford in 1987 and 1988. The result may also reflect, in part, the difficulty of allocating overheads between the manufacturing and wholesaling activities.

10.57. Table 10.14 shows the results of the independent importers only, whose only activity is that of wholesaling as none of these companies consolidate any retailing activities into their results. These wholesaling results are considered further later in this chapter.

TABLE 10.14 Results for the independent importers: analysis of wholesaling, 1986 to 1990

						<i>£ million</i>
	1986	1987	1988	1989	1990	<i>Total 1986 to 1990</i>
Turnover	1,732	2,016	2,512	2,906	2,741	11,907
Cost of sales	<u>1,582</u>	<u>1,836</u>	<u>2,279</u>	<u>2,665</u>	<u>2,507</u>	<u>10,869</u>
Gross profit	150	180	233	241	234	1,038
Overheads	<u>77</u>	<u>93</u>	<u>115</u>	<u>135</u>	<u>154</u>	<u>574</u>
Net profit before interest and tax	<u>73</u>	<u>87</u>	<u>118</u>	<u>106</u>	<u>80</u>	<u>464</u>
						<i>per cent</i>
Gross margin	8.7	8.9	9.3	8.3	8.5	8.7
Net margin	4.2	4.3	4.7	3.6	2.9	3.9

Source: MMC from company data.

10.58. Table 10.15 analyses the performance of the tied importers between their main businesses of wholesaling and retailing. The tied importers' wholesaling results are reviewed in more detail later in this chapter.

TABLE 10.15 Results for the tied importers: analysis by wholesaling and retailing, 1986 to 1990

						<i>£ million</i>
	1986	1987	1988	1989	1990	<i>Total 1986 to 1990</i>
<i>Turnover</i>						
Wholesaling	1,292	1,664	2,106	2,436	2,504	10,002
Retailing	84	106	113	125	123	551
Consolidation adjustment*	<u>(74)</u>	<u>(87)</u>	<u>(92)</u>	<u>(91)</u>	<u>(79)</u>	<u>(423)</u>
Total	1,302	1,683	2,127	2,470	2,548	10,130
<i>Gross profit</i>						
Wholesaling	119	129	222	272	249	991
Retailing	10	11	13	14	14	62
Consolidation adjustment*	<u>(1)</u>	<u>(2)</u>	<u>(1)</u>	<u>(1)</u>	<u>(1)</u>	<u>(6)</u>
Total	128	138	234	285	262	1,047
<i>Net profit before interest and tax</i>						
Wholesaling	12	(6)	60	58	13	137
Retailing	4	5	6	6	4	25
Consolidation adjustment*	<u>(1)</u>	<u>(1)</u>	<u>(2)</u>	<u>(1)</u>	<u>-</u>	<u>(5)</u>
Total	15	(2)	64	63	17	157
						<i>per cent</i>
<i>Gross margin</i>						
Wholesaling	9.2	7.8	10.5	11.2	9.9	9.9
Retailing	<u>11.9</u>	<u>10.4</u>	<u>11.5</u>	<u>11.2</u>	<u>11.4</u>	<u>11.3</u>
Overall margin after consolidation	9.8	8.2	11.0	11.5	10.3	10.3
<i>Net margin</i>						
Wholesaling	0.9	(0.4)	2.8	2.4	0.5	1.4
Retailing	<u>4.8</u>	<u>4.7</u>	<u>5.3</u>	<u>4.8</u>	<u>3.3</u>	<u>4.5</u>
Overall margin after consolidation	1.2	(0.1)	3.0	2.6	0.7	1.5

Source: MMC from company data.

*The figures for consolidation adjustments are intended to eliminate double counting in respect of cars which are sold both wholesale and retail by the same company.

Profitability of manufacturing

10.59. In Table 10.16 we set out the manufacturers' financial results from manufacturing new cars for supply in the United Kingdom for the five years 1986 to 1990. The aggregated data have been derived from information supplied by the manufacturers using EMPs.

TABLE 10.16 The manufacturers' financial results of car manufacturing only (excluding exports), 1986 to 1990

	1986	1987	1988	1989	1990	Total 1986 to 1990
Units manufactured ('000)	820	935	986	980	872	4,593
						<i>£ million</i>
Turnover	3,192	4,169	4,705	4,917	4,742	21,725
Cost of sales	<u>2,974</u>	<u>3,649</u>	<u>4,077</u>	<u>4,304</u>	<u>4,403</u>	<u>19,407</u>
Gross profit	218	520	628	613	339	2,318
Overheads	<u>274</u>	<u>185</u>	<u>199</u>	<u>246</u>	<u>168</u>	<u>1,072</u>
Net profit before interest and tax	(56)	335	429	367	171	1,246
						<i>per cent</i>
Gross margin	6.8	12.5	13.3	12.5	7.1	10.7
Net margin	(1.8)	8.0	9.1	7.5	3.6	5.7

Source: MMC from company data.

10.60. Between 1986 and 1990 almost 4.6 million cars were manufactured for sale in the United Kingdom. In addition a further 1.1 million cars were manufactured for export which are not included in our analysis. From 1986 to 1988 there was an increase of 20 per cent in the number of cars manufactured, to a peak of almost 1 million per annum. In 1989 there was a marginal decline in the volume of cars built in the United Kingdom for sale in the United Kingdom followed in 1990 by an 11 per cent fall. The value of these United Kingdom-built cars over the five-year period amounted to an aggregate of some £21,725 million (calculated under EMPs), with an increase in value over four years to a peak of £4,917 million in 1989. The gross profits from United Kingdom car manufacturing peaked in 1988 at £628 million, while the net profit before interest and tax for that year was £429 million.

10.61. The cyclical trend identified earlier in this chapter is borne out by the manufacturing results. Gross margins averaged 10.7 per cent over the five-year period with a peak in 1988 at 13.3 per cent, and significantly lower gross margins of 6.8 per cent and 7.1 per cent in 1986 and 1990 respectively. Net margins have followed a similar trend with an average of 5.7 per cent and a peak of 9.1 per cent in 1988.

Profitability of wholesaling

10.62. Set out in Table 10.17 are the results for the wholesaling operations only of the 17 major suppliers, analysed by cars, parts and other activities. Cars are the major part of the companies' wholesaling operations, representing some 70 per cent of total sales over the five years from 1986 to 1990 and 57 per cent of gross profits in the same period. However, the net profits before interest and tax earned from wholesaling cars were only approximately one-third of the total net profits earned by the 17 major suppliers from their wholesaling operations. Parts wholesaling represented some 70 per cent of total net profits before interest and tax earned by the 17 major suppliers, with an average net margin for the five-year period of 15.2 per cent compared with that for cars of 0.9 per cent. The gross margins earned on parts are also higher than for cars at an average of 32.8 per cent compared with 7.4 per cent. (See paragraph 10.24.)

TABLE 10.17 Results for the 17 major suppliers: wholesaling only of cars, parts and other* (excluding exports), 1986 to 1990

	<i>£ million</i>					
	1986	1987	1988	1989	1990	Total 1986 to 1990
<i>Turnover</i>						
Cars	8,181	9,729	11,758	13,325	12,931	55,924
Parts	1,077	1,254	1,461	1,583	1,705	7,080
Other*	<u>2,284</u>	<u>3,006</u>	<u>3,451</u>	<u>4,187</u>	<u>4,376</u>	<u>17,304</u>
Total	11,542	13,989	16,670	19,095	19,012	80,308
<i>Gross profit</i>						
Cars	512	532	983	1,157	957	4,141
Parts	329	402	486	528	574	2,319
Other*	<u>141</u>	<u>81</u>	<u>171</u>	<u>272</u>	<u>166</u>	<u>831</u>
Total	982	1,015	1,640	1,957	1,697	7,291
<i>Net profit before interest and tax</i>						
Cars	(26)	(45)	294	274	26	523
Parts	134	188	246	248	262	1,078
Other*	<u>(1)</u>	<u>(67)</u>	<u>(10)</u>	<u>62</u>	<u>(62)</u>	<u>(78)</u>
Total	107	76	530	584	226	1,523
<i>per cent</i>						
<i>Gross margin</i>						
Cars	6.3	5.5	8.4	8.7	7.4	7.4
Parts	30.5	32.1	33.3	33.4	33.7	32.8
Other*	<u>6.2</u>	<u>2.7</u>	<u>5.0</u>	<u>6.5</u>	<u>3.8</u>	<u>4.8</u>
Overall margin	8.5	7.3	9.8	10.2	8.9	9.1
<i>Net margin</i>						
Cars	(0.3)	(0.5)	2.5	2.1	0.2	0.9
Parts	12.4	15.0	16.8	15.7	15.4	15.2
Other*	<u>(0.0)</u>	<u>(2.2)</u>	<u>0.3</u>	<u>1.5</u>	<u>(1.4)</u>	<u>(0.5)</u>
Overall margin	0.9	0.5	3.2	3.1	1.2	1.9

Source: MMC from company data.

*'Other' includes commercial vehicles, agricultural machinery, motor cycles, engines for marine and other non-car purposes, parts and components for car production and other items not directly related to cars and parts for replacement purposes. Exports of cars are also included under this heading.

Note: The results in this table exclude direct retail sales which are included in the overall results by business segments shown in Tables 10.3 and 10.4. Adjustments have been made to exclude internal transfers on consolidation and in respect of some minor items.

10.63. Table 10.18 shows the results for wholesaling cars only for the 17 major suppliers, analysed between the manufacturers and tied and independent importers. The weighted average gross margin for wholesaling cars rose from 6.3 per cent in 1986 to 8.7 per cent in 1989 and fell back to 7.4 per cent in 1990. The net margins followed a similar pattern, although the peak occurred in 1988 at 2.5 per cent. The gross margins earned on average by the manufacturers as a group were consistently lower than those of the independent and tied importers on average. The tied importers had slightly higher gross margins at an average of 9.9 per cent over the five-year period as compared with 8.7 per cent for the independent importers. The wholesaling net margins of the manufacturers, independent importers and tied importers vary quite widely from one another. The five-year average for the manufacturers was a negative 0.2 per cent, for the tied importers 1.4 per cent and for the independent importers 3.9 per cent. A cyclical trend is again evident, although the independent importers show a relatively more stable net margin. The differences between the gross and net margins for the three groups indicate that the independent importers have relatively the lowest overhead cost base whilst the tied importers have the highest.

10.64. Over the five years from 1986 to 1990 the manufacturers have accounted for some 60 per cent of total car sales by value and some 50 per cent of aggregate gross profits earned. However, as calculated using EMPs, the manufacturers made a net loss before interest and tax on wholesaling of £78 million in aggregate over the five years. This result is, however, affected in 1987 and 1988 by the way in which Ford calculated its transfers from manufacturing to wholesaling under EMPs.

10.65. Ford's calculations of EMPs were based upon the prices at which cars are imported by Ford from its European sister companies. These prices are established in the currency of the exporting country and converted to sterling at ruling exchange rates. Therefore the EMP transfers are affected by exchange rate fluctuations, which in 1987 and 1988 led to higher manufacturing and lower wholesaling profits. Ford felt it was inappropriate to make any adjustments to the years affected in isolation without reworking the whole of its EMP calculations, which was not possible in the time available. If adjustments were made, the wholesaling segment for the manufacturers, taken over the five years 1986 to 1990, would be shown to make a net profit, using our assumptions as to the margins earned, in the region of £160 million. There would be an equal and opposite effect on the profits of the manufacturing segment.

10.66. The independent importers and tied importers collectively earned £601 million of profits before interest and tax. Sales of cars by the 17 major suppliers' wholesaling operations peaked in 1989 at £13,325 million at wholesale prices, earning gross profits of £1,157 million. Net profits in 1989 were marginally down on those for 1988 at £274 million. Once again the cyclical nature of the car industry is demonstrated by the wholesaling results of these companies with sales, both in unit and value terms, and profits falling in 1990 compared with 1989. This is also reflected in the gross and net margins earned over the five-year period.

TABLE 10.18 Results for the 17 major suppliers: wholesaling of cars only, by manufacturers, independent importers and tied importers (excluding exports), 1986 to 1990

						<i>£ million</i>
	1986	1987	1988	1989	1990	<i>Total 1986 to 1990</i>
<i>Turnover</i>						
Manufacturers	5,157	6,049	7,140	7,983	7,686	34,015
Independent importers	1,732	2,016	2,512	2,906	2,741	11,907
Tied importers	<u>1,292</u>	<u>1,664</u>	<u>2,106</u>	<u>2,436</u>	<u>2,504</u>	<u>10,002</u>
Total	8,181	9,729	11,758	13,325	12,931	55,924
<i>Gross profit</i>						
Manufacturers	243	223	528	644	474	2,112
Independent importers	150	180	233	241	234	1,038
Tied importers	<u>119</u>	<u>129</u>	<u>222</u>	<u>272</u>	<u>249</u>	<u>991</u>
Total	512	532	983	1,157	957	4,141
<i>Net profit before interest and tax</i>						
Manufacturers	(111)	(126)	116	110	(67)	(78)
Independent importers	73	87	118	106	80	464
Tied importers	<u>12</u>	<u>(6)</u>	<u>60</u>	<u>58</u>	<u>13</u>	<u>137</u>
Total	(26)	(45)	294	274	26	523
<i>per cent</i>						
<i>Gross margin</i>						
Manufacturers	4.7	3.7	7.4	8.1	6.2	6.2
Independent importers	8.7	8.9	9.3	8.3	8.5	8.7
Tied importers	<u>9.2</u>	<u>7.8</u>	<u>10.5</u>	<u>11.2</u>	<u>9.9</u>	<u>9.9</u>
Overall margin	6.3	5.5	8.4	8.7	7.4	7.4
<i>Net margin</i>						
Manufacturers	(2.2)	(2.1)	1.6	1.4	(0.9)	(0.2)
Independent importers	4.2	4.3	4.7	3.6	2.9	3.9
Tied importers	<u>0.9</u>	<u>(0.4)</u>	<u>2.8</u>	<u>2.4</u>	<u>0.5</u>	<u>1.4</u>
Overall margin	(0.3)	(0.5)	2.5	2.1	0.2	0.9

Source: MMC from company data.

10.67. We asked the 17 major suppliers to analyse their car wholesaling activities by the major trade channels through which the sales occurred. The results of this analysis for 1989 and 1990 are set out in Tables 10.19 (manufacturers), 10.20 (independent importers) and 10.21 (tied importers). The main trade channel for all the major suppliers was their franchised dealer network. The manufacturers' analysis of their trade channels (excluding exports) showed that between 90 and 95 per cent of all cars (by volume) went via the dealer network in 1989 and 1990. For the independent importers 98 per cent of cars (by volume) were wholesaled through the dealer network, whilst for tied importers between 90 and 97 per cent went via

this trade channel. For both groups of importers, direct sales (direct to the customer) represented very small parts of their wholesaling operations. Direct sales by the manufacturers represented some 7 per cent of units wholesaled. It should be noted that although direct sales by manufacturers are shown as less than 100,000 units, or 7 per cent of units sold, the distinction between direct sales and sales through the dealer networks, as reported to us by the manufacturers, is not clear cut. A manufacturer may physically deliver a car directly to the customer, but he may credit that sale to a dealer and pay that dealer a handling charge. This sale might be recorded by one manufacturer, and reported to us, as a direct sale, but by another as a sale via the dealer network. We did not ask the manufacturers to separate these particular sales into their different categories.

TABLE 10.19 **The manufacturers: analysis of wholesaling by trade channels, 1989 and 1990***

	1989			1990		
	<i>Dealers†</i>	<i>Direct</i>	<i>Other</i>	<i>Dealers†</i>	<i>Direct</i>	<i>Other</i>
Units sold	1,300,703	94,689	7,012	1,142,647	92,746	28,892
Turnover (£m)	7,482	460	41	7,030	479	177
Share of turnover (%)	93.7	5.8	0.5	91.5	6.2	2.3
Gross margin (%)	9.5	(15.4)	0.5	7.7	(15.8)	(1.7)
Net margin (%)	2.4	(16.6)	0.5	0.0	(17.2)	(2.2)

Source: MMC from company data.

*Excluding exports.

†One manufacturer analysed its sales between the domestic market and export only. It was assumed for the purposes of this table that domestic sales were all made through the dealer channel.

TABLE 10.20 **The independent importers: analysis of wholesaling by trade channels 1989 and 1990**

	1989			1990		
	<i>Dealers</i>	<i>Direct</i>	<i>Other</i>	<i>Dealers</i>	<i>Direct</i>	<i>Other</i>
Units sold	452,807	4,599	2,168	389,587	6,612	1,313
Turnover (£m)	2,864	29	13	2,689	41	11
Share of turnover (%)	98.6	1.0	0.4	98.1	1.5	0.4
Gross margin (%)	8.6	7.5	10.4	8.6	5.7	5.4
Net margin (%)	3.5	2.7	-	2.7	2.4	0.2

Source: MMC from company data.

TABLE 10.21 **The tied importers: analysis of wholesaling by trade channels, 1989 and 1990**

	1989			1990		
	<i>Dealers</i>	<i>Direct</i>	<i>Other</i>	<i>Dealers</i>	<i>Direct</i>	<i>Other</i>
Units sold	314,178	6,340	3,830	272,301	4,675	23,273
Turnover (£m)	2,387	20	29	2,353	13	138
Share of turnover (%)	98.0	0.8	1.2	94.0	0.5	5.5
Gross margin (%)	11.4	(3.4)	0.6	10.5	(11.1)	2.6
Net margin (%)	2.3	(10.8)	0.6	0.7	(23.7)	(0.6)

Source: MMC from company data.

10.68. A comparison of the gross and net margins between the various trade channels for the manufacturers shows marked differences. Overall the margins for each trade channel have worsened from 1989 to 1990, with the most significant decline being that for the dealer channel through which more than 90 per cent by value of all sales pass. Direct sales by the manufacturers are made at a negative gross margin of

some 15 to 16 per cent, which equates to a gross loss per unit of some £820 per car in 1990. This compares with a gross margin of nearly 8 per cent via the dealer channel which is equivalent to a gross profit of £470 per car. Although this suggests that the manufacturers are selling at a loss for direct sales, the theory behind the pricing of such sales is that of marginal revenue and contribution. The fixed costs and the majority of semi-variable costs of a manufacturer will be covered by the revenue from sales via the dealer channel, so that any extra sale to a direct customer needs to cover only the variable costs of that sale. Any revenue above those variable costs is a contribution to cover other costs or to profits if the overall result is in profit.

10.69. Both groups of importers also show generally worsening margins in 1990. It may be noted that although the independent importers undertake direct sales at margins lower than through the dealer network, unlike the manufacturers and tied importers these direct sales do not incur gross losses. Included within the 'other' category are exports made by the importers, which amounted to less than 3,500 cars in 1989 but in 1990 increased to some 21,000 cars, virtually all of which were exported by Honda to the Continent.

10.70. We also asked the 17 major suppliers to analyse their wholesaling activities by model range, and to name the models of their competitors which they considered to be in direct competition with their own models. Using these responses and an industry classification provided by DRI Europe Ltd we prepared the following three tables for 1990 for the manufacturers, independent importers and tied importers. The categories into which the model ranges are divided are:

- A*: utility class;
- B*: small or supermini class;
- C*: lower medium class;
- D*: upper medium class;
- E*: executive/large class;
- F*: luxury class;
- Sports*: sports models; and
- Leisure*: leisure and multi-purpose vehicles.

But see also paragraphs 4.16 to 4.20 on market segmentation.

10.71. Tables 10.22, 10.23 and 10.24 set out the results of this analysis by model range for the manufacturers, independent importers and tied importers respectively.

TABLE 10.22 **The manufacturers: analysis of wholesaling by product line, 1990***

	<i>Category (see paragraph 10.70)</i>								
	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E</i>	<i>F</i>	<i>Sports</i>	<i>Leisure</i>	<i>Total</i>
Units sold	10,898	341,044	466,629	349,010	80,083	0	4,021	12,600	1,264,285
Turnover (£m)	41	1,559	2,599	2,384	869	0	42	192	7,686
Share of turnover (%)	0.5	20.3	33.8	31.0	11.3	0	0.6	2.5	100.0
Gross margin (%)	4.9	3.1	4.2	7.4	13.8	N/A	6.2	7.3	6.2
Value per unit (£)	3,759	4,572	5,570	6,831	10,851	N/A	10,469	15,238	6,080

Source: MMC from company data.

*Excluding exports.

TABLE 10.23 **The independent importers: analysis of wholesaling by product line, 1990**

	<i>Category (see paragraph 10.70)</i>								
	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E</i>	<i>F</i>	<i>Sports</i>	<i>Leisure</i>	<i>Total</i>
Units sold	0	73,408	155,645	109,039	34,149	2,840	18,916	3,515	397,512
Turnover (£m)	0	317	888	867	372	43	209	45	2,741
Share of turnover (%)	0.0	11.6	32.4	31.6	13.6	1.6	7.6	1.6	100.0
Gross margin (%)	0.0	8.5	7.4	8.2	9.9	12.4	10.6	13.6	8.5
Value per unit (£)	0	4,314	5,703	7,954	10,881	15,174	11,073	12,716	6,894

Source: MMC from company data.

TABLE 10.24 **The tied importers: analysis of wholesaling by product line, 1990**

	<i>Category (see paragraph 10.70)</i>								
	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E</i>	<i>F</i>	<i>Sports</i>	<i>Leisure</i>	<i>Total</i>
Units sold	16,200	63,274	76,904	83,448	37,382	18,957	1,884	2,200	300,249
Turnover (£m)	42	273	468	747	498	375	72	29	2,504
Share of turnover (%)	1.7	10.9	18.7	29.8	19.9	15.0	2.8	1.2	100.0
Gross margin (%)	8.6	15.4	9.1	13.2	8.0	2.8	11.4	12.5	9.9
Value per unit (£)	2,590	4,315	6,087	8,946	13,331	19,790	38,140	13,230	8,340

Source: MMC from company data.

10.72. These tables contain a complex mix of different models from different suppliers which is further compounded by the mix of variants within each model. The relative dominance of any one group (manufacturers, tied importers or independent importers) within a particular model range will also affect the analysis. This leads not only to differences in average values per model within the same model range, but also across the three groups analysed and to different gross margin patterns across model ranges.

Summary

10.73. Car manufacturing is an international business with the world's major manufacturers often taking a view that transcends national boundaries. The majority of Europe's major manufacturers have integrated operations that are European-wide, with the transfer of parts, sub-assemblies and completed cars between manufacturing and assembly plants in different countries. These transfers require the negotiation and agreement of transfer prices between the various national companies that form the European-wide operations, and it is on these transfer prices that a significant part of the profitability of a national company may depend.

10.74. In view of the difficulties involved in testing the reasonableness of these transfer prices and the fact that a national competition authority cannot identify the international costs and profits that underlie these transfer prices, it is difficult to reach a view on the true level of profitability in the United Kingdom. The information available to us, taking into account all the performance measures (gross and net margins, ROCEs and cash flows), does not suggest that unduly large profits are being earned by either the manufacturers or importers in the United Kingdom. However, the results, both in aggregate and when segmented, are dependent upon the transfer prices adopted by both manufacturers and importers. The transfer prices of cars imported into the United Kingdom determine the profitability of the importers and significantly affect the profits of those manufacturers which import cars. The basis of the setting of the transfer prices of the manufacturers also directly affects, through their EMP calculations, the profits of the manufacturing and wholesaling segments.

Profitability of retailing new cars

10.75. The retailing of new cars is, in almost all cases, carried out by dealers who are appointed by the manufacturers and importers of the relevant marque of car. The services that dealers provide generally include the majority of the following:

- (a) the sale of new cars;
- (b) the sale of used cars;
- (c) the sale of parts;
- (d) the provision of servicing facilities;
- (e) bodywork and repair facilities;
- (f) the sale of petrol and other items through forecourts;
- (g) car rental and car hire services; and
- (h) other miscellaneous services.

For this report the main activities which we concentrate on are the sale of new cars and parts.

10.76. In the paragraphs which follow we summarise the figures we obtained from trade publications and from our financial questionnaire to dealers. We also reviewed inter-firm comparisons ('composites') prepared from periodic returns by dealers, which summarise selected financial and operating data on a basis which is standardised within a particular franchise.

10.77. Since not all the composites which are collected on behalf of the manufacturers and importers are compiled on exactly the same bases, direct comparison of some statistics and departmental results as between franchises is difficult. Therefore we ourselves carried out a survey of larger dealers, using a standard financial questionnaire, in an attempt to provide a more accurate comparison of different dealers' performance. Subject to some qualifications, we believe that the results obtained are sufficiently reliable for the purposes of this report.

10.78. At almost all dealers' premises new cars are sold alongside other products and services. The dealers who take part in the composite surveys and those who responded to our questionnaire all allocate direct costs to the departments to which they relate. However, there are indirect overheads that are not related to any specific department which most dealers either do not allocate, or allocate in a variety of different ways. The profitability of individual departments of dealers cannot therefore be measured and compared at the net profit before interest and tax level. Only overall dealership profitability can be measured at the net profit before interest and tax level. Accordingly, the profitability of individual departments, for instance new sales or parts departments, has to be measured at the level of 'departmental profit', ie the profit of a department (eg new car sales) after deduction of all direct costs relating to that department (eg costs of new cars, salesmen's salaries, etc) but before deduction of any indirect overheads (ie those which do not relate directly to any department). When reference is made to 'all departments' profit, this is the aggregate of the departmental profits of all the departments in a dealership.

Trade publications

10.79. Set out in Tables 10.25, 10.26 and 10.27 are summaries of the performance of dealers for the first nine months of 1990 as extracted from retail motor trade publications and based upon dealer composites. These summaries compare the performance of four broad categories of dealer:

- (a) Major volume-Ford, Vauxhall and Rover.
- (b) Medium volume-Peugeot, Renault, Volvo, Fiat, VAG (UK) and Citroën.

(c) Japanese-Toyota, Honda and Mazda (Nissan (UK) is not included as it does not produce dealer composites).

(d) Specialist-BMW and Mercedes-Benz.

TABLE 10.25 Sales mix of main departments within categories of dealers, nine months to September 1990

	<i>Major volume</i>	<i>Medium volume</i>	<i>per cent</i>	
			<i>Japanese</i>	<i>Specialist</i>
New and used cars	78.3	80.0	80.4	80.7
Car parts	8.2	8.9	6.8	8.7
Workshop and servicing	4.7	5.0	3.6	5.4
Bodyshop	1.8	0.8	2.2	1.2
Forecourt	6.1	4.5	6.7	3.5
Other departments	<u>0.9</u>	<u>0.8</u>	<u>0.3</u>	<u>0.5</u>
	100.0	100.0	100.0	100.0

Source: MMC from trade publications.

TABLE 10.26 Departmental profit mix of main departments within categories of dealers, nine months to September 1990

	<i>Major volume</i>	<i>Medium volume</i>	<i>per cent</i>	
			<i>Japanese</i>	<i>Specialist</i>
New and used cars	36.2	37.6	56.0	61.9
Car parts	18.4	19.9	12.2	13.8
Workshop and servicing	28.4	30.6	20.0	17.7
Bodyshop	10.5	6.6	7.0	2.6
Forecourt	4.9	4.7	3.2	3.1
Other departments	<u>1.6</u>	<u>0.6</u>	<u>1.6</u>	<u>0.9</u>
	100.0	100.0	100.0	100.0

Source: MMC from trade publications.

TABLE 10.27 Average margins of categories of dealers, nine months to September 1990

	<i>Major volume</i>	<i>Medium volume</i>	<i>per cent</i>	
			<i>Japanese</i>	<i>Specialist</i>
Gross margin*	12.2	12.4	N/A	N/A
'All departments' margin†	5.6	5.5	8.0	9.6
Net margin‡	1.9	1.8	4.4	5.0

Source: MMC from trade publications.

*Gross margin is the aggregate gross profit of all departments expressed as a percentage of turnover of those departments.

†'All departments' margin is the sum of the profits of each department after deduction of all direct costs related to those departments but before deduction of indirect and unallocated overheads, expressed as a percentage of the total turnover of those departments.

‡Net margin is the net profit before interest and tax expressed as a percentage of turnover.

MMC retailers' financial questionnaire

10.80. We sent a financial questionnaire to a sample of dealers who held franchises for 15 out of the 17 major suppliers in the United Kingdom. NMUK was not included as it does not distribute but only manufactures cars in the United Kingdom (Nissan UK is the appointed distributor until 31 December 1991). For this survey, only dealers with sales of 200 or more new cars in 1989 were approached. In the lists of dealers supplied to the MMC by the 15 suppliers approximately 2,500 were shown as selling 200 or more new cars in 1989. From these, a random sample of 500 was chosen to receive the questionnaire.

10.81. We received just less than 150 replies that we were able to use. Response varied by franchise held, with the best response rate from the franchises with the greatest number of dealers, such as Ford, Vauxhall, Rover and Peugeot. Since the questionnaire called for detailed accounting figures for two financial periods which did not necessarily coincide with the financial years of the dealers contacted, many dealers could not readily provide the information requested. Although the response was limited, when the results were compared with those provided by the composites for the same franchise we were satisfied that they were adequate for our purposes.

10.82. Because of the timing of the despatch of the questionnaire, the results for the 1990 calendar year would not have been available and therefore the results of our survey cover the 1989 calendar year and the first nine months of 1990. It is always difficult to compare financial results for two periods of time of different length, especially where the business being reviewed is affected by seasonal factors, as is the case for the retailing of new cars. Although the two periods of our survey cannot be compared in absolute terms, it is possible to compare the resulting margins and the contribution of various departments to overall sales and profits. However, when considering the results of our survey set out below, the seasonal factors which affect new car dealers must be borne in mind. Thus, the last quarter of any year is characterised by a decline in vehicle sales and profits, especially for new cars. The effect of this is to change the departmental profit mix, by reducing the profit contribution of the new car sales department and increasing the contribution made by the parts, servicing and other after-sales departments. In addition, as the volume of new car sales falls, the departmental margin of the new car sales department also declines. It was put to us by some of the manufacturers and importers that this effect was more severe than usual in the last quarter of 1990.

10.83. For the reasons set out above, this section reviews the relative profitability of dealers, rather than their absolute profitability. However, in order to put this review into a wider context, we have reviewed the absolute profits of dealers as shown in the composite data for the calendar years 1989 and 1990. As explained in paragraph 10.77, direct comparison of the composite data between franchises is difficult, but our review of these data did reveal certain general patterns. In 1990 the net profit before tax of most franchises fell when compared with the previous year. The general fall in profits appeared to be between 20 and 40 per cent, with increased interest and property costs being a significant factor in these results. Within the dealers' departments, the performance of the car sales departments suffered most in 1990, with falls in departmental profits of up to 45 per cent.

10.84. Set out in Table 10.28 is a summary of the average gross margin, 'all departments' margin, net margin before interest and tax, and ROCE for the dealers who answered our questionnaire. The 'all departments' margin is the sum of the profits made in each department before the deduction of indirect and unallocated overheads, as a percentage of the total turnover of those departments.

TABLE 10.28 Average margins and ROCE of a sample of dealers in 1989 and 1990

	<i>per cent</i>	
	1989	1990
Gross margin*	11.9	12.4
`All departments' margin†	5.8	5.9
Net margin‡	2.0	2.0
ROCE	17.9	
<i>Bank of England reported returns§</i>		
Retailing and distribution:		
Food	20.9	
Stores	19.2	
Other	21.8	

Source: MMC survey and Bank of England.

*Gross margin is the aggregate gross profit of all departments expressed as a percentage of turnover of those departments.

†`All departments' margin is the sum of the profits of each department after deduction of all direct costs related to those departments but before deduction of indirect and unallocated overheads, expressed as a percentage of the total turnover of those departments.

‡Net margin is the net profit before interest and tax expressed as a percentage of turnover.

§Bank of England Quarterly Bulletin November 1990. `Profitability of large companies'.

10.85. The aggregate gross margins of all departments earned by different franchises fall within a fairly narrow band, with all except two franchises having overall margins of between 10 and 14 per cent in both 1989 and 1990. The highest gross margin, earned by the same franchise, was 18.7 per cent in 1989 and 19.2 per cent in 1990. `All departments' margins follow a similar pattern. The net margin before interest and tax, which shows an average of 2 per cent in both 1989 and 1990, ranges by franchise from 0.7 to 4.4 per cent in 1989 and from 1.2 to 4.2 per cent in 1990. Only two franchises increased their net margins from 1989 to 1990, whilst several showed marked falls. Bearing in mind the comments made in paragraph 10.82, the 1990 margins shown in Table 10.28 may be overstated as they refer only to the first nine months of that year.

10.86. We compared the average ROCE of the dealers with the returns provided by the Bank of England for certain types of retailers and distributors. As pointed out in paragraph 10.33, the Bank of England figures are not directly comparable, but if they were to be calculated on the same basis as our ROCE figures the returns could be two to three percentage points higher. It should also be noted that the Bank of England figures are for `large companies' which may not be directly comparable. However, reliable data of returns for small and medium-sized retailers and distributors are not readily available. As the results for 1990 from our study are for nine months only, very few dealers were able to provide balance sheet data and the resultant sample was too small to provide a valid comparison for 1990 ROCEs.

10.87. Table 10.29 shows the sales mix and departmental profit mix of the dealers surveyed. This table shows the relative importance of individual departments to the sales and profitability of the dealership. New car sales as a proportion of the average dealer's total sales fell from 54.4 per cent in 1989 to 51.9 per cent in 1990, while the contribution to profits of new car sales fell more significantly from 30.0 to 24.2 per cent of `all departments' profits. The departments which showed increased contributions to `all departments' profits between 1989 and 1990 were used car sales, servicing and bodyshops.

TABLE 10.29 Sales and departmental profit* mix of a sample of dealers in 1989 and 1990

	1989		1990	
	Turnover	Departmental profit	Turnover	Departmental profit
New cars	54.4	30.0	51.9	24.2
Used cars	25.1	17.2	26.6	18.9
Car parts	9.8	20.9	10.2	20.8
Workshop and servicing	4.3	21.6	4.6	24.7
Bodyshop	1.2	6.0	1.4	7.0
Forecourt	3.0	2.3	3.1	2.3
Miscellaneous activities	<u>2.2</u>	<u>2.0</u>	<u>2.2</u>	<u>2.1</u>
	100.0	100.0	100.0	100.0

Source: MMC survey.

*Departmental profit is the profit earned by a department after deduction of all direct costs related to that department but before deduction of indirect and unallocated overheads.

10.88. It is clear from Table 10.29 that profits earned from parts and servicing form a significant proportion of overall dealer profits, and increasingly so in 1990. Although sales of parts contributed only 10.2 per cent of total dealer sales in 1990, they contributed in excess of 20 per cent of departmental profits. The provision of servicing contributed 4.6 per cent of total dealer sales in 1990, but almost 25 per cent of departmental profits. This significant contribution to profits from parts and servicing is also reflected in Table 10.30, which shows the gross margins and the departmental margins earned in 1989 and 1990 from the various departments. The highest gross margins and departmental margins were earned in servicing and bodyshops which are relatively labour-intensive. For the reasons noted in paragraph 10.78, it has not been possible to allocate indirect overheads between the various departments, and thereby measure their net profit before interest and tax individually.

10.89. While both Tables 10.29 and 10.30 show an increasing importance for parts and servicing profits, and falling gross and departmental margins for new cars, these effects may both be understated when the seasonality of dealers' business, as noted in paragraph 10.82 is considered.

TABLE 10.30 Gross and departmental margins* earned by each department within a sample of dealers in 1989 and 1990

	1989		1990	
	Gross margin	Departmental margin*	Gross margin	Departmental margin*
New cars	6.1	3.2	5.9	2.8
Used cars	7.9	4.0	8.0	4.2
Car parts	24.9	12.5	25.0	12.1
Workshop and servicing	65.6	29.2	68.5	31.6
Bodyshop	57.4	29.0	58.3	29.6
Forecourt	9.2	4.4	9.0	4.4
Miscellaneous activities	<u>15.8</u>	<u>5.4</u>	<u>15.8</u>	<u>6.1</u>
	11.9	5.8	12.4	5.9

Source: MMC survey.

*Departmental margin is the profit of a department expressed as a percentage of that department's turnover.

10.90. A more detailed analysis of the new car sales, separating sales into 'retail', 'fleet' and 'other', is set out in Table 10.31. In this section 'retail' and 'fleet' sales refer to the classifications that the dealers who responded to our questionnaire ordinarily use. 'Fleet' sales are those which are classified according to the definition provided by the supplier (commonly, sales to a customer who runs a fleet of more than 25 cars) or by the individual dealer where he considers a buyer of sufficient numbers of cars in a period to be a fleet buyer. A 'retail' buyer would be an individual purchaser who was not a 'fleet' purchaser or did not qualify as a buyer under a special scheme (eg as an employee of the manufacturer or importer).

TABLE 10.31 **Analysis of results of new car sales departments at a sample of dealers: sales, gross profit mix and gross margins, 1989 and 1990**

	1989			1990		
	<i>Sales mix</i>	<i>Gross profit mix</i>	<i>Gross margin</i>	<i>Sales mix</i>	<i>Gross profit mix</i>	<i>Gross margin</i>
Retail	45.8	65.8	8.8	45.2	63.9	8.4
Fleet	37.5	21.6	3.5	39.1	24.6	3.7
Other	<u>16.7</u>	<u>12.6</u>	<u>4.6</u>	<u>15.7</u>	<u>11.6</u>	<u>4.3</u>
	100.0	100.0	6.1	100.0	100.0	5.9

Source: MMC survey.

10.91. Table 10.31 shows that the average gross margin earned on retail sales is more than twice that earned on fleet sales. In 1989 the retail gross margin was 8.8 per cent compared with 3.5 per cent from fleet sales. In 1990 the difference narrowed somewhat as retail gross margins fell to 8.4 per cent and those for fleet sales increased to 3.7 per cent. As dealers do not normally allocate departmental or overhead costs to retail and fleet sales, it is not possible to look at the relative net margins that these two different types of sale would earn. It should be noted, however, that certain indirect overhead costs (which have not been allocated in this analysis) would be charged against retail sales and not fleet sales. These might include stocking charges and advertising costs. 'Other' sales in Table 10.31 include sales of vans and light commercial vehicles, sales to employees (both of the dealer and the manufacturer or importer) and other sales such as those from a main dealer to a second-tier dealer where applicable.

10.92. The major volume franchises, Ford, Vauxhall and Rover, are more dependent upon fleet sales for both turnover and profits than other franchises. Within these major volume franchises retail sales amount to only 33 per cent of new car sales turnover on average, contributing 47 per cent of gross profit from new car sales. Other franchises derive an average of 80 per cent of new car sales turnover from retail sales, which contributes 85 per cent of gross profits. In 1990 the major volume franchises earned gross margins of 3.1 per cent on average on fleet sales compared with 6.6 per cent for retail sales. The other franchises achieved gross margins of 7.8 per cent on fleet sales and 10.6 per cent on retail sales.

10.93. Within new car sales a significant element of total income (and therefore margin) is derived from bonuses and incentives provided by the suppliers, from finance and insurance commissions and accessory sales, and from delivery charges. Table 10.32 shows these sources of income as a percentage of the total income of new car sales. Bonus and incentive income as a proportion of new car sales income rose from 17.1 per cent in 1989 to 19.2 per cent in 1990. The proportion of total new car sales departmental income which is derived from these three sources was almost 30 per cent in 1990, having risen from 28 per cent in 1989.

TABLE 10.32 **Analysis of bonuses and incentives, finance and insurance commissions and accessory income, and profits on delivery charges as a proportion of new car sales departmental income for a sample of dealers, 1989 and 1990**

	<i>per cent</i>	
	1989	1990
Bonuses and incentives	17.1	19.2
Finance and insurance commissions and accessory income	7.7	6.9
Profits on delivery charges	<u>3.3</u>	<u>3.4</u>
	28.2	29.6

Source: MMC survey.