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Background to the United Kingdom industry

Introduction

13.1. The earlier chapters have described the main features of the United Kingdom market for new cars. A car is among the first, and still the most important, of consumer durables. It is, after a house, the most expensive object bought by most people, often both a prized personal possession and a status symbol, and its financing, if the consumer has to pay for it himself, makes a substantial demand on disposable income, quite apart from running costs. The mobility a car provides is essential to many people's way of life. At the same time the car raises social problems of road safety, congestion and pollution. All these factors ensure that it remains a focus of public and governmental attention.

13.2. The car industry continues to be the archetype of mass production, with a cost structure-high development and other fixed costs and low costs of incremental output-that makes profitability dependent on volume. But demand for new cars is highly responsive to the state of the economy and measures to control it; downturns in the economy were reflected in sharp falls in sales of new cars in 1974/75, 1979 to 1981 and 1990/91. Over the most recent period the number of cars sold looks likely to fall from 2.3 million in 1989 to an estimated 1.5 million in 1991. The industry plays a key role in the United Kingdom economy. In 1990 over 40 different manufacturers supplied the United Kingdom market; 2 million new cars sold (for £19 billion) accounted for about 3.5 per cent of gross domestic product. In June 1990 the employment of about half a million people, accounting for 2 per cent of the workforce in employment, was directly related to motor vehicles; about one-quarter of a million people being employed in assembly and manufacture of vehicles (including component manufacture) and a further quarter of a million in their distribution. Of the 1.3 million cars produced in the United Kingdom in 1990, over 400,000 (about 32 per cent) were exported; imports were much larger at 1.2 million and took a 57 per cent share of the market. In 1990 there was an adverse trade balance on cars of £4.2 billion. In 1991 exports greatly increased, principally to Germany, reflecting events in Eastern Europe, and to Italy. The adverse trade balance was much reduced.

The international context

13.3. The United Kingdom industry must be seen in the context of the world market, and particularly that of the European Communities (EC). The 2 million new cars sold in the United Kingdom in 1990 formed part of a total EC market of some 12.2 million. By comparison, in the other two main world markets, 9.5 million new cars were sold in the United States and 5.1 million in Japan. The major suppliers, American, European or Japanese, operate on a multinational basis. Most manufacturers sell in several countries and the largest suppliers sell in most countries of the world. Four of the five main car manufacturers in the United Kingdom, Ford, Vauxhall, Peugeot and Nissan Motor Manufacturing UK (NMUK), are wholly-owned subsidiaries of companies registered outside the United Kingdom and, indeed, of the 17 major suppliers[1] in the United Kingdom (those with more than 1 per cent each of the United Kingdom car registrations in 1990) only one, Rover, is ultimately controlled by a United Kingdom-registered company (British Aerospace). Components are procured throughout Europe and specialist engine or gearbox factories produce for a number of different assembly plants. Within Europe it is common for a supplier to plan his production so that one factory will produce a particular model for all or a number of countries. For example, Ford imports all Granadas, most Sierra and some Fiesta and Escort models into the United Kingdom, and is currently exporting Fiestas from the United Kingdom; and Peugeot assembles the 405 in the United Kingdom and exports it to France and other EC countries; all its other models are imported. Among the major United Kingdom suppliers only Rover manufactures all of its cars entirely in the United Kingdom.

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[1]A supplier in this context is a manufacturer or an importer. For the purposes of this inquiry both Nissan UK, which at present distributes Nissan cars in the United Kingdom, and NMUK, which manufactures Nissan cars in Sunderland, are suppliers of Nissan new cars. We therefore recognise 17 different suppliers, each supplying more than 1 per cent of the new cars registered in the United Kingdom in 1990. We call these the 17 major suppliers. In terms of market share, there are 16 suppliers each with more than 1 per cent of the United Kingdom market.

Japanese competition

13.4. Over the last 20 years a major feature of the car industry has been the strength of Japanese competition, based in part on new production methods. Japanese manufacturers have made rapid inroads into other manufacturers' markets, particularly the United States where their share of the market has increased substantially to 28 per cent in 1990.

13.5. In the early 1970s it appeared that the Japanese were poised to make similar inroads into the United Kingdom and other EC markets. United Kingdom imports from Japan rose from a few thousand in 1970 to take almost 10 per cent of the market in 1975. The response of the industry and some governments was to seek to limit imports from Japan. Most of the constraints still remain: France, Spain, Italy and Portugal have import quotas for Japanese-produced cars, all of which were in place by the mid-1970s, and since 1975 the Japanese have adopted voluntary export restraints (VERs) in the United Kingdom car market which have held imports from Japan to less than 12 per cent of all new car sales in any one year. As a result of these constraints the Japanese share of EC national new car markets varies widely; in 1990 it was over 20 per cent in the Benelux countries, over 40 per cent in Ireland, 15 per cent in Germany, about 10 per cent in the United Kingdom and 3 per cent in France. Overall the Japanese share of the EC market in recent years has been about 10 per cent.

13.6. The other main related development has been the move by Japanese suppliers to set up manufacturing operations in their main overseas markets. These are usually described as `transplants' although they are no different from other car suppliers' manufacture or assembly operations overseas, such as those in the United Kingdom of Ford, Vauxhall or Peugeot. Japanese overseas manufacture was established first in the United States, where its production now provides over half of the Japanese 28 per cent share of that market, but Japanese plants are now being established in the EC. The main Japanese projects so far announced for car production and assembly within the EC, by Honda, Nissan and Toyota, will all be located in the United Kingdom. Despite improvements in productivity by the established United States and EC industry it is generally accepted that the Japanese still retain a significant competitive advantage in both their home and overseas production.

Influences segmenting the EC market

13.7. Apart from the major constraint of VERs on Japanese exports (coupled with the EC common external tariff of 10 per cent) the EC market gives open access to all suppliers. However, despite the moves to a single market, the national markets within the EC still remain segmented from each other on the demand side by a number of factors, such as different taxation systems, different national type approval regimes for cars, and differences in consumer tastes. Perhaps most importantly the United Kingdom and the Republic of Ireland are segmented from the rest of the EC because the legal requirement to drive on the left in effect demands the use of right-hand drive (RHD) cars. The United Kingdom, too, is distinguished by the relative and absolute size of its company car sector. We discuss all of these later in more detail, in paragraphs 13.46 to 13.54.

Nature of the product

13.8. There are two further important features of the EC market-the complex variety of the products being offered and the distribution system. Cars are classified by the industry within generally recognised segments.[1] Most of the large manufacturers offer a model range of their marque in each segment. A given model range is offered in a number of models and model variants,[2] differing in style (hatchback, estate, saloon), number of doors, engine sizes, and trim levels from basic to luxury, shown by such generally recognised symbols as L, GL and GT.

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[1]The (widely-adopted) classification formulated by DRI Europe is: utility; small; lower medium; upper medium; large; and luxury/sports.

[2]Applying this to Ford as an illustration of these terms: Ford is the manufacturer of Ford marque cars; the Escort is a model range; the Escort 1.3L is a model; and the Escort 1.3L 3-door is a model variant; a variation is a minor difference, eg a colour.

For example, Ford told us that it offered over 17,000 variations in the United Kingdom market. This presents a major task in evaluating price and specification differences, both for a single maker's cars and between different marques. Moreover, because of the national differences discussed above, even where the same model appears to be available in different countries, there will still be differences in specification and in description, including series lettering, that make it extremely difficult, even for the well-informed, to make accurate comparisons across national borders.

The distribution system

13.9. The last structural feature to be highlighted in this description of the background to the inquiry is the distribution system. In all EC markets, and indeed in all free markets world-wide, the major suppliers all use broadly the same system of selective and exclusive distribution (SED). Under this the supplier entrusts the sale of its range of cars to a number of selected dealers who may sell only to final customers or to other dealers within the franchised network. Dealers are allotted territories in which they are given prime responsibility for both selling and servicing[1] the supplier's cars. The dealer usually undertakes not to handle competing cars within the territory defined in the agreement and there are sometimes restrictions on his holding competing franchises outside his territory. The contractual agreements between suppliers and dealers set out in considerable detail how the dealership is to be operated.

13.10. The agreements with dealers include restrictions that fall to be considered under Article 85(1) of the Treaty of Rome. They have, however, been given a block exemption, for a period of ten years from 1 July 1985, by the EC Commission under Article 85(3)-set out in EC Regulation 123/85 (the Regulation: see Appendix 6.2)-because of the balance the system was perceived to achieve between the benefits which the system provided (particularly in selling, servicing and maintaining a complex and potentially dangerous product) and these restrictions. However, the block exemption contained in the Regulation recognises that these benefits must not be provided at the expense of detriments to consumers and the Notice[2] to the Regulation, issued by the EC Commission, provides for review and possible withdrawal of the exemption if price differences between national markets exceed certain limits. The effects of this system on the market are discussed more fully in our conclusions.

Changes in the industry

13.11. A number of significant changes are now occurring and developing within the car industry, some internally, others externally, generated.

13.12. Cars continue to become both more technically complex, with increased use, for example, of sophisticated engine management systems, and more reliable, with less frequent and simpler servicing requirements and fewer mechanical breakdowns. Model ranges are being changed more frequently with the Japanese taking the lead in shortening the development cycles. New computerised ordering production methods suggest that, in the near future, customers in Japan will be able to have cars produced to their individual order and delivered within a couple of weeks. The spread of such methods could radically alter the current system under which manufacturers produce to meet forecast demand and dealers have to stock and sell the cars produced, and where incentives and special offers are a major feature in shifting unsold vehicles.

13.13. Externally generated changes include the moves in the EC Commission (discussed later in paragraphs 13.132 to 13.134) to replace individual member states' restraints on Japanese competition by a transitional EC-wide understanding, in preparation for the complete removal of restraints by the end of the century. Quite apart from these developments, the establishment of Japanese local production and the free movement of its products within the EC will generate strong competitive pressures. A common type approval system will be introduced within the EC at the end of 1992 which will ease the free movement of

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[1]A feature of the system is the requirement on each dealer in virtually all networks to provide servicing of all cars within the supplier's range, even if they have not been sold by that dealer.

[2]General Notices are issued from time to time by the EC Commission which provide guidance for undertakings and indicate the Commission's view on various matters; the Notice concerning EC Regulation 123/85 was officially published on 18 January 1985.

cars between the markets of member states. RHD, however, will still remain a barrier to the free movement of cars into the United Kingdom from elsewhere in the EC, except Ireland.

Background to the reference

13.14. For a number of years consumer associations within the EC, including the Consumers' Association (CA) in the United Kingdom, have drawn attention to apparently continuing differences in prices of cars between EC member states, and especially to comparisons which suggested a generally higher level of prices within the United Kingdom. A report published, in October 1989, by the Bureau Européan des Unions de Consommateurs (BEUC), the EC-wide organisation of consumer associations, suggested that, in spite of the provisions of the block exemption designed to ensure that free movement of cars was not impeded by the permitted restrictions on competition and that price differences were kept within bounds, substantial differences continued and that the United Kingdom prices were continually at the higher end of the range for the models studied. In making the present reference the Director General of Fair Trading (DGFT) drew attention to concern about apparent price differences between the United Kingdom and other EC markets and their possible connection with the SED system. Concurrently the EC Commission has been conducting an examination of price differences between member states, in the light of the provisions of the block exemption.

13.15. United Kingdom price levels and price comparisons with other EC markets are discussed in paragraphs 13.91 to 13.119. Whilst the concerns drawn to our attention by the DGFT form an important part of our inquiry, the terms of the reference to us go wider, as set out below.

The monopoly situations

13.16. Under the terms of the reference made by the DGFT and dated 9 May 1990 we are required to investigate and report on whether a monopoly situation exists in relation to the supply of new motor cars within the United Kingdom, by manufacturers and importers of such motor cars, and if so, by virtue of which provisions of section 6 of the Fair Trading Act 1973 (the Act), and in favour of what person or persons, the monopoly situation is to be taken to exist. If we identify a monopoly situation we have to consider whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or persons to exploit or maintain the situation, whether any of their actions or omissions are attributable to the situation and whether any facts found in pursuance of our investigations operate or may be expected to operate against the public interest. We first consider the existence of a monopoly situation or situations. The subsequent questions are dealt with later, in paragraphs 13.19, 13.32, 13.128, 13.129, 13.165 and 13.166.

The scale monopoly

13.17. Section 6 of the Act defines two kinds of monopoly situation in relation to the supply of goods. First, a monopoly situation under section 6(1)*(a)* or *(b)*, usually described as a scale monopoly, is taken to exist where at least one-quarter of all the goods of a particular description which are supplied in the United Kingdom are supplied by or to the same person or group of interconnected bodies corporate.

13.18. Shares of the United Kingdom new car market are customarily calculated in terms of new car registrations, for which comprehensive statistics are published monthly by the Society of Motor Manufacturers and Traders (SMMT). These figures, shown in Table 4.11, show that the Ford Motor Company (Ford) has supplied more than one-quarter of all new cars registered in each year since 1979, although in recent years the share has tended to fall. In 1990 Ford provided 25.3 per cent of all registrations and its wholly-owned subsidiary, Jaguar Ltd (Jaguar), accounted for a further 0.5 per cent. During the first months of 1991 their combined share fell below 25 per cent but then recovered before falling back sharply in August, but rising again in September. Both at the date on which the reference was made and for significant periods during our inquiry, Ford, with Jaguar, has had a market share in excess of 25 per cent.

13.19. We therefore conclude that a monopoly situation exists in relation to the supply of new cars within the United Kingdom by virtue of section 6(1)*(b)* of the Act, Ford and Jaguar being members of one and the same group of interconnected bodies corporate, and that this monopoly situation exists in favour of Ford and Jaguar.

The complex monopoly situation

13.20. Under the provisions of section 6(1)*(c)* and 6(2) of the Act a complex monopoly situation is taken to exist when at least one-quarter of all the goods of a particular description, which are supplied in the United Kingdom, are supplied by or to members of one and the same group consisting of two or more persons (not being a group of interconnected bodies corporate) who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict or distort competition in connection with the production or supply of these goods.

13.21. In April 1991 we notified the SMMT and all those companies which we identified at that stage as suppliers (ie either manufacturers or importers, or both) of new cars within the United Kingdom that we had provisionally concluded that a complex monopoly situation existed in their favour relating to the imposition of VERs on the number of new cars imported from Japan into the United Kingdom market; and we notified those companies that we had provisionally concluded that a complex monopoly existed in their favour relating to certain practices affecting the distribution arrangements for new cars in the United Kingdom.

VERs: the provisional complex monopoly conclusion

13.22. The first complex monopoly situation provisionally identified related to the VER arrangements described in paragraphs 9.4 to 9.15. These arrangements were introduced at the end of 1975 following discussions between the SMMT and the Japan Automobile Manufacturers Association (JAMA) and as a result of active intervention by Her Majesty's Government (HMG) with the Japanese Government to encourage an understanding. The effect of the arrangements is to limit the Japanese new car imports to about the share of the United Kingdom market that they held in that year, ie about 11 per cent. Since 1975 discussions between the SMMT and JAMA have taken place every year in order (amongst other things) to reach a broad measure of agreement on the forecast size of the United Kingdom market in the following year. Since 1975 imports of cars from Japan into the United Kingdom have not exceeded 12 per cent of the market in any year. The SMMT is a company limited by guarantee, with a membership which includes, but is not confined to, all suppliers of new cars to the United Kingdom market. We therefore concluded provisionally that a group consisting of JAMA, the SMMT and its members so conducted their respective affairs, through the SMMT/JAMA discussions, as to prevent, restrict or distort competition in connection with the supply of new cars and that at least one-quarter of the new cars supplied within the United Kingdom were supplied by members of this group. We concluded provisionally that this complex monopoly situation operated in favour of the SMMT and those of its members that manufactured or imported new cars. We so informed all these persons.

13.23. Following the provisional conclusion it was put to us by a number of car suppliers that the SMMT's discussions with JAMA would not have taken place or have led to any limitations on imports of Japanese cars without the active support and involvement of HMG and that HMG, and not the SMMT, were therefore to be regarded as responsible for the introduction of VERs, the SMMT in effect acting as an agent rather than conducting its own affairs. It was also put to us that the SMMT was acting in these discussions as an independent corporate body rather than acting directly on behalf of its individual members. It was argued that SMMT members had not independently or of their own initiative taken any action to restrict Japanese imports, and that they should not, simply by virtue of this membership, be regarded as conducting their respective affairs in the specified manner. It was also argued by one supplier that if the MMC's account of the arrangements was correct the arrangements between JAMA and the SMMT amounted to an agreement registrable under the Restrictive Trade Practices Act 1976 and therefore could not, by reason of section 10(2) of the Act, be taken into account for the purpose of section 6.

13.24. We are clear that, regardless of any role played by HMG, conduct by both JAMA and the SMMT was an integral part of the arrangements in the first place. We are, however, concerned with current conduct. The senior officers of the SMMT, usually the President or Vice-President, who have led the SMMT team in the talks with JAMA throughout the period 1975 to 1991, have invariably been Board members of major United Kingdom suppliers of vehicles or components. They have, however, been acting *ex officio* and not on behalf of their companies. Although we found some evidence in the mid-1970s of direct support from one supplier for the SMMT talks with JAMA, the arrangements were entered into 16 years ago and we found no evidence of such involvement in recent years or of any discussion supportive of the SMMT's policy on VERs within the companies themselves. The only internal company discussions we are aware of are those by importers of Japanese cars concerned with the problems caused for them by the VER arrangements.

13.25. After considering the responses to the public interest letter we decided that there was insufficient evidence to enable us to establish that the members of the SMMT individually were themselves responsible for the present conduct of the SMMT at its regular meetings with JAMA. Since only SMMT members, but neither the SMMT nor JAMA, supply cars as described in the terms of reference, the supply condition as laid down in section 6(1)*(c)* of the Act is not satisfied. We therefore find that the VER arrangements do not give rise to a complex monopoly situation in terms of section 6 of the Act.

13.26. It is, however, clear to us that VERs have a major and distorting effect on the operation of competition within the United Kingdom car market. In our opinion the effect is such that it would be impossible for us to fulfil our statutory duty in relation to the other complex monopoly situation described in paragraphs 13.31 and 13.32 without having due regard to the impact of VERs, which we do in paragraphs 13.131 to 13.134.

The complex monopoly situation relating to distribution

13.27. The second complex monopoly situation provisionally identified concerned suppliers' practices in relation to the distribution of their new cars. Most of these practices (set out in the public interest letter of April 1991 and in Appendix 12.1) relate to the SED system.[1] Although the detailed provisions of their dealer agreements vary, this system is used by almost all new car suppliers and by all the major suppliers each with more than 1 per cent of the market (including Ford, which we have already identified as a scale monopolist).

13.28. Some of the suppliers rejected the provisional finding in relation to all or some of the practices. It was put to us that all contractual arrangements for supply inevitably restrict the freedom of the parties and that the basic commercial freedom to adopt a specific method of distribution designed to promote efficiency and to refrain from supplying in other ways, even though it placed limitations on the conduct of the parties, did not in itself constitute restrictive conduct of the kind which section 6 of the Act was designed to address.

13.29. It was also put to us that it was necessary for us to show that the prevention, restriction and distortion of competition we identified had adverse effects on competition, and necessary for us to examine the market situation of each participant to show that its behaviour contributed to such an effect. Further it was argued that it was necessary to identify a separate monopoly situation in relation to each of the practices and to show that in each case the supply conditions of section 6 were fulfilled.

13.30. We have considered these arguments, both generally and in respect of the particular practices identified in the public interest letter. We accept that some provisions of supply agreements may restrain the conduct of the parties without affecting competition but we think it possible to distinguish those aspects of the parties' conduct and agreements which prevent, restrict or distort competition in the market we are studying. We accept that some of the practices we had identified provisionally did not necessarily have these effects. We also note that few restrictions are absolute; that there is provision in all the agreements for constraints to be varied upon one or other party giving consent; and that frequently there is a stipulation that such consent should not be unreasonably withheld. We consider, however, that the allocation of exclusive territories to dealers; suppliers' restrictions on the extent to which a dealer can sell competing

[1]By this we mean the system set out in the suppliers' agreements with their dealers, and in related documents. These generally embody most or all of the obligations and restrictions permitted by the Regulation but are not necessarily confined to them.

products; on the number, location and size of dealerships; on how far a dealer can promote sales outside the territory; as to whom he can make them; and on the extent to which he can carry on other types of car-related business, are all provisions which constrain the ability of a dealer to compete as he sees fit and thus prevent, restrict or distort competition, both between brands and within the suppliers' own brand. These provisions are analysed more fully in Chapter 6 and its appendices. In reaching this conclusion we do not accept that we are required to establish whether the effects of the conduct we have identified are good or bad. Nor do we consider it is necessary to establish a separate monopoly finding for each of the practices identified. They are all part of, or closely linked to, the SED system for new cars to which all the major suppliers conform, although the detailed provisions of their individual supply agreements may differ. We consider that the conduct we have identified is sufficiently similar to justify our finding a single coherent complex monopoly situation.

13.31. We therefore find that the suppliers of new cars listed in paragraph 4 of Appendix 2.2 are persons who so conduct their respective affairs as to prevent, restrict or distort competition in relation to the supply of new cars in the United Kingdom in one or more of the following ways:

(a) entering into SED agreements with dealers that, either in the agreement or related documents, contain one or more of the following provisions:

- (i) exclusive territories are allocated to dealers within which no other dealer will be supplied;
- (ii) the dealer is restricted in the extent to which he may promote the sale of the supplier's cars outside his territory;
- (iii) limits are placed on the number and location of the supplier's dealerships held by dealers and on the total volume of new cars sold through them;
- (iv) limits are placed on the number and location of other suppliers' dealerships held by dealers;
- (v) the extent to which, or conditions under which, dealers can engage in other car-related businesses are limited;
- (vi) dealers are prevented from selling competing new cars from the same site; and
- (vii) dealers are allowed to sell new cars only to final customers, or their authorised agents or to other franchised dealers; and

(b) refusing to supply new cars for resale except through the supplier's franchised dealer system.

These persons together supplied over one-quarter (in fact over 90 per cent) of the new cars registered in the United Kingdom in 1990.

13.32. We therefore conclude that a monopoly situation exists by virtue of sections 6(1)*(c)* and (2) of the Act (ie a complex monopoly situation). We further conclude that the complex monopoly situation we have identified operates in favour of those companies listed in paragraph 4 of Appendix 2.2. As we have explained in paragraph 6.14, we are required to leave out of account for this purpose and for our subsequent consideration of the public interest the agreements of those companies listed in Appendix 6.1 which are either registered under the Restrictive Trade Practices Act 1976 or appear to us to be so registrable. This we have done.

EC aspects of the inquiry

13.33. The present inquiry has important EC aspects which we discuss here before examining the market situation. In considering the matters before us we must take into account the relevant provisions of both United Kingdom and EC law and we have done so.

13.34. Our functions are set out in the Act which gives us the duty as an investigative body to report to the Secretary of State on the questions referred to us by the DGFT. If we find that a monopoly situation exists we are required as part of our investigations to consider whether any of the facts found in pursuance of our investigations operate or may be expected to operate against the United Kingdom public interest, and what action, if any, should be taken for the purpose of remedying or preventing any adverse effects we identify. If we think fit, we may make recommendations as to such action.

13.35. As we have noted in paragraph 13.10, the distribution of cars within the EC is subject until 30 June 1995 to the terms of the Regulation. The Regulation exempts from the provisions of Article 85(1) suppliers' agreements which contain certain defined requirements or obligations. It effectively determines the form of distribution agreements that may lawfully be used by suppliers throughout the EC (although use of agreements conforming to the Regulation is not compulsory). In addition to the fact that the Regulation has only a limited life, Article 10 of the Regulation provides that the EC Commission may withdraw the benefit of the Regulation where it finds that in an individual case an agreement which falls within its scope nevertheless has effects which are incompatible with the provisions of Article 85(3) of the Treaty.

13.36. We recognise that United Kingdom competition authorities must take account of EC law in dealing with the rights and obligations which arise from its provisions. In considering the present United Kingdom distribution system we have kept in mind the provisions of the Regulation and its current endorsement of the arrangements within its scope.

13.37. It was put to us by one party that the existence of an EC regulatory regime for car distribution precluded us from making recommendations or even from reaching any conclusions on the United Kingdom public interest in relation to the practices covered by the Regulation. We reject this view. The block exemption is not an integral part of the Treaty. It has been granted for ten years only and expires in 1995. The Regulation and its Recitals reflected the views of the EC Commission at the time when it was adopted in 1985. Moreover, as already noted, the Regulation itself provides for withdrawal of its benefit in certain circumstances. It is open to us, as a national competition authority, to examine the effects of the distribution system on the United Kingdom public interest, to make findings and, if we think fit, to make recommendations.

Market influences

13.38. To enable us to examine further the SED system and the effects of the conduct we have identified as the basis for our complex monopoly situation finding and to answer the remaining statutory questions set out in section 49 of the Act, we need to consider the framework within which the suppliers are operating. We therefore consider first other factors which distort or segment competition in the market, the way in which prices are set and evidence on the level of United Kingdom prices.

Factors affecting competition

VERs

13.39. The first and most important of these factors is the existence of VERs in the United Kingdom, and the more formal restrictions in some other EC countries. We discussed the effect of VERs with suppliers. Most of them considered that the restraints have had little practical effect on United Kingdom car prices or on the range of models available to United Kingdom consumers, given the number of non-Japanese suppliers freely competing in the market. These views seem to us untenable.

13.40. We noted the findings of the Organisation for Economic Co-operation and Development study (see Appendix 9.2) which found that prices in the United Kingdom market up to 1982 were probably some 10 per cent higher because of VERs but that the effect on price then became less important. On the other hand the more recent Cardiff Business School study (again see Appendix 9.2) suggested a 20 per cent effect on prices. A study (see paragraphs 9.41 to 9.49) of prices of Japanese cars in Japan, the United Kingdom and the United States (a large and now comparatively open market with comparable shipping costs) was carried out for us by consultants. This study, although necessarily limited in scope, suggested that, even when specification differences have been allowed for, prices in the United States may be significantly lower on average than for comparable models in the United Kingdom and that prices in Japan may be lower still. The differences appear widest in the small car segment.

13.41. Evidence on the comparative efficiency of Japanese manufacturers also suggests considerable scope in the longer run for decreases in the prices of Japanese cars sold in the EC. For example, a comparative study published in 1990[1] showed that the average man-hours required to assemble a volume-produced car in Japan in 1989 was 16.8, while in (non-Japanese) plants in the EC the average was more than double at 35.5. Moreover, the same source estimated that in the mid-1980s EC volume car producers spent 2.9 million man-hours in developing a new car compared with 1.7 million by Japanese producers.

13.42. The restrictions have limited not only the number of Japanese cars but also the range of models offered in the United Kingdom. Toyota, Honda and Colt (as distributors of Mitsubishi cars) told us that within their volume limits they had concentrated on the larger, more profitable models, and we believe this may have deprived United Kingdom consumers of the opportunity in particular to buy some of the very small Japanese cars. Even on some more expensive models the volume of potential sales does not justify incurring the costs of seeking United Kingdom type approval.

13.43. In addition, we are satisfied from the evidence put to us that Japanese manufacturers, within the overall VER, also limit their individual exports, so that VERs not only restrain Japanese suppliers from competing with non-Japanese suppliers but effectively remove competition between the Japanese suppliers themselves.

13.44. It seems to us unrealistic to suppose that, given these constraints, given the apparent difference between United Kingdom and Japanese prices for cars, and given the known comparative efficiency of Japanese producers and their plans to increase their share of the United Kingdom market, free entry for Japanese imports would not have led to a significant strengthening of competition. This view is confirmed by the strength of the support given by all indigenous EC car makers through their association, the Association des Constructeurs Européans d'Automobiles, to the continued need for restrictions over the next decade. A further factor reinforcing the effect of VERs on prices is the distorting effect of the Common External Tariff of 10 per cent on imported cars.

13.45. Some suppliers drew our attention to the lack of any correlation between the severity of VERs in individual countries and price levels in those countries. We discuss in paragraphs 9.23 to 9.27 the price effects of restrictions imposed by national authorities within the EC. In a customs union, ie a market with a single external tariff, where a number of countries impose varying restraints on imports, but without other internal barriers to supply, we would expect that after a period of adjustment competition between the unrestricted suppliers would tend to equalise prices within the market. The individual member states' restrictions would act in aggregate to raise the overall EC price level above the price outside the EC and the more efficient suppliers within the EC would reap the most benefit from the restrictions. We would not therefore expect to see any correlation between the comparative severity of the restraints limiting the Japanese share of the market in individual EC countries and price levels in those countries.

Type approval

13.46. While VERs are the main supply side restriction in the United Kingdom market, a number of other statutory or regulatory requirements segment the market. One contributory factor has been the existence of type approval requirements specific to each EC country which differ in significant respects. Although an individual person who buys a new car elsewhere in the EC and imports it into the United Kingdom for his own use is not subject to the United Kingdom type approval regulations (see paragraphs 4.124 to 4.126), all commercial imports are subject to them. However, the EC Commission has recently stated that an EC-wide type approval regime will be introduced at the end of 1992. From then onwards cars supplied in the EC will be subject to a common type approval in all EC countries. There will, however, still be national regulations, eg on headlamps, which the user should be able to satisfy at relatively minor cost.

[1] *The Machine that Changed the World* by J P Womack, D T Jones and Daniel Roos, Rawson Associates, Collier Macmillan Canada and Maxwell Macmillan International, 1990.

RHD

13.47. A more important barrier is the United Kingdom statutory requirement that everyone should drive on the left of the road. This makes it inconvenient though not unlawful to use left-hand drive (LHD) vehicles in the United Kingdom and so, although the type approval barrier will soon be removed for every EC national, the United Kingdom buyers will still in practice be limited to RHD models. These will be bought either in the United Kingdom (or Ireland) or through the parallel import procedures. Under these procedures (which are part of the block exemption requirements intended to enable the consumer to buy a car wherever prices and quality are most advantageous) RHD models have to be made available in LHD markets, where they are not normally offered, at prices related to those of the comparable LHD models sold in those markets. The procedures (discussed more fully in paragraphs 13.120 to 13.125) are cumbersome and do not appear to have been generally effective. There are other major RHD markets, chiefly in Japan and parts of the Commonwealth, but differing type approval requirements and other factors mean that the products sold there are effectively unavailable to the United Kingdom buyer. Besides isolating the United Kingdom and Irish markets, RHD imposes some small cost and price penalties in the case of some low-volume models. Most major multinational manufacturers plan from the outset for RHD and LHD versions of all their model ranges and spread the development costs across all their output. But some non-United Kingdom EC-based producers develop LHD models first, and only later, depending on estimated demand, will offer an RHD model. The extra cost incurred may be more than offset by the increased volume of sales.

Company cars

13.48. A further factor differentiating the United Kingdom car market is the growth in the provision of company cars and the effects that this appears to have had, in particular on the types and specification of cars purchased and on their pricing. We discuss here the effects on specification. The effects of the company car on pricing are discussed in paragraphs 13.73 to 13.77.

13.49. We discuss the widespread and detailed specification differences between markets for apparently comparable cars in the account of our price comparisons in Chapter 8. Many witnesses drew our attention to the fact that the model variants sold in the United Kingdom were usually more highly specified than comparable cars sold elsewhere in the EC. Sun-roofs and high-quality in-car entertainment were often mentioned as features demanded as standard in the United Kingdom but usually optional elsewhere. It is not easy to explain why the United Kingdom buyer should be offered more highly-specified model variants than buyers in other EC markets. Social factors appear to be at work since the consumer in the United Kingdom seems to attach importance to the car's contribution to social status and personal image. There was, however, general agreement among those who gave evidence to us that the growth in the company car market in the United Kingdom has played a major role in this development. The use of company cars has been growing at senior management levels in other EC countries, particularly in Germany, in recent years but it still remains a far more influential factor in the United Kingdom market, particularly at middle and junior management level. Problems of definition make it impossible to give a precise estimate but it seems reasonable to conclude that between 50 and 60 per cent of all new cars registered each year in the United Kingdom are bought by the non-private sector of the market, ie they are bought by public authorities, or by rental companies, or by business users of every description. Within that total most company car users have a significant element of private use, which is a taxable benefit but is nonetheless an attractive supplement to salary.

13.50. This feature of the private use of a company car has been seen on this scale only in the United Kingdom. The main impetus for its development seems to have come from the combination in the 1960s and 1970s of statutory and non-statutory pay restraint policies and high marginal rates of income tax, which made the offer of a car an attractive means of motivating, recruiting and retaining staff. The continuance of high marginal income tax until the mid-1980s reinforced this growth, as has the extension of the benefit to local authorities' and National Health Service employees. The arrangements for taxing the benefit to the company car user also encouraged the provision of these cars.

13.51. The level of taxation of the benefit of private use of a company car has been increased in recent years. It has been put to us that the benefit to the user is now fully taxed and that after the fiscal measures announced in the 1991 Budget take effect, employers may move to offering salary increases instead of cars. However, we have seen few reports of this actually happening so far. If the user were paid an additional sum in gross salary intended to be sufficient, after tax, for him to meet the full purchase and running costs of the same car as he had before, the net effect for the employer or the employee would depend on the circumstances of each case. The factors involved are discussed in Appendix 4.7. They suggest that for the majority of company car users the benefits of use of the car considerably outweigh the additional income tax paid. These benefits include free insurance, free repairs, usually a replacement car when his own is off the road and none of the loss of capital and interest that is the principal cost of car ownership.

13.52. Cars that are required for the employee to do the job (`tools of the trade' cars) are more likely to be chosen by the employer, but the employee who is offered a car as a `perk' is usually given a choice, either within a specified list of models or within a given price bracket. If such an employee (often referred to as a `user-chooser') wants to add extras these would normally have to be paid for out of his own pocket, as their cost is unlikely to be recouped on resale. The effect of company cars on specifications was given impetus by the major manufacturers' realisation that an effective way to compete in this important market, within the price limits set by the tax arrangements, was to incorporate as standard features in their models attractive extras, eg a sun-roof, central locking, electric windows, and a stereo radio/cassette system. As shown in Appendix 8.1, the difference in level of specification between the United Kingdom and the rest of the EC is much less marked in the small segment, where there are fewer company car purchasers. However, our own review of the development of specifications and model variants over the period 1955 to 1990 showed little evidence to support the frequently expressed view that the onset of widespread company car allocation had also been linked with a significant increase in model variants.

13.53. The present tax system disadvantages the private buyer and screens out a large part of the market from consumer choice based on personal economic considerations. The way in which company car tax is banded by the car's engine size and market value has encouraged the provision of more highly-specified cars at particular tax-band thresholds. For example, if an employee had the use of a company car costing, say, £15,000, in the 1.4 to 2.0 litre band, and had `average business mileage' of between 2,501 and 17,999 miles, his taxable benefit (ie scale charge) would be £2,650, ie 18 per cent of the price. If, however, the price was £19,250 (the first value band limit) the taxable benefit would remain the same, but it would represent 14 per cent of the price. Similarly, the taxable benefit, within this mileage band, on a car costing £19,251 would be £5,500 (29 per cent of the cost); if the price was £29,000 it would remain at £5,500, but this would represent 19 per cent of the price. This tax structure serves as an inducement, at least from the employee's point of view, to push the specification up to the next threshold of the taxable benefit. Since the allocation bands specified by the employer do not usually coincide with the thresholds the employee has an incentive, unless he crosses a tax threshold, to spend up to the highest level permitted by his employer and choice is thus distorted; for example, he may prefer to take a smaller-engined car but with value added by a higher specification.

13.54. While at particular times the main impetus for these developments may have come from the company car buyer the same tastes tend to spread to the private buyer since he must be influenced by the same models as the company buyer when contemplating a new car purchase. The contribution of the motoring press towards the demand for high-specification cars in the United Kingdom should also be noted. These magazines are widely read and are usually regarded as the main source of data and opinion on new models; they give a complete listing of the prices and performance of all models currently available. Reviews of new models and variants, and reports on technical and other developments, stress performance and specification and identify what they regard as competitive shortfalls between models. It appears likely that the United Kingdom consumers' preference for a higher level of specification as a standard feature for both private and company purchase will continue to be an important feature of the markets.

The SED system

13.55. The distribution system for cars combines as its key elements selectivity with exclusivity, but these are separate forms of restriction which do not necessarily co-exist. Selectivity is the right of the supplier to adopt a distribution system under which it supplies only those chosen dealers who meet its required standards, and under which those dealers are forbidden from reselling cars to anyone other than end-users or other resellers approved by the supplier. By its nature the requirement is not normally subject to qualification or exception. By contrast exclusivity can be (and often is) not an absolute but a qualified restriction. Thus a supplier may agree that within a given territory it may give its dealership exclusively to one dealer but nevertheless reserve the right to appoint additional dealers in the same territory at a later date. Equally a dealer may agree to sell at particular premises only cars manufactured by the supplier but may be allowed to sell other suppliers' cars at other premises within the territory.

13.56. The full range of rights and obligations of the supplier and the dealer are set out in an agreement, usually supplemented by a selection of supporting documents and policy statements, and are discussed more fully in Chapter 6. However, most suppliers' agreements with their dealers have a number of common features. Cars are supplied to the dealer at a price calculated by deducting a fixed percentage margin from the list price (less tax) set by the supplier. The dealer is then free to set his own selling price but in most cases may not exceed the list price. Cars are usually supplied to the dealer on a sale or return basis. The dealer does not become liable to pay the supplier until he `appropriates' the car, eg when contracting to sell it to a customer, or buying it for his own purposes, and he then becomes liable for Car Tax and VAT. The dealer is usually expected to sell the supplier's complete range of cars and detailed sales targets are set for each segment of the market. There is a complex system of bonuses for fulfilling these targets for sales of cars and other products and for achieving prescribed standards of quality of service. This is usually supplemented by a marketing plan revised monthly or quarterly, offering special dealer and customer incentives for increasing the sale of particular models.

13.57. A dealer may sell to customers outside his territory who approach him, but his freedom to seek or promote sales outside his territory is usually restricted. A dealer is always required to offer servicing for the supplier's cars whether or not sold by him. Many suppliers also impose restrictions, not included in the agreements but notified to dealers as and when the supplier thinks necessary, on the number of the supplier's dealerships that can be held by a dealer, on their location, and on the total volume of cars that may be handled by a single dealer (or dealer group). Other suppliers have no such limits, or limit only the total number of dealerships. Some combine an overall limit on numbers of dealerships with a proviso that they should not be held in adjacent territories.

13.58. A dealer usually undertakes not to sell competing new cars from the same site. This gives rise to the most obvious feature of the system from the consumer's point of view; for only a handful of low-volume makes is he likely to be able to see more than one make of new car at a dealer's premises. Taking on competing dealerships within the territory is often forbidden and the supplier's agreement is generally required for the taking on of any new dealership outside the territory. Ford, the most restrictive in this respect, does not allow any other dealerships competing with its own to be held by a dealer within 30 miles of his territory. Ford also places restrictions on the freedom of a dealer to engage in car-related activities outside his territory such as owning car rental businesses or second-hand car outlets.

13.59. Although the dealer is nominally an independent businessman, responsible for providing most of his own capital resources, the range and detail of suppliers' requirements leave him more in the position of a franchisee. Like the franchisee he risks his own capital in funding the setting up of his business and its daily operations. Whilst the supplier will clearly have some commercial risk if its dealer ceases to trade for insolvency or other causes, its own capital is not thereby threatened (as it would be if it was in partnership with the dealer). By contrast the dealer is always vulnerable to the termination of the agreement (even if reasonable notice has to be given by his supplier) since he has no interest in the franchise to dispose of and if he cannot transfer to another franchise on the same site the cost will be substantial: for this reason he will be unlikely to initiate or take part in activities that may disturb his relationship with the supplier or his fellow-dealers. His main freedom is in setting individual retail prices, though even in this field a supplier can exercise pressure or `counsel' a dealer to prevent discounting on a scale it regards as undesirable-and during the course of the inquiry we learned that a supplier had acted in this way (see paragraph 12.3.19). The Retail Motor Industry Federation (RMIF) and the Scottish Motor Traders Association (SMTA) drew to our attention their concern that dealers are, by reason of the Restrictive Trade Practices Act 1976, unable to agree the terms of dealer agreements collectively with a supplier. There is for all these reasons a marked imbalance in bargaining power between suppliers and dealers.

13.60. The SED system, with some variations often reflecting legislative intervention, is used by the car industry in free markets throughout the world and by all but the smallest suppliers in the United Kingdom. In the EC it enjoys an EC Commission block exemption which recognises the benefits conferred by the system. The Recitals to the Regulation note that co-operation between manufacturers and dealers ensures that a pre-delivery inspection is carried out and that specialist facilities and staff are available to provide service for a product which may require maintenance and repair at any time, in any location over a prolonged period; concentration by the dealer solely on the supplier's product promotes inter-brand competition; and that the allocation of dealer territories leads to greater knowledge of the market and fulfilment of customer requirements, widespread market coverage and deeper penetration, and facilitates the maintenance of high standards. The extent of the restrictions imposed on dealers as part of the system and their effects on prices and competition are, however, issues which we discuss later, in paragraphs 13.138 onwards.

Entry and market share

13.61. The United Kingdom market at present has well over 40 suppliers of every type and size. In 1990 Ford had one-quarter of the market but there were two other suppliers, Vauxhall (16 per cent) and Rover (13 per cent), with over 10 per cent and five more[1] with between 3 and 10 per cent. In total 16 suppliers each had more than 1 per cent, together holding about 95 per cent of the market. In the 1970s there were major changes in the structure of the market, reflecting the collapse of the market share of BMC/BLMC/British Leyland/BL (in its various forms) from 38 per cent in 1970 to 18 per cent at the end of that decade. Imports, chiefly from the EC, increased from 14 per cent to 57 per cent over the period. Since 1980 there has been much greater stability but Vauxhall's share, which remained at the 10 per cent mark in the 1970s, increased by more than half in the early 1980s. Ford's share fluctuated round 25 per cent for most of the 1970s. It reached a high point of about 30 per cent in 1987 and has fallen steadily over the last four years back to the 25 per cent level. In the last few years Peugeot's market share has also grown from around 4.5 per cent to over 6 per cent in 1990.

13.62. Of the 25 or so smaller suppliers some, such as Rolls Royce, are well-known and long-established names. Others are comparative newcomers. During the 1980s there were six new entrants into the United Kingdom market, mainly from the Far East and Eastern Europe. None has yet gained a 1 per cent market share. Of the six, Proton has had the greatest early success in gaining a market share of half of 1 per cent in two years. Further increases in market share after an entrant's first few years may be more difficult, to judge from the example of the Lada marque, which entered the market in 1974, gained a 1 per cent market share by 1977, but has seen little increase since. As it is not usually economic for a new supplier to set up immediately its own network of dealers, it will have to find other suppliers whose dealers it can share, or find some other type of outlet (for example, a used car business). It may sometimes find difficulty in building up a network of the size and quality it wants. Several suppliers drew attention to restrictions imposed by the larger suppliers on their dealers holding competing franchises as a factor restricting their growth. On the other hand, NMUK envisages few difficulties in Nissan Motor (GB) (NMGB) building up a new distribution network, following the severing of Nissan Motor's arrangements with Nissan UK, to secure a substantial share of the United Kingdom market. But NMGB has the advantage of a well-established name and there are some 150 existing dealers, not owned by Nissan UK, who had invested in a Nissan UK franchise and have undertaken to continue with it under NMGB. For suppliers without the resources to establish themselves as major players suppliers' restrictions on their dealers holding competing dealerships may be a handicap.

13.63. Substantial media advertising is needed to establish and support the brand image (see paragraphs 7.42 onwards). Smaller suppliers and new entrants need to spend considerably more proportionally to sales, to achieve results.

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[1] Peugeot, VAG (UK), Nissan UK, Renault and Volvo.

Price setting

List prices

13.64. Before considering the evidence on price levels we describe the process of price setting. Both independent and tied importers set list prices in close consultation with their overseas supplier, and those United Kingdom manufacturers that are subsidiaries of overseas companies, notably Ford, Vauxhall, NMUK and Peugeot, do so in consultation with the European co-ordinating divisions set up by their parent companies. We understand that list prices in other EC countries are set by national sales organisations or importers in the same way. The list price, set by the supplier, declares the car's competitive position in the market. The United Kingdom list price, including Car Tax and VAT, is often described as the recommended retail price although few sales take place at that price. Some suppliers' agreements require dealers to treat it as the maximum retail price. Cars are supplied to dealers at invoice prices equal to these list prices (less tax) less a dealer margin, usually in the range of 14 to 18 per cent depending on the model. We noted with interest that in the closing stages of our inquiry Vauxhall introduced a model, the new Astra, at a lower list price than the old Astra, and with a dealer margin of 10 per cent. The supplier's margin on a given model is the same to all dealers and on all sales to dealers, regardless of the dealer's size or the volume of purchases. Dealer margins in the United Kingdom are generally a few points higher than the margins given in other EC countries.

13.65. As described in paragraphs 7.50 onwards, suppliers compete closely with each other on price and specification, analysing and matching their immense variety of models down to model variant levels. Although some suppliers, including Ford, drew attention to the underlying aim of setting prices to cover costs, almost all stressed that list prices were chiefly influenced by competitors' prices and adjusted to satisfy market share and profit goals. Smaller suppliers argued to us that in each segment there was a market leader whose actions in terms of pricing and specifications largely determined their own. Ford was said to lead the small and lower medium car segments with the Fiesta and Escort models respectively. Vauxhall led the upper medium with the Cavalier. The existence of a leader meant that, after allowing for differences in specification, others could not price too far out of line and hope to retain sales unless like Rover they were deliberately seeking an up-market image. If a market leader introduced what was previously an optional extra as a standard feature without a price increase, other manufacturers would have to follow suit or lose market share.

13.66. Competition on price is the result not only of suppliers' seeking to increase sales and market share (inter-brand competition) but also of the dealers for each supplier competing with each other (intra-brand competition). Customers are thus able not only to make comparisons between the different cars offered by the various suppliers but also between the terms offered to them by different dealers for the same car. Given the relationships between supplier and dealer the main thrust of competition is inter-brand and is powered by manufacturers' price-setting and promotional activities. The system by which dealers are allowed a margin based on the list price, together with the suppliers' substantial marketing programmes, drawn up in great detail to promote specified models below list price at particular periods, gives suppliers some control over the general level of transaction prices. The dealer, however, retains a considerable measure of freedom as to the terms he agrees with any particular customer and most cars are sold by dealers at a discount off list price negotiated with the individual buyer.

Price negotiations

13.67. Consumers seeking to make an informed decision have to consider information on a multiplicity of models with complex specification differences in order to decide, on the basis of list prices, which cars might suit their needs. Our own price studies showed the difficulties in assessing the value of different specifications, even with the most expert appraisal. Consumers may be aware that discounts are being offered in the market but the amounts are not published by dealers and usually there is no public source of information that will indicate precisely what may be on offer.

13.68. Most suppliers stressed to us, particularly in criticising our price study, that not only list prices but also telephone quotations overstated actual transaction prices: only by personal face-to-face negotiation could the buyer discover the true price on offer. This is no doubt correct. However, we noted that articles in motoring magazines use telephone enquiries as the basis for advising their readers on the size of discounts; that telephone negotiation is the sole basis on which car brokers conduct their business; and that the SMMT commended telephone enquiries to us as a means of establishing the availability, although probably not the full size, of discounts. Even if the consumers have a firm preference for a single model they will have to negotiate with a number of dealers for that franchise to be sure they have secured the best offer. If they are considering more than one maker's model selected on list price the final decision may well be swayed by the size of the discounts on offer and this multiplies the scale of effort required. Even when a private consumer is well-informed and ready to negotiate, the discount available will be influenced by factors he cannot assess, such as the dealer's stocking position or anxiety to make a particular sale to achieve a bonus (related, perhaps to the volume of his sales in a period). The company car buyer, however, is likely to be better informed on the state of the market and to be buying on a larger scale and at regular intervals, all of which will give him a clearer idea of the discounts available and enhanced market power to obtain them.

Discounts

13.69. The size of the discounts given by dealers to customers is a notable feature of the United Kingdom car market and is reflected in the marked disparity between list and transaction prices. It has always been possible for company buyers and some knowledgeable private customers to obtain discounts on published prices in negotiation with dealers but in recent years it appears that a large number of buyers have been receiving significant discounts. In addition larger fleet purchases receive volume discounts from suppliers. The discussion in paragraphs 7.84 onwards suggests that in 1990 the average discount to all types of customer, including both dealer discount and any additional contribution from the supplier, was about 15 per cent.

13.70. This average, however, conceals not only wide variations between customers and types of customer but also wide variations between makes and models. Traditionally discounts were not offered on some makes, usually quality marques such as BMW and Mercedes-Benz, but in the buyers' markets of 1990/91 discounts appear to have been almost universally available-though still differing widely between makes.

13.71. Fleet[1] buyers, usually those with an existing fleet of 25 or more cars, tend to be offered higher discounts by dealers than non-fleet customers. In addition, the larger fleet purchasers usually secure additional discounts from suppliers on a sliding scale, related to volume, and the biggest purchasers buying thousands of cars in a year can secure combined supplier/dealer discounts of 40 per cent or more off list price. The large discounts given by some major suppliers to the larger daily-rental hire fleets reflect the promotional value the suppliers place on their cars being in a position where the potential customer can see them and has the opportunity to drive them. Large discounts are also given to suppliers' employees, and employees' relatives, whose purchases can account for as much as 7 per cent of a supplier's annual new registrations. In our discount survey (which is described in paragraph 7.86 and covered all categories of customer except fleet buyers) the discount on individual transactions in 1990 varied widely but 73 per cent of transactions involved discounts of between 6 and 18 per cent. On average private customers received about 11 per cent and smaller company (non-fleet) buyers perhaps 2 per cent more. That survey gives us no information on fleet discounts; however, the work by A T Kearney Ltd, consultants to Vauxhall, supplied for our price survey suggested that in 1990 Vauxhall dealers' discounts to fleet customers averaged 16 per cent. Our own estimates suggest that when suppliers' additional direct discounts are added total discounts received by fleet customers averaged 22 per cent, ie about double those received by private customers. This comparison, however, overstates the fleet buyers' comparative advantage since some allowance must also be made for suppliers' financial benefits to private consumers which other consultants' evidence suggested might on average be worth 4 to 6 per cent off the list price.

[1] Suppliers have varying definitions of a fleet buyer: see paragraphs 4.34 to 4.36.

13.72. Given the variability of discounts and the lack of published information on them it is not surprising that private consumers appear uncertain about the likely final price for their chosen car. Our consumer survey (see paragraphs 7.80 onwards) showed that around one-third of purchasers expected no discount, but that some did in fact receive one. In the majority of cases, however, the size of discount received was fairly similar to that expected.

Price distortions

13.73. We discussed the effect of the company car on specification in paragraphs 13.48 to 13.54. The importance of the company car in the United Kingdom has also distorted the structure of prices. As explained above, the company car buyer may benefit from both dealers' and suppliers' discounts. Dealers offer higher discounts on such sales, which are likely to be attractive because of the possibility of repeat business. While we have no direct information on the level of discounts in earlier years it is our impression that the difference between the average discounts to the two groups was wider when the car market was more buoyant than at present.

13.74. The second reason for fleet buyers receiving lower prices than private customers is the additional discounts given by most of the major suppliers to substantial fleet buyers. For most suppliers these are given only on purchases of more than 100 vehicles in the year. At the upper end, very large fleet customers usually buying thousands of cars a year, such as the car-rental companies, driving schools, and large private sector companies, received discounts of up to 40 per cent from the dealer and supplier in combination. Ford estimated that such customers received between 31 and 35 per cent from it during 1986 to 1989 and between 36 and 40 per cent in 1990. Table 7.38 shows that in 1990, in respect of fleet sales on behalf of seven main suppliers (excluding Rover), over half had combined dealer and supplier discounts of between 16 and 20 per cent and one-fifth had discounts of between 31 and 40 per cent. Fleet hire management specialists were able to improve their discounts by aggregating the orders for the individual fleets they managed.

13.75. The managers of car fleets of any size have the advantage of specialist knowledge and experience as well as buying power. As a result the company car user whose car is a perk is usually enjoying the benefit of a car bought at a substantially lower price than he would pay for the same car as a private consumer. Indeed one effect of the `company car culture' is to replace multiple individual personal purchases by centralised company purchase.

13.76. The higher prices paid by the private consumer finance the higher discounts given to the company car buyer by both the supplier and the dealer. A number of suppliers argued that the direct discounts given to large buyers were determined entirely by market forces and did not affect the level of margin given to the dealers or other financial benefits they provided for private consumers. We do not accept that the private consumer is unaffected. The major suppliers, with their high proportion of sales to large fleet buyers, have to retrieve from other buyers the substantial revenues forgone by offering extra discounts on these sales, in order to achieve overall profitability, and to keep their United Kingdom operations viable over time. This distorted price structure is maintained by restrictions in the SED system. If dealers were able to realise their full potential, and competition between dealers were less constrained, we would expect them to take the opportunity this situation would provide of promoting business outside their territories and thus developing sales, particularly those to private customers, which provide them with better margins. To increase these sales they will have to offer better terms to their customers, particularly as the latter become more aware of the discounts potentially available. As dealers get stronger they should in time be able to secure from their suppliers an improvement in their trading terms which would mean an increase in their margins in one form or another, depending on how suppliers decided to modify their financial arrangements with dealers. We discuss later the present constraints in the system that prevent this sort of outcome.

13.77. Such an improvement in dealers' margins would in itself lessen the distortion as suppliers, in order to maintain their rates of profit, would have to review their prices to other customers, and the pressure from dealers for better margins could be expected to translate into a reduction in direct discounts to the large fleet customers. The distortion in discounts that currently exists between private and fleet buyers would in this way be reduced.

The level of United Kingdom prices

Price movements

13.78. We examined the trend of United Kingdom car prices relative to the general level of inflation in the main supplying countries (see paragraphs 7.32 onwards). There is a difference of only about 7 per cent between these estimates, spread over a five-year period. However, the indices of car prices are not fully adjusted for specification improvements. A number of suppliers produced evidence that suggested that specification improvements would account for the difference and it does not appear to us implausible that most of this difference would be accounted for if specification changes were fully incorporated. The estimates we refer to reflect list rather than transaction prices and we have no evidence on comparative discounts over the period. Taking account of all these factors we do not think that the increase in average United Kingdom car prices over the period can be judged to have been unreasonable in relation to changes in the general price level.

13.79. Given the market structure and the position of Ford as a scale monopolist we looked for evidence of price leadership. Ford has usually, but not always, been the leader in terms of timing, regularly making the first move in price rounds which occur two or three times a year. Other suppliers tend to follow quickly but they do not always follow Ford in the size of their overall price increases, and within those overall increases there is often considerable variance in the increases on individual models, as suppliers try to reposition them in response to developments in the competition. While Ford is the overall price leader, it is not regarded as the market leader in all segments and its behaviour often responds to that of its competitors, particularly in adjusting the position of individual models. For example, its September 1991 increases did not include the Escort, on which it delayed a decision until the new Vauxhall Astra was priced. There is some evidence that movements in exchange rates have led some importers to make larger changes to their prices at particular periods than domestic manufacturers, but over the longer term importers' prices have tended to come back into line.

13.80. We also noted that these price increases tend to take place at regular intervals regardless of the state of demand. For example, despite weakening of the market in 1990 and the collapse in 1991 Ford introduced price increases through 1990 totalling 15 per cent with further increases of 3.2 per cent overall in January 1991 and 3.8 per cent in September 1991. Suppliers argued that these list price increases were less important than movements in transaction prices. We noted evidence that average discounts given to customers by dealers have increased over the last two years by a few points and that the level of financial support from suppliers has increased. This response appears natural in situations where falling demand is combined with a continuing increase in suppliers' costs and profitability is falling sharply.

Profitability

13.81. In order to consider profitability in the industry we divided the larger suppliers into three groups: those which manufacture cars in the United Kingdom, those importers which are subsidiaries of the manufacturer, ie tied importers, and those importers which are independent of the manufacturer. The manufacturers supply more than 60 per cent of the market as measured by registrations in 1990 and include the three largest United Kingdom suppliers. We considered first their total business and then analysed separately results for cars, parts and other activities. We then separated the wholesaling of new cars from manufacturing. At each level problems of allocation arose.

13.82. We also had to assess the validity of transfer prices. Segmentation of United Kingdom manufacturers' results between manufacturing and wholesaling required the companies to establish transfer prices for the two stages of what they normally regard as an integrated process. Even more important the financial results of both the tied importers and the manufacturers are dependent upon cars being supplied by overseas parent or affiliated companies at agreed transfer prices, in most cases set by a process of `net back' from list prices. We were not able to examine the relationship of these transfer prices to costs and to determine to what extent profits were earned within the United Kingdom as opposed to overseas on these imported cars. While we received information on operations in the United Kingdom we were not able to compel the production of information about operations outside the United Kingdom. A few companies based outside the United Kingdom made clear that information would only be supplied by their United Kingdom subsidiaries and about matters within the subsidiaries' direct knowledge. The parent companies of most United Kingdom car suppliers are based outside the United Kingdom and operate internationally.

Without a full examination of the car manufacturing and wholesaling activities undertaken overseas by these companies, it would be impossible to reach a conclusive view on the true level of profitability in the United Kingdom. Our results have to be considered with these qualifications in mind.

13.83. The financial results of the suppliers, which are considered in Chapter 10, show that over the five years from 1986 to 1990 the average return on capital employed (ROCE) on the supply of cars as a whole for the manufacturers and both groups of importers is below the ROCEs for all industrial groups as provided to us by the Bank of England. The independent importers' ROCEs have been relatively stable over the five-year period but also at a level below the average for all industrial groups. The tied importers' ROCEs were poor except in 1988 and 1989, at the peak of the market.

13.84. It was put to us that ROCE is not a suitable measure of performance for those manufacturers which were assemblers and importers of both cars and parts rather than fully-integrated manufacturers in the United Kingdom, and which had cyclical investment requirements. The major manufacturers told us that they used net margin rather than ROCE as their measure of performance. We recognise that ROCE has to be used with care. It is, however, widely used and, given that during the five-year period Ford, Vauxhall and Peugeot among the main United Kingdom manufacturers have each had ROCEs in individual years which were significantly above the Bank of England figures, we considered it necessary to examine their performance more closely.

13.85. As is more fully explained in Chapter 10, the profitability of the United Kingdom manufacturers is particularly dependent upon high-capacity utilisation, which is in turn dependent upon the United Kingdom economic cycle and the mix of imports and exports in the manufacturers' sales. Ford is the only United Kingdom manufacturer which, apart from a small loss in 1984, has a consistent record of profitability over the ten years from 1981 to 1990 (see Table 10.8). Ford's profits have declined since 1988. In 1990, as a result of the acquisition of Jaguar, Ford lost £275 million before tax due to significant interest charges. Neither Vauxhall nor Peugeot earned significant profits before tax before 1987. It is only since 1987 that these two manufacturers have become profitable due to a combination of a significant improvement in productivity, increased capacity utilisation as the overall car market expanded in the period 1986 to early 1990, increasing market shares and increasing car production in the United Kingdom. Ford, however, has suffered from static car production in the United Kingdom during 1987, 1988 and 1989, followed by a 14 per cent fall in 1990.

13.86. The manufacturers' published accounts show that over the period 1987 to 1990 Vauxhall's operating margins have improved from 3.2 to 7.3 per cent and those of Peugeot from 3.3 to 5.4 per cent; but those of Ford have declined from 5.4 to 3.4 per cent (see Table 10.8). Rover's returns have been relatively poor throughout the period 1986 to 1990; an improvement in 1987/88 was not sustained in later years.

13.87. Over the period 1986 to 1990 the average net profit margin (before interest and tax) of the 17 major car suppliers in the United Kingdom was 3.1 per cent. This ranged from 1.5 per cent for the tied importers to 3.9 per cent for the independent importers, with the United Kingdom manufacturers earning 3.3 per cent. For the importers these margins relate only to wholesaling while for the manufacturers they relate to manufacturing and wholesaling. For the manufacturers this overall margin when segmented showed an average net margin of minus 0.2 per cent on wholesaling and a positive net margin of almost 6 per cent on manufacturing. This segmentation, however, is based on transfer prices that are subject to the qualifications noted earlier (see the discussion in paragraph 10.65).

13.88. When segmented by product, we saw that all suppliers earned significantly higher net and gross margins on parts than on cars or other activities.

13.89. We examined the results of a sample of dealers who responded to our questionnaire and trade publications which were based on composite returns of dealer performance for a number of franchises. These showed overall net margins on all activities in 1989 and 1990 of about 2 per cent with higher margins for Japanese and specialist franchises. The contribution of individual departments could only be analysed at the departmental margin level but this showed significantly higher margins on parts, servicing and bodyshop operations than on new and used car sales, with the first three activities accounting for only 15 per cent of turnover but contributing over 50 per cent of departmental profits.

13.90. We have reviewed the information available to us on the profitability of the car suppliers on all car activities, both averaged over the period and year by year, and the profit margins they earn on cars. This does not show unduly large profits being earned by either manufacturers or importers in the United Kingdom market. The results, however (apart from those of Rover), are dependent upon the transfer prices adopted by both manufacturers and importers. We have been unable to satisfy ourselves that these prices strike a proper balance between profits earned abroad and in the United Kingdom and thus that they correctly reflect the profitability of the suppliers' operations in the United Kingdom. We are therefore unable to reach a view on the true level of the profits earned on the supply of cars in the United Kingdom over the period we studied by those suppliers whose main operations are controlled outside the United Kingdom.

Price comparisons

13.91. In making the reference that led to this inquiry the DGFT drew attention to apparent discrepancies in prices between the United Kingdom and other EC countries. This issue remained a matter of public debate throughout the inquiry, and a good deal of the evidence put to us related to it. We recognised that an analysis of price differences was an important task in our inquiry and, noting that earlier studies by such bodies as BEUC had been comprehensively criticised by the major car suppliers, we engaged consultants, Ludvigsen Associates Ltd (LAL), to carry out a detailed study on our behalf to establish the extent of the differences, both for list and transaction prices, between the United Kingdom and other EC markets.

13.92. A full description of the study and its findings is set out in Chapter 8 and the reports on Phases A and B of the study are at Appendix 8.1 to this report. On the basis of a first report (Phase A) we selected six EC countries in which prices were to be studied. We then chose 20 models in volume production and representative of the main segments of the car market and major suppliers; for each of these a variant was selected that was sold in significant numbers in each of the chosen countries (except for the chosen Rover model). List prices for these model variants were secured in these countries and adjusted for specification differences (Phase B of the report). Because of the difficulties in securing satisfactory information about the prices quoted by franchised dealers outside the United Kingdom, the Harris Research Centre (Harris) was employed to seek price quotations by means of a telephone survey. In the United Kingdom most private purchases of new cars are coupled with a part-exchange transaction in which a discount on the new car is often given by way of an `over-allowance' on the old car. In carrying out the LAL study it would have been impossible to adjust for this factor. Quotations for on-the-road prices were therefore sought from a representative sample of dealers on the basis of a cash purchase without part-exchange. The results were presented in Phase C of the LAL Report and an interim version was made available to all suppliers as an annex to our public interest letter.

13.93. Ford, Vauxhall, Rover and Renault each provided us with studies of price differences that they themselves had carried out or commissioned from independent consultants. All showed United Kingdom prices lower in relation to those in other EC countries than did the LAL study. While different in scope and approach from the LAL study, all helped to illuminate points of difficulty or disagreement in an area where comparisons are complex and difficult. These studies and the comments of other suppliers led to detailed comparisons and reconciliations of specification differences by LAL with the parties over several months. These are discussed in the attachments to the Phase B report and described in paragraphs 8.28 to 8.35.

Comments on the LAL Report

13.94. We received criticisms of various aspects of the LAL Report. We also received serious complaints from two of the major suppliers, Vauxhall and Ford. Vauxhall, following the recent publication by a company associated with LAL of a report on the motor industry, suggested that LAL had made use of the work it had carried out for us, and of information supplied in confidence by Vauxhall, in a publication made with a view to commercial gain. It was suggested that a breach of the prohibition, in section 133(1) of the Act, on the disclosure of information, might have occurred.

It was further suggested that the publicly-stated position of the associated company in its report (to which LAL had contributed) on a number of issues central to our inquiry laid LAL open to allegations of actual or potential bias. We were therefore requested to expunge from our report all reference to the LAL work and to base no conclusions on this work. Ford argued that LAL's apparent commercial interest in a marketing venture whose success, it had been reported, was not consistent with selective distribution in its present form was incompatible with LAL's role as our consultant. Ford stressed the need to ensure that any such conflict of interest had not affected the substance or impartiality of LAL's work for the MMC.

13.95. We deal first with the criticisms of methodology and findings of the report and then with the allegation of bias.

Selection of markets

13.96. Suppliers criticised the choice of EC markets because of the alleged distorting effects on some of taxes, price controls, and the absence of a locally-based car manufacturing industry. In particular it was put to us that prices in Belgium had been kept artificially low by a regime of price controls, and that these low Belgian prices had also distorted prices in the Netherlands. We were urged to concentrate our comparisons on the French and German markets since they had substantial indigenous production and were in this and other respects more like the United Kingdom market. We recognised that pricing levels in Belgium and the Netherlands might be affected by special factors but considered it important to include these countries in our study, given that most public discussion of prices takes them as the bench-marks.

Selection of models

13.97. The selection of model variants was complicated by the fact that it is rarely the case that the same range of variants is offered in each market. It was argued that some of the model variants we had chosen were not properly comparable or were not typical for various reasons. We accept that the 20 model variants chosen were only a small fraction of those available in the market at the time but we consider them sufficiently representative to provide the basis for an examination of price differentials in the market as a whole and for broad segments within it. Our conclusions do not, however, provide a basis for judgments about the pricing policies of individual suppliers. We ourselves accepted that the (pre-1991) Metro did not fully meet our criteria because of its small sales outside the United Kingdom but it was included because we decided that Rover's position as the largest United Kingdom manufacturer must be recognised and the Metro came nearest to meeting the other criteria. Discussions with Rover later disclosed that the Metro's pricing was, to an exceptional degree, affected by its small sales volume and lack of established reputation in the overseas markets.

Specification differences

13.98. In no case were we able to select a United Kingdom model variant which was exactly the same as the model variant offered in any of the other countries in the study. Even when apparently similar model variants were offered in several markets, there were always specification differences reflecting national statutory or administrative requirements and consumer tastes. For example, to take only a few of the more obvious differences, catalytic converters are required or encouraged in some markets, seat warmers are welcome in northern climates, sun-roofs are popular in the United Kingdom but not in Mediterranean countries, and the United Kingdom buyer appears to attach importance to a high level of in-car entertainment (which can sometimes be valued at 10 per cent of the price of a car). There are innumerable smaller specification differences. We noted that the studies by BEUC had taken into account only major differences. In the interests of accuracy we thought it necessary to compile as complete a list of differences as possible, down to minor trim variations. As the LAL Report shows, this can entail as many as 20 or 30 adjustments, many involving quite small sums. These lists were checked with the suppliers and their consultants and represent an exhaustive analysis of specification differences between similar model variants.

13.99. For most of these specification differences price adjustments have been valued on the method used by the suppliers which is market- rather than cost-based. In most cases the adjustment was based on the retail price of the equipment or trim variation when offered as a separate option in as comparable a situation as possible. In a small proportion of cases, where no appropriate option prices were available, LAL based a valuation on the prices of similar items on comparable cars of other suppliers. With only a few exceptions, agreement was reached between LAL and suppliers' representatives on the specification-adjusted figures. The specification-adjusted list prices provided by LAL are shown in Tables 13 to 16 in Appendix 8.2.

Availability of discounts

13.100. In this and the following paragraphs we discuss the further work we ourselves did in response to other criticisms of our approach. We recognised that account must be taken of the availability of discounts. It can be argued that list prices should be the measuring rod, since they are what the dealer would hope to achieve in satisfactory market conditions and since the size of discounts is not publicised and not all customers receive them. However, most consumers know of the existence of discounts if not their extent, and most benefit to some degree from them. We accept that the results of the Harris telephone survey underestimate individual discounts that might have been available if telephone enquiries had been followed up by face-to-face bargaining. Only Ford and Vauxhall have provided us with direct evidence on discounts in other EC markets for their models. Renault has provided direct evidence of United Kingdom discounts and estimates elsewhere. Although this evidence is not comprehensive we have adjusted the LAL transaction prices to incorporate the companies' data. The effect is shown in Table 8.16.

13.101. Various suppliers urged us also to take into account other incentives offered; typically free insurance, free or low-cost finance, or free membership of motorists' organisations. These benefits can be of substantial value in an individual transaction and during the period have been widely used. We have taken account of information provided to us by Ford and Vauxhall on the size of these benefits in relation to total sales to construct an estimate of the benefit on the average transaction in the United Kingdom and the other countries. Nonetheless, these offers are available only on particular models and for limited periods, and many consumers, for various reasons, do not take advantage of them. For those who do the value varies according to their individual circumstances. The benefit on any individual transaction therefore is likely to vary widely from the average.

Exchange rates

13.102. The exchange rates ruling on the date of the survey inevitably affect international comparisons of prices of this kind; the higher the sterling rate, the greater the disparity. List prices for a national market are fixed at intervals, perhaps two or three times a year, and are not directly adjusted to respond to fluctuations in exchange rates.

13.103. The LAL comparisons of list prices were made on five different dates over the years 1988 to 1990, a period which saw substantial changes in the exchange rates for sterling, with the result that the exchange rate adjustment has a major effect on the extent of price differences. The period in the early to mid-1980s when parallel importing into the United Kingdom reportedly took place on a large scale was one when inflationary pressure in the United Kingdom was combined with a strong pound. When the value of sterling was low, price differences were much reduced, as shown by the Vauxhall and Ford studies. We have therefore recalculated our transaction price indices to show the effect of adopting a lower rate as a basis for comparison.

13.104. The indices of specification-adjusted list prices over the period 1988 to 1990 given in Table 8.7 fluctuate around the levels at October 1990, suggesting that price differences have been both larger and smaller over the period than at that date, particularly in periods when exchange rates altered sharply.

The allegation of bias

13.105. We communicated the substance of the complaints described in paragraph 13.94 to LAL, which pointed out a number of factors, which, in its view, prevented there having been any infringement of section 133(1) of the Act. In particular, it argued that the information in question had entered the public domain well before publication of the report in question. In response to the accusation of bias LAL stated that the main components of its analysis were the basic data collected from the car manufacturers and calculations based on these data. These were carried out in an objective manner and strictly in accordance with the methodology agreed in advance with the MMC. Further, it was argued, such data are in any event continuously obtained by LAL from car manufacturers as part of its business as consultants to the motor industry, which requires it to hold complete and up-to-date records of the information in question. Moreover, LAL argued that it is a professional consultancy and any bias in the work could have been expected sooner or later to have become publicly known with consequent serious damage to its professional reputation. Furthermore, as LAL was a consultant to the motor industry and dependent on information from the car manufacturers, it argued that any bias in its work (which was in any event denied) would have been more likely to be in favour of rather than against these manufacturers. LAL stated that it had been impartial and objective in all respects in its work for the MMC.

13.106. LAL also rejected any suggestion that its work was not impartial because of the marketing venture mentioned by Ford. It explained that Euromotor Marketing Services Ltd (EMSL), another company within the Ludvigsen Group, had acted as a consultant to Heathgate Properties Ltd (HPL) about HPL's proposed European Motor City project, providing analysis of current and future trends in automotive retailing and distribution in Europe. LAL told us that by way of remuneration EMSL received 5 per cent of the issued share capital of HPL. LAL explained that it held these shares on trust for EMSL since EMSL was not fully administratively operational when the shares were issued. However, LAL emphasised that this shareholding is very much of a minority nature and that any allegation of bias by LAL in its work for the MMC was too speculative to warrant serious consideration. LAL further pointed out that the main substantive work done by LAL for the MMC was carried out prior to or during November 1990, whereas EMSL's involvement in the European Motor City project did not commence until July 1991. The timing of events therefore precluded any possibility of LAL being influenced in its work for the MMC by EMSL's involvement in the European Motor City project. Further, LAL reiterated the points made in response to Vauxhall's allegation of bias and denied any conflict of interest.

13.107. Before assessing the results of our work we first consider these allegations which we regard as matters requiring serious consideration. The main LAL work for us fell under three heads. First it gave us advice on the selection of countries, the selection of models, and the selection of model variants. Secondly it carried out the detailed specification adjustments to list prices by both identifying and valuing the differences. Finally it incorporated the Harris results into these specification-adjusted list prices to produce estimates of transaction prices adjusted for specification difference.

13.108. For the first stage, that of selection, LAL provided us with full reasons for its advice. These are set out in Phase A of its report at Appendix 8.1. We ourselves made the final selection of countries and of model variants, drawing on other information available to us and in some cases modifying LAL's preference, eg in the selection of a Rover model. We accepted LAL's advice on selection of model variants without modification but checked that they met the agreed sales criteria. While, as explained above, we received criticisms of the individual selection of countries and model variants, no party suggested our choice was perverse or unreasonable.

13.109. At the second stage, the identification and valuation of specification differences, we relied on LAL-indeed the need for specialist advice at this stage was the main reason for employing consultants. Its interim results were put to the parties. They accepted the method of valuation employed but produced a large number of detailed amendments, mainly additional specification differences to be taken into account, and estimates of the value of these differences where published information was involved. After discussions with all the parties, LAL was able to accept the amendments except for a very small number.

13.110. The third stage, Phase C, involved applying the valuations of specification differences, obtained as described above, to the price quotations secured by Harris.

13.111. In sum therefore we were responsible for laying down the broad framework of the study and selecting the countries and models. The detailed work which LAL carried out for us on specification adjustments was checked by the parties concerned and agreement reached on all but minor aspects. The final stage of the work, deriving estimated transaction prices, relies on data provided by another party and if there are to be criticisms of the approach, which we adopted knowing its limitations and have attempted to allow for in our assessment of price differences below, they should be directed at us rather than LAL.

13.112. Whatever the merits or demerits of the allegations set out in paragraph 13.94, which are disputed by LAL, we are satisfied that its work in providing specification-adjusted list prices was not undermined by any bias or potential bias or by any suggested conflict of interest and can be relied on for the further detailed work we ourselves carried out in order to establish the extent of price differences. We have therefore not considered it necessary to expunge from our report references to the LAL work. Nor, in the circumstances, do we think it necessary or appropriate to comment further on the allegations of bias and conflict of interest or on whether a breach of section 133(1) of the Act may have occurred.

The extent of price differences

13.113. The work which formed the basis of our assessment of price differences is set out in great detail in Chapter 8. In evaluating the results it is important to emphasise that there are no strictly identical cars available across the EC markets. Therefore published list prices for apparently similar models, which form the basis for most public comment, need substantial adjustment to take appropriate account of all the factors discussed in paragraphs 13.98 to 13.104 before any meaningful comparisons can be drawn. As we have shown, this involves a great deal of work and judgment. Indices of the unadjusted list prices for the models in the LAL study over the period are given in Table 8.3 and the apparent differences they show are very large. When specification adjustments are made to list prices the gap narrows, as shown in Tables 13 to 16 in Appendix 8.2. Up to this point in the analysis there is broad agreement with suppliers on the basic data. When we move to estimate actual transaction prices, however, the data sources are necessarily less satisfactory and their interpretation a matter of judgment. We accept that the price quotations derived from the LAL study given in Table 8.8 overstate real transaction prices to private customers. When the information on discounts and other benefits from suppliers is used to adjust the LAL quotations to arrive at some estimates of transaction prices the apparent differences narrow further, as shown in Tables 8.16 and 8.17. The final complicating factor that has to be taken into account is movement in the exchange rates, the effect of which is demonstrated in Table 8.14.

13.114. Table 8.18 shows the effect of the different assumptions on all these factors, taken together and separately, on the average price difference across the sample EC countries. From this it can be seen that differences in the exchange rates applied have far the greatest effect in widening or narrowing price differences and that, when our indices are recalculated with the data from the suppliers and their consultants, the large visible price differences overall disappear.

13.115. Tables 8.19 to 8.22 set out the indices for the individual model variants and countries in our study, using the alternative adjustments for both discounts and exchange rates which we consider relevant to the comparisons. The sequence of tables together shows the effects of applying the exchange rates ruling in October 1990, the time of the LAL transaction price study, and then the lower rates ruling in April 1990, to two different combinations of our information on discounts.

13.116. A number of points need to be stressed. First, the price differences that emerge from all these estimates are substantially different from those shown by published list prices for apparently similar models in the different countries. Secondly, the pattern of differences shown in all the comparisons is complex and there is no consistent pattern in them or within market segments. Perhaps most important, we are attempting to make estimates of the differences at a point in time. Over time relative prices of individual models vary, exchange rates move and discounts and financial benefits fluctuate in different markets depending on the state of demand. For example, the relative decline in the United Kingdom market in 1990 followed by a severe slump in sales in 1991 appears to have led to increased discounts and support in that market.

13.117. In order to take some account of all these factors-exchange rates, discounts and financial benefits-we have taken the various estimates in Tables 8.19 to 8.22, all of which contribute to our understanding of the situation, and presented them in Table 8.23, reproduced as Table 13.1, in terms of ranges within which we think the price differences lay. The upper ends of the ranges show the effects of the adjustments relying on information provided by the car suppliers.

TABLE 13.1 **Ranges of indices for estimated transaction prices, 1990**

Model variants	*United Kingdom*	*Germany*	*France*	*Belgium*	*Netherlands*
Small segment					
Ford Fiesta Popular Plus					
1.1 litre, 3-door	100	87-95	88-96	76-82	82-90
Rover Metro L					
1.1 litre, 3-door	100	N/A	72-82	69-77	71-79
Peugeot 205 GL					
1.1 litre, 5-door	100	89-97	100-109	84-92	89-97
Renault 5 Campus					
1.1 litre, 5-door	100	100-109	104-115	90-98	97-105
Fiat Uno 45					
Fire, 3-door	100	99-108	85-94	74-82	90-98
Average	100	94-102	90-99	79-86	86-94
Average excluding Metro	100	94-102	94-103	81-89	90-98
Lower medium segment					
Vauxhall Astra L					
1.4 litre, 5-door	100	105-115	105-117	98-105	97-107
Ford Escort LX					
1.4 litre, 5-door	100	111-121	97-108	94-100	92-99
Volkswagon Golf CL					
1.6 litre, 5-door	100	98-108	100-112	88-98	92-103
Nissan Sunny GSX					
1.6 litre, 5-door	100	92-102	85-96	85-95	80-90
Fiat Tipo DGT					
1.4 litre, 5-door	100	89-95	92-101	85-92	89-96
Average	100	99-108	96-107	90-98	90-99
Upper medium segment					
BMW 318i					
4-door	100	93-104	100-113	90-100	89-100
Vauxhall Cavalier L					
1.6 litre, 5-door	100	99-110	95-105	90-98	91-101
Peugeot 405 GL					
1.6 litre, 4-door	100	89-100	96-109	85-96	83-94
Volkswagon Passat CL					
1.8 litre, 5-door Estate	100	99-110	89-101	96-107	107-120
Ford Sierra GLX					
2.0 litre, 4-door	100	103-111	96-104	95-100	87-93
Average	100	96-107	95-106	91-100	91-102
Large segment					
Mercedes-Benz 190E					
2.0 litre, 4-door	100	91-102	99-114	96-108	91-104
BMW 520i					
4-door	100	89-101	98-114	92-104	89-102
Audi 100 2.3E					
4-door	100	102-113	117-132	83-91	95-107
Vauxhall Carlton GLi					
2.0 litre, 4-door	100	103-113	107-121	101-110	97-108
Renault 25 TX					
2.0 litre	100	81-91	108-121	91-101	82-91
Average	100	93-104	106-120	93-103	91-102
Overall average	100	96-106	94-105	88-96	89-99
Overall average excluding Metro	100	96-106	96-107	88-97	90-100

Source: MMC calculations on data supplied by LAL, ATK, Ford, Rover, MIRU and the Bank of England.

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

13.119. If we look to the future, the United Kingdom membership of the Exchange Rate Mechanism, by fixing exchange rates at near October 1990 levels, creates pressure on United Kingdom prices and discounts which is reinforced by the current United Kingdom recession. It also reduces exchange rate fluctuations as a source of temporary price differences. Taking account of these potential sources of variation, the results of our work on relative prices do not lead us to expect significant differences in the general level of prices between the United Kingdom and France or Germany in the future. We think it reasonable to assume, however, that for individual models particularly in the smaller segment prices to private customers in the United Kingdom will be higher than those available in other EC countries, and especially in Belgium and the Netherlands, and that even the general level of prices may be expected to diverge from time to time. If major differences do emerge, however, United Kingdom private customers may be expected to take advantage of the lower prices, provided that there are effective arrangements for parallel imports, a matter we discuss further below.

Parallel importing

13.120. The procedure for parallel importing, more fully described in paragraphs 5.47 onwards, is provided for in Article 5 of the Regulation and more fully dealt with by the EC Commission in the Notice to the Regulation. Under this procedure a customer from EC member state A can go to a dealer in member state B and ask to be supplied with a car for use in member state A at the price of a comparable car in member state B. The procedures are of particular interest to United Kingdom consumers, who need RHD models not normally sold on the Continent, in contrast to continental residents who can assume, with the advent of common type approval, that the LHD cars available in another member state can be bought and used in their home country without difficulty.

13.121. Our inquiry has suggested that although parallel importing takes place on a substantial scale between the main continental EC countries, there has been little into the United Kingdom in recent years. CA explained that difficulties experienced by its members led it to withdraw its guidance handbook. There are obvious difficulties of language, distance and finance when buying a car in a foreign country. In addition, while the procedures laid down by the EC Commission oblige a supplier to make the car available if an order is placed by a dealer, and a number of suppliers, in response to a request from the EC Commission, have reminded their dealers of the procedures, there is no obligation on a dealer to accept an order from the customer. The system therefore depends on finding a dealer who can advise on the comparable RHD variants, not normally sold by him, and is prepared to take on the business, offer a reasonable delivery date and quote an acceptable price. He may be unaware of the extra charges the manufacturer is allowed to make to cover specification differences, administrative costs and price distortions caused by taxes or price control (see paragraphs 5.48 and 5.55). As we noted in paragraph 13.103, parallel importing into the United Kingdom took place on a considerable scale in the early 1980s when inflationary pressures were combined with a strong pound; it would appear that either obstacles have increased or that present price differences between the United Kingdom, Belgium and the Netherlands, although significant on some models, are not large enough for consumers to pursue the complex procedures.

13.122. We recognise that, given the RHD problem, there is something inherently artificial in a system that relies on making available elsewhere in the EC, at constructed prices, RHD cars that are normally sold only in the United Kingdom, for import back into it. However, given the special position of the United Kingdom buyer, and since RHD cars will not in normal circumstances be offered to ordinary buyers in other EC countries, it would be desirable from the United Kingdom consumers' point of view that the present procedures for parallel importing be made to work. We therefore examined what further measures might be put forward by the Secretary of State for consideration by the EC Commission to ensure that the system delivers the expected benefits in the United Kingdom. We have noted the reference in the EC Commission's Twentieth Annual Report on Competition Policy to the case of *Ecosystems SA v Peugeot SA*, which concerns the rights of intermediaries seeking to acquire motor vehicles for customers across national boundaries, and is currently under consideration by the EC Commission. If the decision goes in favour of Ecosystems it will offer considerable potential for the growth of true arbitrage within the EC. It may also encourage new entrants with adequate resources to develop the role of the professional arbitrageur in the United Kingdom despite the RHD problem.

13.123. It would be desirable if the same service to consumers could be provided through the franchised dealer network. It is in theory open to an individual United Kingdom dealer to buy cars from a dealer in the same marque in another country, but he is likely to find most manufacturers unwilling to supply cars to United Kingdom specification in that country unless they are satisfied that he has obtained authorisations from individual customers (and the likelihood is that he will be strongly discouraged from thus acting as a professional intermediary). It is likely, too, that his colleagues in other EC countries will not be encouraged to assist him. Stronger dealers, however, should be better placed to overcome these obstacles.

13.124. Another possibility that we think should be borne in mind, in considering any need for further improvement in the system, is the suggestion that responsibility for providing RHD cars in such circumstances should lie directly with the supplier's national sales company rather than with the individual dealer in the member state where the customer wishes to buy for export. It is the supplier, through its distribution organisation, which has the power to ensure that the equivalent RHD car is made available in that member state on terms that comply with the Regulation and can arrange for it to be supplied either directly or through nominated dealers. It can be argued that it is the supplier that is the chief beneficiary of the SED system which the Regulation permits and it is therefore the supplier that should accept as part of this system the obligation to make it work. We suggest that the Secretary of State might draw this possibility to the attention of the EC Commission as a matter that should be borne in mind when the future of the block exemption is considered.

13.125. We considered whether one way of making parallel importing more effective and cutting through the price and specification difficulties that it raises would be to require EC manufacturers, whenever they have engineered an RHD version of a model or model range (which from 1993 will meet common EC type approval requirements), to make available in all EC markets RHD versions of the LHD model variants offered in those markets, to the same specification and at the same price. Most manufacturers have told us that producing RHD variants of their LHD models did not involve additional costs. With the increased flexibility of production methods and computerised controls that we have seen, manufacturers already organise production at most plants to assemble their models on a single line in an enormous range of variants and option packages, and RHD is one of the important variables built into the programmes. The requirement would make it an option available on all variants. Most suppliers argued, however, that the option packages they offered had to be limited; such an obligation, by effectively doubling the number of option packages they provided, would add unnecessary complexity and cost to an assembly process that they were already trying to simplify by cutting down variants. It would also be unreasonable in requiring manufacturers to make available model variants which were not in any of their `contract programmes' (ie the list of model variants they made available to dealers in each market, to meet consumer demand in that market). While we recognise the current force of these arguments we expect that continuing developments in controlling the production and assembly process to meet individual consumer requests will make this course increasingly feasible.

Price monitoring

13.126. If, as we suggest, price differences on some scale are likely to continue, the question arises of monitoring price differences. In addition to the arrangements for parallel importing the Notice to the Regulation introduced safeguards for withdrawing the block exemption if, as a result of obligations exempted by the Regulation, substantial price differences emerged. The EC Commission is currently carrying out an examination of price differences but as yet we understand has no arrangements for continuous monitoring. Clearly without such monitoring these safeguards are ineffective. Our own experience has shown the obstacles in the way of making price comparisons and demonstrated the large resources needed to carry them out properly on an EC-wide basis. Some form of self-assessment under which suppliers provided regular information might assist but it would still be a major task to evaluate the results in a reasonable time. We think that a more promising route is to focus on trying to identify and remove restraints which can be shown to contribute to the maintenance of the differentials.

Assessment

13.127. We first consider the statutory questions in section 48*(c)* and *(d)* of the Act.

13.128. We consider that those in whose favour the complex monopoly situation exists are taking steps to exploit and maintain the monopoly situation in that they choose to use a system of distribution which is selective and exclusive which includes the provisions described in paragraph 13.31. As we have explained in paragraph 13.31, we consider that these provisions have the effect of preventing, restricting or distorting competition and we therefore conclude that in adopting these provisions those in whose favour the complex monopoly situation exists are taking steps, by way of uncompetitive practices, for the purpose of exploiting and maintaining the complex monopoly situation. We do not find, however, that those in whose favour the scale monopoly situation exists are taking these or any other steps for the purpose of exploiting and maintaining that situation.

13.129. We do not consider that there are any actions or omissions which are attributable to either monopoly situation within the meaning of sections 48*(d)* and 49(1) of the Act.

13.130. We now examine the effects of these elements of the SED system which have been identified in paragraph 13.31 as the practices giving rise to the complex monopoly situation, together with other features of the distribution system, and whether any of the facts found in this examination operate or may be expected to operate against the public interest. In so doing we must take account of other factors affecting competition in the United Kingdom market, which we first discuss.

VERs

13.131. We have discussed earlier the effects of VERs in the United Kingdom and identified them as the major factor affecting competition in the market. We consider that they have caused prices in the United Kingdom to be higher than would obtain in a competitive situation and have restricted the choice of models available to the United Kingdom consumer. In the absence of a monopoly finding related to VERs it would be inappropriate for us to make any finding or recommendations under the Act. Nevertheless, we consider it would be wrong, at this final stage of what has been a lengthy and expensive inquiry, to avoid expressing views on the main feature of the market where change is needed.

13.132. In July 1991 the EC Commission, on behalf of the EC as a whole, and the Japanese Government reached an understanding on future VERs. As will be seen from the discussion in paragraphs 9.56 onwards, although a number of details of the scheme have been made known, the way it will be implemented is far from clear. The aims are that all nationally negotiated VERs should be superseded by an EC-wide restraint at the end of 1992, that this EC-wide VER should continue until the end of 1999, that there should be no restrictions on Japanese cars produced within the EC and that from the year 2000 there should be no restrictions at all. This would allow Japanese exports to the EC as a whole and to the restricted national markets (except the United Kingdom) to grow absolutely over the period, but their share of the EC market would fall to 8 per cent from its present 10 per cent. In the case of the United Kingdom the VER figures postulate both an absolute and a relative decline in Japanese exports from the levels over the period 1989/90 and a fall to about 7 per cent in their share of the forecast United Kingdom market in 1999. There is to be unrestricted movement within the EC of cars produced by EC-based Japanese-owned plants, although the Japanese are said to have recognised the EC Commission's concern about the effects of excessive concentration of sales of Japanese-owned EC production in particular national markets. By 1993 three such plants will be operating in the United Kingdom, and there are plans to build others elsewhere in the EC. Estimates of their production in 1999 (which amount to some 8 per cent of the total EC market forecast for 1999) have been taken into account in forecasting the target figures for Japanese vehicle exports in 1999 in the EC-Japanese arrangement. The only forecasts given are for 1999. It is not clear how Japanese market shares are expected to move year by year to the 1999 position and what will happen if demand deviates from the trend originally assumed. Nor is it clear whether the VER levels forecast would be affected if the levels of Japanese-owned production in the EC exceeded the forecast estimates.

13.133. The effect of these arrangements on the United Kingdom market has to be considered in the context of the likely development of EC-based Japanese production. As described in paragraphs 9.65 onwards, there are many unknown factors, including how many of the major Japanese suppliers' model ranges will be produced within the EC by the late 1990s, and to what extent United Kingdom production will be exported to other member states. Nor do we know how individual Japanese manufacturers, particularly those which do not plan to manufacture cars within the EC, will share total Japanese exports to the United Kingdom. A further factor will be the ability of individual Japanese manufacturers, restraints apart, to increase their share of the United Kingdom market. Nissan, now producing over 100,000 cars a year in the United Kingdom, has indicated that it aims to increase its present 4 per cent share of the United Kingdom market to 10 per cent by the end of the century and to establish a chain of some 475 dealers to achieve this. Toyota has indicated that it expects substantial growth in United Kingdom sales. Plans on this scale, particularly if other Japanese manufacturers follow, are bound to have strong effects on competition and on price.

13.134. Against this background it is impossible to predict with any certainty the effects of continuing VERs in the United Kingdom or the extent to which they will constrain individual suppliers. Clearly the situation could develop in ways which left VERs as a serious constraint on the range and number of cars offered by at least some Japanese suppliers with a continuing effect on prices in the market. In evidence to us the Department of Trade and Industry indicated that, if HMG does not wish restrictions to remain in the United Kingdom, nothing in the EC-Japan arrangement would prevent HMG from achieving this result. We think that on purely competition grounds the removal as quickly as possible of these restrictions in the United Kingdom would be desirable. There are, of course, wider considerations to be taken into account, such as reciprocity, Japanese plans for new EC production, and the effects on United Kingdom car production and employment. We are not in a position to reach a view on what effect the removal of United Kingdom VERs would have on the behaviour of Japanese suppliers, given the consensus arrived at with the EC Commission, or on whether the removal would have repercussions on that consensus or on the treatment of Japanese-owned EC-based production. We hope, however, that the Secretary of State, in assessing the many factors involved, will give full weight to the competition arguments.

RHD

13.135. We have identified RHD as an important factor that will continue to prevent United Kingdom consumers from taking advantage of EC price differences when these occur by segmenting the EC market. Apart from the United Kingdom, the Republic of Ireland and Malta the last country in Europe to drive on the left was Sweden, which changed over in 1967. It is over 20 years since the United Kingdom position was reviewed, when vehicle imports were of little significance, and we suggest that the costs and benefits of change should now be reassessed.

Company cars

13.136. We have discussed the effect of company cars on prices and specifications. We consider that they have been a factor in leading to a generally higher level of specification in the United Kingdom within model ranges and that this has been reflected in prices. Within the company car sector major fleet purchasers can secure fleet and volume discounts not available to others, and particularly not to private consumers, and this in our view has tended to raise the price paid by the latter.

Recent increases in the level of taxation of the benefit of private use of company cars have somewhat lessened their attractiveness and it is possible that this, together with the introduction (in 1992/93) of employers' liability for National Insurance contributions in relation to the benefit, may reduce the number of company cars and consequently their effects on specifications and prices may become less important. Company cars, however, still offer substantial private use benefits and we recognise that the company car culture and current attitudes cannot easily be changed even if tax neutrality were attained.

13.137. As explained in paragraph 13.53, we consider that the system of banding the tax scale charges by original market value and engine capacity has led to the provision of highly-specified cars, geared particularly to the first value threshold of £19,250 or the 2-litre engine capacity threshold or a combination of both. If the scale charge were not banded, but expressed as a percentage of the list price or cost, the clustering of highly-specified cars at particular tax band thresholds (and the discrimination against those buying cheaper cars within the band) would no longer occur. This would remove a distortion to competition and promote administrative simplicity. We suggest that the basis of charge be kept under review with a view to avoiding the present bunching.

Some features of the distribution system

13.138. We now examine the effects of the practices we have identified in paragraph 13.31 and whether these or other features of the distribution system operate or may be expected to operate against the public interest. We noted in paragraph 13.60 the benefits of the SED system recognised by the Recital to the Regulation governing the EC block exemption. It delivers active inter-brand competition between suppliers, while allowing some intra-brand competition. Under it the car suppliers can ensure over the life, generally several years, of what is a sophisticated product, a standard of repair and service that enables them to protect the reputation of their marque. These benefits of the system must be borne in mind in assessing any adverse effects. In the following sections we examine first the effects of some other features of the distribution system which were drawn to our attention.

13.139. We looked at the arrangements for dealers to stock cars. It was suggested that suppliers' practices in setting sales and stocking targets for different model ranges had forced individual dealers to stock models that did not necessarily reflect consumer tastes. We think it reasonable that within the SED system a supplier should expect its dealers to offer its whole range of cars and to have his selection from the range available for inspection. Suppliers clearly in their own interests do their best to forecast demand accurately. If they make mistakes both they and their dealers suffer. Since they provide a large range of models, in itself a response to market demands, miscalculations will occur. The widespread practice of swapping cars between dealers in the same franchise (see paragraph 5.32) provides a mechanism for matching individual preferences and we have no evidence that consumers generally are dissatisfied with the range of choice available. The demand for cars (by private consumers in particular) is highly sensitive to the economic climate. The industry is complex in manufacture and assembly, with high levels of fixed costs and low costs for incremental output. For the manufacturers therefore the major objective is to maintain volume or-in the industry's graphic phrase-to `move the metal' and this is reflected in suppliers' expenditure on promotion and advertising, as well as their controls over dealers' targets and the way the dealers are encouraged by various means to reach sales targets, all of which suggest vigorous inter-brand competition. We do not consider the suppliers' practice of target-setting harmful to competition within the industry.

13.140. It was also suggested that consumer choice was restricted because basic models available elsewhere in the EC are not offered in the United Kingdom. We found that for the main model ranges the basic model is always available in the United Kingdom but tends to have some additional features offered as standard. The suppliers argue that they simply provide models and specifications to respond to consumer preferences as shown in the market-place. Within model ranges basic models tend to sell less well in the United Kingdom than models higher up the range. Suppliers have told us that they make better profits on the more expensive models in a range and consumer buying patterns may also be affected by advertising and model availability. We do not think, however, that the average United Kingdom consumer is being manipulated to buy cars with features that he does not want.

13.141. We noted that many dealers are given incentives, based on targets, to promote the sales of other services related to car purchase, such as loan finance, insurance and extended warranties sponsored by the supplier. In two cases we noted that dealers were required to sell a certain proportion of extended warranties. It was suggested that this required dealers to promote goods which did not necessarily offer the best value to the customer. Although the car supplier often benefits from the arrangements they are also in part a result of its wish to see that the dealer offers as complete a package as possible to tempt the motorist. Provided the dealer is not prevented from promoting alternatives if he so wishes we do not see any harm in the practice, nor in the supplier including such related products in its bonus schemes if it so wishes.

13.142. We examined the arguments that franchised dealers should not necessarily have to provide servicing. It was suggested by CA that the benefits of the system, and in particular the desirability of the franchised dealer having to provide servicing, were overrated and that there was no evidence that the general quality of servicing provided by franchised dealers was superior to that of independent garages. As cars have become more reliable and durable, the amount of after-sales service required, particularly in the earlier years, has declined. The increasing complexity of some features, eg electronic engine management systems, means that when faults do occur a considerable level of expertise is required which may be available only from the franchised dealer. Car suppliers invest in training and manuals to ensure that their dealers can provide a satisfactory level of servicing and the customer has the assurance that if anything does go wrong he can turn to the supplier, which will terminate a dealership if the dealer persistently fails to perform satisfactorily. While we do not think it essential to the successful functioning of the system that every dealer should provide both sales and servicing, we do not think it unreasonable that a supplier should require all its dealers to do so, if it so wishes and if market forces allow it to do so.

13.143. We also examined delivery arrangements. Suppliers make arrangements with independent distributors for delivering cars to dealers and charge the dealer a flat rate regardless of location. Customers are rarely allowed to collect their own cars from the supplier. Suppliers explained to us the many practical difficulties of providing facilities for customers to collect their own cars from the depot or factory in an on-the-road condition and we are satisfied that (although a few suppliers of more expensive cars do so) it would be wrong to insist on their provision by all suppliers. We considered the suppliers' practice of charging a flat rate for delivery throughout Great Britain. There are general arguments for and against delivery charges that reflect the actual costs incurred but, given the complexities of suppliers' delivery arrangements for cars and the widespread practice of car swapping which dealers engage in to match customer requirements, it would appear impossible in this industry to devise a system which matched costs and charges to the individual consumer with any precision. We did not find that a case for any change had been made out.

13.144. The actual delivery charge made by the dealer to the customer (which can be a substantial part of his net profit) and about which we had complaints is not a matter within the scope of our inquiry. The dealer usually sets his own on-the-road charge to cover delivery, number plates and licensing fee. We noted, however, that since September 1991 the Price Marking Order 1991[1] has made it a requirement that all new cars for sale are clearly marked to show the on-the-road price including all extras, as well as the list price.

13.145. We noted extensive criticism from representatives of the insurance industry of the practice of some suppliers in offering free insurance as an incentive to buy a new car. We can see why this does not commend itself to insurance brokers who are losing business that might otherwise come their way, and we can see that in some cases, eg for young buyers of high-performance new cars, the benefits could be very substantial (and possibly not obtainable at all in the normal course). We can see that it is arguably undesirable that high risks, in the insurance sense, should have their path eased, but we do not think that these are matters that bear directly on the competition issues we are considering.

13.146. We received a number of complaints about suppliers' direct sales to large buyers and the fact that because of direct discounts from suppliers large buyers frequently received cars at lower prices than dealers. It was put to us that by so doing suppliers were damaging the dealers they had contracted to support and that, in equity, any volume discounts offered by suppliers should also be made to dealers, volume for volume. Clearly any move by suppliers to develop direct sales on a large scale could undermine

[1] SI No 1382.

their dealers' operations. But the suppliers can be expected to bear this in mind and the sales they are currently involved in are not the most profitable, to them or their dealers. We do not think it appropriate to try to regulate differential discounts offered by suppliers to their dealers and other buyers, although we have noted later that if dealers had greater freedom to expand their businesses and take on competing dealerships, market forces should in time lead suppliers to offer volume discounts for dealers.

13.147. We considered whether the process of individual transaction price-setting by dealers, the variation in transaction prices and the resulting lack of transparency in the price negotiation by the individual private consumer could be improved. We would feel some concern if consumers were misled about the availability of discounts but this does not appear to be the case. There is information available to consumers through the specialist and general press on the availability of discounts for those prepared to look for them; a car is self-evidently an important purchase and a consumer may reasonably be expected to devote some time and energy to the transaction. However, given the great difficulty for the average customer of making valid comparisons, it would clearly be useful if there were regular information about prices. Some information on discounts, other benefits and specification differences is already available from the motoring press and consumers' associations. We think the latter should give further thought to whether they can provide more detailed and regular information to consumers based on their own members' purchasing experiences. Consumers should be aware of the considerable gap between the list and the actual transaction prices and hence the potential size of the discounts available. It is clear that not all consumers realise that when purchasing a new car, as with a used car, it is necessary to `shop around' and negotiate the ultimate price. It is to be hoped that this report will itself increase this awareness.

13.148. We have noted the recent move by Vauxhall to cut both the list price and dealer margins on the new Astra. Vauxhall has indicated in its announcement of the move that it hopes this will lead to transaction prices closer to the list price and less need for consumers to go through a bargaining process that most say they dislike.

The monopoly situation practices

13.149. We now consider the effects of the practices we have identified in paragraph 13.31 which form the basis of the complex monopoly situation and whether any of these operate or may be expected to operate against the public interest.

13.150. The allocation of an exclusive territory within which only the dealer will be supplied with cars and the prevention or restriction of sales promotion by the dealer outside that territory are both practices that restrict the extent and strength of intra-brand competition. The suppliers argue that these restrictions do not prevent the dealer selling to customers who approach him from outside his territory and that a high proportion of sales already take place to such customers. The limited protection given ensures that the dealer concentrates on developing his territory and thus delivers effective inter-brand competition. It also gives the dealer the protection in his territory needed to encourage him to invest in the business on the scale the supplier requires and ensures that the number of dealers the supplier thinks necessary can stay in business. We accept that the allocation of an exclusive territory to the dealer, although restricting intra-brand competition, delivers effective inter-brand competition, and that to allow dealers to establish branches in each other's territories would undermine the concept of the designated territory.

13.151. Other forms of sales promotion, particularly advertising, outside the territory, are in general prohibited or restricted. The restriction on a dealer promoting sales outside his territory is not absolute because local advertising in the press and on the radio will often reach a wider area and many dealers' sales already are made outside their territories. We think, however, that in the absence of the restriction on advertising efficient dealers would be able to expand substantially their sales volumes and scale of operations and thus offer the prospect of lower prices to their customers. A relaxation of the restriction may be expected to also provide some incentive for a change in dealer behaviour towards advertising the discounts that are at present offered only by word of mouth to local enquirers. We would not see such a relaxation, which would enhance intra-brand competition, as undermining the concept of the designated territory. There is a considerable difference of degree between advertising and actually setting up a branch in another territory.

13.152. It was put to us that an over-large expansion of sales by some dealers resulting from such a relaxation would have an adverse effect on smaller dealers' profits and viability. We recognise that the growth of car sales by more efficient dealers will be at the expense of the less efficient. However, we note that, as shown in paragraph 10.88, dealers' profit rates on servicing and parts sales are significantly higher than those on the sales of new cars and a steady source of revenue compared with the volatile new car sales side. The convenience for car owners of having their vehicles serviced by their nearest dealer would protect the viability of the smaller local dealers. It is within the power of suppliers to change the terms of their dealership agreements to ensure that complementary networks of dealers, some concentrating on sales and others on service, would survive. Such specialisation exists already to a small degree for Renault.

13.153. Restrictions on the number and location of the supplier's dealerships held by a single dealer (or group), and on the volume of the supplier's cars that he may handle, are justified by suppliers on the grounds that they prevent an undesirable concentration of power in a single dealer's hands, that multiple dealerships would deprive the consumer of intra-brand competition, particularly if a dealer were allowed to hold the supplier's dealerships in adjoining territories, and that better levels of service are offered by a dealer concentrating on a single territory. It seems clear to us that these limits, even more than the restrictions discussed in the preceding paragraphs, significantly restrict the extent to which a successful and efficient dealer can expand operations and seek benefits either from greater efficiency or from securing better terms from his supplier which might be passed on to the consumer in lower prices. However, any intervention to remove the number and location limits, if it was to be effective, would remove or limit the supplier's freedom to select its own dealers or to approve the transfer of its franchise to a new owner. It would be necessary to have some supervision to settle disputes about dealer suitability and to avoid dealers consolidating dealerships in a particular area and thus weakening intra-brand competition. It must be recognised that the supplier's freedom to decide how many dealers and territories it wants, and how it wishes to be represented in a given territory, are key elements of selectivity in the present distribution arrangements and in enabling the supplier to formulate its marketing structure.

13.154. However, removal of the limitations on volume imposed by some suppliers, which have similar potential effects in restricting future expansion by dealers, would not involve any of these disadvantages, and this would at least remove a further constraint on expansion from the more efficient and successful dealers.

13.155. Restrictions on the dealer holding dealerships from competing suppliers, or engaging in other car-related businesses, eg car rental, second-hand car dealing or `fast-fit' operations, outside his territory, are justified by suppliers who use them as ensuring that the dealer concentrates on promoting the supplier's marque and achieves a satisfactory level of performance. They have similar effects to restrictions on holding the supplier's own dealerships, in limiting the extent to which the efficient dealers or dealer groups can build up their operations and in limiting their sources of income. Restrictions on dealers' building up national chains with large numbers of different dealerships inhibit the development of really large-scale volume sales which might offer the opportunity of better terms for the private customer. Restrictions on holding competing dealerships also restrict inter-brand competition, by making it more difficult for suppliers with a smaller share of the market to secure good and established dealers, and may deter market entry. We note that most suppliers allow dealerships from other competing suppliers to be held outside the territory and that some allow them within the territory, although not usually on the same or adjoining sites. Broadly speaking smaller suppliers tend to be less restrictive than the larger, reflecting their relatively weaker market position, although we note that Vauxhall, the second supplier by volume, takes a more liberal approach than Ford. We think that experience shows that individual dealers, and the larger dealer groups, can manage competing franchises at different locations without any noticeable weakening of inter-brand competition or in the standard of service they provide.

13.156. Most suppliers, however, see restrictions on holding competing dealerships of different marques at the same site as essential to ensure that their marque is sold effectively. There could be some economies of scale from such pooling arrangements, although these may be limited compared with the costs specific to the sales and servicing of the individual marque. More important, the restrictions deprive the consumer of any opportunity to compare directly competing marques at the same site with some resultant inhibition on inter-brand competition. There have been some complaints from consumer organisations on this score. However, on balance we see force in the argument that the supplier's brand be sold alone, in order to ensure concentration of marketing effort at that site, and that the brand is presented in the way the supplier wants, and that this results in effective inter-brand competition. Should distinct advantages of shared sites become apparent to dealers and consumers over time, market forces would encourage their more widespread use.

13.157. The suppliers' refusal to supply new cars for resale except through their dealer network and the linked restrictions on dealers which allow them to sell only to final customers, their authorised agents or to other franchised dealers are both essential elements of a selective distribution system and we accept the suppliers' arguments that they are necessary to ensure that dealers provide effective pre-delivery and after-sales service to the standards which are required by the supplier and backed by him. We have already recognised these as benefits of the system and a major element in inter-brand competition.

Conclusions

13.158. We have earlier examined the influences, including VERs, tending to raise the level of United Kingdom prices. We have drawn attention to the distortion in prices to private customers that we attribute to the position of the company car in the United Kingdom. We have noted that, although we do not expect significant differences in the general level of prices between the United Kingdom and France or Germany, prices for individual models, and particularly in the small car sector, may be expected to be significantly above those in other EC countries, particularly Benelux and the Netherlands. From time to time the general level of prices may also be expected to be significantly above that in other EC countries. We have noted how the British Isles are uniquely excluded from many of the benefits of parallel importing when price differences do emerge. The causes of higher prices to United Kingdom private customers may as we suggest lie outside the distribution system. Nevertheless, while we have noted earlier the benefits provided by SED, we consider that certain features of the system, namely those restrictions by suppliers which limit advertising by a dealer outside his territory, limit the volume of cars he can sell, the extent to which he can hold competing franchises, or prevent him engaging in other car-related businesses, all contribute to the maintenance of higher prices. They do this by preventing action by the dealer that would otherwise mitigate their effects; they limit the ability of dealers to grow stronger, to develop bargaining power in relation to the supplier, and generally to increase their efficiency and independence in making business decisions.

13.159. If the more efficient dealers were free from these restrictions on expanding their business and able to hold dealerships from all the major suppliers, they could be expected to expand their operations by developing the volume of sales to private buyers. Achieving higher volume would depend on, and provide scope for, lower prices and would result in more open advertising to customers of the prices on offer. Increased sales and the development of business with other competing suppliers would strengthen the dealer's position in seeking more favourable terms from suppliers. A dealer would also be in a stronger position to exploit price disparities between the United Kingdom and other EC markets by offering to act as an intermediary in carrying out parallel importing. The ability to develop a range of car-related activities would strengthen his position. Essentially the dealer would then be in a stronger position to act competitively in a way which tended to redress the present detriments to the private consumer set out above.

13.160. We then considered whether any developments in the market were likely to alter our assessment. Over the next few years VERs in the EC are to be relaxed and we have indicated our hope that the process in the United Kingdom may be speeded up. Relaxation of VERs together with the availability of cars from Japanese-owned plants in the United Kingdom should exercise powerful pressure on prices in the United Kingdom and the effect on the distribution system cannot be foreseen at this stage. We have noted the recent agreement for closer co-operation on development and manufacture of cars between Rover and Honda which will effectively extend the benefits of Japanese methods to almost a quarter of the United Kingdom market, even if no closer link is established between the parties.

13.161. Common standards in the EC and review of the working of the block exemption may offer more scope for free movement of cars, although RHD will remain a barrier to arbitrage.

13.162. We hope that fiscal measures will continue to reduce the distortions caused by the company car culture but would not expect any rapid changes in the behaviour of companies and users.

13.163. Our inquiry has been taking place at a time when the United Kingdom car market has fallen dramatically and conditions are abnormal. There is greater awareness by United Kingdom consumers, partly as a result of the depressed market, of the fact that transaction prices and discounts vary widely and of the need to bargain and to shop around, and we would hope this awareness will continue. However, as the market recovers discounts are likely to be harder to secure.

13.164. Taking these factors into account we expect some increase in competitive pressures on the industry over the next few years. We do not, however, consider that these developments would remove the detriments we have identified.

13.165. We have already identified the adoption of the following restrictions (among others):

- restrictions on the extent to which the dealer may promote the sale of his supplier's cars outside his designated territory;

- limits on the total volume of the supplier's new cars that may be sold through a single dealer or dealer group;

- limits on the number and location of other supplier's dealerships held by the dealer; and

- limits on the extent to which or conditions under which dealers may engage in other car-related businesses;

as steps taken, by those in whose favour the complex monopoly situation exists, to exploit and maintain this situation (paragraphs 13.31 and 13.128). We now conclude for the purpose of section 49(1)*(b)* of the Act that these restrictions also represent facts which we have found in pursuance of our investigations and which operate or may be expected to operate against the public interest, in that (and having the particular effects adverse to the public interest that) they prevent dealers from developing their businesses in the ways we have outlined and thereby, in the ways that we have shown (paragraphs 13.151, 13.154 and 13.155), limit intra-brand competition between these dealers, restrict inter-brand competition and the entry of new suppliers, prevent the emergence of larger and more efficient dealers and deny consumers the benefits of increased competition, particularly the potential benefit of lower prices. For the reasons set out in paragraphs 13.150, 13.153, 13.156 and 13.157 we do not find that the other practices set out in paragraph 13.31 constitute facts which operate or may be expected to operate against the public interest.

13.166. We have already found that no steps are being taken for the purpose of exploiting and maintaining the scale monopoly situation. Neither are any actions or omissions within the meaning of sections 48*(d)* and 49(1) of the Act attributed to the scale monopoly situation (paragraphs 13.128 and 13.129). We further conclude that there are no facts found pursuant to our investigation relating to the conduct of Ford and Jaguar, as persons in whose favour the scale monopoly situation exists, which operate or may be expected to operate against the public interest.

Recommendations

13.167. We are required by section 54(3) of the Act to consider what action (if any) should be taken for the purpose of remedying or preventing the adverse effects we have identified and we may, if we think fit, make recommendations as to such action.

13.168. We have identified a number of restrictions imposed by suppliers in their agreements with dealers with the effects adverse to the public interest that we have stated in paragraph 13.159. We put potential remedies to the parties and have considered the arguments put to us by suppliers for the retention of these restrictions, in particular that the present arrangements were required to ensure that dealers concentrated on promoting their supplier's marque and developing their territory to the best of their ability, and that they already allowed satisfactory intra-brand competition while preserving the overall coverage of the network.

13.169. As we have indicated in the earlier discussion, we consider that removal of detriments, while it would lead to some changes in suppliers' distribution systems, would not undermine the benefits they provide to the consumer, in terms of inter-brand competition and standards of sale, servicing and repair underwritten by the manufacturer. We therefore recommend action to remedy the adverse effects of the restrictions we have identified in paragraph 13.165, as set out below.

13.170. We do not propose fundamental change to an established system, but we recommend the removal of any restrictions on franchised dealers, whether by means of agreements or otherwise, which:

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

(b) limit the dealer's freedom to hold or acquire dealerships outside that designated territory;

(c) prevent a dealer holding or acquiring competing dealerships within his designated territory; provided that the supplier may be entitled to require that any other dealership acquired be at a separate location and a reasonable distance away from its dealership and under separate management;

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

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

13.171. In recommending that dealers should be allowed freedom to advertise outside their territories we do not consider that the present restrictions allowed under the block exemption should be relaxed to allow targeted approaches such as cold calling. Nor do we think that dealers should be allowed to promote sales by setting up any kind of branches outside their territory, which would undermine the concept of a designated dealer territory.

13.172. We have explained in paragraph 13.156 why we think suppliers should be allowed to prevent their cars being sold from the same sites as other makes or from adjoining sites, in order to promote the marque and maintain effective inter-brand competition. Our recommendation, *(c)* above, that dealers may be allowed to acquire competing dealerships within the designated territory is therefore subject to conditions designed to ensure that the management of such dealerships is separate and that the dealerships themselves are far enough apart to be recognised as separate undertakings with the object of ensuring the inter-brand competition. The distance involved will vary with the type of territory; for example, in a conurbation a smaller distance should be more acceptable than in a rural area. The dealer must be able to show against objective criteria that acquiring the new dealership will not weaken inter-brand competition.

13.173. It would be important that the benefit of the recommendations should not be frustrated by action by a supplier to vary other aspects of its arrangements with its dealers. For example, the expected benefits of a dealer's freedom to advertise might be frustrated if his out-of-area sales were not allowed by the supplier to count for bonus, or if an increase in the volume of an individual dealer or dealer group's sales were to result in action by the supplier to redraw the designated territory or to cut back the number of supplier's dealerships held.

13.174. In considering these recommendations the Secretary of State will doubtless take into consideration the provisions of the Regulation, including Recital 29 (see paragraph 6.20). He will note the views of the Directorate General IV of the EC Commission, which have been challenged by some suppliers, on the interpretation of the Regulation and in particular the view that restrictions on the holding of dealerships from other suppliers outside the supplier's designated area of responsibility are not covered by the block exemption. In making our recommendations we do not regard it as necessary for us to reach a view on the correct interpretation of the Regulation. However, we suggest that when the Regulation is reviewed the opportunity be taken to remove the present uncertainty about its application.

13.175. There is also the issue of whether a member state may legally adopt national legislation imposing more stringent requirements in matters of competition law than are required under corresponding EC legislation. However, this again is not an issue which affects the nature of our role or our recommendations. If, and to the extent that, the issue arises, it is open to the Secretary of State to consult with the EC Commission on those of our recommendations to which the Regulation or other EC legislation relate.

13.176. In addition to our recommendations we have identified a number of other matters, not covered by our findings, where we have made suggestions for review of existing policies. These are:

- VERs in the United Kingdom (paragraph 13.134);

- the structure and level of company car taxation (paragraph 13.137);

- the requirement of driving on the left (paragraph 13.135); and

- the procedures under the Regulation for parallel importing (paragraph 13.124).

One member, Mr D G Goyder, has identified a number of additional matters, concerning the provisions of the Regulation, where he believes further measures should be considered when it comes to be reviewed. His views are set out in the statement that follows.

M S LIPWORTH *(Chairman)*

D G GOYDER

C C BAILLIEU

I S BARTER

A P L MINFORD

S N BURBRIDGE *(Secretary)*

31 October 1991

Supplementary statement by Mr D G Goyder

13.177. Whilst I fully support the conclusions and recommendations of this report I believe that measures additional to those set out in paragraph 13.170 are required. In my view the Secretary of State should be asked to draw the attention of the EC Commission, at the appropriate time during the review of the Regulation, to the following:

(a) In view of the observations of the report in paragraph 13.126 that price monitoring is necessary if safeguards set out in the Regulation are to be effective, I believe that manufacturers should themselves, as an integral part of the Regulation, be under an obligation on a regular basis to provide sufficient information to the EC Commission on prices and specifications to enable it to make selective checks on the pricing of relevant models. Manufacturers should also provide details of their internal procedures for ensuring that parallel imports (whether made privately or by intermediaries or dealers) can take place without obstruction. This is of particular importance to United Kingdom consumers because of RHD.

(b) I believe that uncertainties about the interpretation of the Regulation (some of which are referred to in the list of questions and answers about it contained in Appendix 6.3) should be clarified so that manufacturers and dealers can know precisely those restrictions and conditions that can legitimately be included in dealer agreements. In particular, in my view there should be a provision in the Regulation that the inclusion in a dealer agreement of clauses which restrict competition but are not specifically exempted by its provisions would automatically remove its protection under the block exemption. This would bring the Regulation into line, for example, with the Exclusive Dealing and Exclusive Purchasing block exemptions (EC Regulations 1983/83 and 1984/83 respectively).

(c) In view of the marked imbalance in negotiating position between manufacturers and dealers noted at paragraph 13.59, I believe that strengthened provisions should be included in the Regulation to protect dealers on matters such as minimum notice and agreement periods.

D G GOYDER
31 October 1991