

11 Views of other interested parties

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Retail Motor Industry Federation and Scottish Motor Trade Association

11.1. The RMIF and SMTA said that they were the principal trade associations covering the retail motor trade in the United Kingdom: their 15,000 members encompassed all main trading areas of the

sector from the largest motor vehicle distribution groups to single-site used-car retailers and non-franchised vehicle service outlets, as well as motor-cycle retailers, vehicle recovery operators and petrol retailers.

11.2. The RMIF and SMTA said that the qualities that the purchaser of a new vehicle looked for in his purchase were reliability, durability and safety; economy in terms of fuel and servicing costs, and in maximising resale values; ease of purchase of new vehicles and ease of disposal of the purchaser's current vehicle; and convenience. The franchise system offered an efficient and economic system for meeting consumers' needs: the importance of the franchised distribution system to the achievement of these objectives was recognised in paragraph 20 of the preamble to EC Regulation 123/85. The RMIF and SMTA added that the validity of the EC's conclusion was supported by the fact that, both in the United Kingdom and internationally, the new car market was seen as highly competitive, and that wherever vehicle manufacturers could operate and compete freely they had opted for essentially the same system.

11.3. On the issue of vehicle pricing, the RMIF and SMTA said that their members regarded their interests as being essentially identical to those of their retail customers. The better the value for money they could offer the more vehicles they could sell, with consequent benefits to the consumer as well as to their service business potential. The RMIF and SMTA said that they were not able to comment on comparable pricing of individual models in the United Kingdom, within the EC, or elsewhere. The vehicle manufacturers alone were in a position to do this authoritatively as they set retail prices, a process which did not involve consultation with franchised dealers. However, the RMIF and SMTA said that they were aware of the BEUC report and were broadly sympathetic to the arguments that apparent price differentials between EC member states substantially reflected differences in vehicle specifications, taxes, inflation rates, the existence of price controls in some countries and exchange rate fluctuations. The RMIF and SMTA said that published levels of profitability for the major indigenous car manufacturers did not suggest that their individual pricing policies for the United Kingdom market had given rise to profitability levels that would offer scope for significant price reductions. The RMIF and SMTA said that the highly competitive nature of the United Kingdom market was clearly demonstrated by the monthly motor vehicle registration statistics, showing 17 suppliers with a market share of 1 per cent or more.

11.4. The RMIF and SMTA said that their members' control and influence on new car prices was limited. Dealers purchased vehicles at wholesale prices usually expressed in terms of a percentage reduction from the recommended retail price (RRP) rather than a cash sum. These percentages were usually of the order of RRP minus 12 to 18 per cent for main dealers and RRP minus approximately 10 to 15 per cent for some retail dealers (who had obtained vehicles through a main dealer). Within most franchises from time to time there were also margin augmentations (or bonus payments) reflecting sales achievement, levels of consumer satisfaction or the dealer's success in meeting his supplier's dealer standards.

11.5. The RMIF and SMTA said that such bonus schemes were often used to compel franchised dealers to use suppliers' credit finance, extended warranty and other schemes, which dealers considered were not always in their customers' best interests. These interests were best protected by franchised dealers having the freedom to select for their customers from a range of suppliers' other car-related goods. The RMIF and SMTA added that even the largest dealer groups, selling some thousands of vehicles each year, acquired them on the same terms as the smallest dealer who might perhaps be selling only 100 vehicles each year.

11.6. The RMIF and SMTA said that, because of widespread public awareness of the relationship between manufacturers' RRP and the wholesale price to the selling dealers, both business and private buyers tended to look for a substantial discount (except where popular models were in short supply). This point had been confirmed by the BEUC report. Manufacturers in their advertisements urged potential customers to look for a deal from franchised retailers. The result was that purchasers were generally disinclined to buy unless they received a significant discount off the posted price. The RMIF and SMTA said that in addition the franchised dealers had to cover the cost of increasingly stringent manufacturers' requirements on such matters as the presentation of premises and product; training and workshop standards and equipment; customer care and satisfaction; and sophisticated information interchange.

Having met those requirements dealers had to make a profit on a gross margin of between 12 and 18 per cent (which the customer would be seeking to reduce to between 5 and 10 per cent). Such gross profits compared unfavourably with those available in other retail sectors; average net profits before tax typically lay in the range of 1 to 2.5 per cent of turnover during the 1980s (and a similar figure was also shown amongst dealers in the United States). Average net margins in the 1990s appeared to lie in the range of 0 to 1 per cent.

11.7. The RMIF and SMTA said that they had recently commissioned a major survey of dealer customer satisfaction. This indicated that:

- (a) The great majority of new car buyers were very satisfied with their new car. However, there was a distinct correlation between satisfaction with the car and the customer's overall rating of the dealer's service department.
- (b) Customers typically purchased their new car after shopping around for the best deal.
- (c) Although customers placed a great deal of importance on the quality of the retail environment they were more concerned with environmental quality than uniformity.
- (d) Only 12 per cent of customers were either neutral about, or dissatisfied with, their supplying dealer's sales performance and nine out of ten respondents would probably or definitely consider buying another car from the same dealer.
- (e) Judgment on servicing was primarily based on the performance of the service workshop rather than on showroom facilities or service reception personnel. More than 80 per cent of customers considered themselves satisfied with the overall performance of the dealer used for most of the service or repair work on their car.

11.8. The RMIF and SMTA said that the franchise distribution system was essential if the value for money and levels of service enjoyed by new car purchasers were to be maintained. It was healthy that the franchise system covered large retailing groups and small single-site businesses. In the absence of such a system:

- (a) Retailers would be prepared to buy, stock in any volume, and promote, only those vehicles that would attract immediate public attention and favour. The range of vehicles, colour and specification options immediately available to an intending purchaser would therefore be reduced.
- (b) There would be very little, if any, stocking of vehicles by retailers, who would look to suppliers for the same kind of rapid response as food and white goods retailers currently enjoyed.
- (c) Suppliers would have to meet retailers' demands without the facility offered by the franchise system to forecast, and plan for, the optimum production mix in terms of models, specifications and colours. This must bear adversely on production costs and therefore prices.
- (d) Experience with manufacturers' direct selling to large fleets and to leasing and rental companies suggested that the disparity of purchasing power between the individual vehicle purchaser and volume buyers would become even greater.
- (e) The single retail purchaser would be faced with a variety of intermediaries purporting to be reputable traders. The extent to which vehicle purchasing might involve difficulties, disappointment or dissatisfaction would increase.
- (f) Specialised service and diagnostic facilities would be unlikely to be so generally available.
- (g) Individual customers and independent service providers would not be able to secure the local technical expertise currently available to them through the network of franchised outlets.

The overall result would be reduced standards of availability and service and higher prices to the individual retail customers. This was why even highly competitive newcomers to the international vehicle market had

so far chosen to follow the same distribution systems as their established competitors, and why the vast majority of RMIF and SMTA franchised retailer members argued strongly for the retention of the franchised vehicle distribution system.

11.9. Although the RMIF and SMTA said that they supported the present system, there were aspects of it to which they objected, particularly rules which placed arbitrary restrictions on:

- (a) the number of outlets representing an individual supplier which a retailer could operate;
- (b) the extent to which a retailer could establish or acquire outlets representing competing franchises;
- (c) the retailer's choice of computer equipment and programmes for running his business (although the RMIF and SMTA said that their members accepted that whatever computer system was selected should fulfil the requirement for the interchange of essential information between retailer and supplier); and
- (d) the fact that a significant number of franchise rules were not set out in writing and were communicated to the franchised retailer only when he made a proposal to his supplier, or otherwise acted in a way to which the supplier was opposed.

11.10. The RMIF and SMTA said that franchised retailers accepted that suppliers should have the right to determine the size of their distribution networks and by which companies they wished to be represented in each individual location. They also recognised that no supplier would wish to face a situation in which an individual dealer group operated a disproportionate number of its franchised outlets. At the same time, the provisions which restricted any dealer group to no more than a few outlets or a small share of the supplier's United Kingdom sales-for one supplier, for example, to eight outlets or 3 per cent of sales-were essentially anti-competitive, as were restrictions as to where a retailer might hold the supplier's or a competing supplier's franchise. In certain areas it would be sensible for one franchisee to be responsible for more than one major outlet for the franchising supplier in a particular conurbation, as this could provide opportunities for shared administrative overheads. Equally, if a franchised retailer group had demonstrated to the supplier a history of significant commitment to, and success in conducting, the franchise, any proposals in relation to new franchised outlets for that franchise or a competing franchise should be looked at on their merits.

11.11. The RMIF and SMTA said that the suppliers of even commercially aggressive retailer groups denied them the right to take on a competing franchise if they had temporary and localised problems in customer satisfaction ratings. The RMIF and SMTA said that their members recognised and supported the suppliers' need to emphasise the essential elements of customer satisfaction but thought it was wrong that customer satisfaction performance, as measured by the suppliers, should ever be used as a ground for discouraging or refusing the acquisition of another outlet for a competing franchise.

11.12. The RMIF and SMTA said that the supplier/retailer computer interface problem was in the same category as certain of the supplier's requirements which related to the presentation and decoration of premises. For the supplier to specify some basic essentials was of value to all the supplier's franchised retailers as well as to the supplier itself. Where the supplier went beyond those essentials, the normal consequence would be to involve retailers in expenditure which would in practice be largely unproductive and would thus inhibit the retailers' commercial flexibility. Expenditure beyond certain basic essentials should be a matter for individual commercial choice and judgment by franchised retailers, since they might be expected to know more about customer perceptions and market requirements in their particular area than the supplier. Where this did not happen the franchised retailer would be involved in costs which might be unnecessary to the success of the particular business, and might inhibit business competitiveness.

11.13. The RMIF and SMTA said that they were particularly concerned with the growing practice of suppliers selling large numbers of vehicles direct to fleet vehicle rental companies and to their own personnel at considerably reduced prices which franchised dealers could not match. A recent independent report commissioned by the RMIF concluded that:

- (a) suppliers were bypassing their franchised dealers to sell at least 200,000 cars a year directly to fleet customers;
- (b) directly supplied vehicles were sold at discounts of up to 40 per cent, more than twice the discount dealers were typically able to obtain from their suppliers;
- (c) sales to companies operating 25 cars or more accounted for over one-third of the 2 million new cars sold in 1990;
- (d) the erosion of dealer involvement could undermine the viability of the franchise system, reduce standards and act against the interests of customers and suppliers;
- (e) direct selling at deep discounts-below those offered as normal dealer buying terms-could be seen as a *prima facie* breach of suppliers' obligations to the franchised system; and
- (f) heavy discounting on sales to fleet customers had an adverse impact on the used car market, where residual values were being depressed by over-supply of certain categories of car.

11.14. The RMIF and SMTA therefore considered it essential that:

- (a) present practices under which certain groups of purchasers enjoyed very substantial advantages, at the cost of the individual purchaser, should no longer be permitted; and
- (b) suppliers should be required to recognise that the current rigidity and extent of their detailed franchising rules, and the existence of rules which were both unwritten and not generally publicised, were anti-competitive, and imposed unnecessary costs on their franchised retailers.

11.15. The RMIF and SMTA said that they had on several occasions drawn attention to the present inadequacy of United Kingdom competition legislation, which did not address the imbalance in negotiating strength between the suppliers and even the largest franchised retailers.

11.16. The RMIF and SMTA believed that this problem could be overcome by amending the Restrictive Trade Practices Act to remove from its ambit collective positions taken up, or recommendations made, by groups of businesses having essentially similar contractual distribution arrangements with a new car supplier. Such an exemption could not be anti-competitive because both the supplier and its distributors would have a common interest in maintaining the competitiveness of the product in the retail market-place as long as their relationship continued.

11.17. In commenting on possible remedies put to it by the MMC the RMIF said that certain of the remedies, if implemented, would themselves be the source of considerable mischief within the market-place to the detriment of the consumer. The RMIF also noted that certain of the measures proposed could be implemented only in all EC member states.

Franchised Vehicle Retailers' Section of the Society of Motor Manufacturers and Traders¹

11.18. The FVRS said that various characteristics of the new vehicle distribution system were unique in that they involved:

- (a) the provision of an after-sales activity for warranty and general service for a sophisticated, technically advanced and continually changing product, which required specialist staff and dedicated facilities;
- (b) the investment in high-value stock of both vehicles and parts to provide the customer with a range of choice and quick availability;

¹See also paragraphs 12.35.1 to 12.35.16.

- (c) the provision of customer service levels equal to, or better than, those of other retailers, involving major investment in purpose-built premises; and
- (d) in some instances, the use of the customer's present vehicle as a part-exchange in financing a new vehicle transaction.

The FVRS said that the present selective distribution system enabled individuals and groups to invest in these arrangements in the knowledge that, despite the competitive nature of the market, efficient operators could make a return on investment, although this was low by most retailing standards. The FVRS believed that any major changes to the present system could destabilise the structure, particularly where individual businesses were concerned, and this would impact on the consumer.

11.19. The FVRS said that the relationship between the franchised retailer and the supplier was based upon three elements:

- (a) a formal contract, which included the terms of trading, periods of notice, minimum standards of facilities and finance and management structure;
- (b) a set of operating standards, outlining performance targets, customer service standards, training requirements and stocking levels, which tended to reflect short- to medium-term trading conditions and could be changed at frequent intervals with little notice; and
- (c) various franchising rules that might not necessarily relate to the performance of a particular operation or group but applied generally to relationships between the supplier and the franchisees.

The FVRS said that whilst franchise agreements varied between suppliers and tended to be fixed and non-negotiable, two significant characteristics were worthy of comment:

- (1) the majority of suppliers in the United Kingdom promoted their products by specifying maximum or recommended retail prices, with wholesale prices expressed as a percentage reduction from the RRP, with the same buying terms applying to all dealers; and
- (2) the basis for most franchise agreements was a rolling contract with contingencies for 12 months' notice of termination.

The FVRS said that to support the major investments that had to be made to qualify for a franchise a longer-term contract would be useful and would provide greater confidence for financial institutions that might be involved in the provision of funds.

11.20. The FVRS said that operating and performance standards tended to vary from time to time and involved many aspects of the relationship, including new vehicle and parts purchasing targets for specific periods, assessments of customer satisfaction levels, commitment to training programmes, and facilities and housekeeping standards. The FVRS said that assessments often seemed to be arbitrary and subjective and affected the retailers' margins through performance bonuses. The FVRS said that other areas of performance were also covered, for example the sale of the suppliers' recommended finance programmes or extended warranty schemes. Often the use of such suppliers' schemes was mandatory or, alternatively, if targets for the sales of these products were not achieved, retailers could be penalised. The FVRS said that these products were often not as competitive as others available on the market and argued that retailers should not be penalised if they marketed products that were more competitive and offered better value. The FVRS added that additional margins and bonuses earned under such arrangements controlled the retailers' viability and played a major part in pushing up their profitability to the levels currently being achieved, which were nevertheless relatively low.

11.21. The FVRS said that franchising rules were designed to restrict the number of outlets which any one retailer could represent for any one supplier and sought to limit the retailer's activities to a particular geographic market or territory. The FVRS said that very often such rules were arbitrary and ill-defined when the contract was entered into, frequently emerging as the retailer's business activity developed. Restrictions were imposed:

- (a) on the location of retailing outlets which represented competing franchises under common ownership;
- (b) on the number of outlets or share of volume that one retailing business could represent of an individual supplier;
- (c) on the ability of a supplier to withdraw a franchise following a change in ownership which did not have its endorsement;
- (d) on a franchised retailer acquiring additional businesses of any nature or franchise if performance or customer service standards within an existing franchised operation had not been achieved;
- (e) on the acquisition of used vehicle outlets and service facilities in a territory for which the retailer did not hold a new car franchise; and
- (f) on the choice and use of computer systems and software.

The FVRS said that it considered that these arbitrary rules, which varied from supplier to supplier, inhibited the development of retail businesses at the consumer's expense.

11.22. The FVRS said that though new vehicles were mainly supplied through the franchise network, in recent years suppliers were increasingly bypassing dealers and selling vehicles directly to large-volume fleet and car hire purchasers. The FVRS said that by excluding the franchised retailer the supplier could offer significant additional discounts. However, the purchaser continued to use the franchised retail network for service, warranty and repair work. A variation on this supply arrangement was where a franchised retailer received a handling fee for preparing and delivering the vehicle. The FVRS said that these arrangements, which often involved large volumes of cars, plus those where contract hire companies received discounts or bonuses greater than those received by the franchised retailer, meant that:

- (a) residual values of the cars concerned were lowered, influencing used car values in part-exchange transactions of individual buyers and subsequently the cost of ownership;
- (b) a two-tier pricing structure had emerged whereby fleet or corporate purchasers enjoyed significant price advantages over the individual buyer;
- (c) contract hire and other finance charges were higher to reflect the anticipated lower residual values; and
- (d) volumes and margins were reduced through the franchised retail network, thus requiring retailers to maintain higher charges in other areas of operation to afford even the modest profitability currently being achieved.

11.23. The FVRS said that:

- (a) the current franchise system worked effectively in the consumer's interest;
- (b) franchised vehicle retailers' profitability was relatively low;
- (c) the present relationship between suppliers and retailers imposed restrictions on retailers' attributes; and
- (d) the practice of giving fleet purchasers substantial price advantages had led to a dual pricing policy by certain suppliers.

Co-operative Union (Co-op)

11.24. The Co-op said that it represented the retail consumer co-operatives in Great Britain and had a twofold interest in the inquiry: its long-standing concern for the interests of consumers and its experience in the retail motor trade. As a consumer organisation it consisted of 70 Co-operative Societies owned by 8 million consumer members. Fifteen of those societies operated retail motor groups, with a total of more than 60 franchises.

11.25. The Co-op said that it accepted that there was an apparent disparity between the list retail price of cars in the United Kingdom and the prices for similar cars in other European countries. It also recognised that consumers were disadvantaged if this disparity exceeded the margin envisaged by the EC block exemption.

11.26. The Co-op said that it believed that there should be changes in the system of distribution of new cars in order to reduce prices to consumers. This objective could be reached in two complementary ways. One involved unilateral action by manufacturers to reduce the price of their cars to individual consumers—either by increasing the price to fleet buyers, or by reducing their margins, or both. The Co-op said that this was a matter solely for the manufacturers and that it did not wish to comment in detail on it. The second way of reducing prices was to reform relationships between manufacturers and dealers. The Co-op said that it was opposed to a complete sweeping away of the arrangements between manufacturers and dealers. In the short term this would bankrupt large numbers of dealers and reduce consumers' choice. In the medium term it would probably mean the growth of a limited number of car supermarkets, selling all makes and thereby introducing a new monopoly potential. The Co-op said that in its view the current relationship was biased to the advantage of the manufacturer. The Co-op believed that more flexibility should be introduced to redress the balance in favour of the dealer. In particular:

- (a) A dealer who already had a franchise from one manufacturer should be able to obtain franchises from other manufacturers. At the moment a dealer obtained an initial franchise from a supplier by demonstrating a sufficient level of sales and service facilities. The facilities could be more efficiently used to sell and service other makes of cars but manufacturers often exercised their right to refuse a franchise on the sole ground that the dealer was already selling the cars of a competitor. If this right of refusal were to be taken away from the manufacturer it would be possible for dealers who now sold one make to sell several makes from a single outlet. This would be a more efficient use of resources and would enable dealers to reduce prices to the benefit of consumers.
- (b) Manufacturers' franchises should be awarded for a minimum of five years, so that the necessary capital could be invested with confidence, whereas at present franchises could be given for as little as 12 months.
- (c) Manufacturers should not be able any longer to insist that dealers use manufacturer-owned finance companies when arranging credit sales.

The Co-op believed that there was still a case for a franchised dealer system, particularly to ensure consumer protection in after-sales service. This was not just a matter of routine servicing, which could be done by an unfranchised dealer in many cases. The need for a specialised service provision arose in dealing with repairs. For example, a failed electronic system in a car required sophisticated tools and skills to diagnose and repair. There should, however, be a clear definition of the powers and duties of manufacturers. The powers should be the minimum required to ensure that the dealer could provide adequate sale and service facilities.

Car dealers

11.27. The MMC received evidence from 12 dealers, including several large multi-franchise dealer groups, and held hearings with six of them.

11.28. Nearly all the dealers supported the franchised distribution system. It had been adopted in the early days of motor vehicle retailing; and although there were regional variations it had become the accepted world-wide basis for car distribution. In an intensely competitive and innovative industry, no one had as yet devised and implemented a better system.

11.29. Most dealers said that the present system provided the suppliers with a method by which they could manage their market-place and have security of representation in what was an exceptionally high-investment and high-risk industry. Manufacturers were thereby able to organise their product development and control their manufacturing output to fit the market in the most efficient manner. The franchise system enabled manufacturers to manage the quality of their outlets and their dealers and have direct control over a wide range of areas such as safety and quality of after-sales service.

11.30. An exclusive franchise territory gave the dealer the advantage of being able to assess and measure his market-place. By knowing it he could manage his business within reasonably detailed confines, plan his business in terms of investment in facilities, staff, equipment, training back-up, vehicle flow and spare parts and thereby help avoid taking unnecessary risks or causing disruption to his customers.

11.31. Some dealers said that they believed that the franchise system was competitive and that dealers competed vigorously with one another. Though all manufacturers in the United Kingdom used the same system there was intense competition within that system, particularly between dealers of similar franchises. The territorial designation system in the United Kingdom ensured tough competition between dealers; generally the size of the territories was quite small and there was a fairly close proximity between dealers of the same franchise.

11.32. The present structure of franchising provided the customer with a wide geographical spread of outlets, a high-quality after-sales service-particularly important with growing technology-and a secure market for used cars. Dealers said that the franchise system improved availability of products to the customer and provided a level of after-sales service not found for any other consumer product. Customers enjoyed security of service and supply and the assurance that dealers adhered to the strict standards set by manufacturers and were fully supported by trained staff and service and parts back-up facilities. Some dealers said that market research conducted both by themselves and by manufacturers showed that customers were satisfied with the present system.

11.33. Though most of the dealers acknowledged that there were advantages in the present system, they also complained of various disadvantages. Many thought that the system offered too little security for the dealer, with agreements weighted heavily in favour of suppliers. Agreements were generally short-term in relation to the investment made in the business, they offered no guarantee against a supplier adding additional dealers in an area, and there was little or no right of appeal for a dealer for loss of a franchise.

11.34. Most dealers complained about the restrictions placed on them by certain suppliers preventing them from operating other franchises within a fixed distance from a site. Many dealers thought this to be anti-competitive since it meant less choice for the consumer. Dealer groups wishing to build up an area or national network were effectively prevented from doing so by their being unable to operate in large areas of the country. Conversely, a supplier had relative freedom to change a dealer's territory, put in another dealer or take away some part of a dealer's territory. Several dealers also objected to suppliers imposing a limit on the number of dealerships that any one dealer group could hold. A further constraint was that dealers were subject to rigorous control by suppliers on the buying and selling of a business. In the case of certain franchises dealers had no freedom in the selection of a buyer. Dealers recognised that a supplier had a right to determine who represented him, but in some cases this right could put dealers at a commercial disadvantage.

11.35. Other complaints about the franchise system were that dealers were obliged to hold high inventory levels; and suppliers' stocking requirements sometimes forced dealers to hold models for which there was little or no consumer demand; dealers were increasingly being tied to captive products and services, eg manufacturers' own warranty and finance schemes and parts, and so dealers were unable to provide their own services or negotiate with other suppliers which could often provide goods more cheaply. In addition, bonus schemes, often outside the control of dealers, were offered as incentives to sales staff to sell a manufacturer's own products. Retail groups were prevented from projecting their own corporate identity in

favour of that of the suppliers and many agreements also prevented dealers from undertaking other activities, eg fast-fit or body shops. Several dealers also objected to the introduction of a 'customer satisfaction index' by certain suppliers which meant that if a dealership was given a below-average mark for any of its franchises it was prevented from expanding to any other franchise without the approval of the supplier. A low mark could also mean the withdrawal of a franchise. One dealer group said that it could not believe that the block exemption was intended to give one party so much power over the other.

11.36. One dealer group suggested that distribution agreements should be the same for all suppliers, and should be controlled by an independent body financed by the industry, which would also police its operation.

11.37. Nearly all the larger dealer groups thought that the way forward was to multi-franchise sites, at present not permitted by most of the manufacturers. One group said that the manufacturers had effectively prevented the retailing of cars from developing, and it had advanced little in the past 50 years. Another said that a great deal more retailing professionalism needed to be brought into the business, which was over-controlled. As in other forms of retailing the way forward was multiple dealerships and retail parks. Another said that over five to ten years multi-franchising was inevitable. It was a highly competitive industry with thin margins on car sales, and the investment and standards demanded by the manufacturers were growing. As new cars became more and more reliable, needing less servicing and parts in their first few years, larger territories and larger volumes of business would be needed for a dealer to operate profitably. In addition with the present limitations on setting up new car ventures outside their territory, dealers could not compete with the new fast-fit chains, which would take more and more of the routine repairs, leaving the franchised dealers with only the more complex tasks.

11.38. A looser form of franchise system where dealers were free to handle several brands of product would result in major changes in the way cars were sold. Pricing would be keener and there would be economies of scale with shared management, multi-franchise workshops (including fast-fit and MOT), parts departments and car park, although all thought that showrooms would have to remain compartmentalised.

11.39. Many dealers also said that they objected to the increasing practice of manufacturers of bypassing the dealer system by selling cars direct to fleet and rental buyers at a marginal cost far below the price that dealers were charged. Dealers complained that many of these cars were sold on the used car market after a very short time, sometimes as little as three months, and realised prices higher than had been paid when new, but less than dealers were being charged, so disrupting the second-hand car market. At the present time, for instance, cars with very low mileage could be coming into the market at 30 per cent below equivalent new car prices. The market was driven not by the new but the used car market (and by scrappage rates eight years on). Fleet sales should be channelled through dealers. If there was a rigid distribution system it should be employed and not undercut. Dealers argued that this practice prevented them from competing on price in much of the fleet and rental market and was contrary to the interests of the majority of private customers who bought their cars through the dealer system and then found the second-hand value of their cars greatly reduced.

Peugeot Talbot Dealer Association (PTDA)

11.40. As to the franchise situation, PTDA said that whilst in an ideal situation there would be no infringement of territorial boundaries or controlled pricing this was clearly not the situation. Marketing forces dominated, with the dealer having to offer competitive discounts to both retail and trade customers. PTDA argued that national average profit margins of less than 2 per cent proved conclusively that the customer was receiving good value for money. If, as a result of a change in the law, a dealer's opportunity was restricted, PTDA suggested that the number of dealers would be reduced. If this were to happen the customer would suffer considerable difficulties in obtaining good, efficient and safe after-sales service.

11.41. PTDA said that franchised dealers generally supported the philosophy of exclusive territories and, whilst there were certain constraints on the sale of vehicles outside a dealer's territory, these appeared to have minimal effect. Many large dealers sold more than 50 per cent of their cars outside their territories.

11.42. PTDA said that its dealers were concerned about some of the franchising rules imposed upon them that limited the number and location of dealerships which they might operate. Within some franchises the rules were seen to have a degree of logic that could be accepted by the dealers, but there were exceptions where the required practices could constitute a trade constraint. PTDA said it was generally accepted that it was preferable for all parties that one set of premises should concentrate on the sales and after-sales activities related to one franchise. PTDA said that this should not preclude a dealer from developing parallel business on a site immediately adjacent to his current business.

11.43. PTDA said that franchised dealers made a considerable financial commitment when adopting a manufacturer's or importer's franchise. This included the cost of premises, vehicle stocks, parts stocks, expensive diagnostic equipment, and personnel and training programmes. PTDA said that it was therefore only right that sales of new cars to new customers should only be through dealers who had undertaken that commitment and were able to support the customer throughout the lifetime of the car. PTDA added that whilst many dealers believed that not all the targets set by suppliers were always reasonable, it was inevitable that, in a partnership between dealer and supplier, there should be targets which were agreed upon each year.

11.44. PTDA said that the manner in which wholesale prices were set was standard across the industry. PTDA said that there was concern, however, that certain suppliers were establishing a level of prices for larger purchasers that was substantially lower than the level granted to franchised dealers. This represented unfair trading which should be challenged: suppliers should be prevented from offering discriminatory discounts to specified classes of customers. PTDA added that it was inherent in the franchise system that the supply of all new cars should be through that system. This should preclude suppliers from establishing direct deals with major fleet operators. PTDA said that franchised dealers accepted and supported the system which required them to offer both sales and after-sales services to all customers. Dealers, however, thought that there should be greater flexibility in the areas of loan finance and insurance, where a dealer or group of dealers might be able to offer beneficial terms to the consumer.

11.45. PTDA believed that the system of uniform delivery charges across the whole of the United Kingdom prevented customers in more remote parts of the country being charged premiums for the supply of their new cars. PTDA said that it was generally accepted in the distribution business that a common delivery charge should be made, whatever the product.

The Car Shop

11.46. The Car Shop is a car broker: in effect, it acts as a fee-paid agent for anyone wishing to buy a new car at a discount. It advertises its services, usually in the specialist motoring press. It keeps in close touch with a circle of franchised dealers who it knows are willing to commit themselves in advance to sell cars at specific discounted prices through its agency. Then, in response to an enquiry from a would-be purchaser of a specific model variant, The Car Shop is able to quote the dealer's price and arrange for the dealer to supply the car. The Car Shop does not buy new cars from suppliers and, because of the terms of suppliers' agreements, franchised dealers may not sell cars to it for resale to the public.

11.47. In the first seven months of 1991 it had arranged the sale of 300 cars and expected to arrange the sale of 500 to 600 cars by the year end. It estimated that there were 20 to 30 such brokers in the United Kingdom. There was keen competition between them to offer the deepest discounts.

11.48. The Car Shop said that the suppliers were aware of its existence and that within limits they were prepared to see it continue in operation. Some suppliers looked unfavourably on car brokers' activities, possibly because they considered the customer lost the close service relationship with the dealer. But The Car Shop was sceptical as to whether such a relationship existed: dealers' service workshops were often some way from their showrooms, so that the relationship was with different staff; in any event, the cars that The Car Shop was concerned with were supplied through a franchised dealer who would deal with servicing and manufacturer's warranty.

11.49. The Car Shop told us that it had engaged in parallel importing in the past, but that it no longer did so because the price differential for a car with the correct specification was not large, in most cases no greater than the discount now available in the United Kingdom. It thought that most of its competitors in that field had also withdrawn.

11.50. The Car Shop said that 20 to 30 per cent of its business involved part-exchange. A customer would get more for his part-exchange by going to a main dealer but would also pay more for the new car. The Car Shop did not sell these used cars to the public but sent them to major auctions immediately.

11.51. The Car Shop said that there were important specification differences between what was superficially the same model in the United Kingdom and other EC countries; when the car to the EC specification was brought up to the United Kingdom standard the price difference was eliminated. If a car to the specification of another EC country was imported into the United Kingdom the residual value on sale would be lower than that for the same model variant to United Kingdom specification.

11.52. The Car Shop considered that the typical EC car owner was far less concerned with extra features than his counterpart in the United Kingdom, who was under social pressure to purchase a superior variant of a model and to add visible but often unessential extras after paying a significantly higher price than that of the basic model variant. In The Car Shop's experience, United Kingdom customers did not favour basic model variants.

Insurance companies and brokers

Institute of Insurance Brokers (IIB)

11.53. The IIB, the professional association of insurance brokers, said that more and more cars were now being sold with a year's free insurance. In addition, under one scheme a full 60 per cent no-claims bonus was allowed after only one year if the policy was renewed with the same insurer.

11.54. These deals, which must be financed by car suppliers, or by cross-subsidy from other motorists, or both, were not only having an adverse effect on brokers, with responsible insurers being deprived of business, but were not in the best interest of the general public. These deals allowed young and inexperienced drivers to run cars which would normally be denied them because of a prohibitive insurance premium.

Morgan Insurances Ltd (Morgan)

11.55. Morgan said that the uncompetitive premiums being offered on policies secured through dealers and the guarantee of a 60 per cent no-claims bonus after 12 months were unfair competition which would eventually have to be subsidised by higher premiums from drivers who insured in the normal way.

LFA Insurance Services (LFA)

11.56. LFA said that the concept of free motor insurance coupled with purchase of a new car could result only in further premium increases to the public as a whole because of the likelihood of higher claims being made by many of those who would benefit from the scheme. A very simple proposal form with a promise of maximum no-claims bonus at the first renewal failed to take into account the full risk at the outset; any resulting claims could be offset only by increasing premiums to all concerned and in particular to clients who had suffered the general increases imposed from year to year. It was an insurer's duty to maintain fair and just controls over their costings and increases, and to act in good faith with their clients.

Russell Hamilton & Company (Insurance) Ltd (RHI)

11.57. RHI said that the action of giving free insurance to new car buyers, irrespective of age, location, occupation or driving record, constituted unfair trading and would imperil the businesses, employees and goodwill of thousands of insurance intermediaries who had traded professionally, built up business by goodwill and fair dealing, and had abided by all the rules, regulations and requirements for protecting the insuring public.

Orion Insurance Company PLC (Orion)

11.58. Orion said that both the consumer and itself were being prejudiced through free, or virtually free, motor insurance being offered as an integral part of new car sales. It believed that the motor insurance market could be rendered less stable by this practice and as a result consumer choice would suffer because:

- (a) only a few motor insurers could expect to participate in these arrangements;
- (b) it was the major composite insurers that were securing most of these arrangements, thereby increasing their share of the market;
- (c) insurers which were not party to these arrangements would not be able to compete for related insurance business (because the motorist could not reduce the purchase price of the car by refusing the motor insurance offer and so had little or no incentive to make or continue with separate insurance arrangements);
- (d) the resulting reduction in business volume for some insurers would lead to an increase in operational costs; and
- (e) the ultimate effect of 'free' insurance might be a contraction in the number of minors transacting motor business in the United Kingdom market and a reduction in consumer choice.

Kentish Insurance Brokers (Bromley) Ltd (KIB)

11.59. KIB complained that the practice of certain suppliers offering free insurance and a 60 per cent no-claims bonus after the first year to any person who bought a new car, irrespective of previous claims experience or convictions, other than drink or reckless driving, was an unfair trading practice which should be stopped.

Halfords Ltd (Halfords)

11.60. Halfords said that besides operating as a car parts retailer it ran about 140 servicing operations offering servicing for all makes of car. There were two issues that were of particular importance to it in the context of the inquiry:

- (a) The practices of a number of suppliers prevented independent servicing organisations with fully trained and competent staff, such as Halfords, from carrying out routine servicing and maintenance operations during the warranty period or from carrying out warranty work on the supplier's behalf. Halfords' experience was that many customers were reluctant to have their cars serviced by it for fear of invalidating their warranties. A number of suppliers refused to honour warranty conditions where a vehicle had undergone any servicing or maintenance work by a non-franchised garage, even where the defect requiring warranty work could not be said to be attributed to the servicing or maintenance work carried out by the non-franchised garage.

- (b) The practices of a number of suppliers and importers restricted the availability of technical information that was necessary to enable independent servicing organisations, such as Halfords, to compete with franchised dealers in the provision of routine servicing and maintenance operations. Halfords said that the increasing complexity of vehicle construction and design meant that continued access to such information was vital if independent servicing organisations were to continue to be able to compete with franchised dealers on an equal footing.

11.61. Halfords believed that these practices were manifestations of a complex monopoly situation which existed in the supply of new cars. Further, Halfords believed that not only did these practices restrict competition between franchised dealers and independent servicing organisations, but also that they operated against the public interest by reducing consumer choice and artificially maintaining prices above competitive levels.

11.62. Halfords said that in its view it should be made unlawful for suppliers' warranties to require either routine servicing and maintenance operations or warranty work performed on the suppliers' behalf to be carried out only by a franchised dealer. Halfords considered that warranty provisions which purported to invalidate the warranty where routine servicing and maintenance work had been carried out by a non-authorised dealer should also be made unlawful, unless there was a clear causal link between the servicing or maintenance work and the defect giving rise to the warranty claim.

11.63. Halfords said that it accepted the need to give suppliers some measure of control over organisations permitted to carry out routine servicing and maintenance operations during the warranty period, as well as of organisations entrusted with the performance of warranty work on the supplier's behalf. Halfords said that it believed that the practical solution to this difficulty would be to allow independent servicing organisations (including Halfords) to obtain 'approved service centre' status for the principal suppliers. Halfords would be prepared to allow suppliers to satisfy themselves as to its general levels of competence as a pre-condition of being given approved service centre status. Safeguards would have to be put in place to ensure that suppliers did not attempt to impose unreasonable conditions on independent servicing organisations seeking approved service centre status.

British Vehicle Rental and Leasing Association (BVRLA)

11.64. The BVRLA said that it was concerned at certain car suppliers' increasing involvement in activities carried out by its members, particularly as the suppliers were able to undercut its members on prices. The BVRLA was also concerned that when suppliers increased their new car prices they did so at the same time and by the same amount, which was invariably above the current inflation rate.

Association of Car Fleet Operators Ltd (ACFO)

11.65. ACFO is a trade association representing operators of fleets of cars and light vans. It has about 475 members who together operate over 425,000 vehicles.

11.66. ACFO believed that fleet operators were the dominant force in the United Kingdom market. The fleet market was very varied both in size and other characteristics, but about two-thirds of company cars were exclusively or predominantly allocated to satisfy a work function.

11.67. ACFO believed that the main factors that had led to a high degree of reliance on fleet cars in the United Kingdom were:

- (a) the need for businesses to provide cars to make good the deficiencies of public transport;
- (b) changes in employees' attitudes to new car ownership;
- (c) Government pay and taxation policies, which had made provision of private use of company cars tax-effective; and

- (d) excessive mileage rate reimbursement for business use of employees' cars, which made it more cost-effective for businesses to provide cars.

11.68. ACFO told us that its members were concerned not only with purchase prices and discounts but with the whole life costs of their fleets, in which the residual value was a very important factor. The very large fleet operators, which secured very substantial discounts, accounted for less than 20 per cent of the total annual fleet sales; for the smaller fleet buyers typical discounts were in the range of 10 to 16 per cent, a level which might be achieved by most retail purchasers of new cars. In the case of retail purchases this discount might be realised in the form of an over-allowance made in respect of a vehicle traded in part-exchange.

11.69. ACFO said that the smaller fleet operators usually purchased only one or two cars per month, based on a typical replacement cycle of 36 months. Most fleets were operated for about this period at present, but it was still extending. It was desirable for a small operator to have a steady state of buying and selling throughout the year rather than to dispose of 20 to 30 vehicles at a time.

11.70. ACFO said that the fleet market was served basically by cars manufactured in the EC, of which 60 to 70 per cent were built in the United Kingdom. There had been an increase in diesel-engined vehicles recently and this had widened the choice to include French and German vehicles in the absence of a comparable British diesel.

11.71. ACFO thought that a manufacturer which was planning a model change would discount its old model stocks before introducing a replacement and would endeavour not to increase the effective index price of the old model during the final 12-month period. It would give additional discounts and bonuses to maintain market share for the marque, but the typical standard discount would have remained the same over a number of years.

11.72. In ACFO's view, the list prices of new cars in the United Kingdom tended to be higher than elsewhere in the EC but there was broad parity on invoice prices for models with similar specifications. It quoted the example of a large international company which found that once Car Tax, VAT and other import costs had been met any savings on parallel imports were marginal; the company had concluded that the exercise was not cost-effective, quite apart from the formidable logistic difficulties. ACFO was not aware of any significant United Kingdom fleet operator which bought new cars outside the United Kingdom, and added that if the saving had been worthwhile many fleet operators would have pursued it.

11.73. ACFO said that many people claimed to be able to import cars at an attractive price, but in its experience this was not the case; it might well not be possible to secure a dozen cars in Belgium easily and quickly, because the United Kingdom market required more highly-specified cars compared with its EC competitors. Another factor was that dealers elsewhere in the EC tended to be relatively small with locally concentrated markets and no cross-servicing, whereas the large United Kingdom dealer groups which usually provided fleet cars had a nation-wide support structure, which was needed for the fleet market.

11.74. ACFO told us that elsewhere in the EC the practice of employers providing cars for lower level employees was quite different; there employees tended to use public transport more readily, or receive mileage allowances in respect of business use of their own cars. There was some evidence that tool-of-the-trade cars were increasing in Italy, Benelux and Germany, but little evidence of an increase in France or Spain.

11.75. In ACFO's view there might be a change in purchasing patterns when the United Kingdom plants of the Japanese manufacturers were fully operational, although profits from the reduced costs of production might be used for development and not necessarily passed on to the United Kingdom purchaser. It noted that the Nissan factory in Sunderland had now been producing cars for the United Kingdom market for four years but had failed to secure a foothold in fleet purchasing because:

- (a) there had been a significantly lower residual value of Japanese cars at the three-year, 60,000 miles, fleet car disposal point; and
- (b) although the products had been regarded as reliable and good value for money, the Japanese badge and styling had created resistance in the fleet markets.

In general Japanese manufacturers' fleet sales organisations had not been as well organised as those of their competitors.

11.76. ACFO considered that the existence of the bands for taxation of private use of company cars caused distortion in the market because of clustering at the threshold levels. It had recommended more bands to Inland Revenue in order to reduce clustering and believed that if acted on this would result in more middle level cars being bought.

11.77. ACFO told us that manufacturers aimed much of their publicity at the company car driver, particularly having in mind the driver who had a choice of makes and models, and who would go to the limit of his employer's approved price band. Many of the specification improvements in company cars were safety-related, eg anti-lock braking systems, and were contributory to the United Kingdom's good record in road safety.

11.78. ACFO said that the overwhelming majority of its members required that drivers had their cars serviced by a franchised dealer, in order to protect the investment and to ensure that warranty claims were dealt with quickly and efficiently. Even after the warranty period ended many companies still required that franchised dealers be used because of their speed and efficiency. Dealer investment in expensive tuning and diagnostic equipment was feasible only for one franchise: no dealer could reasonably be expected to undertake the capital investment required for several sets of diagnostic equipment. It was safer to use franchised dealers since there was recourse to the supplier in case of difficulties. Now that servicing had become a much more capital-intensive and specialised business the smaller independent garages would decrease and be able to deal only with old vehicles: this would especially be the case when exhaust gas limitation became mandatory, since adjustment would be possible only by a franchised dealer with the requisite equipment.

Hertz (UK) Ltd (Hertz)

11.79. Hertz is concerned with the daily rental of cars in the United Kingdom: there is also a sister company, Hertz Car Leasing. The parent company of Hertz is the Park Ridge Corporation (USA) through its subsidiaries Hertz International (USA) and Hertz Corporation (USA). Park Ridge Corporation is owned 49 per cent by Ford Motor Company, 26 per cent by Volvo, 5 per cent by Commerce Bank of Germany and 20 per cent by a partnership led by the Chairman of the company; there is Ford and Volvo representation on the main Board. Hertz acquires many thousands of cars each year; the greater part are purchased and the rest are leased: the main marques are Ford and Vauxhall plus small numbers of others including Volvo, Volkswagen and prestige makes.

11.80. Hertz thought that the fact that Ford had such a high market share in the United Kingdom was that it offered a very attractive product range to the car rental industry and that it priced competitively.

11.81. Hertz told us that its initial negotiations for vehicle purchase are with the manufacturers. With Ford and Vauxhall it also involves the franchised dealers whereas this is not the case with Volvo and Volkswagen. Both of its major agreements for car purchase are annual and in each case it has to reach a minimum volume to qualify for a certain level of support.

11.82. Hertz said that it took all the dealer discount margin but paid dealers a handling charge per unit. In addition it took the bonus money that Ford and Vauxhall offered the industry as a whole of between 17 and 25 per cent on top of the dealer margin. It added that whilst there had been a downturn in business over the last year, and hence a reduction in number of cars required, it did not think that it had any cars more cheaply than it would otherwise have had this year. On average it held its cars for six months which was rather longer than the minimum period specified by the manufacturer.

11.83. Hertz bought only very few Japanese cars (a small number of Nissan prestige sports models). In its view the Japanese manufacturers would become competitive for United Kingdom rental companies when their factories are fully established in this country.

Avis Rent-a-Car Ltd (Avis)

11.84. Avis is a subsidiary of Cilva Holdings plc, which is itself a subsidiary of a Belgian company, D'Ieteren NV SA.

11.85. Avis's fleet size (both corporate and licensee) in the United Kingdom is between 12,000 and 18,500 cars, depending on the seasonality. Approximately half are purchased and half are leased from manufacturers' finance houses, eg Ford Motor Credit, Austin Rover Finance and General Motors Acceptance Company. The number of new cars purchased and leased was about 28,000 in 1991, split between Ford, Rover and Vauxhall, plus a few luxury cars.

11.86. Avis told us that in securing bulk supplies it negotiated both with the dealers and the manufacturers. It obtained discounts from the dealers and what was known as advertising rebate from the manufacturers in recognition of the demonstrator and early warning nature of rental fleets, and of the fact that there was no marketing expenditure for the manufacturer as there was in the case of retail vehicles. It added that there was no difference in supply arrangements whether the cars were purchased or leased.

11.87. Avis said that the discount available to it from dealers was fairly standard within a given dealer network and even across different franchise networks for the same type of car; however, dealers' terms of trade were dissimilar because of different rebates for the various models and different ancillary items.

11.88. Avis said that the residual values of cars fell very quickly following registration and that in normal market conditions there was a close correlation between the trend of used car prices and new car prices. However, in 1989 to 1991 the residual values had fallen relative to new car prices. The rumour of a Ford price reduction in the late summer of 1991 had made used car traders nervous and as a result used car transactions in July and August had declined.

11.89. Avis told us that it was in the interest of used car retailers (including the daily rental industry) to see residual values maintained at a high level. The weakened used car market of the past two years had meant a significant reduction in profit for the daily rental companies.

11.90. Avis said that the weak United Kingdom new car market in 1990/91 had little or no effect on rebates since most manufacturers were able to increase exports. The 1991 price cuts were largely a destocking exercise for certain older models; it had not benefited at all from such price cuts, nor did it receive any guarantee on residual values. It would not necessarily buy a car if offered a higher discount or rebate, because a poor residual value could more than offset the initial purchasing benefit.

11.91. Avis said that although Japanese manufacturers were included in its list of tenderers, they had not so far chosen to respond because they would have been unable to supply the numbers it sought. Avis expected this situation to change in the mid-1990s when Nissan, Toyota and Honda plants in the United Kingdom were fully operational.

11.92. Avis said that it neither purchased nor leased cars from outside the United Kingdom because it was not practical for a major car rental company to do so and the administrative and other associated costs would be too great.

11.93. Additionally, Avis told us that the lower-specification model typical elsewhere in the EC would be unacceptable to its rental customers as well as not finding a ready used car market due to the higher-specification models generally available in the United Kingdom.

11.94. Avis said that it carried out the majority of its servicing in its own workshops and used franchised dealers only in the more remote towns. Avis said that it had the facilities and equipment to deal with the vehicles that it acquired and it was approved for servicing and warranty work by the manufacturers concerned. It did not use independents such as Halfords or KwikFit for its servicing requirements.

Eurodollar Rent a Car (Eurodollar)

11.95. Eurodollar is the trading name of Swan National Rentals Ltd; it is one of three operating companies within Swan National Ltd, which is a wholly-owned subsidiary of TSB plc. Eurodollar concentrates in the United Kingdom on daily rentals; it also has subsidiary companies and a number of franchises elsewhere in the EC although these are much smaller than its operations in the United Kingdom. In 1990 Eurodollar took delivery of some 21,000 cars of which just over half were purchased, the remainder being on short-term contract hire.

11.96. Eurodollar said that the 1990/91 economic climate in the United Kingdom had reduced the demand for short-term rental, particularly for larger cars, and this in turn had affected the number of such cars it was now acquiring. It estimated that the demand for 3-litre cars had been cut by some 75 per cent in the last 18 months.

11.97. Eurodollar said that the cost of a car was not the only element in its negotiations with manufacturers for bulk supply. In its view the resale value was a crucial element (and in one case it had not bought from a manufacturer offering the highest discount because it had not been confident that the resale value would be competitive).

11.98. Eurodollar said that the United Kingdom used car market was one of the most sophisticated in Europe, which was of great help to Eurodollar in turning over large numbers of cars. The other EC markets for used cars were not as well-structured, and both manufacturers and operators were now trying to export some cars to Eastern Europe to satisfy the growing demand from that area.

11.99. Eurodollar relied mainly on Ford, Vauxhall, Rover and Peugeot cars, but expected that Japanese manufacturers would make attractive offers once their United Kingdom production was well-established.

11.100. Eurodollar said that when a model was approaching the end of its manufacturing run the manufacturer would offer fleet purchasers inducements to buy it. Conversely, when a new model was introduced the bulk buyer sometimes had to accept a reduction in discount. Eurodollar had been prepared to accept a reduced discount on the new model Ford Escort because it believed that the improved residual value would offset the initial cost disadvantage.

11.101. The minimum period of retention stipulated by suppliers had not been an issue for Eurodollar because it had never wanted to keep its cars for so short a time. It believed manufacturers were concerned that their dealers would fear that, if there was no minimum retention period, the rental companies would make a profit by selling their cars at the end of their rental lives at prices which the dealers could not match. Eurodollar said that in the USA there had been examples of rental companies turning over cars very quickly, thus undermining residual values. Consequently there has been opposition from dealers and attempts to get manufacturers to impose longer retention periods. However, there had been no sign of a similar situation in the United Kingdom.

11.102. Eurodollar told us that the sale prices of its used cars were not normally linked to the current list price or the price it had actually paid. The used car market operated very much at arm's length from the new car market because the used car buyer was normally a private individual buying a single car, and the market was not influenced by companies buying in large volumes.

11.103. Eurodollar was not surprised at the favourable deals it was able to negotiate with manufacturers bearing in mind the numbers it purchased and the consistency in specification required, so that economies of scale in production came through clearly. Furthermore it thought that the manufacturers saw the rental sector as a means of demonstrating their cars to potential buyers and hence as an advertising benefit.

11.104. Eurodollar said that despite the terms it obtained from manufacturers on purchase it still suffered very large depreciation costs and its profits were made from rentals. It denied the suggestion that rental companies broke even on hiring and made their profits on disposal. It said that depreciation costs per unit had risen substantially in the last few years, that the increase in VAT was a significant factor, and that there had been an upward movement in car rental charges in the United Kingdom in the last two years primarily driven by the increase in operating costs and poor residual values.

11.105. Eurodollar did not think that there were significant differences between the specification of cars in the United Kingdom and the rest of the EC nor, in its experience, did manufacturers offer any incentives to rental companies to buy cars of higher specification. Its customers would expect a car that was fully up to specification but not superior to it; if it was below the specification expected of the model its customers would object.

11.106. Eurodollar said that the servicing of its cars was largely carried out by the relevant franchised dealers. It dealt with some large non-franchised companies but was very wary of small garages. Its experience of non-franchised service varied from very good to appalling. It had withdrawn from having its own workshops as a result of the increasing complication of modern cars and the need to invest continually in more sophisticated equipment and training.

11.107. In Eurodollar's view the quality of servicing from the franchised dealer was uniformly acceptable. It took comfort from the fact that any shortcomings would be dealt with severely by the manufacturers which, in its view, were imposing higher and higher standards on their dealers in investment, training and equipment.

11.108. Eurodollar said that the discounts it obtained were passed on to the rental customer who, it considered, had a very attractive deal in the United Kingdom. If these discounts were reduced it would have to increase its prices, which in turn would reduce its market; it did not believe that the residual value of the car would increase in proportion to the reduction in the discount. The price increases, too, would be borne in the most part by business users, and were thus inflationary. It noted that a number of rental companies in the United Kingdom had made very substantial losses in the last few years, mainly because of problems on residual values on used cars.

Automobile Association

11.109. The AA, which represents about 7.5 million motorists, said that price, especially for the private purchaser, was one of the most important considerations when buying a new car. Consequently United Kingdom buyers were concerned if prices charged for similar cars in other European countries showed a marked disparity. The AA said that though it had not received many complaints on this question there was a persistent view held by United Kingdom motorists that they would be obliged to pay significantly more for the same car in the United Kingdom than if it was purchased elsewhere in Europe. Regular consumer surveys showed these differences although the AA pointed out that comparisons could be unsound because of differences in specification.

11.110. The AA said that a franchised dealer network provided the consumer with a ready and adequate source of expertise and service for one particular make of vehicle, but that dealers should not be excluded from or obstructed in providing adequate service for those makes of car for which they did not hold a franchise.

11.111. The AA said that in its opinion standards of service varied little between franchised and non-franchised garages, including fast-fit operations. However, the AA added that the fast-fit operations were investing much more in equipment, premises and training than the non-franchised trade and hence were in a better position to provide a good service both now and in the future. Many had expanded from simple servicing to brake and clutch repairs and might in the future extend to electric and electronic diagnosis and repair if manufacturers' information were made available to them. Manufacturers and importers were generally reluctant to provide details of repair methods and of complex vehicle specifications other than to their franchised dealers. The AA said that this reluctance tended to act against the interest of the consumer in so far as non-franchised repairers and other organisations were hampered in their activities by the lack of such information.

11.112. The AA added that a practice which might well be considered against the public interest in the context of car pricing was that motor manufacturers provided additional products, in particular free or low-cost motor insurance and low-cost financial packages, as incentives to purchase new cars. The AA said that this practice influenced the overall cost of new cars and could have serious anti-competitive effects because:

- (a) It reduced transparency in the market by concealing the true cost both of car insurance cover and of the new car itself.
- (b) For the period of free or low-cost insurance, it caused a new car buyer to switch from his existing insurer to the insurer favoured by the car manufacturer for reasons other than the relative competitiveness of the two insurers.
- (c) After the period of free or low-cost insurance, the likelihood that the car owner would return to his former insurer was limited by natural inertia. Thus the effects of the offer of low-cost insurance were likely to be prolonged.
- (d) If the practice were to become prevalent, it would reduce competition between suppliers of car insurance because car suppliers would make agreements with individual insurers, which would have the effect of limiting the number of insurers operating in the market and preventing or restricting entry into it.
- (e) The practice distorted competition between brokers and other insurance intermediaries, on the one hand, and insurers, on the other hand.
- (f) The effective exclusion of brokers and other intermediaries from part (and, in the future, possibly the whole) of the new car insurance market would deprive them of the commission income derived from that market and make it more difficult for them to provide services in other sectors of the car insurance market.
- (g) The practice indicated a trend on the part of car manufacturers to compete otherwise than on the basis of price.

11.113. The AA thought that the practice was contrary to the public interest because:

- (a) it reduced consumer choice;
- (b) the short-term advantages (eg reductions in administration costs, and elimination of brokers' and intermediaries' commissions) were outweighed by the long-term disadvantages (eg restriction of competition between insurers, and elimination of the information and quotation services provided to consumers by brokers and intermediaries);
- (c) the offer of one year's free insurance to buyers of new cars was subject only to the condition that the buyer of the car had not been disqualified from driving within the previous five years; the offer took no account of the claims experience or insurance rating of the buyer with the consequence that the free or low-cost insurance cover offered to all new car buyers would have to be financed by higher premiums paid by other car owners and drivers; and
- (d) the practice would have an adverse effect on road safety since high-risk drivers would not be deterred from driving badly by the cost of having to pay increased premiums.

The AA said that if offers of this kind were to be pursued the option of a further discount on the new car price should be an alternative available to the customer.

Royal Automobile Club

11.114. The RAC welcomed the MMC's inquiry but said that it did not have at its disposal adequate detailed information or statistics to justify the submission of formal evidence.

Consumers' Association

11.115. CA said that investigation of the selective distribution system was the central issue of the inquiry: CA had long been sceptical of a system that allowed car suppliers to insist that dealerships carry only cars of a particular make, and sell them within predefined territories. CA was in no doubt that such a system acted as a restraint on competition.

11.116. CA said that the manufacturers' and dealers' contention was that the car was a product needing expert maintenance and repair and that the selective distribution system created a network of established marketing channels, of workshops designed specifically to service certain cars, of supply channels for spare parts, and facilities for recalling defective vehicles. CA said that whilst all these aspects, with the exception of established marketing channels, could be construed as benefits to the consumer, they had to be weighed against the effect that selective supply agreements had in reducing and distorting competition. In particular, research carried out by CA over many years had suggested that the quality of car servicing was dismal; customers were no more likely to get good servicing from a franchised dealer than from an independent garage.

11.117. As to the cost of new cars in the United Kingdom, CA said that the BEUC survey had shown that the United Kingdom consumer was paying a substantial premium; criticism that the specification of various models had not been adequately taken into account by BEUC and that exchange rate fluctuations made precise comparisons difficult did not in CA's view explain the very large price differences involved. CA said that a recent survey it had carried out showed that high-specification models similar to those available in the United Kingdom, particularly those from Japanese suppliers, were available in other EC countries but that suppliers also produced low-specification models not offered for sale in the United Kingdom. CA said that the cost of having extras fitted to a low-specification car bought in France or Belgium to bring it up to United Kingdom specification was easily outweighed by the price saving that could be made. CA said that this restriction was a further constraint on consumer choice and yet another manifestation of the segmentation of the EC car market.

11.118. CA said that whilst price differentials might not themselves be a measure of the costs of the selective distribution system nonetheless the system made it easier to maintain those differentials. CA added that a more recent survey it had carried out had shown that the differentials found in the BEUC study had increased slightly. Various explanations had been offered for the price differential between the United Kingdom and other EC markets-changes in the exchange rate, variations in taxation and other Government policies, differences in the costs of production, the nature of the car market and the selective distribution system itself-but none satisfactorily explained why prices in the United Kingdom should be so high.

11.119. CA said that a feature of the United Kingdom car market was that new cars could often be bought at a deeper discount than in other EC countries. However, CA said that it was rare for these discounts to be advertised; the process of securing a discount was often protracted and obscure, and though it often provided a bonus to the keen, experienced and hardened shopper, many people found that kind of haggling unacceptable. Hidden discounts meant that the price system for new cars was completely lacking in transparency, buyers were unable to make price comparisons without a great deal of homework, and open competition between dealerships was prevented. CA added that the United Kingdom consumer, as mentioned in the BEUC report, also faced considerable difficulties in trying to take advantage of cheaper prices in other EC countries through personally importing an RHD car. CA gave examples of some of the difficulties reported by people who had tried out CA's own guidance pack for personal car importing and of its own experiences in a recent survey of Belgian dealers. CA said that most of these cases appeared to be in breach of EC Regulation 123/85; they were being reported to the EC Commission and, in CA's view, provided a clear example of how the selective distribution system appeared to limit availability, and of the pressure that suppliers were able to exert on their dealers.

11.120. CA said that the general conclusion from its analysis was that the differential between United Kingdom car prices and those prevailing in other EC countries was in large measure the result of a deliberate policy of market segmentation by the suppliers, designed to maximise the returns from what appeared to be a highly profitable market. This had been accentuated by the tendency of the weaker suppliers to follow the car pricing decisions of the market leaders: the car suppliers had in this respect clearly been helped by the built-in demand for RHD models. CA said that it was interesting to note that, according to its latest survey, price levels in Ireland-the only other market for RHD vehicles in the EC-

were very nearly as high as in the United Kingdom. If suppliers complied with EC Regulation 123/85 cross-border purchases of cars would be facilitated and the degree of EC market segmentation substantially reduced. But the evidence in the BEUC survey, coupled with CA's own report, suggested that the Regulation was being widely flouted. CA thought this was hardly surprising, since it was in the interest of the suppliers to behave in this way. CA said that it was imperative that the EC Commission be pressed to ensure that EC Regulation 123/85 was properly implemented.

11.121. In addition CA concluded that action also needed to be taken within the United Kingdom to reform the selective distribution system. Even though the system did not appear to be primarily responsible for the major disadvantages suffered by United Kingdom customers compared with those elsewhere in the EC, there could be no doubt in CA's view that an unsatisfactory situation had been perpetuated by the selective distribution system, and that an opening of the United Kingdom market to full competition would help to remove many of the injustices United Kingdom consumers currently faced. CA argued that ending the selective distribution arrangements should in particular bring about:

- (a) *Vigorous competition between dealerships selling particular makes of car.* This was virtually ruled out by the territorial arrangements currently prevailing under the franchise system. There was some competition, eg in levels of discount on cars, but it was largely covert.
- (b) *Greater transparency of prices.* Even though huge discounts could sometimes be obtained by consumers, it was extremely difficult to know where or when to get them without inside knowledge or a great deal of homework, and many consumers found the system too daunting. In addition, lack of transparency meant that the impact of competition on the pricing policy of rival outlets was largely absent.
- (c) *Competition within the showroom.* There was now hardly any sector of the economy where the consumer had to visit several retail outlets before getting a reasonable choice of brands. Cars remained a striking exception, the more so given that most showrooms displayed only one car within a model range. CA argued that this was worse than inconvenient as it actually reduced competition because it made the consumer's search exceptionally long and difficult. CA said that in many rural areas (and perhaps some suburbs) this might even constrain the consumer's actual choice of car make if there were no franchised dealerships conveniently located to carry out servicing under guarantee and provide manufacturers' spare parts.
- (d) *The emergence of a genuine car retailing sector.* CA expected this to be by far the biggest prize from an ending of the selective distribution system. Retailers were already a major force in many other sectors of the economy and were able to exert substantial pressure on suppliers to provide goods which the customer wanted at a reasonable price. Retailers were also in a strong position to sense the state of the market and send the necessary signals through the system, if necessary playing off one supplier against another. In CA's view this kind of pressure appeared to be entirely absent from the car retailing system at present.

11.122. In commenting on possible remedies put to it by the MMC, CA said that for the most part it would describe them as merely tinkering with an increasingly unjustifiable system: some of the remedies might help to promote competition and greater transparency to some degree; but some would not help at all. CA said that its overriding concern was to see the car market as a whole function more competitively so that it could serve all consumers-and particularly those not able or not inclined to become involved in the detailed process of bargaining or parallel importing. These activities had assumed importance in the car industry only because of the anti-competitive nature of its retailing practices.

Consumer Law Committee of the Law Society of Scotland

11.123. The Consumer Law Committee of the Law Society of Scotland said that it was concerned at the continuing disparities in the price of new cars between EC member states as it appeared that the single market was still not operating as intended in that sector.

National Consumer Council

11.124. The NCC said that buying a car was the single most expensive purchase for most consumers, apart from a house. Repeated surveys had shown that United Kingdom new car prices were amongst the highest in Europe. The NCC said that various internal and external barriers to trade, including quotas and VERs, barriers to inward investment, differing technical standards and taxation regimes and selective distribution systems, all helped to separate each national market.

11.125. The NCC considered that exclusive distribution played a significant role in perpetuating price differentials between the United Kingdom and other countries by enabling car manufacturers to seal off the national market, thereby preventing commercial parallel imports and placing severe practical difficulties in the way of any individual wishing to import a car into the United Kingdom. The NCC added that the perpetuation of these systems could frustrate the creation of the single market, and prevent consumers benefiting from more competitive prices and greater choice.

11.126. The NCC said that the high proportion of company cars in the United Kingdom also had a distorting effect on the overall market. Consumers who did not have the privilege of a company car suffered from higher prices and reduced choice and were denied the option of choosing some of the lower-specification models available in other countries. The availability of only higher-specification cars in the United Kingdom also increased prices to the private customer. The NCC said that suppliers' assertions that there was a relatively low demand in the United Kingdom for cheaper and lower-specification cars should be subject to market research.

11.127. Commenting on possible remedies put to it by the MMC, the NCC restated that the problem as it saw it was that United Kingdom consumers were paying much more for their cars than their counterparts in many other EC countries, and the motor industry's selective distribution system clearly played an important part in maintaining these price differentials. In particular the NCC urged that the MMC should draw the attention of the appropriate authorities to the possibility that the Consumer Protection Act 1987 might be breached if, as was claimed by the motor industry, United Kingdom new car transaction costs were always below list prices.

11.128. The NCC said that in its view any proposed solution should be designed to make a significant contribution to bringing the prices paid by consumers in the United Kingdom in line with those paid by consumers in other EC countries. Facilitating personal parallel imports would benefit a small number of consumers but was unlikely to have much effect on prices charged in the United Kingdom market and therefore be of no benefit to the majority of new car buyers. In any case, the NCC added, consumers should not have to go to such trouble to secure lower prices. It was desirable that consumers should have legal redress if they were charged too much: the Financial Services Act provided a model.

11.129. The NCC said that in its view the block exemption from EC competition law granted to the motor industry's selective distribution system should be removed. The MMC's investigation, however, had been restricted to the United Kingdom car market and the NCC was primarily concerned with the severe detriment affecting United Kingdom consumers. The NCC urged the MMC to recommend that the block exemption be removed at the earliest opportunity from the United Kingdom. Should the MMC find a public interest detriment, their report would provide the EC Commission with much, if not all, of the evidence necessary for it to have the block exemption removed from the United Kingdom. The NCC added that it might be that such a recommendation would be welcomed by the EC Commission, and indeed by the EC car industry, as it would enable the removal of the exemption to be evaluated in advance of the review in 1995. The NCC stressed that removing the exemption did not mean that the selective distribution system would disappear, merely that it would have to compete with other distribution systems.

Cardiff Business School

11.130. Professor Garel Rhys and Dr John Bridge of the CBS wrote a paper on VERs that formed part of the submission made to the MMC by the NCC (paragraphs 11.124 to 11.129); they also gave oral evidence.

11.131. On price differentials, the CBS said that differences in specifications were numerous and complicated, and accounted in part for some of the differentials, but an appreciable difference in price, of around £2,000 for a small or medium-sized car, remained to be explained between the United Kingdom and the lowest price markets. Other factors to be taken into account were discounts, which by their nature tended to be obscure, and trade-ins: used cars in the United Kingdom were even dearer, compared with continental prices, than new cars. The used car market in Japan was quite different because of a very severe test imposed after five years, when many cars were withdrawn. Price differentials had arisen for a variety of reasons. Selective distribution was not the cause but might enable differentials to persist.

11.132. The CBS said that it was probably correct, in making price comparisons within the EC, that the MMC should concentrate on France, Germany and Italy, with their long-established car industries. These markets were so large that the manufacturer must try to secure full repayment of costs, whereas selling into Belgium and Switzerland yielded only a contribution.

11.133. The CBS accepted that prices in the United Kingdom were higher than in the rest of the EC. There were a number of reasons for this: there was a degree of market control; selective distribution had some effect; the United Kingdom consumer seemed to be prepared to pay higher prices; and it was difficult to obtain RHD cars outside the United Kingdom. The manufacturers had always tried to charge what the market would bear. The statutory prices and incomes policy in the 1970s had paradoxically led to United Kingdom prices moving out of line with those in the EC. If discounts were allowed for, the United Kingdom market could in some instances offer the lowest price in Europe, but many buyers would not bargain and would pay the list price. The market was not as transparent as it should be, though at the present time dealers were more willing to advertise the true price.

11.134. In relation to some EC markets, such as Germany, the CBS believed that there were informal understandings or unilateral restraints, not declared as VERs, which limited imports from Japan. The EFTA markets were relatively free. The Japanese (JAMA and the Ministry of International Trade and Industry) formed their own view of what was practicable within the European market, and worked out with the manufacturers historically-based market shares. The United Kingdom was the only major market in which Nissan was ahead of Toyota, because of the substantial lead established in the early 1970s by Nissan UK.

11.135. The CBS said that competition within Japan was intense, Toyota having about 43 per cent of the market and Nissan about 27 per cent. The major manufacturers each had separate chains of dealers (not necessarily wholly-owned, but with long-term contracts) competing with one another. From the importer's standpoint the biggest barrier to entering the Japanese market was the low price level.

11.136. The CBS believed that in the absence of VERs Japan might expect to have 20 per cent of the European market by 1998/99. They would want a trade-off between price and volume and would not want to engage in cut-throat competition that might result in the returns from a 20 per cent market share being less than those from a 10 per cent share. Introduction of the Japanese distribution system-big dealer groups, with rapid access to suppliers so that a specific vehicle could be provided within ten days of order-was a future possibility, but not until the Japanese were manufacturing in Europe on a much larger scale. By 2000 the Japanese could be making a million cars a year in the United Kingdom. The Nissan investment and the first arrangements between Honda and Rover were related to United Kingdom VERs, but subsequent investments by Honda and Toyota were more related to the EC market after 1992. Toyota and Nissan wanted to become global companies with a world-wide network; at present General Motors and Ford were the only true multinationals.

11.137. The CBS said that it was not easy to detect a correlation between VERs and prices, partly because of taxation and partly because the Japanese tended to follow the general price trends in individual markets rather than take the initiative. The power of individual Japanese manufacturers was limited: even Nissan, when it enjoyed its exceptional position in 1989 of having 6 per cent of the United Kingdom market, was in no position to set a lead. Given that the French *de facto* VER was equivalent to about 3 per cent of the market and that of the United Kingdom to about 11 per cent, it might be expected that Japanese car prices would be lower in the United Kingdom, but the reverse was the case. The CBS said that exchange rates had a lot to do with this, once a particular price had been set. Price differentials between the United Kingdom and other major European markets had almost disappeared in the mid-1980s. Higher levels of specification were a natural consequence of VERs, the better-specified vehicles having a higher added value. Japanese car prices mirrored the differentials in Europe. In some ways VERs suited the

Japanese, who were getting a very good profit margin in countries like the United Kingdom. In a sense the rest of the world was paying for a large part of the Japanese development programme. Their domestic prices might have to rise if there were free market prices around the world.

11.138. The CBS said that the motor industry was a rivalrous oligopoly, but with market leaders in the big markets whom competitors were reluctant to push too far. The EC manufacturers (outside the United Kingdom) had not undercut prices in the early 1980s, when differentials were high, partly because they wanted high profits and partly because they feared retaliation, eg by Ford. Eventually the dominance of one supplier in each country would disappear and there would be a truly EC-wide market.

11.139. On parallel importing, the CBS said that the fragmentation of the United Kingdom market, with so much product differentiation and its impact on second-hand values, was a disincentive. Exchange rates also played an important part in determining whether or not parallel importing was advantageous at any point in time.

11.140. Pricing in the motor industry was sensitive and complex. Even within a particular range the *ad valorem* mark-up would vary, often with the specification. Dealer margins could vary, too. There could be rapid changes, depending on the manufacturer's supply position, its identification of what it was facing in the market-place, and what it felt the market would bear for a particular model. There had been severe price competition up to 1929 to 1931, but it was 50 years before discounting on a significant scale had become general. The extent of discounting was greater in the United Kingdom than elsewhere, but it was a matter of degree, not kind.

11.141. The CBS said that the Japanese were aiming to develop a new car within a period of 18 months to two years, compared with their current figure of nearly three years and the European and American average of four to five years. That did not mean that the Japanese would necessarily replace cars more quickly, but they could shorten the cycle if they wished, whereas the Europeans would be hard pressed to get down to three years. The Japanese also changed more of the basic components when a model was changed, looking at a life cycle for engines of five to seven years whereas up to 20 years had not been uncommon in Europe. A major cost factor was the design and manufacture of dies and presses, where Toyota had a huge advantage. Time was a proxy for cost and in the development function both were halved. Additionally lean production was matched by lean distribution, enabling cost advantages to be enjoyed at almost every phase.

11.142. The CBS said that approximately 80 per cent of Fiat's sales in 1989 were in protected markets and there was great apprehension (shared by French manufacturers) of the Italian, French and Spanish markets being opened up to the Japanese. However, Fiat was taking steps to allow them to compete and was thought to have the lowest cost base in Europe. The French, especially Peugeot, appeared to be relying more on continuing to keep the Japanese out. Fiat, Volkswagen and General Motors were moving firmly into central and Eastern Europe, Fiat negotiating to establish plants in the Soviet Union and probably taking an equity holding in the Polish companies. Although it would not have a global presence physically, Fiat could have a global volume.

11.143. Manufacturers limited the number of distribution points that could be operated by a single dealer, but dealers were steadily getting more powerful. Increased direct selling by manufacturers was a possibility. It was not immediately obvious that sales and service had to be on the same premises or under the same control. Dealers would not be able to retain exclusive control of electronic diagnostic equipment which would inevitably become generally available and widely used by a computer-literate generation.

11.144. The CBS said that there was hearsay evidence that the United Kingdom market demanded higher specifications than other EC markets. It was argued that this was because of the fleet market where the perk element was increasingly status-related, though until the early 1980s the average fleet car had been of lower specification. Cars were further up the consumer preference schedule in the United Kingdom than anywhere else in the EC. But it was paternalistic of the manufacturer to say that it knew best: customers might like the opportunity to choose a basic specification, indeed there might be quite a substantial demand for it.

Mr John Overend

11.145. Mr John Overend, of Aston Business School, submitted a paper on new car prices. He ascribed the price differential between the United Kingdom and elsewhere in the EC partly to the greater prevalence in the United Kingdom of company cars with high specifications, partly to VERs (because they had the effect of limiting the number of dealers selling Japanese cars, rather than because of more direct effects on prices) and partly on suppliers' reluctance to engage in price competition. These factors were linked; it was because of the importance of the distribution network that suppliers were reluctant to engage in price competition. The size of the sales network was the single most important factor in determining market share. The existence of a thriving market in used cars of relatively recent registration limited the impact of high prices. Manufacturers' efforts to deter parallel imports were probably motivated mainly by the need to protect the interests of their dealers. Exclusive dealerships restricted competition and contributed to higher prices, but they operated in other EC countries as well, and therefore could not be the sole reason for the differential; along with the size, importance and buying arrangements of the company car market, however, they were probably the main reason. Historically, it had been price increases beyond the rate of inflation which had funded price discounting, ie the supplier had put the price up in order to pay the dealer to reduce it. When price discounting became less widespread the industry as a whole was as a result operating on a higher base of list prices. Paradoxically, it could be argued that discounting in the past was partly responsible for high prices now, not because of its effect on profit, but because of the manner of its funding.

Mr Peter Groves

11.146. Mr Peter Groves, formerly Legal Adviser to the SMMT, provided the MMC with a copy of his PhD thesis *Law and Competition in the Motor Industry: EC Regulation 123/85*. It gave a detailed account of the development and final text of the Regulation, reviewed the arguments for and against the principle of selective distribution, summarised the outcome of various cases decided under EC law, and dealt with price differentials between countries and other matters relevant to our inquiry. Mr Groves concluded that the Regulation was profoundly misguided: at best it was an irrelevance, and at worst detrimental to the interests not only of the industry but also of customers.

National Farmers' Union (NFU)

11.147. The NFU said that from time to time its members had expressed concern about the price of new cars in the United Kingdom compared with the rest of Europe and had found it worthwhile to import vehicles personally despite the burden that entailed. The NFU hoped that after 1992 personal importation of cars would become more straightforward thus providing a further opportunity to overcome any price differentials.

Members of Parliament

Mr Andrew Mitchell MP

11.148. Mr Andrew Mitchell MP said that his principal concern was that many of his constituents who had purchased new cars in the United Kingdom were at a disadvantage to their continental counterparts. Mr Mitchell referred to the BEUC report which he said made clear that car manufacturers had been able to partition the European market to keep prices higher in certain member states, particularly the United Kingdom. Mr Mitchell added that, whilst fluctuations in the value of sterling might have accounted for some of the price differences, the value of the pound had dropped in value against the ECU by about 8 per cent between the time of the BEUC report and January 1990 and clear price differences were still evident.

11.149. In addition, Mr Mitchell said that BEUC had found that EC member states, manufacturers and distributors were placing allegedly illegal obstacles in the way of parallel imports. In particular it alleged that:

- (a) the United Kingdom licensing authority repeatedly refused to register cars imported by professional parallel importers;
- (b) some car importers and producers had at times refused to honour guarantees on parallel imported cars; and
- (c) certain dealers in the Republic of Ireland had refused to sell on cars for parallel importation to the United Kingdom market.

The BEUC report had concluded that these allegations deserved further attention not only because they damaged the consumer interest in the United Kingdom but also because potentially they indicated a wider unreported problem elsewhere.

11.150. Mr Mitchell said that he believed his constituents had the right to purchase cars as cheaply in the United Kingdom as they were able to elsewhere. Mr Mitchell said that whilst there might have been complex reasons why the United Kingdom customer had been prepared to tolerate such exorbitant prices (such as the distortion provided by the fact that half of all new cars in Britain were company cars which had blunted the edge of consumer awareness), there was a strong feeling that manufacturers, distributors and dealers had found various ways of protecting the vested interest they had in matters staying as they were.

Mr Keith Mans MP

11.151. Mr Keith Mans MP enclosed a letter from a constituent complaining about delivery charges for new cars. Mr Mans said that he, too, thought that some of the delivery charges made by dealers were exorbitant and bore no relationship to the actual cost of delivery of the vehicle.

Sir Robert McCrindle MP

11.152. Sir Robert McCrindle MP said that the introduction of free insurance schemes, without a realistic cash alternative, could be considered anti-competitive as they were likely to distort existing competition in the car insurance market and thereby affect the long-term interest of the consumer.

Mr William Hague MP, Mr Colin Shepherd MP and Mr David Tredinnick MP

11.153. Mr William Hague MP, Mr Colin Shepherd MP and Mr David Tredinnick MP all submitted letters received from their constituents and asked that the views expressed within them be considered during the MMC's inquiry. These views are reflected either in the views of car dealers (paragraphs 11.27 to 11.39) or the views of members of the public (paragraphs 11.154 and 11.155).

Members of the public

11.154. The MMC received 36 complaints from members of the public about prices. Over half were concerned with price differences between cars bought in the United Kingdom and other EC countries; it was alleged that car buyers in the United Kingdom often paid over 30 per cent more for similar or very similar models. Four complainants said that equivalent cars could be bought in the USA at the same price in dollars as in pounds in the United Kingdom.

Ten complainants said that they had tried to take advantage of price savings in other EC countries by buying cars from foreign dealers and importing them into the United Kingdom: four said that the procedure had been relatively straightforward and more than justified by their savings, but five said that they had encountered great difficulties in trying to obtain a car of their choice and had had to give up. Several had been told by foreign dealers that they could not accept orders for RHD cars as their suppliers might restrict their future supplies of all cars if they accepted such orders. Several complainants pointed out that the non-availability of RHD cars in practice was contrary to the letter and spirit of EC Regulation 123/85. Others said that some manufacturers imposed a waiting time of 12 to 18 months to try to discourage buyers of RHD cars. One complainant said that personal imports were worth the trouble only if no part-exchange was involved as United Kingdom dealers tended to inflate the part-exchange price by allowing the purchaser of a new car a fair percentage of their profit, and this often compensated for the higher initial price of the new car.

11.155. Two complainants said that higher prices in the United Kingdom were indicative of a price-fixing cartel. Three complainants said that the proportion of company-owned or leased new cars in the United Kingdom was much higher than in any other European country. The tax allowances that accompanied each purchase gave manufacturers greater scope for overcharging. If such allowances were abolished the complainants believed that there would be an overall reduction in prices to the general public. Several complainants gave examples of a manufacturer keeping prices artificially high by preventing its dealers from discounting from the list price. Other complaints were that purchasers could buy only through dealers and were denied the cheaper option of buying ex-works; warranty systems were too rigid in binding the purchaser to the franchised dealer network; prices charged by franchised dealers for routine maintenance under warranty were too high; and a purchaser was prevented from transferring an order from one dealer to another to take advantage of an earlier delivery date.

Department of Trade and Industry

11.156. The DTI, Vehicles Task Force, attended two hearings and provided written evidence on VERs on cars imported from Japan and on the arrangements, agreed in August 1991, for importation of Japanese cars into the EC in the period to 31 December 1999.

11.157. The DTI said that a reply to a Parliamentary Question by the then Secretary of State for Trade, the Rt Hon Peter Shore MP, on 21 October 1975, following a visit by him to Japan and earlier discussions between the SMMT and JAMA, effectively marked the commencement of VERs on Japanese car exports to the United Kingdom. Mr Shore said:

I indicated both to the Japanese Government and to their industry that in the British Government's view the rapid build-up this year in Japanese car exports to the United Kingdom was unacceptable. For their part, the Japanese Government predicted that during the remainder of this year their exports of cars to the United Kingdom would decline, and acknowledged that Japanese cars should be exported to the United Kingdom in an orderly way during 1976. I shall continue to keep a careful watch on the situation.

11.158. The DTI said that the SMMT and JAMA met each year to consider, *inter alia*, forecasts of the size of the United Kingdom new car market in the following year. At all of these meetings JAMA had announced that it would pursue a prudent marketing policy in the following year. In practice this meant that the Japanese share of the United Kingdom market would be held at about the level which it had reached in 1975, ie about 11 per cent. The DTI understood that the division of this share between the Japanese manufacturers was a matter for JAMA. HMG had from time to time confirmed to the SMMT and to the Japanese Government that it wished to see the VER arrangements continue but was not involved beyond this.

11.159. The DTI said that other VERs, on televisions, music centres, pottery, stainless steel cutlery, footwear and special steels, had been adopted in the 1970s and abandoned during the 1980s following (in each case) a statement by HMG that they no longer saw any reason for the arrangements to continue. It was to be expected that a similar statement about the VERs on cars would ensure their abandonment.

11.160. The VERs on cars raised conflicting considerations. The DTI had carried out no systematic cost benefit analysis of the VERs' effects, though it was aware of a number of academic studies attempting to quantify them. It was clear that they had protected the United Kingdom vehicles industry at a time when it was at its weakest, allowing it to become competitive enough to trade in international markets. The VERs might also have played a role in attracting Japanese car manufacturers to invest in the United Kingdom, although this was unclear. Against this was the cost to United Kingdom consumers caused by restricting the Japanese supply and so raising the prices of all cars on the United Kingdom market; and also the consequential effect on the balance of payments. The United Kingdom was a substantial importer of cars and restrictions on the imports of Japanese cars might also have been offset in part by encouraging increased imports from other countries. The DTI said that in the long run it might not help the competitive strength of the United Kingdom industry to create easier conditions of competition in its home market, but that the industry had greatly strengthened its competitive position since the early 1980s and now had good growth prospects over the medium term. In sum, the DTI believed that the costs of the VERs had been justified in the circumstances of the time.

11.161. The DTI identified three factors that it thought contributed to the fall in the Japanese share of the United Kingdom new car market in recent years: difficulties in forecasting the total market accurately, problems with the distribution of Nissan cars, and the establishment of Nissan's own production facilities in the United Kingdom.

11.162. The DTI told us that it expected production of new cars in the United Kingdom by Nissan, Toyota and Honda to reach 500,000 units a year by the mid-1990s and to increase substantially thereafter. It was expected that considerable numbers of these cars would be exported to other EC countries, and that other Japanese plants would be built, some of them perhaps elsewhere in the EC. Japanese manufacturers had undertaken that after a short initial period all the cars produced in the United Kingdom would have 80 per cent local EC content. The DTI thought it unlikely that this investment had been attracted to the United Kingdom because of the VERs although the totality of restrictions in various EC member states might have been a factor in decisions by Japanese manufacturers to invest in Europe.

11.163. During the course of the inquiry the DTI informed us about the progress of discussions that were then taking place within the EC about the removal of national restrictions on imports of Japanese cars at the end of 1992. In August 1991 the DTI discussed with us the agreement (so far unpublished) reached by the EC and Japan on the arrangements for car imports from Japan into the EC from 1 January 1993 to 31 December 1999. Our understanding of these arrangements is set out in paragraphs 9.56 to 9.66. However, the DTI told us that HMG had made no decision on restraints in the United Kingdom market either in the period up to 31 December 1992 or in the period from 1 January 1993 to 31 December 1999. If HMG were in due course to decide that they did not wish restrictions to remain in the United Kingdom, the terms of the EC agreement would not prevent them achieving this result.

11.164. The DTI had no views on the present merits or demerits of SED in the motor industry.

Board of Inland Revenue

11.165. At the MMC's request Inland Revenue provided oral and written evidence on the origin and present effects of the system for taxing the benefit of private use of company cars.

11.166. Inland Revenue said that the Finance Act 1976, as amended, had introduced a simplified system of scale charges to replace 1948 legislation under which the benefit of having a company car available for private use was charged by reference to fixed scales. The current provisions were contained in sections 19 and 131 of the Income and Corporation Taxes Act 1988. Scale charges had been increased in most years subsequent to 1976, usually by slightly more than the amount required to match inflation. The scale charges were doubled in 1988/89 (when the then Chancellor of the Exchequer, in his 1988 Budget statement, said that car scales had previously reflected only about one-quarter of the value of a company car for private use). In 1991/92 scale charges were increased by 20 per cent and legislation was enacted under which, from 1992/93, employers will be required to pay National Insurance Contributions (NICs) on the benefit of cars they provide for the private use of their employees.

11.167. Inland Revenue said that it was not aware of any firm evidence that the significant increases in car scales since 1988 were having a measurable effect on the United Kingdom car market. In 1989 car sales, including fleet sales, were booming. Sales for 1990 and 1991 were down, but this was chiefly attributable to general economic factors rather than increases in the car scales: fleet sales had held up well into 1990 and did not decline significantly until after other parts of the market.

11.168. Inland Revenue said that it was not surprising that recent changes in personal taxation appeared to have had comparatively little impact on the fleet market. It had been generally acknowledged, at least until very recently, that company cars continued to be taxed lightly, so increases in the scale charges were doing no more than reduce this disproportion. The personal income tax scale charges did not affect the employer who provided the car, but there were other factors which did: company pension benefits, for example, took no account of imputed car values. Other factors were operational, such as the need to have reliable, well-presented cars available for employees who travelled extensively on business, or the need to provide competitive employment terms for recruitment purposes.

11.169. Inland Revenue thought that, in comparison with the factors which led employers to provide company cars, increases in employees' tax bills might be a relatively small consideration, but the position might well vary from business to business, and depended in part on what type of driver was in mind.

11.170. As to the type of car offered, Inland Revenue thought that the structure of the scales did not impose any fiscal disincentive on either employers or employees. However, at the boundary of each scale band the tax liability (and, from April 1992, employers' NIC liability) necessarily increased, and there was a small number of models which were equipped and priced to take best advantage of this consideration. In particular, relatively highly-specified and high-performance models with an engine capacity just below the 2,000 cc limit clustered just under the £19,250 price threshold. With such cars the low tax charge was clearly seen-and advertised-as a selling point. But in recent years price increases had taken many of these models over the £19,250 threshold, so the advantage had been temporary. The number of these cars was small in relation to the whole company car market, and none of the highest selling fleet cars fell into this category.

11.171. There were other possible approaches to the valuation of the car benefit (see Appendix 4.7) but Inland Revenue suggested that a pragmatic test of how far the benefit was fully taxed would be the extent to which company car drivers were surrendering company cars in favour of running their own cars with employer contributions towards the cost of business use. Inland Revenue said that there was little firm evidence of this happening, and it was difficult to make general statements about whether it would be worthwhile since each case turned on its own circumstances and there were many factors involved.

Directorate General IV of the EC Commission

11.172. During the inquiry we consulted Directorate General IV of the EC Commission. The Directorate General is responsible for competition matters and hence for the administration *inter alia* of EC Regulation 123/85, which governs the distribution agreements for new cars within the EC. As described in paragraph 6.30, we sought the views of the Directorate General on a number of points of interpretation of the Regulation; these views are set out in Appendix 6.3. In addition we put to the Directorate General those issues and remedies relating to the second complex monopoly situation to which the provisions of the Regulation might be thought relevant.

11.173. The Directorate General said that many United Kingdom dealer agreements included provisions that were not exempted by the Regulation. It was a matter of economic assessment how far the individual or cumulative effect of such provisions was restrictive. If there were provisions in the agreements which were clearly restrictive in the circumstances of the United Kingdom, it would be open to the MMC to report accordingly and to make recommendations. In these cases it would be open to the United Kingdom authorities to take action to implement the recommendations.

11.174. In addition, if the MMC were to conclude (in view of circumstances special to the United Kingdom or of what appeared to them to be abuse of the Regulation) that United Kingdom dealer agreements containing provisions exempted by the Regulation operated against the public interest, the national authorities could take appropriate action provided that nothing was done to undermine the fundamental provisions of the Regulation.

11.175. The Directorate General also commented on a number of possible remedies identified by the MMC:

- (a) On relaxation of restrictions on dealers promoting sales outside their territories the Directorate General noted that advertising practice in the United Kingdom appeared to diverge from that envisaged in the Regulation and that if this were so it would be a factor to be taken into account in considering the remedy.
- (b) On Remedy 3¹ the Directorate General said that restrictions on dealers' freedom to import for their own customers from franchised dealers for the same marque in another EC member state, or from the supplier's distribution company in that state, were not exempted under the Regulation.
- (c) The Directorate General expressed concern at the width of Remedy 5 as drafted which appeared to strike at one of the core provisions of the Regulation.
- (d) The Directorate General noted that remedies to ensure the effectiveness of parallel importing envisaged amendment to procedures introduced by the terms of the Notice issued with the Regulation and not the Regulation itself.
- (e) On Remedies 6 to 9, dealing with relationships between suppliers and dealers, the Directorate General had already set out in its response to the MMC questions (see Appendix 6.3) its view that restrictions which the Directorate General had commented on were not exempted by the terms of the Regulation.

11.176. The Directorate General did not consider that the remaining remedies raised issues on which it needed to comment.

¹See Appendix 12.2.