

Part III: Legislative Options

III.1. Introduction

The previous sections served the purpose of structuring the analytical context.

Building on this knowledge, the purpose of the third section is **to analyse the various legislative options put forward by the Commission under the Terms of Reference**. That is:

- To furnish an **understanding** of the various scenarios, sub-scenarios and specific issues ('variables') derived directly or indirectly from the Terms of Reference;
- To assess the **impact**, all other factors unchanged, of the legislative options (scenarios and variables), on the basis of the four loops that were previously identified;
- To structure and combine legislative options in order to establish a limited number of **overall legislative combinations** for analysis.

The legislative options are identified and prioritised according to the pattern laid down by the Commission under the Terms of Reference.

The Commission initially identified five basic scenarios. These scenarios are founded on various combinations of the two fundamental components of the existing system, 'territorial exclusivity' and 'selectivity'. The **five basic scenarios** are⁹⁷:

- **Scenario 1**: Totally 'free' distribution;
- **Scenario 2**: Distribution based on territorial exclusivity;
- **Scenario 3**: Selective distribution based on qualitative criteria;
- **Scenario 4**: Selective distribution based on qualitative and quantitative criteria;
- **Scenario 5**: Selective distribution based on qualitative and quantitative criteria, with limited territorial exclusivity.

In addition, the Commission has identified **specific issues ('variables')**⁹⁸ that should be analysed, if necessary, within the framework of the various basic scenarios.

These ten 'variables' are either emerging practices that may require regulation, or specific legislative issues. The variables are:

- The link between sales and after-sales servicing⁹⁹;
- Restrictions on multi-branding in distribution¹⁰⁰;
- Access to technical information¹⁰¹;
- Access to the trade and multi-branding in after-sales servicing¹⁰²;
- Distribution of original spare parts¹⁰³;
- Method of dealer remuneration¹⁰⁴;
- 'First come, first served' principle¹⁰⁵;
- Availability clauses¹⁰⁶;
- The role of intermediaries;
- Direct sales by manufacturers¹⁰⁷.

⁹⁷ Point (4) of the Terms of Reference, describing the five 'basic scenarios' for motor vehicle distribution systems.

⁹⁸ Points (7) to (16) of the Terms of Reference.

⁹⁹ Refers to points (10) and (11) of the Terms of Reference.

¹⁰⁰ Refers to point (7) of the Terms of Reference.

¹⁰¹ Refers to point (13) of the Terms of Reference.

¹⁰² Refers to points (12) and (13) of the Terms of Reference.

¹⁰³ Refers to point (13) of the Terms of Reference.

¹⁰⁴ Refers to point (14) of the Terms of Reference.

¹⁰⁵ Refers to point (8) of the Terms of Reference.

¹⁰⁶ Refers to point (9) of the Terms of Reference.

¹⁰⁷ This issue will be addressed in general terms, given that direct reference is not made to it in the Terms of Reference.

The third section is divided up as follows:

Section III.2. analyses the **five basic scenarios**. All other variables remain unchanged. The aim is to understand the practical implications of the scenarios and sub-scenarios, to define and compare their impact on the industry and players.

Section III.3. broaches the subject of the **variables**. Their impact is analysed independently as well as within the framework of one or more scenarios, as appropriate. The aim is to identify suitable legislative options for each one of the variables and then to compare them.

Finally, the study identifies various **combinations of the most relevant scenarios and the critical variables**. Given the large number of possible combinations, certain options or combinations have been ruled out because they are not entirely relevant or because their impact is likely to be similar to that of other options or combinations of options.

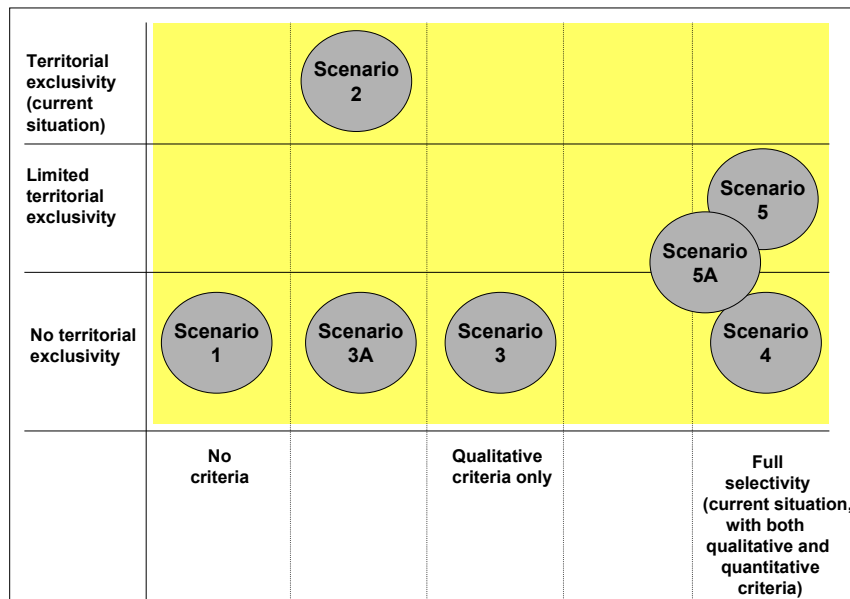
III.2. Legislative scenarios for distribution

The **five basic scenarios** are described as follows according to the Terms of Reference¹⁰⁸:

| | |
|--|---|
| Scenario 1 Totally 'free' distribution | <i>"A system in which independent car distributors have the right to purchase new vehicles from manufacturers or their official distributor networks."</i> |
| Scenario 2 Distribution based on territorial exclusivity | <i>"An exclusive distribution system in which the manufacturer agrees to sell new vehicles only to a single distributor within a well-defined territory."</i> |
| Scenario 3 Selective distribution based on qualitative criteria | <i>"A selective distribution system based only on qualitative criteria."</i> |
| Scenario 4 Selective distribution based on qualitative and quantitative criteria | <i>"A selective distribution system based on qualitative and quantitative criteria with no territorial exclusivity."</i> |
| Scenario 5 Selective distribution based on qualitative and quantitative criteria, with limited territorial exclusivity | <i>"A selective distribution system based on qualitative and quantitative criteria with limited territorial exclusivity in which active and passive sales in other territories are unrestrained."</i> |

In addition, the Terms of Reference outlines a sub-scenario of Scenario 5, Scenario 5A, where exclusivity is limited to five years. Additionally, in order to clarify Scenarios 1 and 3, Andersen has defined another sub-scenario, Scenario 3A, in which only a minimum set of criteria would be imposed on dealers.

The following diagram depicts the characteristics of the scenarios and sub-scenarios:



- Diagram III.1.-

¹⁰⁸ Point (4) of the Terms of Reference, describing the five 'basic scenarios' for the motor vehicle distribution system.

For purposes of comparison, the study describes and analyses the existing legislative framework projected forward to the year 2005. The system-based technique outlined in Section II supports the assessment. This projection takes into consideration the impact of internal and external factors like the introduction of the Euro.

The same analytical process applies to each of the five scenarios, starting with Scenario 5, given that it is the most similar to the existing legislative framework. This eases the task of outlining the impact of each one of the scenarios.

Important preliminary assumptions:

Before analysing each scenario, it is important to spell out the three basic assumptions laid down for the interpretation of the scenarios. These are described in the paragraphs below.

The first assumption is that **'all other variables remain unchanged' in the analysis of the five scenarios.** That means that all the features of the current legislative framework that do not directly relate to the principles of 'territorial exclusivity' and 'selectivity' are kept unchanged. Consequently:

- In Scenarios 3, 3A, 4, 5 and 5A, a **common single set of selection criteria**¹⁰⁹ is defined for all official networks;
- The manufacturers have the right to impose the same type of **restrictions on multi-branding**¹¹⁰ (in distribution and after-sales servicing) as is the case in the current situation;
- The method of dealer remuneration is **freely defined**¹¹¹ by the manufacturers;
- The manufacturers are entitled to reserve the right to make **direct sales** to certain types of clients;
- Access to technical information, original spare parts distribution, warranties and recalls remain the same as under the existing system.

In the case of selective distribution (Scenarios 3, 4, 5 and 5A), it is assumed that the authorised **qualitative and quantitative criteria correspond to the criteria defined and authorised within the framework of the existing system**¹¹². Specifically, the manufacturers would retain the **right to link distribution and service activities** i.e. to oblige their prospective distributors to build the capabilities required to ensure full after-sales servicing that covers the entire range¹¹³.

Finally, in the case of totally 'free' distribution, it appears that **any obligations imposed on the manufacturer and his network to sell to any prospective distributor could only be enforced if the former holds a dominant position.** This is not the case for any of the car manufacturers. Consequently, **Andersen assumes that, in Scenario 1, the distribution of new vehicles and original spare parts is conducted at the manufacturer's discretion,** either directly or via contracts signed with the distributors of their choice.

¹⁰⁹ The hypothesis of establishing a dual set of criteria will be addressed in the analysis of the variables (new entrants/new practices), with a view to envisaging a system of competing or complementary channels.

¹¹⁰ The alternatives will be analysed in part III.3. on the variables (multi-branding).

¹¹¹ The alternatives will be analysed in part III.3. on the variables (dealers remuneration).

¹¹² A detailed description is given of these criteria in table III.1. on the next page.

¹¹³ Correspond to the option identified in point (10) of the Terms of Reference. The other options available in relation to the selection criteria for repair activities will be analysed in part III.3 on the variables (link between sales and after-sales).

III.2.1. Current framework projected forward to 2005

III.2.1.A. Description of the current framework

The existing system is a selective and exclusive system.

Selective distribution:

The dealers are selected based on product-based quantitative and qualitative criteria, defined and issued in a transparent manner by the manufacturer.

The following table outlines the types of criteria most commonly used by the manufacturers:

| Area | Qualitative selectivity | Quantitative selectivity |
|---|--|---|
| Link between sales and after-sales | Possibility of selecting distributors on the basis of their ability to provide after-sales service. | Not covered. |
| Sale covering the entire range | Criteria related to the display and the sale of the entire range. | Criteria related to the number of models in stock and on display. Criteria related to the sales targets per model (renegotiated annually). |
| Active brand promotion policy | For example: - Decoration of the premises; - Brand visibility; - Collaboration with national/regional distributor. | Not covered. |
| Product-specific technological knowledge | For example: - Obligations in terms of product-specific knowledge and training; - Integration of the manufacturer's terms of warranty. | Not covered. |
| Limit on the number of players | Not covered. | Possibility for the manufacturer to define a given number of players for a given area. |

- Table III.1.-

This distribution mode can limit the number of official dealers, given that:

- The use of qualitative criteria is an indirect way for the manufacturer to limit the number of official dealers;
- The manufacturer is entitled to limit the maximum number of official dealers for a given area even if the latter do not actually hold territorial exclusivity.

Re-sale possibilities are limited as the official dealers are not authorised to sell the vehicles to re-sellers outside the network (unauthorised dealers).

Exclusive distribution:

Under an exclusive distribution system, the manufacturer agrees to sell his goods exclusively to one dealer within a given territory, and therefore **assigns a territory exclusively to one dealer**. In these cases, the location of sales and service outlets is subject to the manufacturer's approval.

The official dealers are protected in the sense that the **manufacturers can stop the dealers from carrying out active sales in other territories**.

The sole exception to territorial exclusivity is **direct sales** where the manufacturer is entitled to sell his products directly to certain customer segments.

Overview of the main features of the existing system:

The table below outlines the main features of the existing system. The description of all other scenarios would include these features and they would be used as a reference for comparison.

| Current framework projected forward to 2005 | |
|---|---|
| Selection of dealers: | According to qualitative and quantitative criteria defined by the manufacturer |
| Allocation of vehicles: | According to annually negotiated sales targets Exclusive supply to one distributor in a given territory |
| Resale to other distributors: | Permitted inside the network only |
| Location of sales and service outlets: | Subject to manufacturer's approval One dealer per territory |
| Number of outlets: | Limited by the manufacturer |
| Protection of the investment: | Ban on active sales in other territories No competing channels (except direct sales) |
| Regulation of after-sales servicing: | Compulsory link between sales and after-sales service Only the official dealers are authorised to distribute original spare parts and to carry out recall and warranty-related operations. |

- Table III.2.-

Positions of the players:

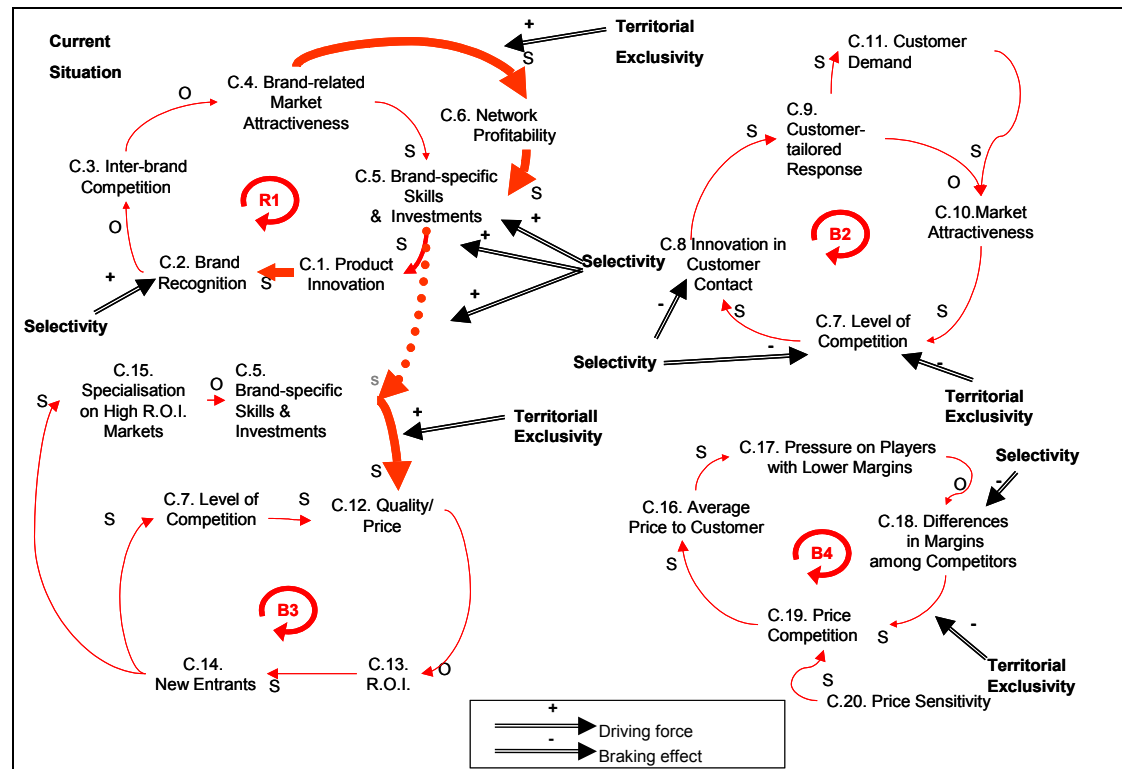
The positions of the players in relation to 'exclusivity' and 'selectivity' are as follows:

| | Territorial exclusivity | Selectivity |
|-----------------------------------|--|---|
| Manufacturers | In favour of the current situation | |
| Small official dealers | In favour of the current situation | In favour of qualitative criteria, yet asking for a relaxation of quantitative selection criteria (sales targets in particular) |
| Larger official dealers | Advocate a more flexible approach to the principle of territoriality | |
| New entrants and consumers | In favour of doing away with territorial exclusivity | On the whole, in favour of qualitative type criteria and opposed to quantitative criteria. More specifically: <ul style="list-style-type: none"> - Opposed to the maintenance of the link between sales and after-sales in its current form; - In favour of minimum qualitative criteria, insofar as they are effectively linked to the specific features and technological specifications of the product; - In favour of implementing a different system for new entrants (different sets of selection criteria according to the type of distribution channel) or a substantial relaxation of the criteria that are left at the manufacturers' discretion. - Opposed to the criteria related to the obligation to offer all the models of the vehicle range; - Opposed to criteria requiring all dealers to use purely traditional and physical sales processes (showroom); - Opposed to criteria limiting the number of dealers within a given territory; - Certain segments of new entrants appear to be in favour of quantitative criteria, provided these relate to overall sales volumes rather than to specific targets for the entire vehicle range. |

- Table III.3.-

III.2.1.B. Dynamic impact assessment

Part II studied the impact of the legislative framework on the system-based model. The following diagram gives an overview of the influence of these legislative factors on the system:



- Diagram III.2.-

The impact of the external factors may either affect one of the system's components or the relationship of cause and effect. They may either exert a driving force (+) or have a braking effect (-). The relationships represented by thick arrows are those that are reinforced by the external legislative factors. The relationships represented by dotted arrows relate to the relationships between loops.

To understand the similarities and differences between the impact of exclusivity and the impact of selectivity, the two dimensions are analysed separately below.

The **impact of exclusivity** on the four loops can be summarised as follows:

| Influencing factors | Players | Impact on loop 1 (product innovation) | Impact on loop 2 (customer-tailored response) | Impact on loop 3 (overall value for money) | Impact on loop 3 (value for money of specialised repair) | Impact on loop 4 (price to customer) |
|-------------------------|---------------|---------------------------------------|---|--|--|--------------------------------------|
| Territorial exclusivity | Manufacturers | <u>Driving force</u> | <u>Brake</u> | | <u>Driving force</u> | <u>Brake</u> |

- Table III.4.-

A major brake on B2 (customer loop) in sales service

The most direct impact of territorial exclusivity would be the **restriction of intra-brand competition in distribution** (impact on C7) between the following groups:

- **Traditional official dealers;**
- **Various types of distributors who develop different distribution formats.**

These two impacts would tend to limit the level of innovation in customer contact (C8) and would maintain a slow speed of activation of the customer loop (B2).

A major driving force for R1 (product loop)

Territorial exclusivity would guarantee that the official dealer has a certain level of sales volume, together with additional revenue directly related to after-sales servicing work (impact on C4). It therefore would provide substantial protection of the dealer's investments and profitability (C6).

The profitability of the official networks would contribute to boosting brand-specific skills and investment (C5), and, in turn, to maintaining a high activation level of the product loop (R1).

Stabilising effect on B3 (reliability loop)

The reinforcement of the official players' profitability and brand-specific investment (C5) would indirectly reinforce the overall reliability of after-sales servicing (C12), particularly concerning specialised activities or specific models.

Minor braking impact on B4 (price loop)

Limiting intra-brand competition (C7 in B2) would have an indirect impact on the level of price competition (C19). This impact, however, needs to be put into perspective, given the following:

- Competition already effectively exists between the official network players¹¹⁴ ;
- Price competition is primarily limited due to the similarity of the margins of all the players (C18).

¹¹⁴ As already mentioned in part II, 30 to 60% of the sales are made outside the dealer's territory.

The **impact of selectivity** can be summarised as follows:

| Influencing factors | Players | Impact on loop 1 (product innovation) | Impact on loop 2 (customer-tailored response) | Impact on loop 3 (overall value for money) | Impact on loop 3 (value for money of specialised repair) | Impact on loop 4 (price to customer) |
|---------------------------------|---------------|---------------------------------------|---|--|--|--------------------------------------|
| Qualitative selection criteria | Manufacturers | <u>Driving force</u> | <u>Brake</u> | | <u>Driving force</u> | |
| Quantitative selection criteria | Manufacturers | <u>Driving force</u> | <u>Brake</u> | | <u>Driving force</u> | <u>Brake</u> |

- Table III.5.-

The main driving force on R1 (product loop)

A manufacturer's ability to define selection criteria provides him with control over the marketing policy. **It helps manufacturers promote their brand image (C2), enforce safety and quality standards, and manage sales volumes for the entire range (C1).**

Selectivity therefore represents the main driving force of the product loop (R1). It constitutes a guarantee for long-term integration among the various players throughout the value chain.

A major brake on B2 (customer loop)

As in the case of exclusivity, described above, **selectivity acts as a direct barrier to intra-brand competition (C7)**. Selectivity constitutes a de facto access barrier to distribution for players wishing to develop alternative business models¹¹⁵, and therefore reduces levels of innovation in customer contact (C8). In addition, the ability to influence the number of players via quantitative selection criteria results in a limitation of the number of official dealers.

Stabilising impact on B3 (reliability loop)

When dealers are allowed to carry out brand-specific and complex repair work, selectivity serves as a means for manufacturers to ensure continuity of servicing for the entire life of the vehicle, for all types of models, for all types of services and in all geographic areas (C12).

Braking impact on B4 (price loop)

Selectivity tends to limit the number and the diversity of distribution and service players. It therefore reduces the differences in margins (C18), which, in turn, affects the level of price competition (C19).

¹¹⁵ The manufacturers currently favour the development of a single business model. The obligation to offer the entire vehicle range is a barrier to the development of alternative structures by specialised players.

Long-term impact:

The following table gives an overview of how the industry would look in the long term (5 to 10 years) if the current legal framework were to be maintained. It reflects an extrapolation of the **trends currently underway** (see current situation).

| Current framework projected forward to 2005 | | |
|---|---------------------------------------|---|
| | Current situation | Current framework projected forward to 2005 |
| Impact on the four loops | | |
| Product loop (R1) | High | Same |
| Customer loop (B2) | Low (sales) High (after-sales) | Same |
| Reliability loop (B3) | Stable | Same |
| Price loop (B4) | Stable | Same |
| Impact on the four areas of competition | | |
| Inter-brand competition | High | Same |
| Intra-brand competition | Low | Slight increase |
| Competition in after-sales servicing | Medium | Increase for non-specialised repair work Decrease for specialised repair |
| Market integration | Low | Slight increase |
| Impact on the distribution market | | |
| Market share held by official distribution networks | 100% | Same |
| Level of product innovation | High | Same |
| Cost structure for the sale of new vehicles | About 30% of the final price of a car | Slight rationalisation of distribution costs (already underway) |
| Level of price competition | Stable | Same |
| Number of distributors (fragmentation level) | High number | Increase in concentration among players And reduction in the number of sale outlets |
| Manufacturers' control over their marketing policy | High | Same |
| Differentiation of distribution forms according to customer segments, car models and geographical areas | Low | Slight innovation in distribution channels By the manufacturers and their networks e.g. direct sales, Internet or customer relationship management |
| Impact on the after-sales market | | |
| Official networks' share in after-sales market | About 53% | Slight increase in networks' market share Compared to independent players |
| Number of service outlets | About 335,000 | Increase in the number of 'fast fit' repair Outlets ; less independent repair outlets; Increase in the number of 'Hub and Spoke organisations |
| Average value for money of service provided | Medium | Same |
| Density and reliability of service outlet coverage | Medium | Same |

- Table III.6.-

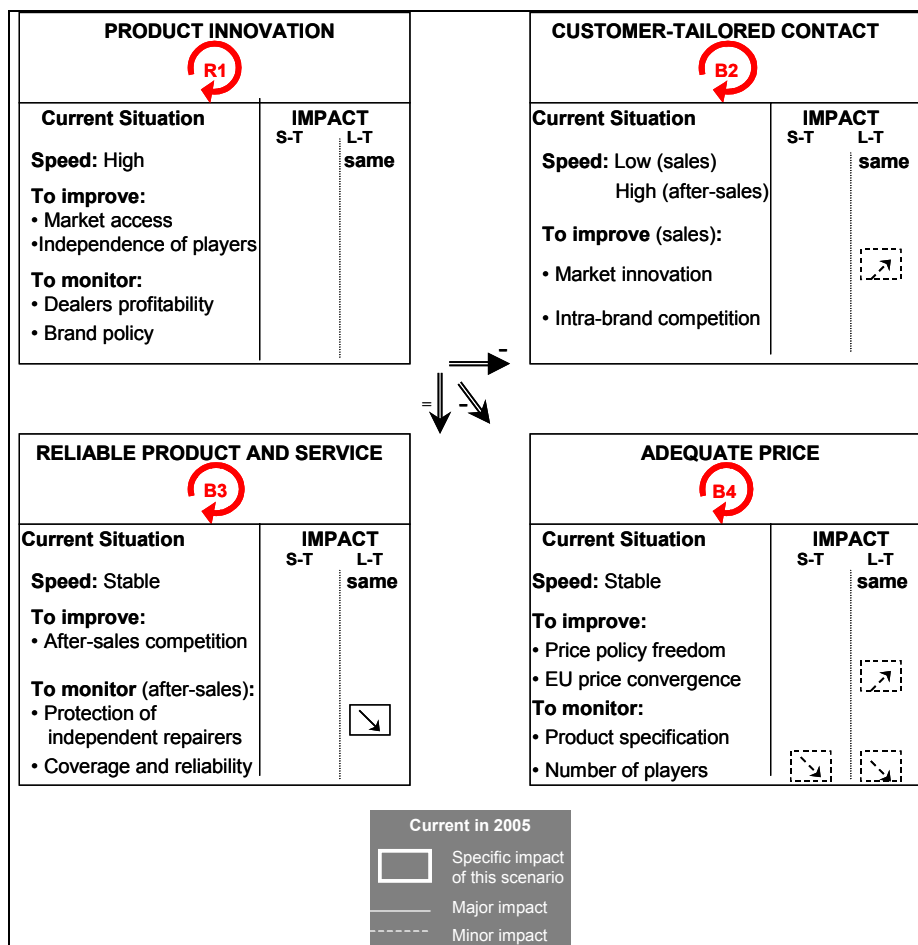
III.2.1.C. Summary of the current framework projected forward to 2005

The projection of the current legislative scheme forward to the year 2005 reflects an extrapolation of the trends currently underway. It would result in **the activation pattern of the four loops that remain unchanged**. In other words, the product loop (R1) would sustain its high speed of activation, the reliability loop (B3) would be stabilised and the customer loop (B2) and price loop (B4) would be slowed.

More specifically, 'territorial exclusivity' would ensure the efficient territorial distribution of investments and protect the official distributors' profitability, while 'selectivity' would benefit manufacturers, enabling them to honour their commitments and maintain control over their marketing policies (in relation to image and sales volumes).

If the current legal framework were to remain unchanged, **the profile of competition in the industry, the market structure and the extent to which customer needs are satisfied would undergo progressive natural development**. These developments would include increased network concentration; slight innovation in customer contact by manufacturers and their networks; more integrated domestic market and price convergence; even stronger product specialisation; pressure on traditional independent repairers, and specialisation of after-sales players.

The diagram below depicts the likely developments of the four loops relative to the current situation. It indicates the impact on the areas for improvement and risk factors. Arrows in the middle of the diagram highlight the interactions between the loops.



- Diagram III.3 -

III.2.2. Scenarios 5 and 5A – Limited territorial exclusivity and full selectivity

III.2.2.A. Description

Scenario 5:

Scenario 5 is a selective and exclusive distribution system close to the current legislative scheme. The only difference is that the **definition of the territorial concept is less strict**. In fact, official distributors would not be authorised to open sales or service outlets outside their territory, but could organise their own personalised advertising (telephone, e-mails, direct mail, door-to-door,...) and could send their sales teams outside their territory.

Implications of this scenario are summarised in the table below:

| | Scenario 5 |
|---|---|
| Selection of dealers: | Same as in the current legislative scheme i.e. qualitative and quantitative criteria defined by the manufacturer |
| Vehicle allocation: | Same as in the current legislative scheme i.e. based on annually negotiated sales targets currently negotiated and with exclusive supply to one distributor in a given territory |
| Resale to other distributors: | Same as in the current legislative scheme i.e. only inside the network |
| Location of sales and service outlets: | Same as in the current legislative scheme i.e. subject to the manufacturer's approval and with only one dealer per territory |
| Number of outlets: | Same as in the current legislative scheme i.e. limited by the manufacturer |
| Protection of investments: | Protection of dealer's investments is more limited than in the current legislative scheme as active sales in other territories are allowed. However, there are no competing or complementary channels (except for direct sales). |
| Regulation of after-sales servicing: | Same as in the current legislative scheme i.e. compulsory link between sales and service activities; only the official dealers can distribute original spare parts, carry out recall operations and repairs under warranty |

- Table III.7.-

Scenario 5A:

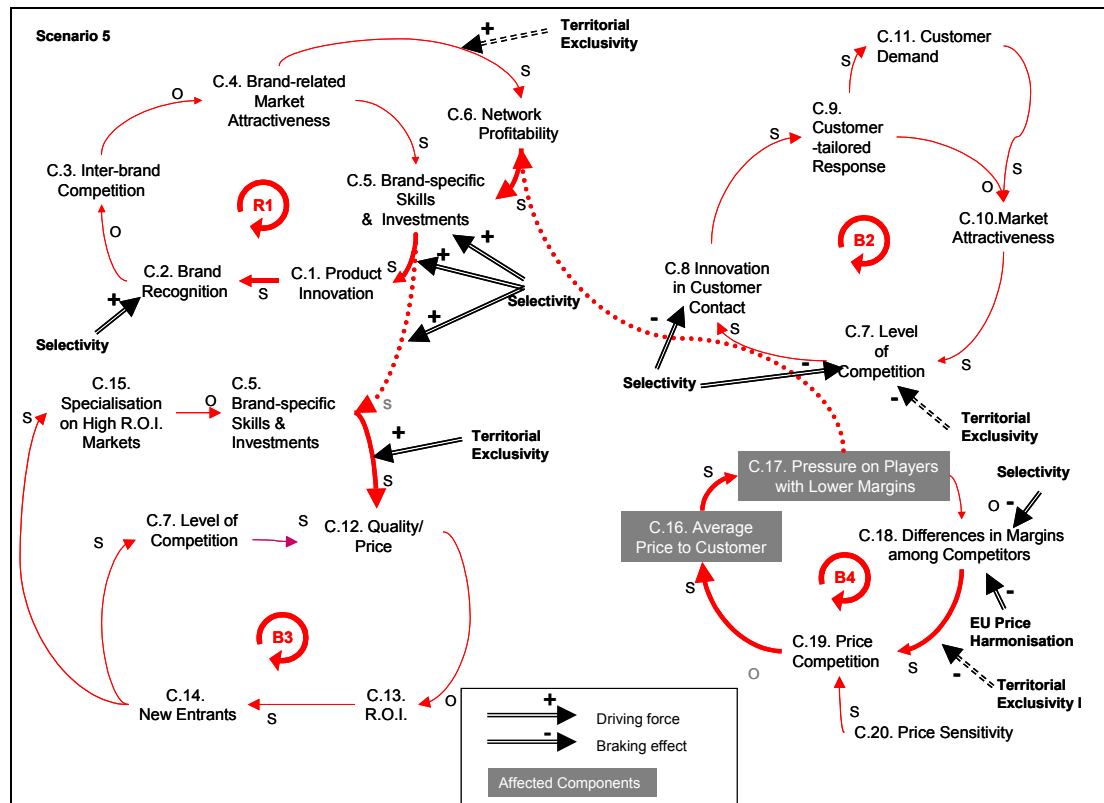
Scenario 5A is a sub-scenario of Scenario 5 where the **term of exclusivity** agreements would be **limited to 5 years**¹¹⁶. Therefore, the period during which investments of newly established dealers would be protected is shorter compared to Scenario 5, where exclusivity would not have any time constraints. Compared to Scenario 4, however, Scenario 5A would somewhat protect the initial investments of newly established dealers.

In reality, this scenario would be closer to Scenario 4 where territorial exclusivity is removed. Indeed, in practice, the main geographical areas where established dealers operate would be open to competition from new entrants, while some specific territories, mainly new geographical markets for a given brand, could be allocated exclusively to one dealer for a five-year period. During this period, these newly allocated and exclusive territories would not be protected from active sales carried out by other dealers.

¹¹⁶ The Terms of Reference provide for the examination of a sub-scenario whereby new distributors can be granted limited territorial exclusivity for a maximum of five years in order to protect their initial investments.

III.2.2.B. Dynamic impact assessment

The diagram below illustrates the impact of Scenario 5:



- Diagram III.4.-

The diagram illustrates the impact of exclusivity and selectivity on the system (double arrows). The dotted arrows refer to the 'more flexible' nature of territorial exclusivity under this scenario. The components highlighted are those for which the impact is different to the impact of the 'current situation' (framework of the Block Exemption) projected forward to 2005'.

The impact of Scenario 5 compared to the impact of 'The current framework projected forward to 2005' can be summarised as follows:

| | |
|---|---|
| Slight acceleration of B4 (Price loop) | <p>More flexible territorial exclusivity would directly affect the level of intra-brand competition in some areas (C7). This, in turn, would affect the level of price competition (C19) in these attractive areas (high density and/or profitability) as well as in relation to parallel imports. Once the market share has been re-distributed, there would be a similar balance to that reached with the 'current framework projected forward to 2005' (reference situation).</p> <p>Price competition (C19) therefore would promote European price convergence (C16) and would reinforce the existing trend of excluding players with lower margins (C17), that is, the smallest dealers, and particularly those based in urban areas.</p> |
| No difference to R1 (Product loop) | <p>In the short term, the pressure on the weaker players (C17) would affect the official network's average profitability (C6). In the medium term, this impact would be countered by the achievement of the targets set (acquisition of market shares), concentration, and the reorganisation of the networks (a trend already underway today). The increase in size of an average dealer would also improve the dealer's bargaining power.</p> <p>Furthermore, maintaining territorial exclusivity and selectivity (as shown by the various reinforcing arrows pointing to R1) would likely preserve the activation level of the product loop (R1).</p> |
| No difference to B2 (Customer Loop) | <p>The slight, temporary activation of intra-brand competition (C7) would not really allow for the development of competing channels, so this factor would not have a decisive impact on either innovation in service and customer contact (C8).</p> |
| No difference to B3 (Reliability Loop) | <p>By maintaining territorial exclusivity, the uniformity of the investments channelled towards after-sales servicing (C5) could also be maintained, thus ensuring value for money and service outlet coverage (C12) similar to those existing at present.</p> |

Players' reactions:

The manufacturers' main reaction to Scenario 5 would be to accelerate the convergence of European prices (before taxes) even in a context where fiscal harmonisation is not achieved.

| Influencing factors | Players | Influence | | Description |
|--------------------------------|---------------|-----------|--------------|--|
| | | On: | Impact | |
| Convergence of European prices | Manufacturers | C18 | <u>Brake</u> | Greater price convergence within European countries is the most likely reaction from manufacturers to growing parallel imports. Prices would not, however, completely converge due to the lack of tax harmonisation. |

- Table III.8.-

Adaptation period:

The loops are likely to adapt rapidly following the introduction of the new system (within 6 to 18 months). Adaptation time for Scenario 5A, however, would be closer to that of Scenario 4.

Long-term impact:

The long-term impact of Scenario 5 is similar to that described under the heading 'current framework projected forward to 2005'. The differences are summarised in the table below:

| Scenario 5 | | |
|---|--|---|
| | Current framework projected forward to 2005 | Scenario 5 |
| Impact on the four loops | | |
| Product loop (R1) | High | Same |
| Customer loop (B2) | Low (sales) High (after-sales) | Same |
| Reliability loop (B3) | Stable | Same |
| Price loop (B4) | Stable | Slight increase The increased activation of the loop in densely populated/cross-border areas has a temporary impact that would stabilise as soon as the prices converge and a degree of concentration is developed in densely populated areas |
| Impact on the four areas of competition | | |
| Intra-brand competition | High | Same |
| Intra-brand competition | Slight increase | Increase in certain areas |
| Competition in after-sales servicing | Increase for non specialised repair work; Decrease for specialised repair work | Same |
| Market integration | Slight increase | More rapid market integration |
| Impact on the distribution market | | |
| Market share held by official distribution networks | Stable | Same |
| Level of product innovation | High | Same |
| Cost structure for the sale of new vehicles | Slight rationalisation of distribution costs (already underway) | Slight increase in the marketing costs , particularly for distributors |
| Level of price competition | Stable | Same |
| Number of distributors (fragmentation level) | Increase in concentration among players and reduction in the number of sales outlets | Trend reinforced |
| Manufacturers' control over their marketing policy | Stable boost parallel imports and | Same BUT: The dealer's ability to carry out active sales outside his territory would likely would incite manufacturers to ensure pre-tax price convergence at European level. |
| Differentiation of distribution forms according to customer segments, car models and geographical areas | Slight innovation | Increase in virtual channels, marketing and 'Customer Relationship Management' initiatives, particularly in densely populated areas |

| Scenario 5 | | |
|---|--|------------|
| | Current framework projected forward to 2005 | Scenario 5 |
| Impact on the after-sales market | | |
| Official networks' market share in after-sales market | Slight increase in official networks' market share compared to independent players | Same |
| Number of service outlets | Increase in the number 'fast fit' chains and 'Hub and Spoke' organisations but a decrease in independent repairers | Same |
| Average value for money of service provided | Stable | Same |
| Density and reliability of service outlet coverage | Stable | Same |

- Table III.9.-

The impact of this scenario on the various players would be minor, as illustrated in the table above.

For the **manufacturers**, the main change compared to the current situation would be the increased pressure to make prices converge in the European Union.

The impacts for **official dealers** would include:

- Increased pressure on the weakest players;
- More independence from the manufacturers for the biggest players;
- Increased investments in marketing.

Traditional independent repairers with a conventional 'generalist' multi-brand market approach would find it difficult to survive due to the increased technical complexity.

III.2.2.C. Summary of Scenario 5

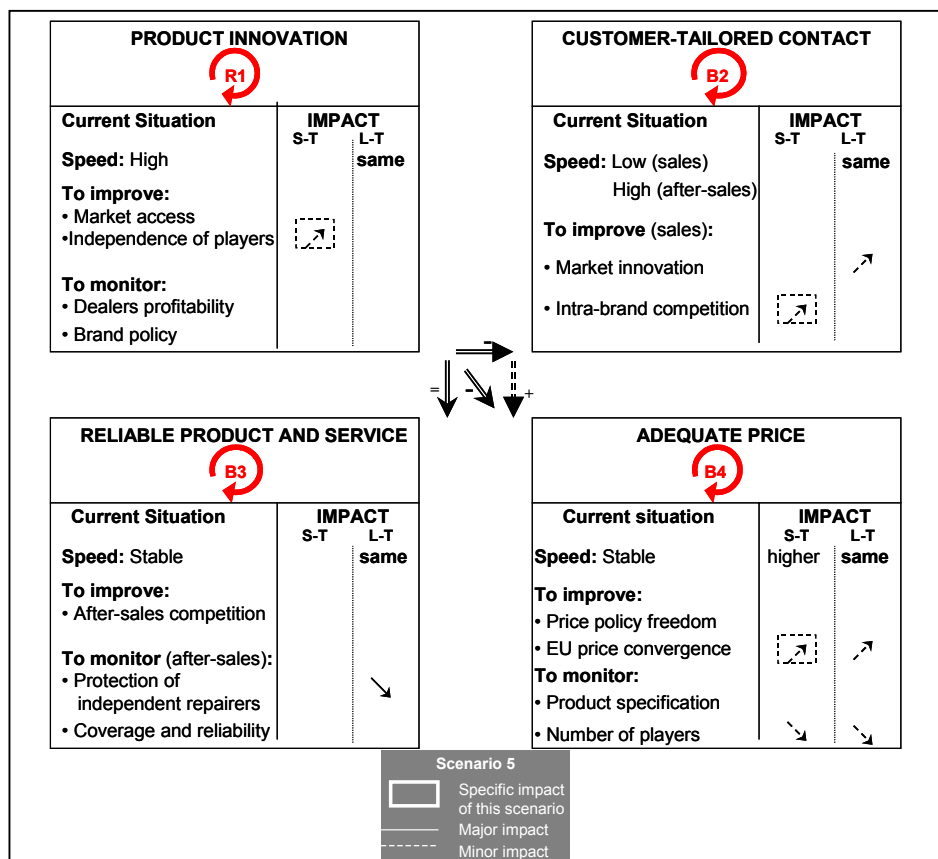
The main difference between Scenario 5 and the current legislative framework is that the territorial concept is less strictly defined in Scenario 5, which means that dealers would be able to actively sell in other territories.

Scenario 5 would offer some de-compartmentalisation of geographic markets, would allow **acceleration of European market integration** while making parallel imports easier. Manufacturers would face increased pressure to accelerate price convergence in the European Union.

For the official networks, this framework would **stimulate marketing initiatives and the management of customer relationships slightly**, but essentially in the most profitable areas. The weakest dealers would face increased competitive pressure while the biggest players would enjoy more independence from manufacturers. The **concentration among distributors**, which is an impact already observed under the projection of the current framework forward to 2005, would be slightly reinforced by this greater intra-brand competition.

Although market integration and intra-brand competition would slightly increase, **the impact of this scenario would not be very different from the developments in the industry** that would occur if the current legal framework were to be maintained. In particular, Scenario 5 would preserve the characteristics of fragmentation (e.g. a large number of sales and service players) and a single distribution format. The activation of the four causal loops of the industry would remain unchanged.

As summarised below, based on the same schema as that previously used, the long-term impact on the speed of activation of the loops is neutral compared with the 'current framework projected forward to 2005'. However, in the short term, some changes are seen:



- Diagram III.5 -

Scenario 5A:

In addition, a sub-scenario, 5A, in which exclusivity would be restricted to five years has been taken into account, in order to protect initial investments of newly established dealers.

In practice, two forms of dealership agreements would co-exist in such a framework:

- Existing dealers would operate their dealerships without regard to any exclusive territory. Given that all other features would be the same as in Scenario 5, this would be a situation similar to Scenario 4 where various dealers may compete within the same area; and
- Newly established dealers would operate their dealerships knowing that the manufacturer would not be allowed to have any other dealer in the territory for five years. However, these newly established dealers would face competition from active sales carried out by other dealers.

Considering the high proportion of dealers already established, this scenario would be the closest to Scenario 4, where exclusivity is totally removed.

This option may be an efficient way to combine incentives to invest in new or less attractive areas where manufacturers may decide to open new dealerships and a to promote a more competitive market structure in regions where market penetration by existing dealers is already high.

Concerning the effect in which the initial investment would be protected, it should be noted that one could find other means of protection, such as guaranteeing reimbursement of initial investments.

III.2.3. Scenario 4 – Qualitative and quantitative selectivity

III.2.3.A. Description

Scenario 4 is a selective distribution system, with no territorial exclusivity.

While the exclusive allocation of a territory would no longer be authorised, it does not altogether exclude the notion of 'geographical area'. Distributors would be free to operate new sales and service outlets provided the maximum number of outlets, as established directly or indirectly by the manufacturers, is not reached within a given area. Their commercial activities would not be limited to any territory in principle.

Allocation of new vehicles to distributors would still be based on annually negotiated sales targets designed to reach a minimum sales volume and cover the entire range. However, in this scenario, territory would no longer serve as a basis for determining these targets.

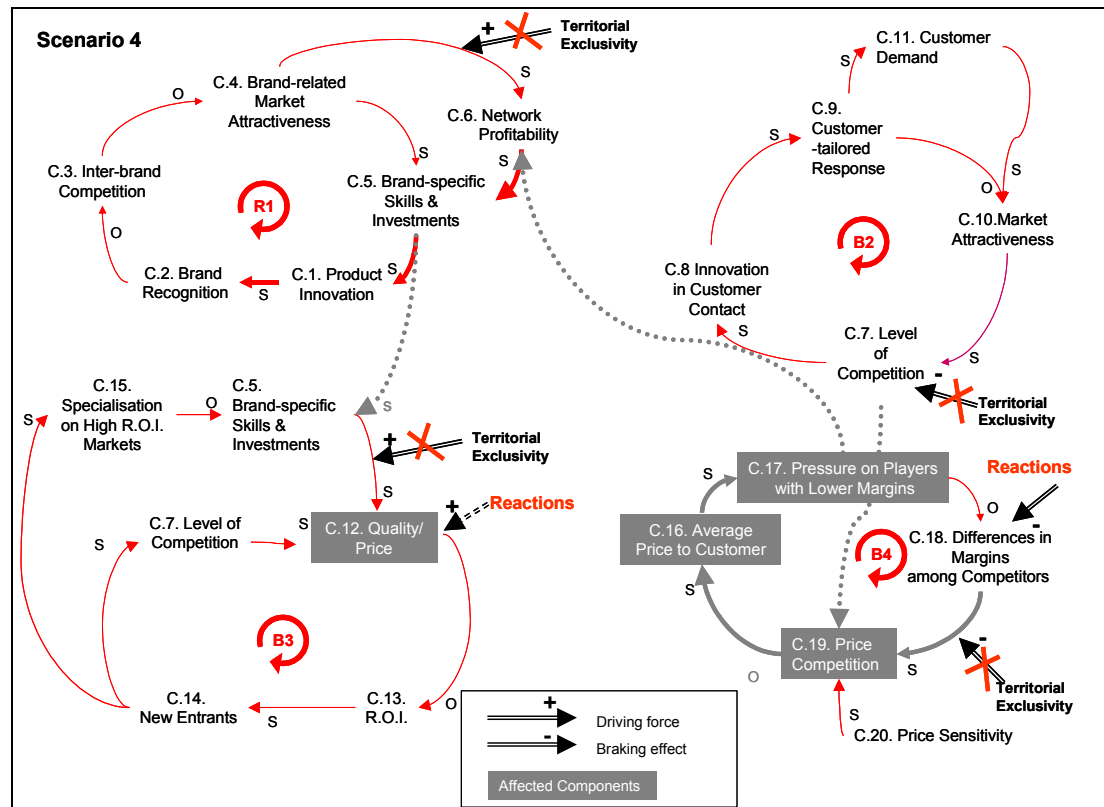
Consequently, the practical implications of the scenario are listed below:

| Scenario 4 | |
|---|--|
| Selection of dealers: | Same as in the current legislative scheme i.e. qualitative and quantitative criteria defined by the manufacturer |
| Vehicle allocation: | According to annually negotiated sales target |
| Resale to other distributors: | Same as in the current legislative scheme i.e. only inside the network |
| Location of sales and service outlets: | Distributors meeting the selection criteria would be free to operate new sales and service outlets in the territory of their choice provided the maximum number of outlets for the area in question is not reached . Their commercial activities would not be limited to any territory. |
| Number of outlets: | Close to the current legislative scheme i.e. limited by the manufacturer as the latter has the authority to set a maximum number of outlets per area |
| Protection of the investment: | Protection from competing dealers is limited . However, there are no alternative distribution channels (except direct sales). |
| Regulation of after-sales servicing: | Same as in the current legislative scheme i.e. compulsory link between sales and service activities; only the official networks would be allowed to distribute original spare parts and to carry out recall operations and repair work covered by warranty |

- Table III.10.-

III.2.3.B. Dynamic impact assessment

The impact of Scenario 4 is illustrated in the diagram below¹¹⁷:



The description below focuses on the specific implications of Scenario 4, i.e. those which differ from the implications already outlined in Scenario 5.

Slight increase in the speed of activation of B2 (Customer loop)

The most direct impact of the abolition of territorial exclusivity is that it would allow the co-existence of various distributors in the same territory, which would lead to an increase in intra-brand competition (C7).

However, the enforcement of strict selection criteria by the manufacturers would still be a means used to prevent the development of competing channels i.e. alternative distribution formats based on new business models. The impact on the innovation in customer contact (C8) would remain limited.

¹¹⁷ The diagram illustrates the difference between Scenario 4 and Scenario 5, in other words, the abolition of territorial exclusivity. In order to simplify the diagram, only specific impacts have been represented.

Strong short-term activation of B4 (Price loop)

As a consequence of increased intra-brand competition (C7) and the increase in price competition resulting from the increased level of competition (C19), the short-term implications already described in Scenario 5 would be duplicated, namely:

- A drive towards price convergence at European level;
- The exclusion of the smaller dealers, particularly in urban areas.

In this situation, **price competition would likely intensify, affecting the average profitability of all the players in the short term.** This increase in price competition would result in the re-distribution of market share for a given territory. Furthermore, the least competitive dealers (C17) would be forced out of the market. Indeed, due to the current weak average profit level, a slight increase in the average discount given to customers would affect the profitability of a great number of players.

Quantitative selectivity (limiting the number of outlets, sales targets on the full range) **and the method of dealer remuneration should, however, allow the manufacturers to limit margin differentials between dealers (C18) as well as the level of price competition (C19).**

In the long run, once the dealers' concentration level has stabilised, margins would improve and prices would stabilise.

No change in R1 (Product loop)

As explained under Scenario 5, the short-term weakening of official dealers' profitability would be countered in the medium term by heavier concentration and the reorganisation of the networks.

The level of brand-specific investment is not likely to be affected in the long term, given that the manufacturers have sufficient tools to be able to continue to influence brand image policy and regional sales targets.

Perturbations on B3 (Reliability loop)

The market exclusion of small-scale official dealers would mean a **short-term reduction in the number of official service outlets, leading to short-term imbalances in the networks' service outlet homogeneity and coverage.** Nonetheless, in the long term, the demands in terms of service outlet coverage would lead to the stabilisation of the number of official service outlets, be it through direct investments by the manufacturers or through incentives for official dealers.

The absence of territorial exclusivity complicates the practicality of linking sales to after-sales, given that the notion of responsibility for a specific territory would no longer exist. In practical terms, the result that would be observed would be the strengthening of the specialisation trend among players and outlets. These would opt to concentrate either on sales, repair, or 'full facility' operations. The way in which the link between sales and after-sales servicing is organised would eventually have to be re-worked, as priority would either have to be given to price uniformity (at the expense of coverage) or to coverage (at the expense of uniform price levels).

Players' reactions:

The manufacturers are likely to take the following measures to counter certain negative effects of abolishing territorial exclusivity:

| | Influencing factors | Players | Influence | | Description |
|--------------------|-----------------------------------|---------------|-----------|---------------|--|
| | | | On: | Impact : | |
| Emerging practices | | | | | |
| | Investments in servicing | Manufacturers | C12 | Driving force | The geographical disparities between the investments made by the official distributors would probably have to be countered by increased investments, on the part of manufacturers, into network support and training, as well as incentives to ensure adequate coverage. In extreme cases, certain manufacturers may directly invest in servicing outlets. |
| | Adaptation of remuneration policy | Manufacturers | C18 | Brake | The method of dealer remuneration is a key network management tool for manufacturers. The target-related bonuses that are used and that relate to the whole range of products is a means of fighting against volume sales of some standard 'best-selling' products. |

Table III.11.-

Adaptation period:

In the short run, the implications of Scenario 4 would be very similar to those of Scenario 5. There would be greater activation of the price loop (B4) in certain geographic areas and the progressive exclusion of some smaller players from the market.

In the medium term (2 to 5 years), the impact of the trend towards greater player specialisation in the sales or after-sales field would be gradually felt.

Scenario 5A would lead to a less disruptive transition towards the removal of territorial exclusivity.

Long-term impact:

Compared to Scenario 5, the most similar scenario, the implications of Scenario 4 are as follows:

| Scenario 4 | | |
|---|---|--|
| | Scenario 5 | Scenario 4 |
| Impact on the four loops | | |
| Product loop (R1) | High | Same |
| Customer loop (B2) | Low (sales) – High (after-sales) | Same |
| Reliability loop (B3) | Stable | Temporary imbalances in the sales outlet coverage and future development dependent on the players' reactions |
| Price loop (B4) | Slight increase | Short-term activation |
| Impact on the four areas of competition | | |
| Intra-brand competition | High | Same |
| Intra-brand competition | Increase in some areas | Increase Competition boosted within the network but no competing channels developed based on alternative business models |
| Competition in after-sales servicing | Increase for non-specialised repairs but decrease for specialised repairs | Same |
| Market integration | More rapid integration | Even faster market integration |
| Impact on the distribution market | | |
| Market share held by official distribution networks | Stable | Same |
| Level of product innovation | High | Same |
| Cost structure for the sale of new vehicles | Slight rationalisation of distribution costs. Slight increase in the marketing costs particularly for distributors | Trend reinforced |
| Level of price competition | Stable | Same |
| Number of distributors (fragmentation level) | Increased concentration and reduction in the number of sales outlets | Same Increase in the proportion of multi-site dealers |
| Manufacturers' control over their marketing policy | Stable BUT pressure on European prices to converge | Trend reinforced |
| Differentiation of distribution forms according to customer segments, car models and geographical areas | Slight innovation | Emergence of dealer specialisation trend ('full facility' vs. 'sales only' vs. 'repair only') and pressure on the compulsory link between sales and after-sales |
| Impact on the after-sales market | | |
| Official networks' share in after-sales market | Slight increase in official networks' market share compared to independent players | Same |
| Number of service outlets | Stable | Reduction in short/medium term and imbalances Instability exerts pressure on the current way of organising the sales/after-sales link |
| Average value for money of service provided | | |
| Density and reliability of service outlet coverage | | |

- Table III.12.-

As indicated in the table above, this scenario would have a major impact on the players. For manufacturers, the areas of impact include:

- Increase in intra-brand competition;
- Pressure to narrow price gaps;
- Increasing concentration, which would likely promote 'lean distribution';
- Difficulty in managing geographical coverage.

Regarding the official networks, the main opportunities and threats include:

- Trend towards concentration;
- Multi-site growth opportunities;
- Player specialisation.

Scenario 5A:

The main difference between Scenario 4 and Scenario 5A would be the reduction of short-term instability and imbalances in Scenario 5A. In the longer term, impact of these two scenarios would be similar.

III.2.3.C. Summary of Scenario 4

The most direct impact of the abolition of territorial exclusivity would be the co-existence of various distributors within the same territory, which would increase **intra-brand competition** as well as **price competition** in certain areas. It would also speed up the concentration and internationalisation of dealers described in Scenario 5.

However, the abolition of territorial exclusivity as such, with all other variables remaining unchanged, would not fundamentally alter close working relationships within the automobile industry. In fact, **using various other means, manufacturers would be in a position to preserve control over their marketing and sales strategies and the development of new distribution formats**, for example by:

- Limiting the number of players within a given area (quantitative selectivity);
- Laying down qualitative selection criteria to hinder the genuine coexistence of different distribution forms;
- Using methods of dealer remuneration that stimulate brand-specific investment.

The absence of territorial exclusivity would make the linking of sales to after-sales service more complex, given that the notion of responsibility for a specific territory would no longer exist. In practical terms, the specialisation trend among players and outlets would strengthen, as they would opt to concentrate either on sales, repair or 'full facility' operations. The way of organising the link between sales and after-sales servicing would eventually have to be re-worked. Otherwise, manufacturers would face increasing difficulty in managing geographical coverage of their service network.

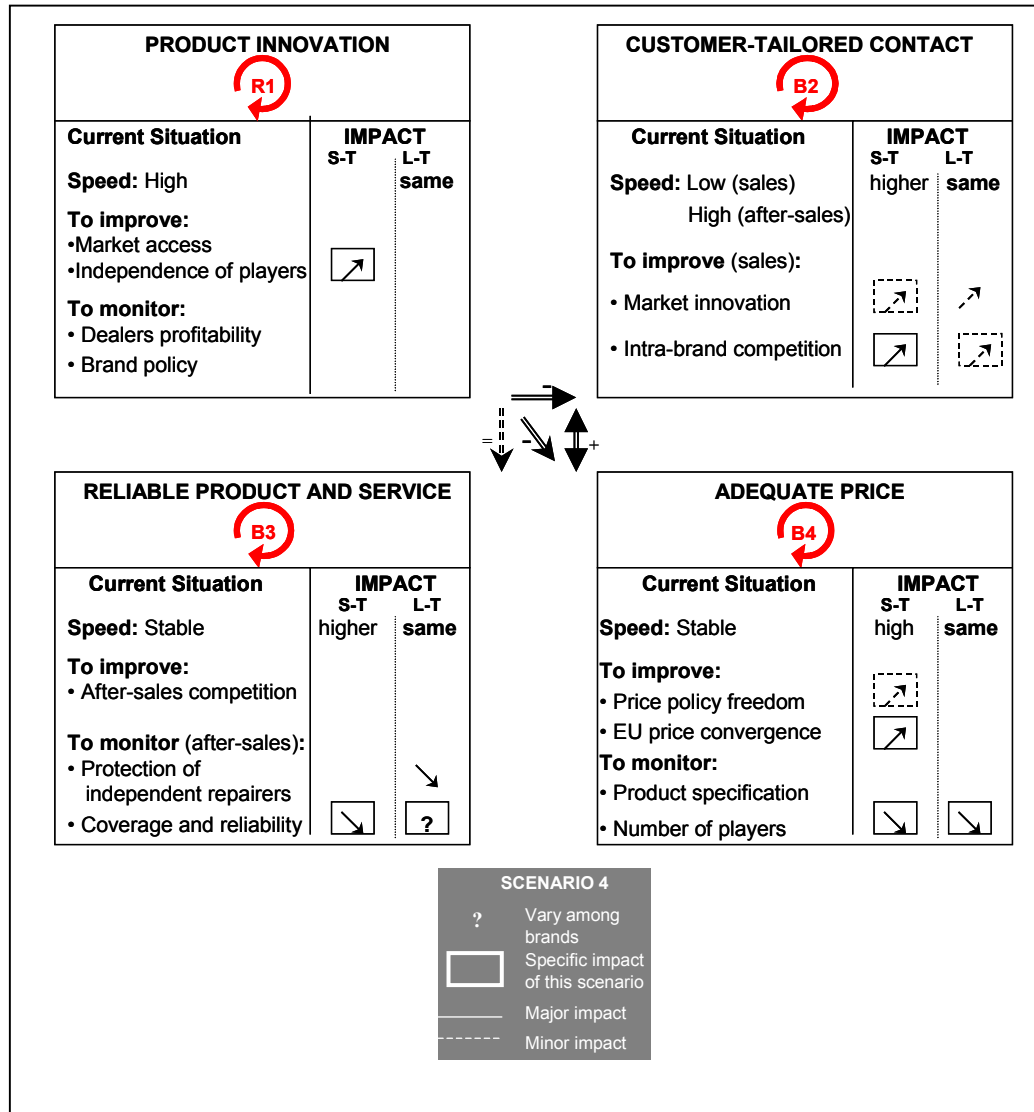
Furthermore, it is likely that this scenario would also involve **structural changes in the economics of car distribution**. Likely modifications would include rationalisation of distribution costs, a development in which marketing costs would increasingly be borne by the distributors and **increased differentials in cost profiles among types of players**.

Although it appears that, in the long term, the balance of the industry would not be profoundly changed, **the disruptions in the after-sales market caused in the short and medium term constitute risk factors**.

In the long term (2 to 5 years), specialisation of players would be gradually felt. The impact for established, traditional dealers would be significant. **The average size of a dealer would likely increase as well as the number of 'Hub and Spoke' structures of specialised repair outlets and the proportion of international and multi-site players.**

Scenario 5A could be seen as a way to ensure a less disruptive transition towards a distribution system without any reference to territories.

The short- and long-term implications of Scenario 4 compared to Scenario 5 can be graphically summarised as follows:



- Diagram III.7 -

III.2.4. Scenarios 3 and 3A – Qualitative selectivity only

III.2.4.A. Description

Scenario 3 is a system of selective and non-exclusive distribution. The selection criteria are purely qualitative and linked to the nature of the product and the requirements for promoting the brand¹¹⁸. Any player meeting the criteria would be able to sell new vehicles and spare parts. The manufacturer would be responsible for the allocation of vehicles in a non-discriminatory way.

A legal examination of the obligation for manufacturers to supply vehicles to distributors, however, reveals that in order to avoid a dispute the vehicles should be allocated based on the distributor's sales record and perhaps on the distributor's projected market growth. Although it is a way to guarantee equity, it would appear that the players already established are given priority over prospective, new entrants.

| Scenario 3 | |
|---|--|
| Selection of dealers: | According to qualitative criteria only |
| Vehicle allocation: | At the request of the distributors – If there is a dispute, vehicles are allocated based on the sales record and projected growth |
| Resale to other distributors: | Same as in the current legislative scheme i.e. only inside the network |
| Location of sales and service outlets: | Manufacturer has no mean to influence outlets location. |
| Number of outlets: | Unlimited provided the qualitative criteria are met |
| Protection of investments: | Dealers are no longer protected from competing official dealers. However, there are no competing or complementary channels (except for direct sales). |
| Regulation of after-sales servicing: | Same as in the current legislative scheme i.e. compulsory link between sales and service activities; only the official networks are allowed to distribute original spare parts and to carry out recall operations and repairs covered by warranty |

- Table III.13.-

Scenario 3A:

Scenario 3A is a system of selective distribution, based on qualitative criteria only, which are strictly defined and regulated¹¹⁹.

For example, in such a scenario, the possibility given to manufacturers of selecting distributors on the basis of their ability to provide after-sales service may be more strictly regulated. (This is discussed in more detail in the study of the link between sales and after-sales servicing in the section dedicated to the variables.)

Another area of regulation would be the sale of the entire product range. A new regime may compel manufacturers to accept players not willing to cover the entire range into their networks.

Similarly, criteria related to the brand promotion policies may be restricted in order to allow alternative channels. For example, conditions regarding showrooms might be limited.

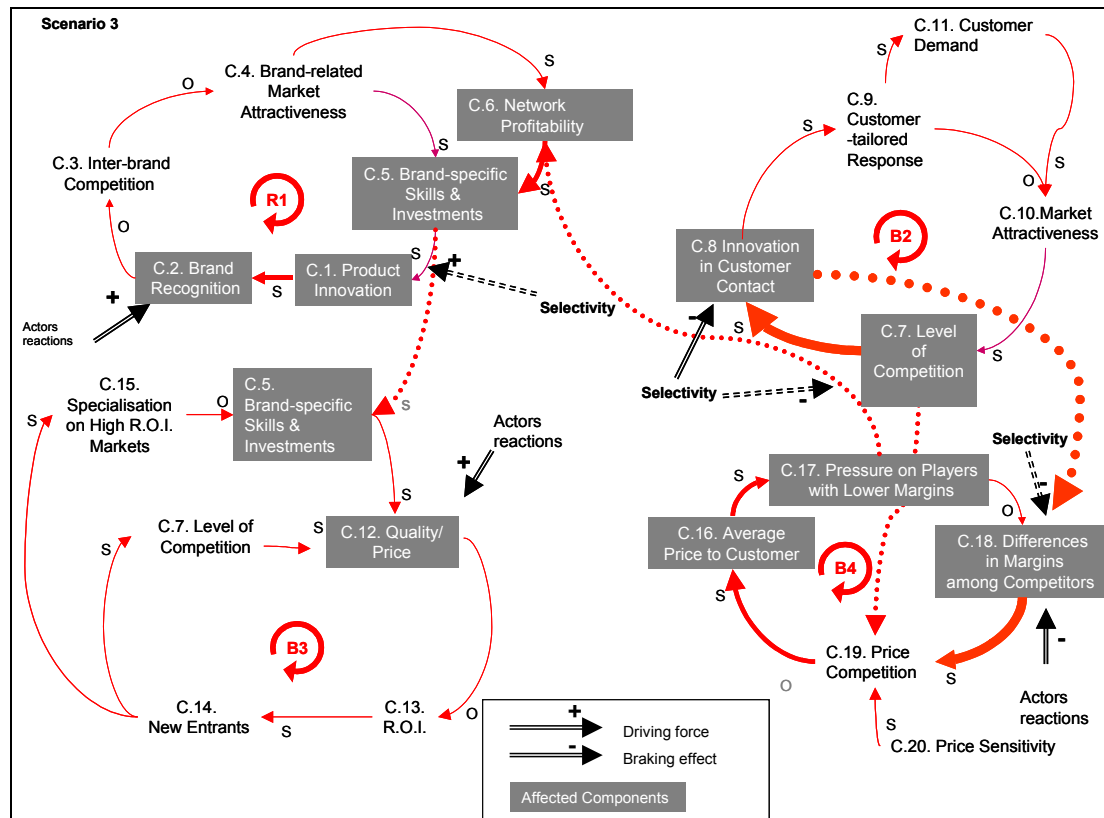
In such a scenario, the idea would be to only preserve the criteria that relate to the preservation of the reliability of the car throughout its life.

¹¹⁸ There are no quantitative criteria such as limits on the number of players, sales targets, compulsory stocks,...

¹¹⁹ See table III.1. for a description of the types of criteria most commonly used by manufacturers today.

III.2.4.B. Dynamic impact assessment

The short- and medium-term impact of Scenario 3 on the four loops can be illustrated as follows:



- Diagram III.8.-

Disruption of R1 (Product Loop)

The main difference between Scenario 4 and Scenario 3 is that sales targets would not have to be negotiated covering the entire vehicle range or reaching a minimum sales volume. Consequently, the link between brand-specific investments made by the official networks (C5) and product innovation (C1) would be weakened. **It would be more difficult for manufacturers to manage the sales volumes for each specific model, the launch of new products or stock allocation. Control could only be exerted through the margins given to the players.**

This difficulty could lead to a general weakening of the product loop. This effect would vary among brands, depending on brand recognition levels and the scale of investments in marketing on the part of manufacturers. It would, of course, be easier to avoid such repercussions if brand recognition and market penetration levels are high.

Slight modification of B2 (Customer Loop)

, Compared to Scenario 4, Scenario 3 would foster a slight increase in innovation in distribution channels, since there are fewer constraints in terms of sales targets. However, the overall impact would be limited since **qualitative criteria would maintain the obligation to offer the entire vehicle range, to sell according to a traditional showroom concept, and would maintain the compulsory link between sales and after-sales.** Distributors therefore would need to be large enough to make the heavy initial investment required.

Disruption of B3 (Reliability Loop) As explained under Scenario 4, there would be an exclusion of some smaller players and an increased focus on the most profitable areas. This would create:

- An imbalance in services and prices;
- Pressure to re-think the link between sales and after-sales servicing.

Unlike Scenario 4, it is, however, impossible to accurately forecast the long-term implications of Scenario 3 because:

- The manufacturers would not, in this case, have sufficient means to counter the repercussions;
- The players' reactions would depend on the way in which some of the legislative variables¹²⁰ are defined.

Strong activation of B4 (Price Loop) A direct parallel can be drawn with Scenario 4, given that increased competition in the most popular segments/areas:

- Would have the same impact on prices and provoke the same reaction from manufacturers, who might even revise their method of remuneration;
- Would put certain variables into serious question¹²¹.

Given the range of feasible outcomes, it is not possible to predict how the industry would be affected in the long term.

Players' reactions:

The manufacturers' main reactions to Scenario 3 are as follows:

| Influencing factors | Players | Influence | | Description | |
|---------------------|-----------------------------------|---------------|-----------|----------------------|--|
| | | On: | Impact: | | |
| Emerging practices | | | | | |
| | Investments in servicing | Manufacturers | C12 | <u>Driving force</u> | As with Scenario 4, the geographical disparities between the investments made by the official distributors would probably have to be countered by increased investments on the part of the manufacturers in network support and training, as well as incentives to ensure adequate coverage. In extreme cases, certain manufacturers may directly invest in servicing outlets. |
| | Adaptation of remuneration policy | Manufacturers | C18 | <u>Brake</u> | As with Scenario 4, method of dealer remuneration is a key network management tool for manufacturers. The target-related bonuses are used, in particular, as a means of fighting against mass-marketing practices. |
| | Reinforcement of marketing tools | Manufacturers | C2 and C8 | <u>Driving force</u> | Manufacturers would be able to promote their brand loyally through direct investments in marketing and new practices (CRM, for example) as well as through the constant reinforcement of segmentation. |

-Table III.14.-

Adaptation period:

Within the framework of Scenario 3, the system's evolution would be gradual. During the initial stage (short term), the existing players would first adapt to the new legal framework (concentration, geographical reorganisation) and, at a later stage (medium term), new players would penetrate the market.

It is only in the long term that a new balance would be reached. The adjustment to some of the ten variables would lead to:

- Geographical coverage being stabilised thanks to new incentives and direct investments in servicing on the part of manufacturers;
- The stabilisation of the level of price competition because of a re-distribution of market share.
- Some new entrants being forced out of the market because their business model is unprofitable.

¹²⁰ See the section dedicated to the link between sales and after-sales and to multi-branding.

¹²¹ An in-depth analysis of these variables is presented in part III.3.

Long-term impact:

Below, Scenarios 3 and 4, the most similar scenarios, are compared The impact is as follows:

| Scenario 3 | | |
|---|---|--|
| | Scenario 4 | Scenario 3 |
| Impact on the four loops | | |
| Product loop (R1) | High | Same BUT differences in the manufacturers' distribution strategies may arise as weaker brands find it harder to maintain investment levels. |
| Customer loop (B2) | Low (sales) – High (after-sales) | Same BUT activated in the short term |
| Reliability loop (B3) | Stable | Temporary disruptions in service outlet coverage. Future development would depend on the players' reaction. |
| Price loop (B4) | Activated in the short term | Same The development of new business models would depend on how the variables are interpreted. |
| Impact on the four areas of competition | | |
| Inter-brand competition | High | Same |
| Intra-brand competition | Increases Competition within the network Strongly activated but no competing Channels based on alternative Business models would emerge. | Same New players could, however, penetrate the market in the short and medium term. |
| Competition in after-sales servicing | Increase for non-specialised repairs Decrease for specialised repairs | Same |
| Market integration | More rapid integration | Same |
| Impact on the distribution market | | |
| Market share held by official distribution networks | Stable | Same |
| Level of product innovation | High | Same, with a risk that innovation would diminish among weaker brands |
| Cost structure for the sale of new vehicles | Rationalisation of distribution costs. Increase in the marketing costs particularly for distributors | Slowed in the short term by the emergence of new entrants. Trend reinforced |
| Level of price competition | Stable in the long term | Same |
| Number of distributors (fragmentation level) | Heavier concentration and a Reduction in the number of sales outlets. Increase in the proportion of international and multi-site Players. | Same Trend reinforced |
| Manufacturers' control over their marketing policy | Stable in the long term | Costs of managing the networks are higher |
| Differentiation of distribution forms according to customer segments, car models and geographical areas | Specialisation among players (full facility v sales only v repair only) and pressure on the compulsory sales/after-sales link and remuneration method in their current form | Trend reinforced |

| Scenario 3 | | |
|--|--|------------|
| | Scenario 4 | Scenario 3 |
| Impact on the after-sales market | | |
| Official networks' share in after-sales market | Slight increase in market share | Same |
| Number of service outlets | Reduction in the short/medium term and imbalances | Same |
| Average value for money of service provided | | |
| Density and reliability of service outlet coverage | | |
| | Instability puts pressure on the current way of organising the sales/after-sales link. | |

- Table III.15-

III.2.4.C. Summary of Scenarios 3 and 3A

In Scenario 3, the selection of dealers would be purely based on qualitative criteria linked to the nature of the product and the requirements for promoting the brand. **Any player meeting the criteria would be able to sell new vehicles and spare parts.** The manufacturer would be responsible for organising vehicle allocation in a non-discriminatory way.

The main difference between Scenario 4 and Scenario 3 is that **there would no longer be sales targets.** In addition, manufacturers would have no means of influencing the location of outlets.

Although in Scenario 3 the abolition of quantitative selection criteria could lead to an increase in the number of players, the latter would naturally be limited in the long term. Indeed, investment requirements tend to increase the average size (average sales volume) needed to operate effectively in the sales and after-sales markets. Consequently, **although manufacturers would not be able to limit the number of players on each territory, the industry would adapt automatically.**

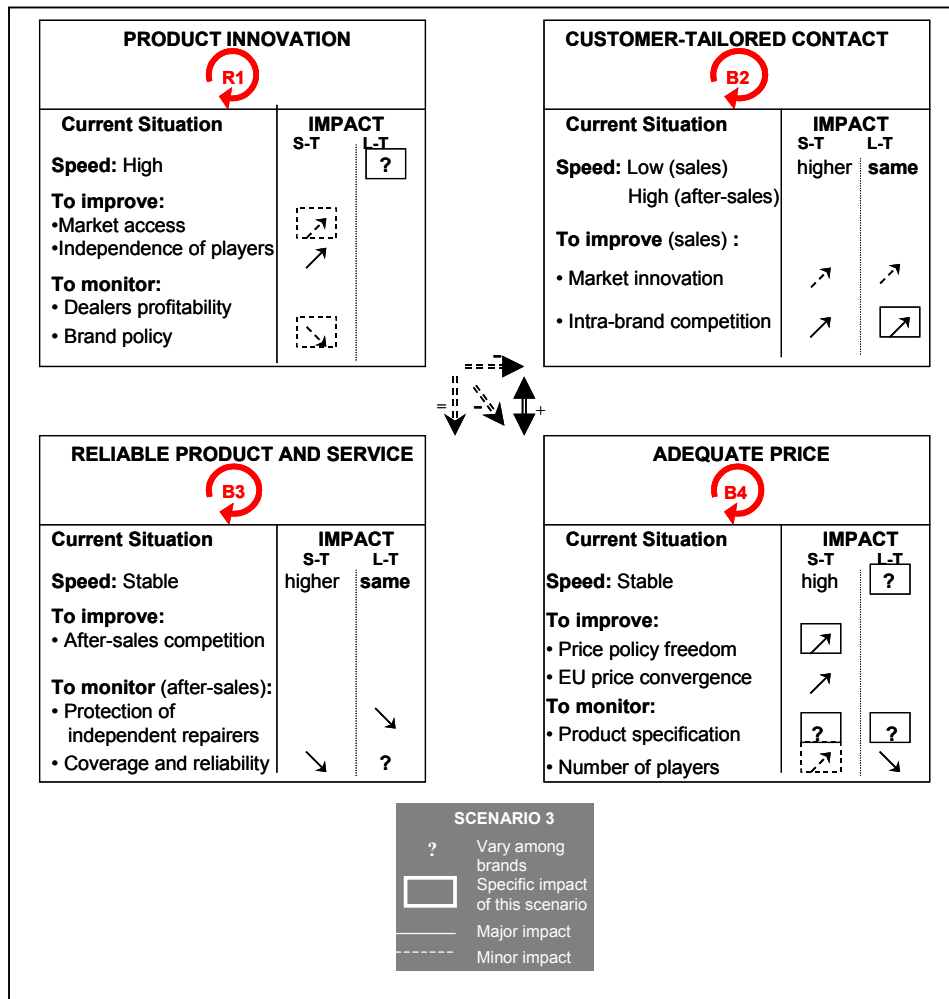
It would be more difficult for manufacturers to manage the sales volumes for each specific model, the launch of new products or stock allocation. Control could only be exerted through the method of dealer remuneration. Therefore, **differences in the manufacturers' distribution strategies may arise**, as weaker brands would find it harder to maintain network investment levels or geographical coverage. **In the long term, this might result in a reduction of the product range.** However, manufacturers would use other means to counter the abolition of quantitative criteria, **to ensure that the whole of the vehicle range is offered.** Manufacturers would effectively use the margins granted on the different models, target-based bonuses and recommended prices to encourage distributors to offer the entire range.

Although there would be fewer constraints in terms of sales targets compared to Scenario 4, **Scenario 3 would only allow for a slight increase in innovation in distribution forms.** Penetration of additional new entrants and the development of new business models would remain limited since qualitative criteria would maintain the obligation to offer the entire vehicle range as well as the compulsory link between sales and after-sales servicing. In addition, since the current restrictions on multi-branding would be preserved, new distributors would need to be large and specialised enough to make the initial investment required and to ensure a sufficient sales volume.

Overall, Scenario 3 would reinforce the trends of concentration and specialisation described for Scenario 4, and would increase the likelihood of short-term disruption, particularly in the area of servicing. Major changes would be required on the part of the manufacturers and certain variables would come under increasing pressure, such as the link between sales and after-sales servicing, the method of dealer remuneration and/or the restrictions on multi-branding. It would take time for the various players to assimilate these new practices.

More fundamentally, **the closeness of working relationships between manufacturers and official dealers would face disruption.** The increased independence of distributors, and the ability to focus on some specific car segments or on 'best selling' models would oblige manufacturers to fundamentally re-think distribution and brand strategies. This would represent a threat to product innovation. However, this effect would differ according to the interpretation that is done of the nature of authorised qualitative selection criteria – for example, criteria may include the obligation to offer the whole product range - and the method of dealer remuneration that manufacturers are allowed to use.

The diagram below shows the impact of Scenario 3 compared to Scenario 4. It highlights the difficulty of identifying the changes to speed of activation of the loops in the absence of a more precise analysis of how the variables would evolve¹²²:



- Diagram III.9 -

Scenario 3A:

Due to the ambiguous nature of qualitative selection criteria that could be broadly interpreted, it is difficult to differentiate Scenarios 3 and 4. Thus, another scenario, Scenario **3A** has been defined, where the nature of the authorised criteria would be strictly regulated. This regulation would include restricting the obligation to offer the entire vehicle range and would also include some constraints relative to the marketing policy of the manufacturer.

The impact of this scenario would be the same as described above, but more marked. Specifically, the disruption in the relationships between manufacturers and their official networks would be more pronounced. This might lead the industry towards some rationalisation and decreasing product innovation.

While Scenario 3 would remove quite a few of the barriers imposed by current legislation, it would not significantly promote the emergence of new players and/or business models. Scenario 3A, however, would allow increased arrival of new entrants.

¹²² The variables will be analysed in section III.3.

III.2.5. Scenario 2 – Territorial exclusivity

III.2.5.A. Description

Scenario 2 deals with exclusive distribution.

In Scenario 2, **all types of qualitative criteria would be used when drawing up dealership agreements**. The criteria could vary from one territory to the next and would be left to the discretion of the manufacturer. Even if manufacturers were to have control over the number of official dealers and their location, **official dealers would be free to run a second level distribution network by re-selling vehicles** to any other player, including **independents**. However, there would be no control over the number of independent re-sellers or over their commercial practices.

In practice, the **allocation of vehicles would be done according to annually negotiated sales targets and with exclusive supply to one distributor in a given territory**. In addition, allocation of vehicles should be done in a non-discriminatory manner according to supplementary requests from official dealers.

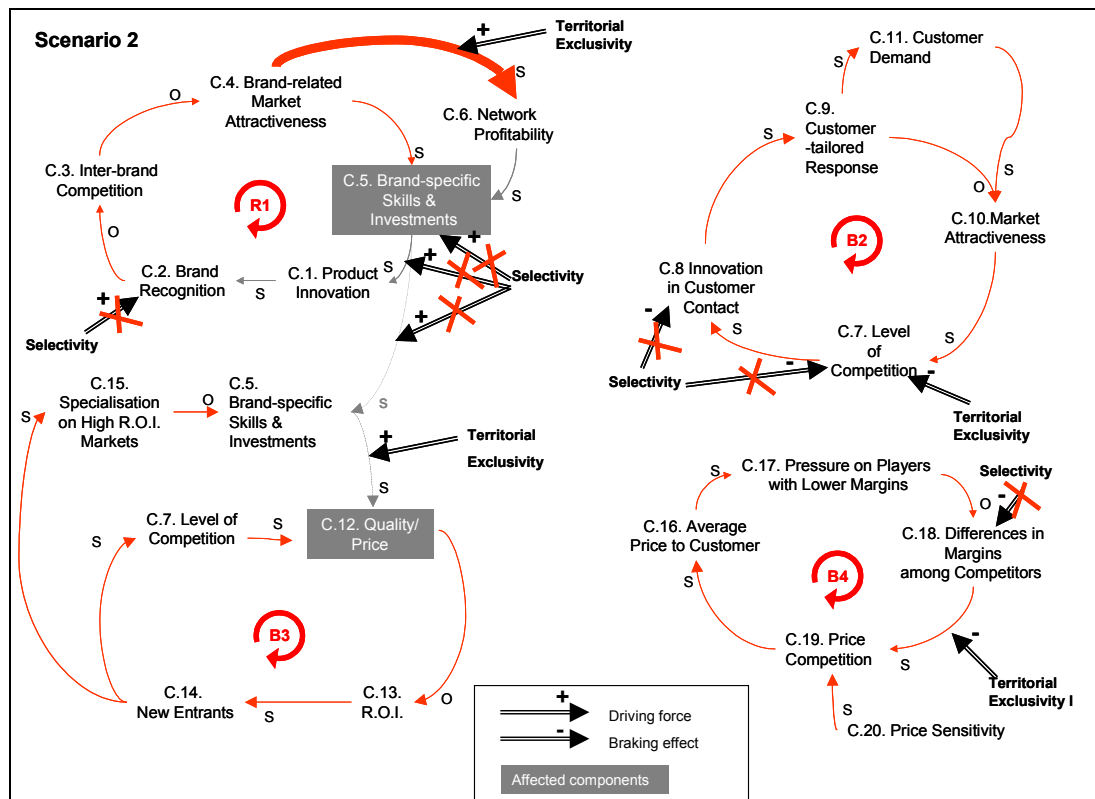
| Scenario 2 | |
|---|---|
| Selection of dealers: | All types of qualitative criteria could be used when drawing up the dealership agreement (defined 'once and for all'). The criteria could vary from one territory to the next. |
| Allocation of vehicles: | Same as in the current legislative scheme i.e. according to annually negotiated sales targets and with exclusive supply to one distributor in a given territory |
| Resale to other distributors: | Official distributors would be allowed to sell vehicles to any independent distributor . |
| Location of sales and service outlets: | Same as in the current legislative scheme i.e. subject to manufacturer's approval with only one distributor per territory |
| Number of outlets: | As in the current legislative scheme, the manufacturer could limit the number of official dealers. However, there would be no control over the number of independent resellers . |
| Protection of the investment: | Official dealers would receive territorial protection from competing official players. However, competing distribution channels would be possible through the emergence of second-level networks . |
| Regulation of after-sales servicing: | Same as in the current legislative scheme i.e. compulsory link between sales and after-sales activities; only the official networks could distribute original spare parts, carry out recall operations and repairs covered by warranty |

- Table III.16.-

III.2.5.B. Dynamic impact assessment

Because Scenario 2 would retain the principle of territorial exclusivity, the impact assessment study is carried out in comparison with the current legislative framework.

The diagram below illustrates the impact of Scenario 2, and compares it to the current framework projected forward to 2005:



- Diagram III.10 -

The impact study mainly focuses on the possibility to create a second level distribution network consisting of independent resellers. This is the most important difference between Scenario 2 and the current framework.

Possible slight brake on R1 (Product loop)

Like the current framework, **Scenario 2 would guarantee a certain protection of the distributors' investments (C6)**. However, the arrival of independent resellers would exert some pressure on the manufacturers. It would be more difficult for them to ensure brand-specific investment and competence in line with their marketing policy (C5).

Brake on B2 (Customer loop)

Like in the 'current framework projected forward to 2005', **territorial exclusivity would limit intra-brand competition (C7)**, at least among the official dealers. Re-sale of new vehicles to independent distributors would be left to the discretion of the networks. However, manufacturers would be in a position to exert indirect control through the setting of sales targets. In such conditions, these sales would be limited in volume. They would not therefore have much impact on competition between players¹²³.

¹²³ Furthermore, the official networks would be forced to share their margins with the second level network. Given current profit levels, such sales would mainly arise as a means of getting rid of unsold stock.

**Stabilising effect
on B3
(Reliability loop)**

Within Scenario 2, dealers would maintain full responsibility over their territory to manage after-sales coverage and reliability.

**Slight acceleration
of B4
(Price loop)**

Scenario 2 would not be likely to modify the cost structure of any player in distribution or service. The structural impact on the price loop (B4) would therefore be comparable to that defined within the current framework projected forward to 2005. Overall, distribution costs are likely to progressively decrease for all dealers.

However, the activity of the independent re-sellers is likely to increase price competition. Indeed, these players would take advantage of any price difference and engage in arbitrage through parallel imports. This would drive price convergence.

In addition, the presence of these new players might also lead to increased price competition within a given area. This effect would, however, be less significant than the first one.

Players' reactions:

The main reactions from the manufacturers would be to:

- Ensure more rapid convergence of European prices to avoid too great impact from independent resellers;
- Increase distribution costs to ensure a minimum level of quality within the networks.

| Influencing factors | Players | Influence | | Description | |
|---------------------|----------------------------|---------------|--------|----------------------|---|
| | | On: | Impact | | |
| Players' reaction | | | | | |
| | European price convergence | Manufacturers | C18 | <u>Brake</u> | Manufacturers' likely reaction to increased parallel imports would be to ensure greater convergence between prices in the various European countries. Convergence would only, however, be partial. It would have a braking effect on the price loop and parallel imports. |
| | Securing of quality levels | Manufacturers | C5 | <u>Driving force</u> | Part of the costs of ensuring minimum distribution quality levels (for independent re-sellers) would be borne by the manufacturers |

-Table III.17.-

Adaptation period:

Once the new system is in place, the loops are likely to adapt rapidly to the new situation (within 6 to 18 months).

Long-term impact:

Like Scenario 5, Scenario 2 is comparable to the current legislative framework because it is the most similar. The impact of Scenario 2 compared to that of the current framework projected forward to 2005 is as follows:

| Scenario 2 | | |
|---|--|--|
| | Current framework projected forward to 2005 | Scenario 2 |
| Impact on the four loops | | |
| Product loop (R1) | High | Same BUT slight risk of instability, depending on the car segment and the area. |
| Customer loop (B2) | Low (sales) – High (after-sales) | Same BUT some increase in intra-brand competition by independent re-sellers |
| Reliability loop (B3) | Stable | Same |
| Price loop (B4) | Stable | The acceleration of this loop, spurred by the emergence of resellers in high density and cross-border areas, is opportunistic |
| Impact on the four areas of competition | | |
| Inter-brand competition | High | Same |
| Intra-brand competition | Increases slightly | Increases slightly |
| Competition in after-sales servicing | Increase for non-specialised repairs and a decrease for specialised repairs | Same |
| Market integration | Increases slightly | Same |
| Impact on the distribution market | | |
| Market share held by official distribution networks | Stable | Decreases slightly for sales to final consumers |
| Level of product innovation | High | Same |
| Cost structure for the sale of new vehicles | Slight rationalisation of distribution costs (already underway) | Same |
| Level of price competition | Stable | Slight increase in some areas |
| Number of distributors (fragmentation level) | Increase in concentration among players and reduction in the number of sales outlets | Same |
| Manufacturers' control over their marketing policy | Stable | Complicated by the absence of selectivity for independent resellers , which makes it difficult to keep a regular control over distribution operations |
| Differentiation of distribution forms according to customer segments, car models and geographical areas | Slight innovation | Stimulated by reselling activities, although mainly in the short term. |
| Impact on the after-sales market | | |
| Official networks' share in after-sales market | Slight increase in the networks' market share | Same |
| Number of service outlets | | |
| Value for money of service provided | | |
| Density and reliability of service outlet coverage | | |

- Table III.18.-

III.2.5.C. Summary of Scenario 2

In Scenario 2, all types of qualitative criteria would be used when drawing up dealership agreements with official dealers. However, the criteria may vary from one territory to the next and are left to the discretion of the manufacturer. In practice, the **allocation of vehicles would be done according to annually negotiated sales targets and with exclusive supply to one distributor in a given territory**. Allocation of vehicles should be done in a non-discriminatory manner according to supplementary requests from official dealers. **With regard to official networks, this situation is not significantly different from the current legislative framework**. Therefore, the current framework projected forward to 2005 could serve as a reference for comparison.

Even if manufacturers had control over the number of official dealers and over their location, official dealers would be free to run a second level distribution network by re-selling vehicles to any other player, including independents. However, there would be no control over the number of independent re-sellers or over their commercial practice. **The opportunity of running a second level network is the most distinctive feature of Scenario 2.**

In Scenario 2, the opportunities for parallel imports that are currently limited to the action of intermediaries would be broadened. This would, especially in the short and medium term, accelerate price convergence between countries and enable greater market integration. The study highlights however several limitations to this impact including the following factors:

- Supply of vehicles to independent resellers may prove to be limited as this would be done at the discretion of official dealers;
- The role of independent re-sellers is by nature opportunistic and it would disappear with reduction of price differentials;
- Scenario 2 would maintain full territorial exclusivity for the official network while Scenario 5 would offer the opportunity to official dealers to actively sell in other territories;
- Scenarios 3 and 4, by removing territorial exclusivity, would bring a structural response to the issue of market compartmentalisation more so than Scenario 2.

A side effect of creating a second level network is that there are no criteria for access to the network for independent re-sellers and no means for manufacturers to control their activities. In such a context, Scenario 2 would run the risk of compromising the quality and professionalism, aspects that are increasingly important even during the sales process. It is difficult to guarantee uniformity. Such a lack of uniformity may be counter to the interests of the official networks and to those of the consumer.

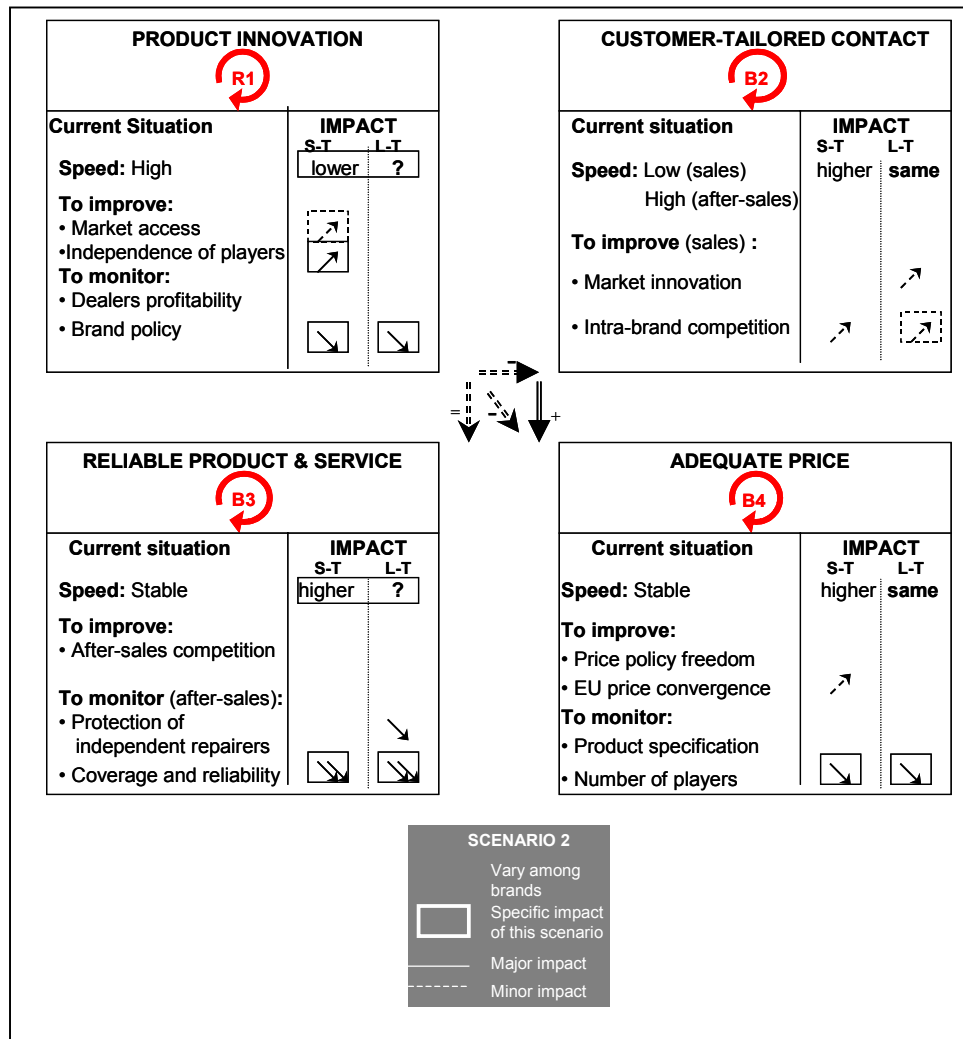
Under Scenario 2, official dealers would maintain full responsibility over their territory for managing after-sales coverage and reliability. This scenario would also increase official dealers' independence from manufacturers as regards the sales of new cars.

Scenario 2 would offer **a solution enhancing market integration and reinforcing intra-brand competition through parallel imports**. However, the scenario would offer **no real structural response to new players who want to enter the automobile distribution market**. They would be limited to the role of an additional retail distributor and may face uncertainty of supply. They would not be able to negotiate conditions directly with manufacturers.

In addition, Scenario 2 would offer **no structural improvement in intra-brand competition within the official network**, as active sales outside the territory of responsibility would be restrained.

Finally, **quality and service might not be homogeneously guaranteed**, due to the uncontrolled operations of independent re-sellers.

The impact of Scenario 2 on the loops relative to the current legislative framework projected forward to 2005 can be summarised as follows:



III.2.6. Scenario 1 – 'A free for all'

III.2.6.A. Description

Scenario 1 is a system of 'open' distribution in which selectivity and exclusivity would be abolished.

However, from a legal point of view there is little likelihood that manufacturers could be obliged to deliver vehicles to every would-be distributor. This may only be required where a manufacturer has a dominant position.

Based on this 'non-compulsion' principle, Scenario 1 has been interpreted as a scenario in which the distribution of new vehicles and original spare parts would be organised directly by manufacturers based on ad hoc arrangements with the players of their choice. Therefore, the main implications of Scenario 1 are that the choice of distributor and mutual rights and responsibilities would be left to the discretion of the manufacturer.

| Scenario 1 | |
|---|---|
| Selection of dealers: | At the manufacturer's discretion (contractual) |
| Allocation of vehicles: | At the manufacturer's discretion, unless he is in a dominant position |
| Resale to other distributors: | Uncontrolled |
| Location of sales and service outlets: | Depends on individual agreements and manufacturer's initiative |
| Number of outlets: | Depends on individual agreements and manufacturer's initiative |
| Protection of the investments: | Depends on individual agreements and manufacturer's initiative |
| Regulation of after-sales servicing: | Depends on individual agreements and manufacturer's initiative |

- Table III.19.-

III.2.6.B. Summary of Scenario 1

Since the interpretation of the scenario states that manufacturers can implement the distribution strategy of their choice, it seems logical that they would try to produce a high speed of activation of the product loop (R1), which is the dynamic that leads product innovation and brand recognition.

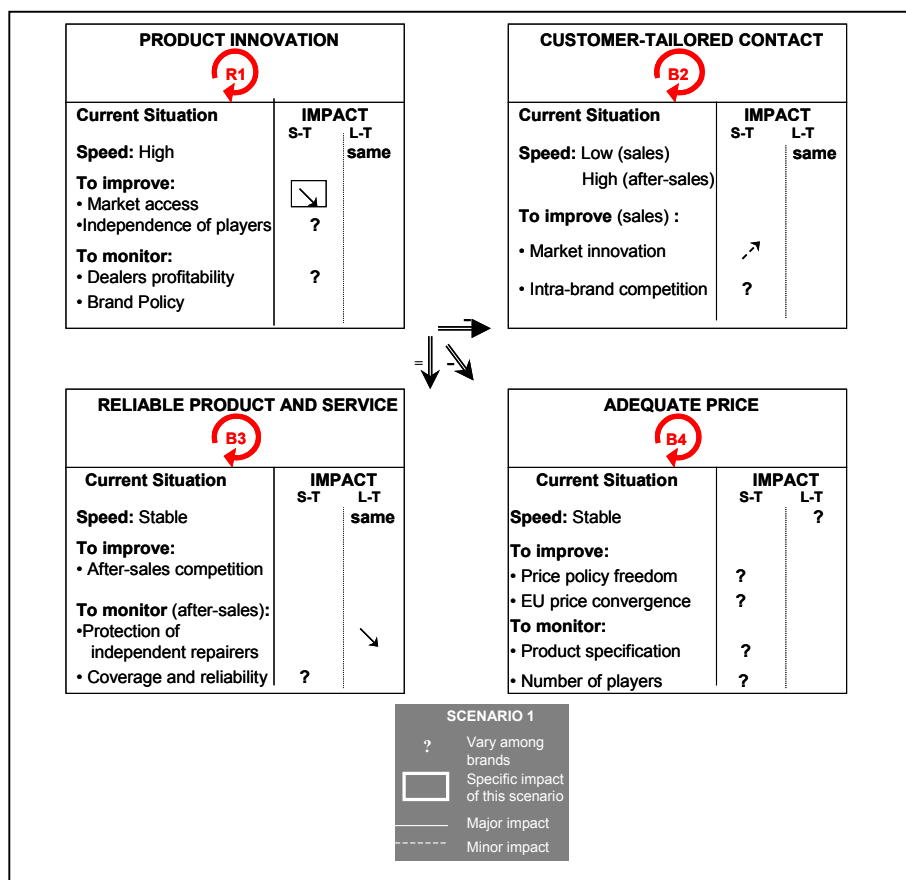
Scenario 1 would lead towards a **diversification of distribution strategies on the part of the manufacturers**. Therefore, a detailed, system-based impact analysis of this scenario has not been developed.

The **current official dealers would also face significant instability** given that they would have to operate in an uncertain contractual context and that manufacturers may choose alternative distribution forms.

It is also noticeable that, whereas other scenarios open the market somewhat, **this scenario does not guarantee access to the market**. Indeed, manufacturers may choose to restrict the number of their distribution partners.

As no manufacturer has a dominant position, it seems difficult in the context of Scenario 1 to allow all distributors to freely purchase vehicles from any car manufacturer. Therefore, **Scenario 3A, in which manufacturers are obliged to supply vehicles to any distributor meeting basic, non-restrictive, qualitative criteria** is the closest feasible alternative.

The diagram below summarises the main implications of this scenario, relative to that of the current framework projected forward to 2005:



- Diagram III.12 -

III.2.7. Summary of the scenarios analysis

The following pages aim to provide a **comparative view of both the interpretation and the impact of the various scenarios**. The conclusions will detail the comparative impact assessment on the four areas of competition, the satisfaction of customers' needs and the six major categories of players. In addition, an overview of the strengths and weaknesses of the scenarios about the areas for improvement and risk factors will be given.

III.2.7.A. Interpretation of the legislative scenarios for distribution

Understanding the practical implications of the scenarios is an essential prerequisite to the impact study. The interpretation of each of the scenarios and sub-scenarios are summarised below.

- Scenario 1 is the only 'totally free distribution' scenario. It has been interpreted as a scenario in which distribution would be directly conducted by manufacturers and would be based on ad hoc agreements with the distribution partners of their choice.
- Scenario 2 is a framework that is similar to the current situation with regard to the official networks. However, it has a unique feature. It would allow official dealers to re-sell new cars to any independent distributors.
- Scenario 3A is an intermediate scenario which lies between Scenario 1 and Scenario 3. Only minimum and regulated selection criteria would be allowed. This sub-scenario helps to better differentiate Scenario 3 from Scenario 4.
- Scenario 3 and 4 are selective but non-exclusive distribution systems. While Scenario 4 is based on qualitative and quantitative selectivity, only qualitative criteria could be used in Scenario 3. The study has highlighted certain difficulties in assessing differences between qualitative and quantitative criteria.
- Scenarios 5 and 5A are two scenarios where territorial exclusivity would be maintained, but limited. In Scenario 5, active sales outside the territory of origin would be authorised, while Scenario 5A is based on the same 'limited' exclusivity but with a limitation in time (5 years). It appears, however, that Scenario 5 is close to the current framework, while Scenario 5A is closer to Scenario 4.

The table below provides a schematic reminder of the five scenarios analysed, along with the additional sub-scenarios (Scenarios 3A and 5A) that were defined:

| | | | | | |
|---|-------------|-------------|---------------------------|--|---|
| Territorial exclusivity (current situation) | Scenario 2 | | | | |
| Limited territorial exclusivity | | | | | Scenario 5 Scenario 5A |
| No territorial exclusivity | Scenario 1 | Scenario 3A | Scenario 3 | | Scenario 4 |
| | No criteria | | Qualitative criteria only | | Full selectivity (current situation, with both qualitative and quantitative criteria) |

- Diagram III.13 -

In addition, the table below summarises the main practical implications of the scenarios:

| | CURRENT | Scenario 5 | Scenario 4 | Scenario 3 | Scenario 2 |
|---|----------------|-------------------|-------------------|-------------------|-------------------|
| Selection of dealers on the basis of objective and transparent criteria | YES | YES | YES | YES | +/- |
| Allocation of vehicles on the basis of the sales targets negotiated | YES | YES | YES | NO | YES |
| Resale to other distributors | NO | NO | NO | NO | YES |
| Location of sales and service outlets controlled by the manufacturer | YES | YES | +/- | NO | YES |
| Number of players limited by the manufacturer | YES | YES | YES | NO | YES |
| Protection of investments through exclusive distribution rights | YES | +/- | NO | NO | YES |
| Compulsory link between sales and after-sales and exclusive distribution of original spare parts, recall operations and repairs covered by warranty | YES | YES | YES | YES | YES |

- Table III.20.-

Scenario 1 has not been included because of the specific nature of the relationships. Features of Scenario 3A are similar to those of Scenario 3. It is the same for Scenarios 5 and 5A.

This table further highlights **different implications of Scenarios 4 and 3**. These differences relate to:

- **The principle for allocating vehicles;**
- **The control by manufacturers over outlet location and number;**
- **The extent to which dealers' investments are protected.**

Additionally, as the scenarios have been interpreted in a context in which all other elements remained unchanged, the following assumptions have been made:


- **The link between sales and after-sales servicing** is considered unchanged i.e. manufacturers have the right to oblige distributors to be repairers and vice-versa;
- **In terms of multi-branding**, the manufacturers are still allowed to impose certain non-competition clauses in distribution and after-sales;
- **Other variables linked to after-sales**, like the characteristics of original spare parts distribution, 'access to the trade', access to training and information remain unchanged;
- **The method of dealer remuneration** remains to be freely determined by the manufacturers.

III.2.7.B. Impact on the four industry causal loops

The impact on the activation of the four loops can be outlined as follows:


- The nature of the impact of **Scenarios 2, 3, 4, 5 and 5A** on the various loops would be similar, but the intensity of impact would vary;
- The impact of **Scenario 1** is more difficult to assess, but is likely to preserve the current high speed of activation of the product loop (R1);
- **Scenario 3A** would tend to modify the pattern of activation of the loops, risking a reversal of the product loop and an acceleration of the other three.

The table below summarises the main areas of impact of all scenarios except Scenarios 1 and 3A:

| PRODUCT INNOVATION  | |
|---|---|
| (+) | No long term brake on the loop |
| (-) | Additional cost for managing distribution |


None of these scenarios would entail a lasting braking effect on the product loop (R1).

Nevertheless, in Scenarios 4 and particularly 3, the manufacturers would have to react vigorously in the areas of remuneration policy and network monitoring, to ensure the maintenance of innovation levels. Any necessary changes may increase the cost of distribution.

| CUSTOMER-TAILORED CONTACT  | |
|--|---------------------------------------|
| (+) | Increase in intra-brand competition |
| (-) | No major change in distribution forms |


None of the scenarios would have a significant impact on the customer loop (B2) in relation to after-sales servicing.

None of the scenarios would really open the market to alternative distribution forms. The speed of innovation would depend on the reaction of the traditional players. Although there would be a place for innovation within Scenario 2, the absence of selection criteria for resellers would make it risky.

| RELIABLE PRODUCT AND SERVICE  | |
|---|---|
| (+) | Coverage modification |
| (-) | No impact on competition |
| (+) | Increase of professionalism and specification |

Concerning the reliability loop (B3), Scenarios 3 and 4 would give rise to serious disruptions in the coverage of the official service outlets. In the long term, these scenarios would lead to greater specialisation among the service outlets.

None of the scenarios would significantly modify the market share balance between official networks and independent repairers.

| ADEQUATE PRICE  | |
|---|--------------------------------------|
| (+) | No long term modification |
| (-) | Concentration trends are accelerated |
| (+) | Increased European price convergence |

In the short term, all the scenarios would somewhat accelerate price competition.

In Scenario 5, the trend would be limited to a few cross-border or densely populated areas.

In the other scenarios, the impact would be more wide reaching and would further increase concentration of dealers.

III.2.7.C. Impact on the four areas of competition

The comparative assessment of the scenarios on the competition indicators defined by the Commission can be summarised as follows:

- **Inter-brand competition¹²⁴ would remain effective** in every scenario.
- **Intra-brand competition would be reinforced** in Scenarios 3, 4, and 5 (but especially 3) in terms of competition **between traditional official dealers**.
- **Intra-brand competition between complementary or competing channels i.e. distributors with different business models would remain limited** and at the initiative of manufacturers. In Scenario 2, the role of independent re-sellers would be limited to parallel trade. Qualitative selection criteria could be used to prevent Scenario 3 from introducing innovation in distribution.
- **None of the scenarios would have a significant impact on the level of competition between official and independent players in the after-sales market.** Conversely, the increased professionalism and specialisation of the official networks as well as the increased technical complexity would tend to weaken the competition between different players.
- **Competition in after-sales would slightly intensify among players of the official networks** under Scenarios 3 and 4.
- **Market integration is reinforced in all cases, but most quickly in Scenarios 2, 3 and 4,** to the benefit of customers. Particularly in Scenarios 2, 4 and above all 3, pressure on price convergence within the European Union would intensify although this would never be total given the absence of tax harmonisation.

III.2.7.D. Impact on the satisfaction of consumer needs

No scenario as such has a decisive impact on the level of satisfaction of consumer needs. The analysis reveals, however, some developments:

- In the short term, fluctuations in consumer satisfaction are likely to occur in all scenarios due to short-term market instability. The main effects would include **short-term price reductions and fluctuations in the level of service within the networks**.
- **None of the scenarios would have a significant impact on long-term consumer prices for new vehicles or on the reliability of servicing.**
- However, in Scenarios 3 and 4, increased professionalism and specialisation would lead to qualitative improvements in the long term in both sales and after-sales servicing. This may positively **influence the average quality/price ratio for servicing**. However, in the short term, there may be **local variations in the level of coverage and in value for money**.

¹²⁴ The competition has been assessed by looking at the European market as a whole.

III.2.7.E. Impact on the six groups of players

Impact on the market structure can be summarised as follows:

Official dealers:

- **In most of the scenarios, pressure on the smallest and weakest players is apparent.** The size necessary to provide profitability is likely to increase. **Acceleration of the trend towards concentration is expected**, especially in Scenarios 3A, 3 and 4.
- **For the biggest players, Scenarios 3A, 3 and 4 would lead to more independence from manufacturers and opportunities for multi-site and international growth.**
- **Although the compulsory link between sales and after-sales servicing is maintained, Scenarios 3A, 3 and 4 would lead to progressive specialisation of the players in sales and/or after-sales markets.** Increased differentiation in the structure and positioning of players is to be expected, particularly between 'repair only outlets', large full facility dealers and 'Hub and Spoke' arrangements.

Independent repairers and spare parts manufacturers:

- **Independent repairers and spare parts manufacturers would face growing difficulty in retaining market share in all scenarios.** This is because of increased technological complexity of service and pressure on margins due to the reorganisation of the official networks.

Car manufacturers:

- **Scenario 3 and mainly Scenario 3A would tend to weaken the working relationships between manufacturers and the distribution players.** The increase in intra-brand competition and the differences in its nature between different geographical areas or markets would cause additional reactions by manufacturers. These would relate to remuneration policy, marketing, and investments in networks or incentives, in order to guarantee that their marketing decisions are put into effect and to provide an adequate density of sales and service outlets. Consequently, all sorts of distribution strategies could be in evidence among manufacturers. It is likely that weaker brands would face difficulties in maintaining a high innovation level.
- **Disturbances in networks entail the risk of causing a short-term slow-down in the implementation of lean distribution.** However, the expected acceleration of concentration in Scenarios 3A, 3 and 4 should favour this implementation of lean distribution in the medium-term.
- **The scenarios based on abolishing territorial exclusivity (Scenarios 3 and 4) risk raising certain network administration problems because of the increasing difficulty of managing the geographical spread.**
- In Scenarios 5, 5A and 4 and particularly in Scenarios 3 and 3A, **pressure for price convergence within the European Union** would intensify, although this would not be total given the absence of tax harmonisation;

'Candidate new entrants' in sales:

- **Opportunities for additional new entrants to penetrate the distribution market are limited in all scenarios** because most of the selection conditions imposed are de facto barriers to the development of alternative business models. Furthermore, the initial investments needed to enter a market where penetration is already high are a barrier to entry that would remain significant.

III.2.7.F. Conclusion

Scenario 1, in a market structure where no manufacturer is in a dominant position, **would be unlikely to address the defined improvement objectives**. Legal enforcement of this scenario appears problematic. In addition, such an open market would cause heavy disruptions, in particular for the weakest players. Indeed, selectivity and exclusivity are factors that lead to there being a large number of small players on the market. Abolition of either one or both of these factors represents a threat to the fragmented nature of the industry.

In its present form, the concept of territorial exclusivity creates a compartmentalisation of markets. Therefore, it slows both the natural trend towards European market integration and limits intra-brand competition. More specifically, it delays the co-existence of competitive or complementary channels. Scenarios 2, 5 and 5A offer partial solutions:

- **Scenario 2** would offer a partial solution to the lack of market integration. However, allowing the activity of independent re-sellers while keeping the principle of full territorial exclusivity for the official dealers would make it difficult to ensure continuity of responsibility for the vehicle throughout the value chain. In addition, this would not be in line with the expectations of would-be new distributors in the industry.
- **Scenario 5** would slightly reinforce current developments in the industry, where sales outside of the territory of responsibility become common practice.
- **Scenario 5A**, where exclusivity is restricted to five years, is close to Scenario 4. It may fulfil the need to combine incentives to invest in new or less attractive areas with a more competitive structure in high penetration regions.

Scenarios 4 and 3 totally abolish the principle of territoriality. However, if all other variables were to remain unchanged according to the current definitions of exclusivity and selectivity, these scenarios would still lead to industry developments that are in line with the trends currently underway. No profound change in distribution forms and limited impact on the after-sales market would be observed:

- **Scenario 4** would introduce some structural changes to the market. These would include increased concentration and internationalisation of markets. A specialisation trend would also develop that would create pressure on the link between sales and after-sales servicing as well as fiercer competition. This scenario would introduce instability in the short and medium term.
- **Scenario 3**, in addition to the effects of Scenario 4, would somewhat threaten the working relationships within the automobile distribution industry. This might lead to a decrease in the level of innovation, especially among the weakest brands. However, depending on the interpretation that is given to the nature of qualitative selection criteria, the distinction between Scenarios 3 and 4 varies in significance.

Scenario 3A has been created as a variant of Scenarios 3 and 1. It is based on restricted qualitative selection criteria that are designed to allow greater market access to new entrants. It is the only scenario that would really allow for creation of alternative distribution formats. However, such a scenario would have the significant effect of weakening the close relationships between manufacturers and their network. Risks would include a brake (slowing) on product innovation.

Finally, there is a series of grey areas that remain concerning the precise nature of the overall legislative framework. These additional legislative options are studied in the next section.

Scenarios 5, 4 and 3A are different from each other and are all relevant scenarios. These have been further analysed and combined with legislative variables.

III.3. Variables

The ten variables defined in the Terms of Reference analysed below include:

- The link between sales and after-sales service;
- Restrictions on multi-branding in distribution;
- Access to technical information;
- Access to the trade and multi-branding in after-sales service;
- Distribution of original spare parts;
- Method of dealer remuneration;
- The 'first come, first served' principle;
- Availability clauses¹²⁵;
- The role of intermediaries¹²⁶;
- Direct sales by manufacturers.

For each variable, the assessment will consist of the following:

- A summary of the current situation and the issues involved;
- An identification of the various possible legislative options;
- A summary of the position of the players;
- An independent assessment of each variable's impact on the industry's four generic loops ('Product Loop' – R1; 'Customer Loop' – B2; 'Reliability Loop' – B3; 'Price Loop' – B4) or, where necessary, certain components taken in isolation;
- An assessment of the contribution of that variable to the areas for improvement and risk factors identified in the conclusion of Part II.

¹²⁵ This specific clause states that within the European Community vehicle manufacturers must supply their dealers within their distribution networks with all types of vehicles upon a consumer's request, including corresponding models with specifications applicable to Member States other than those in which the vehicle is purchased.

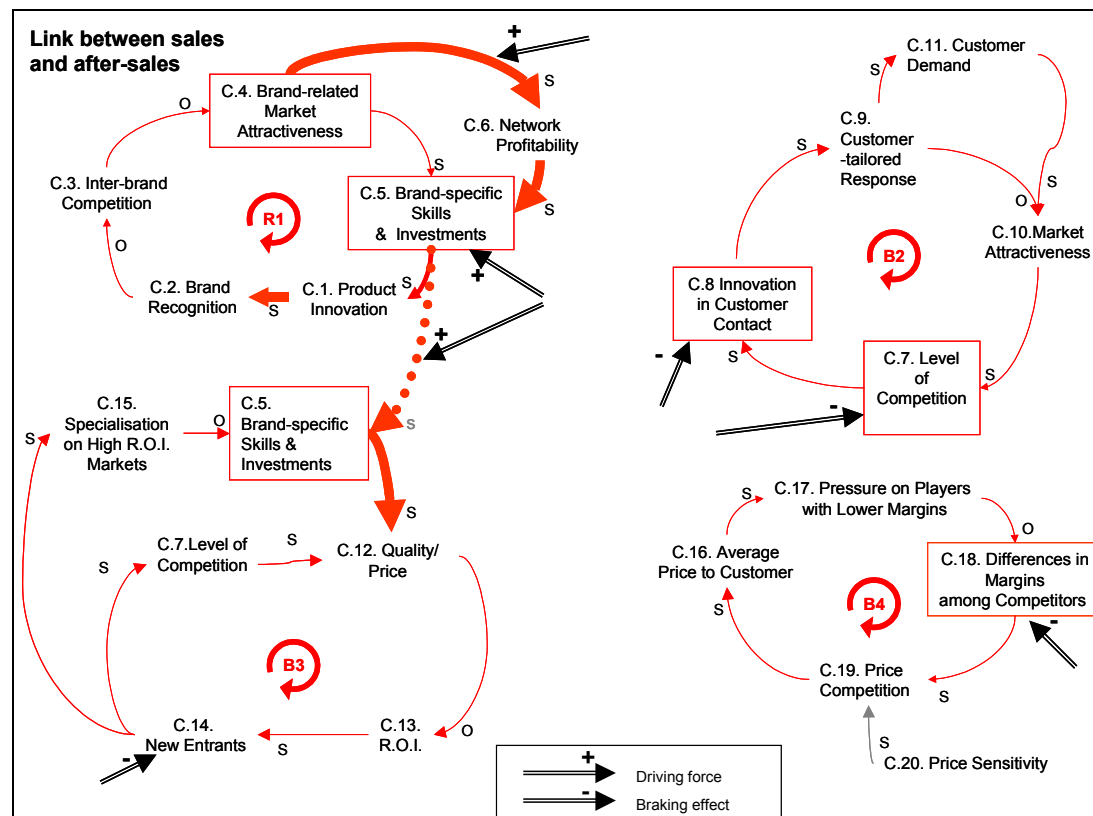
¹²⁶ Intermediaries act on behalf of final consumers in whose name they purchase or collect a specified vehicle.

III.3.1. The link between sales and after-sales service

III.3.1.A. Current situation and issues

The link between sales and after-sales service is an integral part of the qualitative selection criteria manufacturers use when choosing their dealers. This link forces every distributor who wishes to sell vehicles of a particular brand to offer adequate maintenance and repair facilities (basic and complex) for all the brand's models.

The impact of the sales/after-sales link on the system has been addressed in Part II. The diagram below provides an overall view of the influence that this factor has had on the system:



- Diagram III.14 -

The impact of the external factors may either affect one of the system's components or the relationship of cause and effect. They may either exert a driving force (+) or have a braking effect (-). The relationships represented by thick arrows are those that are reinforced by the external legislative factors. The relationships represented by dotted arrows relate to the relationships between loops.

| | Influential factors | Players | Impact on Loop 1 (product Innovation) | Impact on Loop 2 (tailored Customer Response) | Impact on Loop 3 (overall quality / price) | Impact on Loop 3 (Quality / price of specialised repair) | Impact on Loop 4 (price to customer) |
|---|------------------------|---------------|---------------------------------------|---|--|--|--------------------------------------|
| Characteristics of the current distribution system | | | | | | | |
| | Sales/after-sales link | Manufacturers | Driving force | Brake | | Driving force | Brake |

– Table III.21 –

| | |
|---|--|
| A major R1 (product loop) driver | <p>The sales/after-sales link has a dual impact on the innovation loop R1:</p> <p>It gives players in official distribution networks the opportunity to develop an integrated portfolio of activities (C4) that allows them to win customer loyalty and achieve profit stability – keeping in mind that the overall profitability of the official players is maintained by repairs and distribution of spare parts.</p> <p>This link allows manufacturers to manage the brand-specific investment (C5) required to ensure the image and reliability of the brand. It is used as a way of allocating responsibility throughout the life of the vehicle.</p> |
| A major brake on B2 (customer loop) within sales | <p>The obligation to link sales and after-sales constitutes a major barrier to the entry of any player wishing to penetrate the sales market without having the technical skills associated with after-sales. This slows both the customer innovation process (C8) and intra-brand competition.</p> |
| Stabilisation of B3 (reliability loop) | <p>It is by means of the sales/after-sales link that manufacturers are able to guarantee acceptable homogeneity of investments in service (C5) and hence satisfactory geographical coverage of service points (C12). This is in spite of competition from independent players in the after-sales market (C7).</p> <p>On the other hand, the link between sales and after-sales service forms a barrier to entry for independent repairers who wish to expand their services to include complex brand-specific repair work (C14).</p> |
| Indirect impact on B4 (price loop) | <p>The integrated sales and after-sales service structure of the official networks constitutes an indirect way of limiting price competition because the price of a new car is integrated in the concept of 'Total Cost of Ownership'.</p> <p>The existence of distribution or repair specialists would allow the development of cost structures that are noticeably more competitive¹²⁷ (C18) and weaken the market position of integrated players.</p> |

The problems and issues involved in any breaking of the link between sales and after-sales service may be summarised as follows:

- Maintaining reliable service for the consumer throughout the life of the vehicle in any geographical area for every type of service and vehicle within the brand;
- Allowing manufacturers to meet their responsibilities in terms of warranty claims and recalls;
- Anticipating and managing the pressure on the profitability of the traditional official networks (integrated sales and after-sales players) which a partial loss in market share might well cause.

¹²⁷ The impact of specialisation and professionalisation on certain services may be seen from the example of fast-fit chains specialising in certain simple repair work allowing them to compete with the prices of the official networks for these services.

III.3.1.B. Legislative options

The options¹²⁸ to be considered when analysing the link between sales and after-sales are as follows:

- Maintaining the sales/after-sales link **as currently defined**;
- **Breaking** the sales/after-sales link i.e. a situation in which 'official' distributors of new vehicles and 'official' repairers would be selected by the manufacturer on the basis of two different sets of criteria¹²⁹;
- **Reorganising** the sales/after-sales link which would entail obliging **distributors** who sell new cars to offer after-sales servicing although they would not be obliged to provide the service themselves. They **may choose to have a partnership with one or more official repairers**.
- be transformed into one or more partnerships;
- Obliging distributors to be repairers as well, but **without any obligation for the repairers to be distributors**;
- **Using different sets of criteria** where a distinction between players in the official network would be subject to a compulsory sales/after-sales link and independent distributors would be allowed to concentrate on sales¹³⁰.

The sales/after-sales link may be interpreted in terms of the legislative scenarios as follows:

| | Scenario 1 | Scenario 2 | Scenario 3 and 3A | Scenarios 4 and 5A | Scenario 5 |
|---|----------------------------|------------|-----------------------------|-----------------------------|------------|
| Interpretation of the sales/ after-sales link | At the players' discretion | Unchanged | All options are conceivable | All options are conceivable | Unchanged |

- Table III.22 -

In Scenarios 2 and 5, which are based on territorial exclusivity (in which the official dealer is responsible for that territory), only the option of maintaining the sales/after-sales link is practical.

In Scenario 1, the compulsory link between sales and service would be removed because distribution and service are 'totally free'. However, the analysis of this scenario revealed how complex it is to assess this legislative framework. From a legal stance, it would seem difficult to oblige a manufacturer that is not in a dominant market position to deliver vehicles for sales to any candidate distributor. In this context, it is likely that manufacturers would be in a position to contractually impose service capabilities on their distribution partners.

Hence, **to give an independent impact analysis of breaking the sales/after-sales link, it is necessary to analyse it within the context of Scenario 4** - the one nearest to the current situation, but doing away with the principle of territorial exclusivity.

¹²⁸ A link with points (10), (11), and (12) of the Terms of Reference.

¹²⁹ Such a system would no longer allow a manufacturer to link compulsory these two activities but would not prevent a selected distributor from asking to be selected as a repairer as well (or vice-versa).

¹³⁰ The logic of a dual set of criteria has already been touched on in the conclusion to the analysis of the scenarios.

III.3.1.C. Position of the players

The traditional players would like for all distributors to also be required to be repairers. However, some would accept the following situations:

- The concept of having 'official' repairers – but this must remain at the discretion of the manufacturers and must be justified by reasons of financial viability in particular regions.
- The fact that official dealers would be obliged to maintain the link while others, like 'official repairers', would not be obliged to develop sales activities. This solution would have the advantage of allowing the manufacturers to retain control of these two activities and would also improve after-sales competition.

The majority of spare part manufacturers¹³¹ are in favour of breaking the sales/after-sales link. They point out that such a break would give them more direct access to the official repair network.

At the new entrant level,

- Both Internet companies and mass marketing players are favourably disposed to breaking the sales/after-sales link because it does not fit their business models. They also point out that it is up to the consumer to choose a retailer with or without the link.
- Banking and insurance companies favour maintaining the link insofar as their business model is partly founded on a close partnership with the manufacturers¹³². Furthermore, they believe that only the official networks are in a position to guarantee the quality of complex repairs.

Finally, although end consumers are in favour of breaking the link, they are also aware that alternative arrangements must be put in place for all distributors in order to guarantee after-sales service (directly or indirectly).

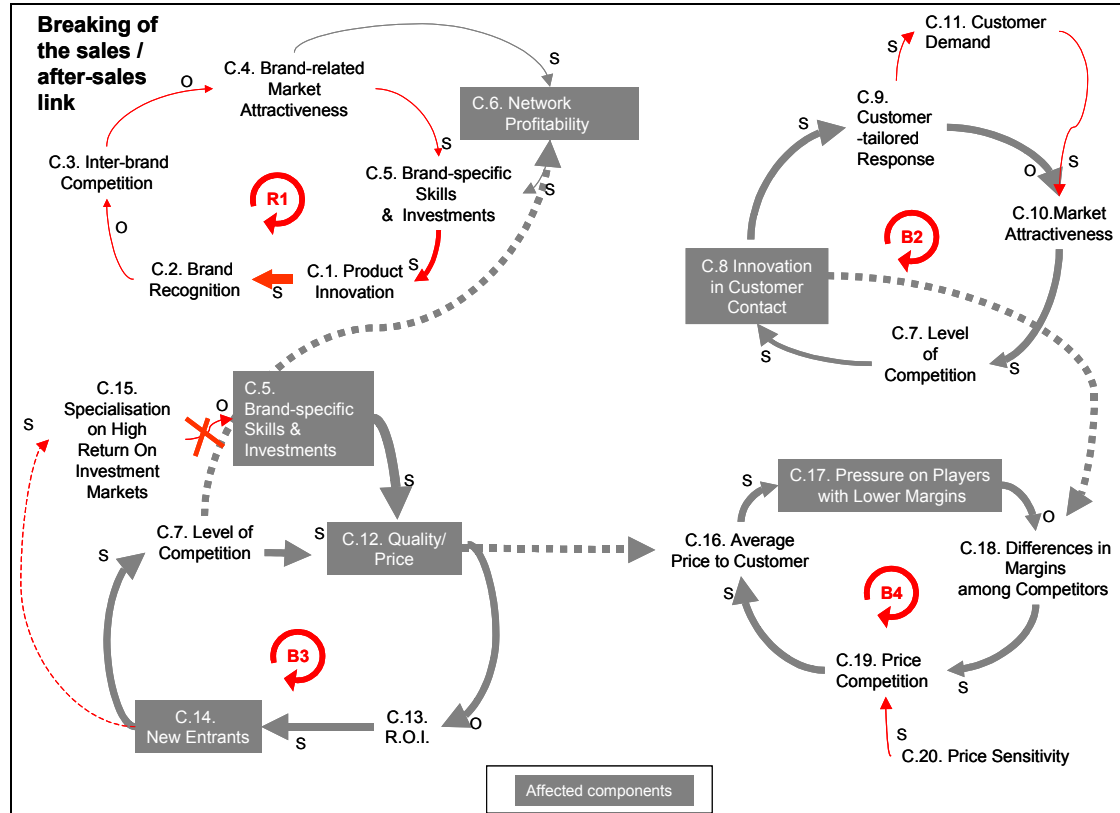
¹³¹ Not everyone wanted to make his or her views on this subject known.

¹³² As car sales are merely a business attracting the sale of insurance and vehicle financing products, these players favour a partnership approach with proven logistics.

III.3.1.D. Impact analysis

The impact analysis on breaking the sales/after-sales link has been carried out in the context of the fourth legislative scenario (qualitative and quantitative selectivity without territorial exclusivity). The method of dealer remuneration is considered to be freely determined. The after-sales and multi-branding variables remain unchanged.

The analysis is depicted in the diagram below:



- Diagram III.15 -

The components highlighted (in grey) are those affected by breaking the sales/after-sales link. The diagram also illustrates (in bold) the relationships brought about by the break.

The diagram illustrates how breaking the sales/after-sales link has a major, structural impact on both the distribution and after-sales markets.

| | |
|--|---|
| Acceleration of B2 (customer loop) in sales | <p>In the short term, breaking the sales/after-sales link would allow arrival of new players specialising in distribution¹³³ and customer innovation (C8).</p> <p>In the medium term, this trend should stabilise around a new balance of market share between traditional integrated sales and after-sales dealers and players specialising in sales.</p> |
| B3 (reliability loop) stabilises in a different equilibrium | <p>A conflicting development in the reliability loop is probable. Breaking the sales/after-sales link would give the repairers an opportunity to become official repairers, which would tend to increase the level of brand-specific skills and specialisation (C5). This would have a positive impact on the quality/price ratio (C12). However, this development of 'repair only' players would increase competition in service and would tend to de-stabilise the traditional official dealers (C6). This loss in profit would have a negative impact on the level of brand-specific skills and investments (C5). These two opposing trends would likely stabilise around a new equilibrium of market share between 'full facility' dealers and 'repair only' specialists.</p> <p>It is likely that in the short term one might observe the promotion of some of the current independent repairers to official repairers. This would tend to weaken many traditional players. If manufacturers were to restrict multi-brand repair work, it is probable that the number of official repairers would stabilise in the medium term.</p> <p>Hence, the main consequence, already observed in Scenario 4, would be an increase in specialisation.</p> |
| Strains on R1 (product loop) | <p>Breaking the sales/after-sales link entails a risk for manufacturers because they may lose customer loyalty. It involves both an operational risk in terms of managing vehicle aftercare and a commercial risk.</p> <p>In the short term, the innovation loop is slowed by the following:</p> <ul style="list-style-type: none"> - Reduction in the profitability of traditional integrated sales / after-sales players with competition in both distribution and servicing; - Investment differentials between geographical areas causing anomalies in the geographical coverage of service points. <p>Some manufacturers might react by granting authority to practise multi-branding of repair work, particularly for those brands with lower market penetration.</p> <p>For manufacturers, another requirement of this un-bundling of sales and after-sales businesses would be to develop attractive remuneration methods for the different types of market positioning.</p> |
| Indirect impact on B4 (price loop) | <p>In contrast to the impact of the various basic scenarios, breaking the sales/after-sales link would form the basis of a deeper and more structural change in the price loop. The possibility of specialising in one or another of the downstream automobile businesses would lead to cost structure differentials between players and hence margin differentials (C18) and to intensified price competition (C19). This would happen irrespective of whether it involves the price of certain services taken in isolation or the concept of 'Total Cost of Ownership'. This increase in price competition would not be restricted to the short term since it would only be reduced when the market stabilises.</p> |

¹³³ The significance of this trend could increase and Part IV of the report contains a thorough discussion of the business models liable to develop. Only the trends are reported here.

Long-term impact:

As with the five basic legislative scenarios, the table below summarises the impact in comparison with Scenario 4:

| Breaking the sales/ after-sales link (using Scenario 4 as the base, all other variables unchanged) | | |
|--|--|---|
| | Scenario 4 | Breaking the sales/after-sales link |
| Impact on the four loops' speeds | | |
| Product loop (R1) | High | Brake but long-term stabilisation |
| Customer loop (B2) | Low (sales) – High (after-sales) | Acceleration in both sales and after-sales |
| Reliability loop (B3) | Stable | New balance |
| Price loop (B4) | Short term stimulation | New balance |
| Impact on the four areas of competition | | |
| Inter-brand competition | High | Same |
| Intra-brand competition | Increase Strong stimulation of competition within networks but no emergence of alternative competing channels based on new business models | Increase Strong increase in competition between distributors and 'full facility' players (competing channels) |
| Competition in after-sales servicing | Increase in non-specialised repairs but reduction in specialised ones | Increase across all services |
| Market integration | Faster growth | Same |
| Impact on the distribution market | | |
| Market share held by official distribution networks | Stable | Same |
| Level of product innovation | High | Same |
| Cost structure for the sale of new vehicles | Cost rationalisation linked to an increase in average size Increase in marketing costs for distributors | Same |
| Level of price competition | Stable in the long term | Same |
| Number of distributors (level of fragmentation) | Tendency towards concentration and reduction in the number of sales outlets. Increase in the proportion of multi-site and international distributors | Greater increase due to the market positioning of some players to become repairer only outlets |
| Manufacturers' control over their marketing policy | Stable in the long term | Made more difficult (operational and commercial risk) |
| Differentiation of distribution forms according to customer segments, car models and geographical areas | Development of players' specialisation ('full facility' vs. 'sales only' vs. 'repair only') and pressures on the sales/after-sales link and remuneration policy in their present forms | Increased trend |

- Table III.23 –

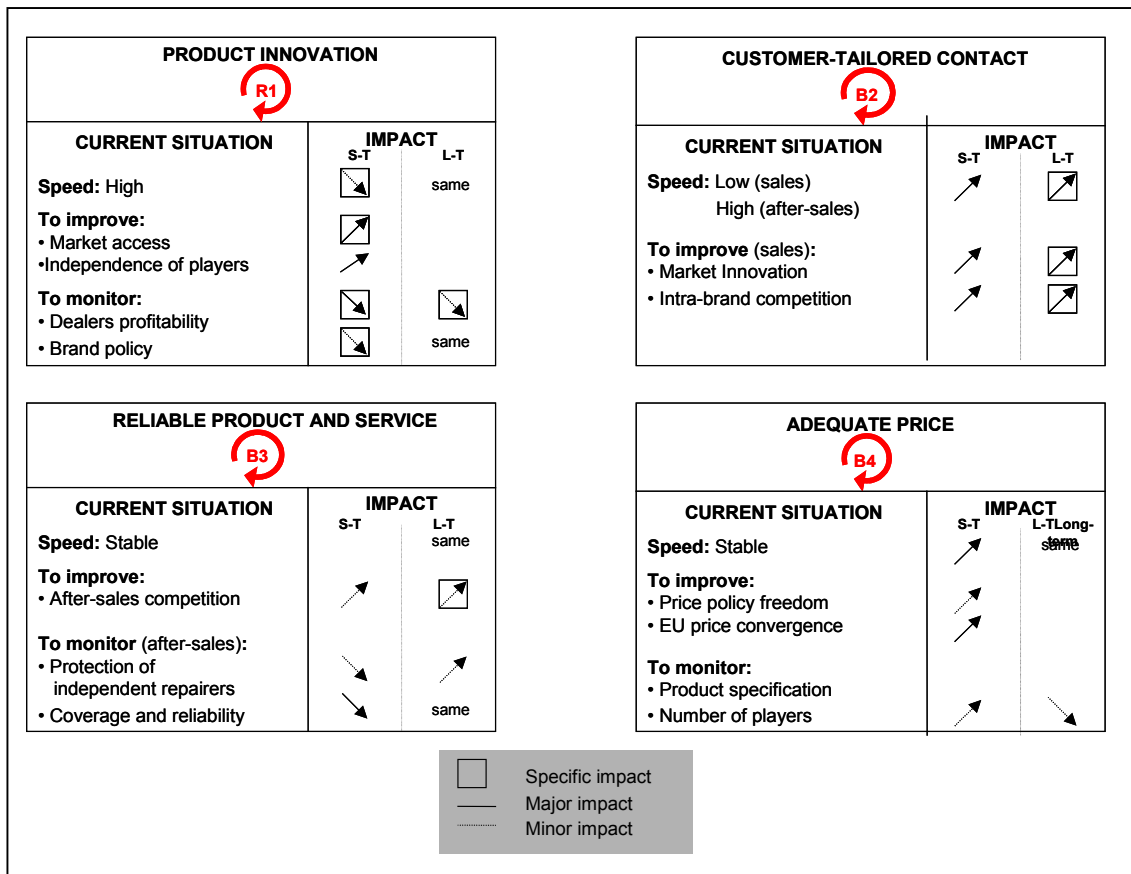
With all other variables unchanged, the impacts on distribution would be similar to those described in Scenario 4. 'Sales only' players would only be able to exist on the market as brand exclusive players fulfilling all the traditional quantitative and qualitative criteria. Therefore, it would be difficult for new entrants to develop alternative distribution formats.

| Breaking the sales/after-sales link (using Scenario 4 as the base, all other variables unchanged) | | |
|---|--|---|
| | Scenario 4 | Breaking the sales/after-sales link |
| Impact on the after-sales market | | |
| Official networks' share in after-sales market | Slight increase in market share | Increase Attractiveness of brand networks to independent repairers who can gain access to the repair business without going into the distribution market - It involves a chance to benefit from brand awareness and access to information and training on a basis of lower investment requirements Strong differentiation between manufacturers according to their ability to demand brand exclusivity |
| Number of service outlets | Short and medium term decrease and disruptions | Increase in the proportion of players capable of carrying out specific repair work |
| Average value for money of service provided | Instability | Improvement as a direct consequence of the increase in competition |
| Density and reliability of service outlet coverage | Instability | Short-term improvement then stabilisation |

- Table III.24 -

III.3.1.E. Conclusion

The diagram below summarises the system-based analysis of reorganising the sales/after-sales link in the context of Scenario 4:



- Diagram III.16-

Reorganisation of the link between sales and after-sales within the context of Scenario 4 would achieve the following:

- It would meet the objectives of stimulating intra-brand competition and competition on the after-sales market in a more fundamental way than the legislative scenarios taken alone;
- It would entail a structural change in the industry leading to a different balance of market share between players, as well as various distribution forms and levels of specialisation (impact of changing the balance between B2, B3 and B4);
- It would require manufacturers to adapt substantially in order to counteract the disruptions caused by the reduced profitability of the traditional official players.

The analysis permits conclusions to be drawn in terms of the relevance and level of risk of each of the proposed legislative options:

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|---|---|---|--|
| Current legislative situation: Every distributor is obliged to be an official repairer and vice-versa | | | |
| Options: <ul style="list-style-type: none"> - 'Breaking' the sales/after-sales link: the two businesses are governed by distinct conditions - 'Reorganisation' of the sales/after-sales link: maintenance of an obligation on distributors to conclude a partnership with one or more official repairers. - 'Official repairers': Requirement for distributors also to be repairers: no requirement for repairers to be distributors. - 'Sets of distinct criteria' : requirement for the sales/after-sales link for players in the official network and the opportunity for independent players to concentrate on sales | <p>High</p> <p>High</p> <p>Moderate</p> <p>Moderate</p> | <p>High</p> <p>Moderate</p> <p>Limited</p> <p>Limited</p> | <p>Rapid changes in the market structure including short-term instability. Each brand will adapt differently.</p> <p>Promotes opening up of markets while limiting short and medium term instability.</p> <p>Parallel with the current restructuring of networks along 'hub-and-spoke' lines would only have an impact on after-sales competition.</p> <p>It would benefit new entrants in sales from outside the automobile industry but would have no impact on after-sales competition.</p> |

- Table III.25 -

A total break in the link between sales and after-sales servicing would lead to significant disruptions. It is not the existence of the link between sales and after-sales servicing that should be questioned, but the nature of its organisation.

The study identifies a possible alternative: 'reorganisation'. Instead of providing the service themselves, distributors would be allowed to offer after-sales servicing through partnership agreements with authorised repairers. 'Reorganisation' of the link is an option that would encourage a progressive opening up of markets and specialisation of players in the sales or service market, while limiting instability and negative effects.

III.3.2 Restrictions on multi-branding in distribution

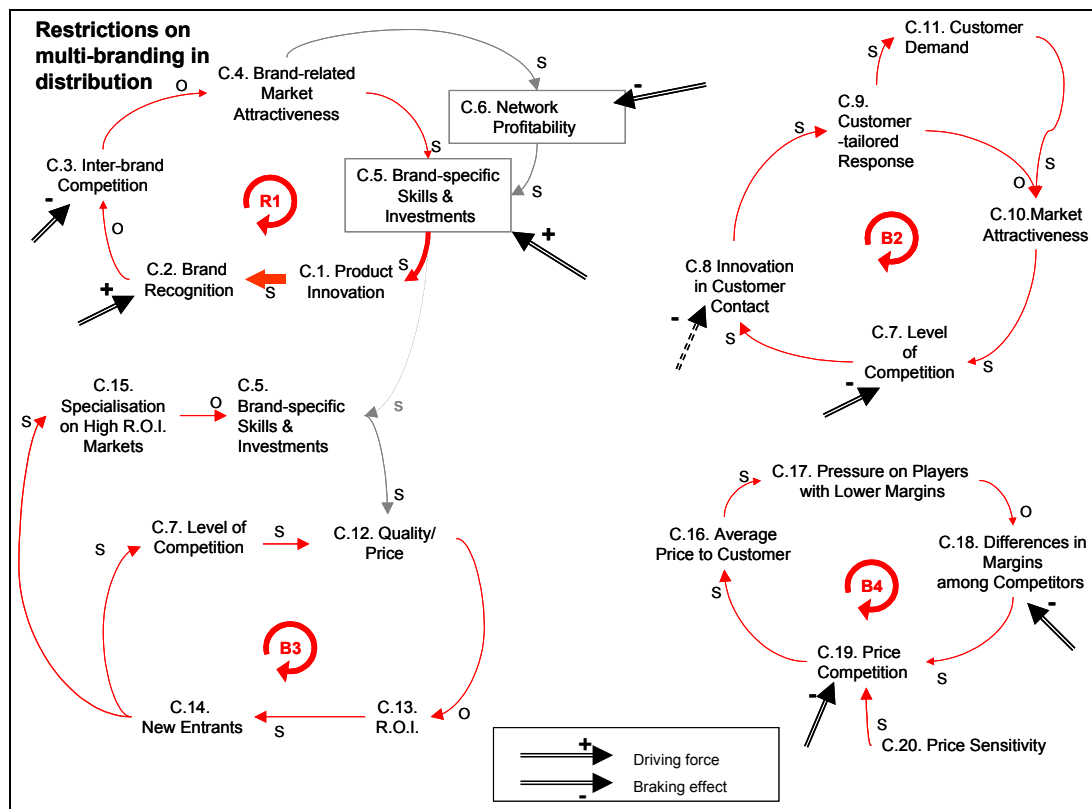
III.3.2.A. Current situation and issues

Multi-branding is the ability to sell or maintain models or parts from different manufacturers within the same environment and/or structure.

In vehicle sales, multi-branding is restricted by both the market structure (manufacturers' standards) and the legislation¹³⁴. The only examples of unifying dealerships for different brands within one group remain very limited because of the small economies of scale realised and the necessary critical size.

In Sweden or Finland, multi-branding is more developed and appears to be a practical solution to less densely populated areas. However, in general, multi-branding practices may be restricted by the large investments required. The expertise and the brand-specific offers of traditional players tend to counterbalance any advantages multi-brand distributors may offer to end-customers. The emergence of the Internet¹³⁵ as a comparison tool might also limit the perceived value of multi-branding.

The impact of multi-branding restrictions on industry loops may be depicted as follows:



- Diagram III.17 -

¹³⁴ Article 3, clauses 3 & 4 of regulation 1475/95: manufacturers are entitled to impose the following terms: sale of motor vehicles put up for sale by a person other than the manufacturer is possible only in separate sales premises under separate management by a separate legal entity and in such a manner that no confusion of brands is possible. With regard to after-sales service, the distributor must ensure that no third party benefits unduly from the supplier's investments.

¹³⁵ The Internet is increasingly satisfying the need for comparability expressed by customers.

| Influencing factors | Players | Impact on Loop 1 (product Innovation) | Impact on Loop 2 (customer-tailored response) | Impact on Loop 3 (overall quality / price) | Impact on Loop 3 (Quality / price of specialised repair) | Impact on Loop 4 (price for customer) |
|---|---------------|--|---|--|--|---------------------------------------|
| Characteristics of the current distribution system | | | | | | |
| Restrictions on multi-branding | Manufacturers | <u>Driving force</u> Brake ¹³⁶ | Brake | | <u>Driving force</u> | Brake |

- Table III.26 -

A major driver of R1 (product loop)

Brand exclusivity is **the basis of the product loop** (R1). In fact, it allows investments in networks to be channelled to the brand (C5), co-ordination of marketing policies (C1 and C2), and the creation of the brand differentiation necessary to stimulate the dynamics of its business as a whole.

However, it should be noted that it is impossible for distributors to give effect to certain synergies representing one or more additional brands. Especially in particular areas or with low market penetration brands, this may constitute a **brake on the networks' profitability** (C6).

The trade-off between profitability of networks and protection of the brand image is at stake.

A brake on B2 (customer loop) in sales

As explained below in the player position analysis, consumers would be looking for multi-brand distribution methods. Hence, the restrictions on multi-branding act as a **brake on innovation in customer contact** (C8).

Furthermore, the majority of new entrants wish to develop multi-brand business models and restrictions on multi-branding constitute **one of the barriers to entry** for these players¹³⁷ (action on C7).

No direct impact on B3 (reliability loop)

Multi-branding in distribution has no direct impact on B3. However, brand exclusivity is a way of guaranteeing an acceptable level of skill and investment in the brand (C5).

Indirect impact on B4 (price loop)

The restrictions on multi-branding have a dual impact on the price loops' equilibrium:

- One impact is to limit price transparency by restricting comparability, which has a direct impact on the level of price competition (C19);
- A second impact is that it requires identical investments by every player (all are subject to the same restrictions), and hence similar margin (C18); this restricts the opportunities for price competition between players.

The issues at stake in multi-brand distribution may be summarised as follows:

- The importance of brand exclusivity to **manufacturers' marketing policies**;
- The barrier it represents to the **development of new players who must be willing to develop different business models**. These would include the development of distribution and after-sales service groups that cover different brands belonging to different manufacturers. The manufacturers would be seeking either similar technologies that are complementary (technical multi-branding); or seeking common customers differentiated by the level of service (targeted multi-branding); or volume over a limited number of models strongly encouraged by heavy discounting (mass multi-branding);
- The search for **economies of scale on brand-specific investments**, or on dealership general management costs (accounting, stock control...).

¹³⁶ A dual, opposed impact on the product innovation loop may be observed here (product loop).

¹³⁷ In Part IV the terms of entry for new players will be analysed by means of a combination of scenarios and variables allowing various entry barriers to be lifted.

III.3.2.B. Legislative options

The legislative options are as follows:

- Retain the current restrictions on multi-branding in distribution¹³⁸;
- Partially or totally abolish current restrictions: 'multi- distributors' or '**full multi-branding**'¹³⁹ options would grant freedom for distributors to sell different brands of vehicles, provided they meet other conditions set by manufacturers and/or legislation;
- Use **several sets of criteria** to manage the coexistence of exclusive and multi-brand channels¹⁴⁰.

Depending on how other variables or scenarios are combined, the impact of allowing multi-branding may be very different.

The table below shows the **extreme legislative combinations** in terms of the multi-branding variable:

- In the first row, the context is the most conservative scenario (Scenario 5) and all other variables remain unchanged;
- The second row refers to an intermediary combination in which Scenario 4 is combined with the re-organisation of the sales/after-sales link and with the coexistence of different sets of criteria depending on the channel;
- The last row reflects the biggest changes to the legislative framework. It combines lifting the restrictions on multi-branding with breaking the link between sales and after-sales and is a scenario with minimum selection criteria (Scenario 3A);

| Scenarios | Sales/after-sales link | Multi-branding |
|------------------------------------|------------------------|---|
| Scenario 5 ▲ ⋮ | Unchanged | 'Multi-distributors' or 'Full multi-branding' |
| ... Scenario 4 ... ⋮ ▼ | Reorganised | Several sets of criteria |
| Scenario 3A | Broken | 'Full multi-branding' |

- Table III.27 -

¹³⁸ **Multi-showroom:** distributors are allowed to sell vehicles of different brands under the following conditions: different buildings, different legal entities/accountancy, different sales forces and different marketing approaches.

¹³⁹ - **Multi-distributor:** distributors are allowed to sell vehicles of different brands under the following conditions: same building, same legal entity/accountancy, different sales forces and no possibility of consumer confusion between brands. Remark: the sales force depends directly on the vehicle manufacturers and the multi-brand distributor is remunerated for the space dedicated to the brand, per vehicle sold, etc.

- **Multi-brand:** distributors are allowed to sell vehicles of different brands under the following conditions: same building, same legal entity/accountancy, same sales forces, and no possibility of consumer confusion between brands.

¹⁴⁰ For reference, the logic of distinct sets of criteria has already been discussed in the context of the sales/after-sales link.

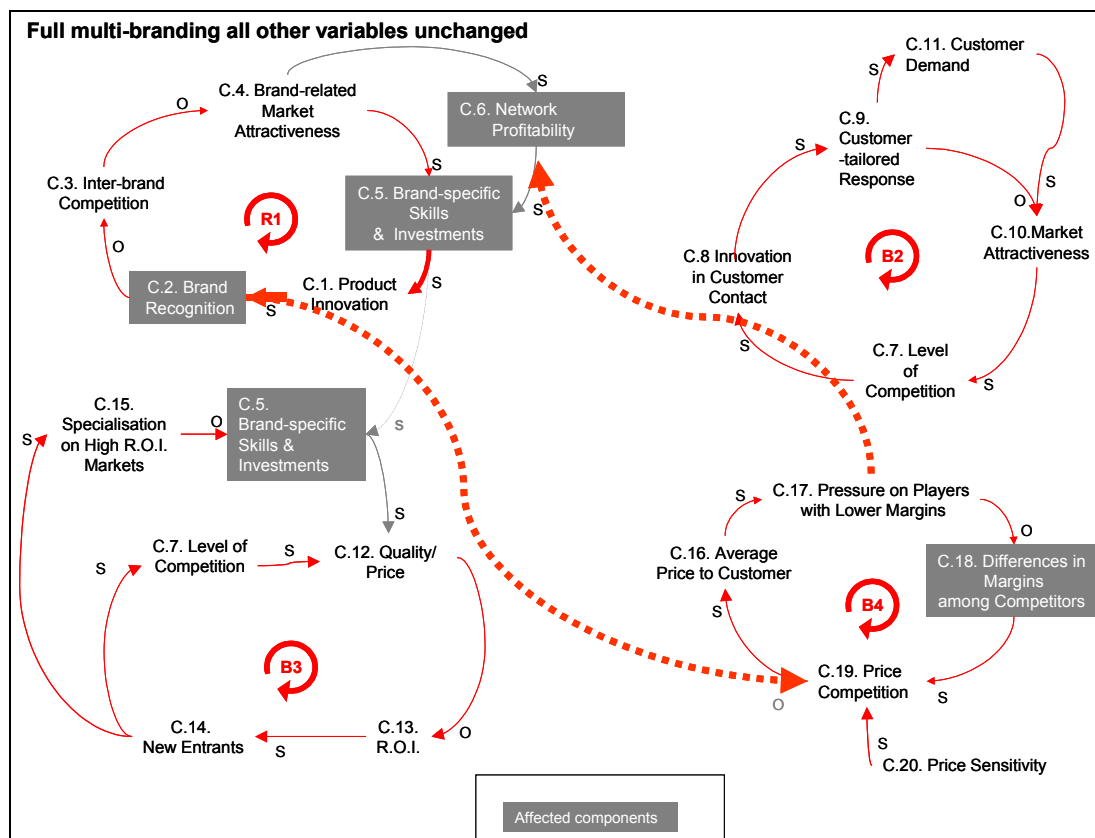
III.3.2.C. Position of the players

The players' positions are divergent in terms of this variable. Manufacturers are not in favour of multi-branding, but consumers and new entrants are. Official dealers have a divided stance.

III.3.2.D. Impact analysis

As mentioned briefly in the analysis of legislative options, an impact analysis of the multi-branding variable is difficult to carry out. Its impact will vary considerably depending on the combination of other variables.

Hence, the diagram below is intended to show the trends brought about by growth in multi-branding. All other variables remain unchanged:



- Diagram III.18 -

The impact of the external factors may either affect one of the system's components or the relationship of cause and effect. They may either exert a driving force (+) or have a braking effect (-). The relationships represented by thick arrows are those that are reinforced by the external legislative factors. The relationships represented by dotted arrows relate to the relationships between loops.

A brake on the product loop (R1)

For distributors who opt for it, multi-branding means increased independence from manufacturers. It also means the opportunity to make their investments more profitable by increasing the volume of business in their territory. Because of the size of the investments involved, only large-scale distributors would be able to develop a multi-brand operation. Hence, **if multi-brand operations truly bring economies of scale, concentration of the official networks could be accelerated considerably.**

However, in a context in which manufacturers maintain control over the qualitative and quantitative selection criteria the prospects for economies of scale are limited.

In the event that a large proportion of players opts for multi-branding, the product loop (R1) would slow. By restricting the specificity of each brand (C2), multi-branding could have some impact on strengthening inter-brand competition (C3).

No impact on B2 (customer loop) in sales

In a territorial exclusivity scenario, growth of multi-branding should have no significant effect on intra-brand competition (C7). Moreover, if all the qualitative and quantitative selection criteria remained in force, multi-branding would not lead to any real innovation in sales processes or customer contacts (C8).

In the long term, strong growth in multi-branding would result in a reduced level of intra-brand competition because of the large reduction in the number of players.

No impact on B3 (reliability loop)

If both the qualitative and quantitative selection criteria and the compulsory sales/after-sales link remained, the impact on the reliability loop would be marginal.

Limited impact on B4 (price loop)

The sole impact on the price loop (B4) lies in the opportunities for economies of scale realised by multi-brand distributors that would allow them to develop more competitive cost structures (C18). This would allow better positioning with regard to price competition.

The impact is marginal for various reasons including the following:

- In the context of qualitative and quantitative selection, economies of scale would be limited;
- Territorial exclusivity restricts the opportunities for price competition.

In extreme cases, if multi-branding grew considerably and led to a weakening of the product loop (R1) as explained above, it could lead to mutually reinforcing effects on the customer loop (B2) and the price loop (B4) - **as well as an increase in the proportion of mass-markets in the industry.**

The diagram summarises the various long-term impacts described below¹⁴¹:

| Scenarios | Sales/after-sales link | Multi-branding | Product loop (R1) | Customer loop (B2) | Reliability loop (B3) | Price loop (B4) |
|-------------|------------------------|--------------------------|-------------------|--------------------|-----------------------|-----------------|
| Scenario 5 | Unchanged | Full multi-branding | = | = | = | = |
| Scenario 4 | Reorganised | Several sets of criteria | = / - | = / + | = | = / + |
| Scenario 3A | Broken | Full multi-branding | - | = / - | Unstable | + |

- Table III.28 -

In Scenario 5 where the sales/after-sales link remains unchanged, in the long term, the impact of full multi-branding on the four loops would be limited to certain players or to highly populated areas.

Scenario 4 is an example of a “halfway” case, in which the sales/after-sales link would be reorganised and where there are different sets of criteria for exclusive and multi-brand players. Here the long-term impact would be more pronounced. Note the slowing of the product loop and the acceleration of both the customer and price loops. This means that new entrants who develop lean price structures would capture some market share and put pressure on the traditional networks.

Finally, the last line shows the more profound impact this variable could have in combination with other variables. Note the slowing of the product innovation loop (R1), a slight brake on customer innovation (the customer loop – B2), instability in service cover (the reliability loop - B3) and stimulation of price competition (the price loop – B4).

¹⁴¹ = means that the activation level is unchanged; - means that the loop is slowed; + means that it is accelerated.

III.3.3. Access to technical information and diagnostic equipment

III.3.3.A. Current situation and issues

The current regulation states that vehicle manufacturers must make the technical information required for the repair or maintenance of their vehicles accessible to independent repairers (subject to payment) - provided it is not covered by any intellectual property rights and does not constitute identified, substantial, or secret know-how. Even in the latter cases, technical information needed by independent repairers may not be withheld in an abusive or discriminatory manner¹⁴².

In reality, the situation is much more complex. Due to the interdependence between car components and the numerous intricate functions of a vehicle, access to technical information and diagnostic equipment is difficult to arrange. It requires financial investment as well as an ever-increasing level of training. This **situation creates de facto barriers to access to technical information**.

The impacts on the system of the barriers to technical information that have already been mentioned in Part II are recalled below:

- A slight acceleration of the product loop since the barriers expand the captive services of the official networks;
- A brake on competition in after-sales servicing and hence on the quality/price ratio.

| Influencing factors | Players | Impact on loop 1 (product innovation) | Impact on loop 2 (customer-tailored response) | Impact on loop 3 (overall quality/price) | Impact on loop 3 (quality/price of specialised repair) | Impact on loop 4 (price for customer) |
|--|---------------|---------------------------------------|---|--|--|---------------------------------------|
| Barriers to access to technical information. | Manufacturers | Driving force | | Brake | Brake | |

- Table III.30 -

Hence, the main issues are as follows:

- Maintaining the competitive market position of independent repairers and, by extension, the overall **level of competition** in the after-sales market;
- **Clarifying what information** should be available and what can be retained by official dealers and manufacturers;
- **Adequate pricing** for accessing the information;
- The **liability** of the party that provides the information.

III.3.3.B. Legislative options

The regulatory alternatives to consider include the following:

- **Retaining** the current legislative situation as is with no additional intervention;
- **Facilitating** freedom of access but setting up an independent body responsible for monitoring the proper application of this access and the readiness with which it is put into practice;
- **Restricting** access solely to official service outlets and those capable of giving a complete diagnostic of the vehicle.

¹⁴² Article 6, paragraph 1 point 12, section 28 of Regulation 1475/95.

III.3.3.C. Position of the players

All the players are in favour of keeping the current situation almost unchanged:

- The traditional players (basically the manufacturers) state that they will not be liable for improper use of their information by independent repairers unless this access is accompanied by ad hoc training. They are liable only for errors present in the information supplied. Furthermore, they do not wish to provide access to information covered by intellectual property law.
- Spare part manufacturers, independent repairers and new entrants want total access, including to technical information covered by intellectual property law¹⁴³.

III.3.3.D. Conclusion

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|--|--|---------|---|
| Current legislative situation: Freedom of access for all parties concerned to technical information and diagnostic equipment, provided that they are not protected as intellectual property. | | | |
| Options: - Facilitation : reinforce access to technical information and diagnostic equipment | Moderate | Limited | Facilitates opening up of the after-sales market and maintenance of the competitive situation of independent repairers. |
| - Restriction : restrict access solely to 'official service outlets'/necessity to acquire all the information. | Option not relevant | N/A | None of the players advocate this option. It would represent a step backward compared to the current situation. |

- Table III.31 -

Access to technical information, training and diagnostic equipment are major problems for boosting competition in after-sales. Since manufacturers and their official networks remain protected by intellectual property rights, the risk factor associated with facilitating such access is low.

The legislative option of restricting access will not be carried forward in this analysis since it is considered to be irrelevant.

¹⁴³ The issue of On-Board Diagnostics (OBD) technical information is not yet specifically covered in the current Regulation, although it is a topic of major importance for competition between the various players. In this case too, some of the information may have intellectual property-related parts. However Directive 98/69/EC provides for a specific requirement for availability of OBD related information. Furthermore, although the importance of OBD currently mainly revolves around emission control, it will, at a later stage, also include other areas, such as information and the code for certain technical functions of the vehicle including ones involving safety and comfort. A new scheme should also make it possible to include this kind of factor.

III.3.4. Access to the trade and multi-branding in after-sales servicing

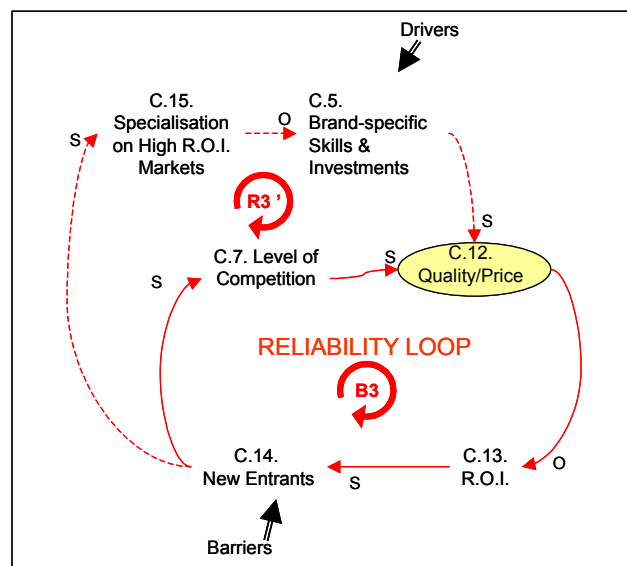
III.3.4.A. Current situation and issues

The two aspects of this variable are access to warranty and recall operations and the opportunity for official repairers to carry out after-sales servicing on vehicles of different brands.

In the current situation three of the following types of players co-exist:

- **Official service outlets**, that are mostly single brand dealers authorised by the manufacturer to take on warranty and recall operations and who carry out all types of repair; They are also authorised distributors of original spare parts;
- **Independent repairers**, that are mostly multi-brand players with no contractual tie to a manufacturer; They carry out repair work obtaining spare parts either from independent wholesalers where spare parts of matching quality are available, or from the official service outlet for original spare parts;
- **New entrants** that are divided between 'fast fit' repair chains and car centres, that sell spare parts of matching quality and carry out minor repairs on a multi-brand basis, and also car departments in supermarkets and retailers of spare parts, whose activities are to mainly sell parts of matching quality and of lesser quality.

It has been shown in the analysis of the current situation that this variable has a dual impact on the reliability loop (B3):



- Diagram III.19 -

In combination with territorial exclusivity, the obligation to repair the whole range, to maintain the sales/after-sales link, and the restrictions on multi-branding in after-sales servicing¹⁴⁴ are **means manufacturers use to guarantee their brand-specific technical investment in service** (C5). This also means they can ensure quality and an even coverage of service outlets (C12).

In addition, it creates barriers to some types of service (C14) for independent repairers, which reinforces the profitability of official dealers.

¹⁴⁴ A manufacturer may not require its distributors to set up separate workshops (article 3, paragraph 4). However, it may require them not to allow a third party to benefit unjustly from its investments, for example, if it has underwritten the cost of buying technical equipment used in the distributor's workshop. The manufacturer may demand that the equipment is not used to repair vehicles of another brand. On the other hand, the manufacturer may not impose financing or equipment (source: Explanatory Brochure on Regulation 1475/95).

In such a context, changing the rules on access to after-sales servicing activity would help independent repairers sustain **market share** in the most profitable segments (vehicles more than four years old). This can be achieved by developing loyalty at the time of warranty and recall work (the captive period when vehicles are less than three years old) or by quality certification.

For official service outlets, the underlying issue is to realise **economies of scale** by repairing all brands.

Note that these issues must be viewed in a context in which consumer loyalty to official service outlets at the end of the warranty period is limited. On the other hand, for official repairers, the economies of scale from multi-branding are hard to realise because repair work (except for minor ones) are increasingly brand-specific and often use exclusive equipment and staff. In reaction to this, multi-brand repairers have become more specialised in certain types of repairs (injection, ABS...).

III.3.4.B. Legislative options

The following are regulatory alternatives to be considered:

- Retaining the current system of open access to the market for independent repairers except for warranty and recall work and restriction on multi-branding for official networks);
- Establishing a **more diverse approach to gaining access to the trade** (different sets of selection criteria depending on the type of repair, creation of an independent certification body);
- **Lifting all restrictions on multi-branding in after-sales servicing** for official players¹⁴⁵.

The introduction of different sets of selection criteria would allow players specialising in repair and maintenance of one brand and those specialising in certain specific services on a multi-brand basis to co-exist. An independent body might register repairers according to standard criteria accepted by the manufacturers¹⁴⁶. These repairers would be authorised to perform warranty and recall operations.

III.3.4.C. Position of the players

Manufacturers and official dealers have come out in favour of retaining the present system. They argue that:

- For liability reasons only participants nominated by the manufacturer can carry out warranty and recall work. A system opening these activities to other players would complicate liability issues and make checking on the performance of such work even harder;
- They cannot imagine a two-level selection process that would incorporate single-brand players, who would have to make considerable investments to cover the low profit sub-markets and multi-brand players, who would only invest in profitable activities.

For their part, spare parts manufacturers, independent repairs and new entrants support a scenario with different types of access to the trade based on sets of criteria defined by an independent body.

Consumers, fleet companies and end-users, are also in favour of a scenario with different types of conditions for accessing the market. They insist on the idea of selection organised by an independent body.

¹⁴⁵ See footnote 144 on pg.161.

¹⁴⁶ It appears that one alternative that would allow any repairer to take on this type of work must be abandoned: a legal analysis shows that it is not possible to impose such a move on manufacturers.

III.3.4.D. Conclusion

As mentioned in the table below, registering repairers able to perform certain specialised repair work would improve the competitive position of current independent repairers and increase the overall level of competition in the most complex sub-markets within after-sales servicing.

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|--|--|---|---|
| Current legislative situation: Coexistence of single-brand players contractually tied to a manufacturer and independent multi-brand players | | | |
| Options: <ul style="list-style-type: none"> - Certification by an independent body of registered repairers authorised to carry out warranty and recall work - Certification by an independent body of registered repairers authorised to carry out specialised repairs on different brands - ‘Full Multi-branding in after-sales service’ : Lifting of all restrictions on multi-branding in after-sales servicing¹⁴⁷ | <p>Limited</p> <p>High</p> <p>Moderate</p> | <p>Moderate</p> <p>High</p> <p>Moderate</p> | <p>Legal applicability unlikely and business case doubtful.</p> <p>Would reinforce competition in after-sales servicing - a situation in which official repairers would have competition over a wider range of services. Hence, the risk of pressure on the profitability of networks would increase.</p> <p>Risk of reduction in brand-specific expertise.</p> |

- Table III.32 -

¹⁴⁷ See footnote 144 on pg. 161. Under the current framework, multi-branding in repair work is allowed, provided that the same equipment does not unjustly benefit vehicles of another brand.

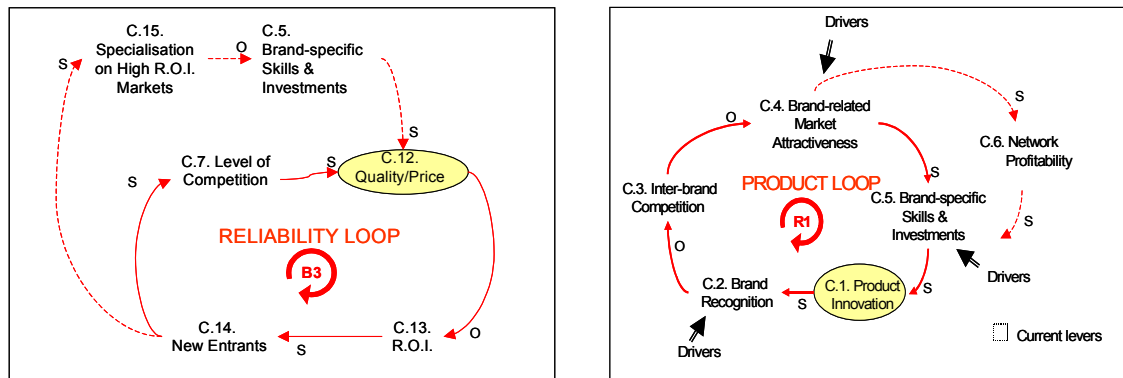
III.3.5. Distribution of original spare parts

III.3.5.A. Current situation and issues

Three following essential issues must be analysed within this context:

- **The definition of original spare parts**, which is currently defined as those either produced directly or approved by the manufacturer;
- **The branding of original spare parts**, since manufacturers generally put their logo on the parts even if they did not produce them;
- **The degree of access** for independent and official dealers to original spare parts¹⁴⁸.

The impact of the distribution system of original spare parts in its current form was raised in Part II.2.2. It is summarised as follows:



- Diagram III.20 -

| | Influencing factors | Players | Impact on loop 1 (product innovation) | Impact on loop 2 (customer-tailored response) | Impact on loop 3 (overall quality/price ratio) | Impact on loop 3 (value for money of specialised repair) | Impact on loop 4 (price for customer) |
|---|--|---------------|---------------------------------------|---|--|--|---------------------------------------|
| Characteristics of the current distribution system | | | | | | | |
| | Exclusivity of distribution of original spare parts through the official network | Manufacturers | <u>Driving force</u> | | <u>Brake</u> | | |

- Table III.33 -

This system of distributing original spare parts via the official networks has a braking effect on competition in after-sales servicing (C7). It also has a reinforcing effect on the attractiveness of brand-specific markets (C4), which contributes to the sustained profitability of the official networks.

¹⁴⁸ In the current situation, independent repairers are obliged to go through official dealers who are themselves obliged to go through manufacturers.

Hence, re-defining the concept of original spare parts is linked to the following factors:

- The **degree of competition in after-sales servicing** and, in particular, to the re-positioning of spare part manufacturers and independent repairers in this market who are now in competition with official service outlets (official dealers may also try to further invest in this activity);
- The **reduction and redistribution of margins** this would involve;
- Protection of the **investments made by the parts designers**.

III.3.5.B. Legislative options

The following are regulatory options to be considered:

In terms of the **definition** of original spare parts:

- Retaining the current legislative situation;
- Putting spare parts of matching quality i.e. those produced on the same production line as original spare parts or conforming to the original specification certified by an independent body in the same category as original spare parts.

In terms of the **branding** of original spare parts:

- Retaining the current legislative situation;
- Giving freedom to spare part manufacturers to put their logo/brand on the parts they supply to manufacturers. This de facto removes the distinction between spare parts of matching quality and original parts.

In terms of the **access** given to independent repairers:

- Retaining the current legislative situation;
- Giving all repairers the same access whether via the manufacturer or directly to spare parts manufacturers.

III.3.5.C. Position of the players

Except for the traditional players (manufacturers and, to a lesser extent, official service outlets), a clear preference is shown for:

- Extending the concept of original spare parts to spare parts produced on the same production line as originals;
- Giving freedom to spare part manufacturers to put their logo and/or brand name on the parts they supply to manufacturers;
- Giving all repairers the same access to original spare parts.

The traditional players justify keeping the current situation unchanged, and defend this position based on:

- Liability issues that would be raised between different participants in case a spare part supplied by one spare part manufacturer were to damage other parts supplied by other spare part manufacturers;
- Intellectual property considerations linked to the cost of research and development carried out by manufacturers and their partners to develop the spare parts produced by the spare part manufacturers;
- The doubts that this would raise in the mind of the consumer about the reliability of original spare parts.

III.3.5.D. Conclusion

The legislative options and their evaluation are summarised as follows:

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|---|--|----------|---|
| Current legislative situation: Restrictive concept of original spare parts, pseudo-exclusive presence of the manufacturer's brand, and access to parts controlled by the manufacturer | | | |
| Options: - Opening up the spare parts concept | High | Moderate | Reinforces opening up the market |
| - Free use of logos | High | Slight | Reinforces opening up the market |
| - Direct access to original spares | High | Moderate | As above, but seriously destroys the profitability of current official networks |

- Table III.34 -

Liberalising all or some aspects of the distribution of original spare parts is a variable with a decisive effect on the industry, including the following:

- Purchase prices negotiated by manufacturers would be affected;
- A de facto opening of the after-sales market giving all repairers the opportunity to have direct access to original spare parts;
- A significant impact on the profitability of official networks¹⁴⁹.

Again, as is the case with the issue of access to the trade, the issue of original spare parts involves both a question of intellectual property and the practical organisation of manufacturers' liability.

In the interests of simplicity, in the remainder of the analysis the study will use a more general legislative option (liberalisation of distribution of spare parts) which incorporates the three options discussed.

¹⁴⁹ Cf. Appendix 10 (Modelling Exercise 1 – Dealers Profitability).

III.3.6 Method of dealer remuneration

III.3.6.A. Current situation and issues

The way in which prices are determined and distributors remunerated¹⁵⁰ is in line with the features of the current automobile distributive market.

In today's single channel context, the method of dealer remuneration is intended for a market in which distributors are independent companies buying and selling at their own risk. The more they can charge for their intermediation, the more they earn.

Provided that vehicle manufacturers recommend the prices of new cars and dealers rarely depart from the recommendations, manufacturers are in effect setting dealer remuneration in a *soft* way that is the same for all players. Differentiation between one dealer who puts great effort into promoting the brand and another who does not sell as much can only be achieved through volume discounts, sales target discounts, etc. Currently, these practices are not applied.

The remuneration method is a decisive tool for the manufacturer in **controlling marketing policy** as well as volumes sold.

III.3.6.B. Legislative options

Two issues need to be addressed. The first issue is whether or not the system of dealer remuneration should be regulated. The second issue relates to the type of remuneration methods that could be used, including:

- Margins on purchase volumes;
- Margins on sales volumes;
- Margins on qualitative criteria.

The second dimension relates to application of the system, which would involve the following:

- Must be identical for every player;
- Depends on the type of player (size, channels)

In terms of **price setting**, the following are the two conceivable regulatory alternatives:

- List price at consumer level where the vehicle manufacturers would set a list price for the sale of their brand models to final consumers and distributors would only be allowed to give discounts on this price;
- Freedom for dealers to fix their price for the final consumer and to advertise based on that price. The vehicle manufacturers would not be able to recommend retail prices.

¹⁵⁰ **Currently** the remuneration system is based mainly on:
margin on recommended prices, fixed per vehicle,
bonuses linked to sales targets,
increasingly, qualitative remuneration,
some margins linked to the number of vehicles purchased (for example, temporary promotional campaigns linked to special models, volume discounts at the end of the year...).

III.3.6.C. Position of the players

The traditional players, manufacturers and official networks, are generally in favour of the present 'uncontrolled' system. They are opposed to a system based only on volume discounts.

Some players in the official networks, candidate new entrants to distribution and consumers are much more in favour of a volume-based method of dealer remuneration.

All players agree that different methods would be difficult to monitor and that there should therefore be a single system for everyone.

Overall, all traditional parties in the automobile distribution sector (vehicle manufacturers, national/regional distributors, and official dealers) favour a list price at the consumer level because it allows manufacturers to maintain control of their pricing strategy.

The new potential players and consumers would prefer dealers to have the freedom to set prices. This would enable all the distribution players to have their own price positioning. However, some new entrants as well as fleet consumers have argued that a list price should be used at a European level as a mechanism for greater transparency and price convergence.

III.3.6.D. Conclusion

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|--|--|----------|--|
| Current legislative situation: <ul style="list-style-type: none"> - Remuneration method is unregulated - Several methods of remuneration co-exist - Application of system is identical for every player - Recommended prices are set by manufacturers | | | |
| Options: <ul style="list-style-type: none"> - Regulation of the authorised method(s) of dealer remuneration | Moderate | High | This is contrary to the normal practices of a market where all players are free to set their remuneration methods. |
| <ul style="list-style-type: none"> - Remuneration based on volume | Moderate | High | Establishing volume discounts would cause a heightening of competition and concentration among the players. It could, on the other hand, act as an incentive for distributors to concentrate on best-selling models. |
| <ul style="list-style-type: none"> - Different remuneration methods for different channels | Moderate | Moderate | It raises the issue of the difficulty of ensuring equitable treatment |

- Table III.35 -

The following are the main conclusions to be drawn for this variable:

- The possibility to legally enforce a system in which dealer remuneration is regulated appears to be limited;
- From a legal standpoint, manufacturers should be allowed to set recommended prices. Moreover, greater freedom for distributors to set prices would have a significant impact only in cases of large differences in margins between players;
- A change in the type of remuneration method would have a decisive impact on the system (i.e. if remuneration were to be based on volume, there would be an impact).

III.3.7 'First come, first served', intermediaries, and availability clauses

These three variables are jointly analysed since they all relate to integration of national markets.

III.3.7.1. 'First come, first served'

A. Current situation and issues:

At present manufacturers are allowed to organise vehicle allocation to national markets and carry out stock management based on country sales targets. It is a system based on stock quotas.

A major challenge behind the vehicle allocation system is that of operational efficiency. Although the 'lean distribution' concept is becoming increasingly important, manufacturers believe that such 'pull' methods – where customer demand is driving production - will never be fully implemented. The following factors describe why 'lean distribution' would never be fully implemented:

- If good production cost management is to be achieved, **minimum production planning** is necessary because of the growing complexity of vehicles and increased outsourcing of spare parts and systems.
- Since consumer demand fluctuates greatly, a production that would fully rely on the order system would be difficult to operate. Therefore, it is vital to keep a 'push system' (pushing vehicles that are produced to distributors) in order to ensure the sales of excess capacities and of existing inventories.
- **Managing deliveries** would be more complex and difficult in a 'first come, first served' system (at a European level), especially with imported vehicles where delivery times are higher;
- Without a 'push' distribution system **promoting new models** and other special versions would be much more difficult.

Beside these operational challenges, from a commercial point of view, the current system to determine sales forecasts and manage accordingly has some advantages:

- Dealers **avoid losing sales due to non-availability**. A minimum amount of stock is required;
- The current vehicle allocation system obliges distributors with **a sound and healthy business plan** for the period in question. Moreover, setting such targets also guarantees to the dealer that at least those cars will be delivered.

However, current practices for vehicle allocation indirectly sustain price differences between countries¹⁵¹. This has a braking effect on market integration.

¹⁵¹ Cf. Appendix on the development of these practices in relation to non-harmonisation of taxation.

B. Legislative options:

Legislative options include:

- The current situation which is based on car allocation quotas where vehicle manufacturers are allowed to set and manage vehicle stocks at national/area level and at the distributor level, even if no territory has previously been defined;
- A system based on the **'first come, first served' principle** where vehicle stock must be managed at the European level in order to satisfy distributors' demands for vehicles in the order that they arrive.

An alternative option may be determined, based on a combination of pre-determined sales objectives and, for the remaining sales, a 'first-come, first served' type of system.

It should be noted that **this question of vehicle allocation is of primary importance within the context of a legislative framework where territorial exclusivity is retained**. In a context like Scenario 2, such a principle would provide official dealers with much more flexibility to purchase vehicles and re-sell them to independent distributors.

In the context of scenarios where territorial exclusivity is removed (like scenarios 3, 3A and 4), the emergence of international players will 'de facto' limit inefficiencies of the current allocation system.

C. Position of the players:

The manufacturers believe that the problem of allocating vehicles to distributors is an operational one that should not be subject to legislation.

Official distributors and new entrants¹⁵² prefer the 'first come, first served' principle. Such a system would make it possible for them to source cars on a European level and to supply the consumer with the most appropriate vehicle. Hence, stock costs are reduced and push sales of specific models are avoided.

¹⁵² New entrants focusing on the international market believe the system of national quotas is a way for manufacturers to compartmentalise national markets artificially. However, they believe that price convergence would eliminate this difficulty.

III.3.7.2. Intermediaries

A. Current situation and issues:

First, as stated in the Explanatory Brochure¹⁵³ to Regulation 1475/95, intermediaries act on behalf of final consumers in whose name they purchase or collect a specified vehicle.

In today's context there are intermediaries on the European market who specialise in realising (privately) price advantages from the price differentials between the different countries in the EU. Nevertheless, the system of mandates, which give them authority to purchase cars, restricts this trade to a small quantity of vehicles.

Pursuant to the current framework, an intermediary is considered to have privileged relationships with a dealer when the latter supplies more than ten percent of its cars to an intermediary. Under these circumstances, the intermediary foregoes the right to act on behalf of final consumers. The supply of cars through intermediaries is therefore constrained within the current distribution system.

The current impact of intermediaries on the market is first to offer **well-timed responses to certain inefficiencies** caused by the compartmentalisation of European markets and secondly to **facilitate importing cars** for consumers.

Intermediaries would naturally disappear if tax harmonisation were to occur and if prices were to converge.

B. Legislative options:

The question is whether intermediaries should retain their present position in the new regime.

C. Position of the players:

Because of the role it plays in the industry, most players, apart from the new ones, would like to retain the intermediary function:

- The traditional players (vehicle manufacturers and their official dealers) want to keep the intermediary's function as such. They argue that the concept gives new entrants the opportunity to penetrate the market, while being in line with legislation;
- Some of them are in favour of abolishing the requirement by which a distributor's sales to an intermediary may not represent more than ten percent of its sales;
- New entrants and consumers, especially fleet companies, sometimes ask for a more liberal and clearer definition of intermediaries. However, the new players do not see a need for intermediaries once other independent distributors are authorised by the new regime.

¹⁵³ 'Distribution of Motor Vehicles, Explanatory Brochure', European Commission, p27, 1995.

III.3.7.3. Availability clauses

A. Current situation and issues¹⁵⁴.

There is a specific availability clause in the current regulation. This states that within the European Community vehicle manufacturers must supply their dealers within their distribution networks with all types of vehicles upon a consumer's request, including corresponding models with specifications applicable to Member States other than those in which the vehicle is purchased.

In reality, this is not consistently practised and manufacturers often charge extra to adapt a vehicle to the market specifications. This extra charge varies greatly from one country to another.

Some examples of the variation in the extra charge are:

- For right-hand-drive cars (RHD) the extra cost ranges from almost zero to ten percent of the total cost of the vehicle¹⁵⁵.
- In the context of exporting vehicles from the United Kingdom to Japan, some manufacturers never charge extra, whereas the same type of vehicle being exported to an EU Member State incurs extra charges.

These examples show that current practices may be undertaken in order to protect local margins. This was analysed in the previous section.

The clause aims to **facilitate parallel imports** (prior to a perfectly integrated European market).

B. Legislative options:

The two questions that arise are:

- "Should this clause be retained?"
- "Can it be permissible to have a surcharge for a vehicle of the same type with another country's specifications?"

C. Position of the players:

In general, all players have expressed a preference for maintaining the availability clause under the new regime until European markets are fully integrated. However, the following should be kept in mind:

- Some players suggested that a European Ombudsman should monitor the application of the availability clause;
- The vehicle manufacturers and their distributors argue that there should be the possibility of charging for the extra costs involved. Others claim that to do so would be contrary to European common market ideals. However, it is noteworthy that producing vehicles with non-standard specifications do generate specific costs (administrative paper work, special moulds for RHD...);
- Finally, it has also been argued that it is more important to concentrate on other issues such as the European Validity Declaration on every vehicle and European tax harmonisation.

¹⁵⁴ The impact of the availability clause is generally less than that of some other major issues that have been discussed. It involves only a limited number of cases - for example, the availability of right-hand-drive cars to UK customers in continental Europe.

¹⁵⁵ 'Car Import Guide', December 2000/January 2001.

III.3.7.4 Conclusion

The possible legislative options in terms of these three variables may be summarised as follows:

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|--|--|----------|---|
| Current legislative situation: <ul style="list-style-type: none"> - Vehicle allocation on a country-by-country basis - Authorisation of intermediaries - Existence of vehicle availability clauses | | | |
| Options: <ul style="list-style-type: none"> - Regulated vehicle allocation ('first come, first-served') | Moderate | Moderate | The players dispute the legal validity of this option. In addition, the analysis shows that its operational applicability is debatable ¹⁵⁶ . |
| <ul style="list-style-type: none"> - Retain and clarify the role of intermediaries | Limited | Limited | Marginal impact |
| <ul style="list-style-type: none"> - Regulation of vehicle availability | Limited | Limited | Highly marginal impact |

- Table III.36 -

The role of intermediaries and availability clauses are factors that facilitate parallel imports between countries. There are factors that have little impact on the industry due to the high level of consensus between the players.

Another legislative option consists of modifying the current method of vehicle allocation to distributors by adapting, for example, a **'first come, first served' system**. However, the legal validity and the operational applicability of such a system are unclear.

It is important to note that these variables would specifically play a role in the scenarios where territorial exclusivity is retained.

In other scenarios, the actions of the traditional and emerging distributors on the market are likely to improve market integration and price convergence.

In the remainder of the analysis, these three variables are considered unchanged.

¹⁵⁶ See III.3.7.1. Where the arguments are developed.

III.3.8. Direct sales by manufacturers

III.3.8.A. Current situation and issues

Despite the territorial exclusivity principle that benefits the official networks, the current regulation addresses the manufacturer's ability to reserve the right to directly sell to certain customer categories. This exception is currently used by manufacturers for the benefit of some fleet companies, and it is a practise that is highly integrated with their official networks.

The issues linked to direct sales are essentially the following:

- Better response required to the **specific needs** of growth segments such as fleet companies (globalisation of contacts);
- Improvement needed in the **cost structure** of big orders.

Hence, direct sales are a channel that supplements the network¹⁵⁷ and a tool to take on any emerging new entrants in mass sales. Nonetheless, there is a risk that this channel will be used in the long term to capture a considerable share of the network's sales and to reinforce the negotiating power of fleet companies.

III.3.8.B. Legislative options

Legislative options include:

- Retain the current situation unchanged;
- Adapt **more stringent regulation** of direct sales;
- **Prohibition** of manufacturers making direct sales.

III.3.8.C. Position of the players

Most of the dealers¹⁵⁸ perceive direct sales to be a threat to the turnover of the official networks. Different other players converge in favour of the freedom to make direct sales.

In such a context, a more precise definition of the concept and the customers to whom it applies along with a higher degree of integration with current channels are required.

¹⁵⁷ The network could nonetheless receive commission for certain services carried out.

¹⁵⁸ The official position of the CECRA (European Council for Motor Trades and Repairs) in September 2001 is that direct sales should not be permitted in principle and that the only exception would be supplies agreed in advance between the manufacturers and the European dealers associations for the particular make.

III.3.8.D. Conclusion

Below is a description of the legislative options to be considered:

| Possible legislative options (all other factors unchanged) | Relevance (relevant to the areas for improvement) | Risk | Comments |
|--|--|---------|--|
| Current legislative situation: Practice and access uncontrolled (manufacturers' ability to reserve the right to sell directly to certain categories of customer) | | | |
| Options: - More detailed regulation of the practice | Moderate | Limited | This allows for better clarification of the respective market roles of networks and manufacturers within a context in which direct sales could develop on a larger scale in the future. |
| - Abolish the possibility of manufacturers making direct sales | Irrelevant option | N/A | This does not correspond with the position of any player in the industry. |

- Table III.37 -

Most players agree that direct sales should be maintained in certain conditions, but on a limited basis. This variable should be further defined – specifically the customer categories to whom it applies. Therefore, this variable will no longer be included in the remainder of the analysis (except as a market condition).

III.3.9 Summary of the variables analysis

The aim of the variables analysis was to assess possible legislative options based on the ten variables defined by the Commission. The purpose of this summary is to present a comparative view on these variables and options.

The following pages present the various legislative options identified, a description of the way the variables were categorised into groupings with similar impacts and an impact assessment of the most critical variables.

III.3.9.A. Understanding the legislative options

All ten variables defined in the Terms of Reference have been studied. These are:

- The link between sales and after-sales service i.e. the opportunity for manufacturers to impose both types of activity on official network players;
- The restrictions on multi-branding in sales i.e. the opportunity for manufacturers to impose certain limits on the sale of different brands;
- Access to technical information, especially for independent repairers;
- Access to the trade and multi-branding in after-sales servicing;
- Distribution of original spare parts;
- The nature and regulation of the method of dealer remuneration;
- The 'first come, first served' principle i.e. an alternative to the current industry practice of national sales targets for allocating vehicles to distributors;
- Availability clauses;
- The role of intermediaries;
- Direct sales by manufacturers.

The analysis of the different variables defined by the Commission has made it possible to identify a number of legislative options. These are summarised in the table on the following page.

| Variable | Current situation | Conceivable new legislative options |
|--|---|--|
| Sales/after-sales link | Obligation on every official dealer to also be an official repairer (and vice-versa) | <ul style="list-style-type: none"> ▪ Broken: the two activities are governed by separate conditions; ▪ Reorganised: retain an obligation on distributors to conclude a partnership with one or more official repair players; ▪ 'Official repairers': obligation on distributors to also be repairers, no obligation on repairers to be distributors; ▪ Several sets of criteria: compulsory sales/after-sales link for players in official networks and the opportunity for independent players to concentrate on sales. |
| Multi-branding in distribution | Manufacturers may impose certain conditions on multi-branding | <ul style="list-style-type: none"> ▪ Multi-distributors: freedom for distributors to sell vehicles of different brands but with separate sales forces; ▪ Full multi-branding: freedom for distributors to sell vehicles of different brands (no non-competition clause); ▪ Several sets of criteria: for single and multi-brand players. |
| Access to technical information | Access to technical information and diagnostic equipment for all parties concerned as long as the information is not considered to be intellectual property | <ul style="list-style-type: none"> ▪ Facilitate access to information: reinforce access to technical information and diagnostic equipment. |
| Access to the trade Multi-branding in after-sales servicing | Coexistence of single brand players contractually tied to a manufacturer and independent multi-brand players | <ul style="list-style-type: none"> ▪ Certification for warranty and recall: Certification by an independent body of registered repairers authorised to carry out warranty and recall work; ▪ Certification for specialised repairs: Certification by an independent body of registered repairers authorised to carry out specialised repairs; ▪ Full after-sales multi-branding: repairers may carry out any repair on any brand. |
| Distribution of original spare parts | Restrictive concept of original spare parts, almost exclusive presence of the manufacturer's brand, and access to parts controlled by the manufacturer | <ul style="list-style-type: none"> ▪ Liberalisation of spare parts: expanded definition of what comprises spare parts, freedom for parts producers to use their own logos, and direct access to original spares for independent repairers. |
| Method of dealer remuneration | Method of dealer remuneration set by manufacturers without controls | <ul style="list-style-type: none"> ▪ Remuneration based on volume: volume discounts; ▪ Regulation of remuneration: where methods of dealer remuneration are regulated; ▪ Depending on several sets of criteria: different methods of remuneration depending on the channel. |
| 'First come, first served' vehicle allocation principle | Vehicle allocation organised by manufacturers on a country-by-country basis | <ul style="list-style-type: none"> ▪ 'First come, first served' principle: regulated vehicle allocation at a European level. |
| Intermediaries | Authorisation of intermediaries | <ul style="list-style-type: none"> ▪ Clarify the role of intermediaries: retain but clarify their role. |
| Availability clause | Existence of availability clauses | <ul style="list-style-type: none"> ▪ Clarification of availability clauses: regulation of vehicle availability. |
| Direct sales | Manufacturers maintain the right to sell directly | <ul style="list-style-type: none"> ▪ Clarification of direct sales: definition of the practice. |

- Table III.38 -

III.3.9.B. Grouping of variables according to similar types of impact

A review of the current situation and the issues linked to each of the ten variables shows that they influence the loops in specific ways. The table below depicts the nature of these influences on the loops:

| | List of variables | Influence of industry loops on the areas for improvement | | | |
|----|---|---|--|---|---|
| | | Product loop (R1) Increase independence of downstream players ¹⁵⁹ | Customer loop (B2) Allow access to new entrants to diversify sales channels | Reliability loop (B3) Restrict barriers to entry to the after-sales market | Price loop (B4) Freedom to compete on price |
| 1 | Link between sales and after-sales service | X | X | X | |
| 2 | Restrictions on multi-branding in distribution | X | X | | |
| 3 | Access to technical information and diagnostic equipment | | | X | |
| 4 | Access to the trade and multi-branding in after-sales servicing | X | | X | |
| 5 | Distribution of original spare parts | X | | X | |
| 6 | Method of dealer remuneration | X | X | | X |
| 7 | 'First come, first served' | | | | X |
| 8 | Availability clauses | | | | X |
| 9 | Intermediaries | | | | X |
| 10 | Direct sales | X | X | | |

- Table III.39 -

The examination of the following issues has allowed the analysis to be more narrowly defined:

- Because of its **central nature** (direct influence on three of the four loops), the **sales/after-sales link** was analysed first;
- In order to understand **the impact multi-branding** in distribution has on the customer loop (B2) and more particularly on access for new entrants, the **combination** of this variable **with the sales/after-sales link and with different scenarios** was analysed;
- Access to technical information, distribution of original spare parts, access to the trade, and multi-branding in after-sales servicing are **variables specifically linked to the after-sales market** whose **impacts are of the same nature**;
- The three **variables** ('first come, first served' principle, availability clause, and intermediaries) **linked to the integration of European markets** (acting mainly on the dynamics of the price loop – B4) **were collectively analysed**.

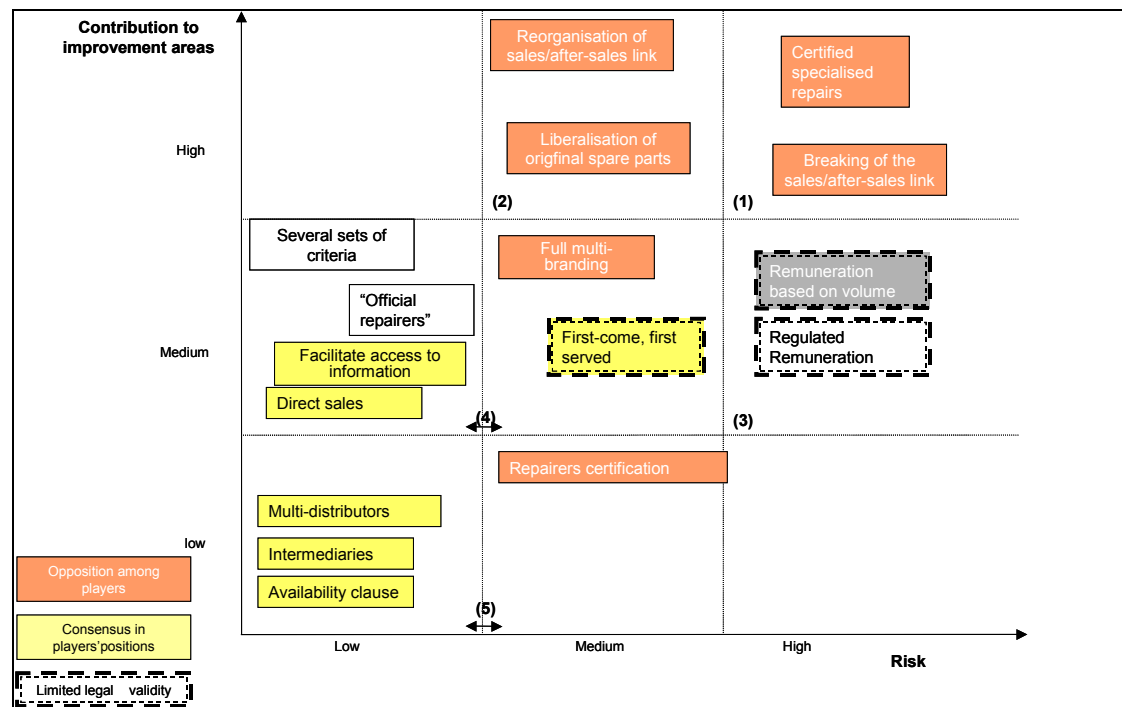
¹⁵⁹ Downstream players refer not only to traditional dealers but also to potential new entrants to the distribution or after-sales market.

III.3.9.C. Prioritisation

Comparison of the variables and their legislative options shows that they differ in terms of the following:

- The market positions of the players, which tend to either converge or diverge;
- The degree to which they are legally valid ('legal validity');
- Relevance to the defined areas for improvement;
- The associated risk level.

These similarities and differences are represented in the diagram below:



- Diagram III.21 -

For each variable, the contributions to the areas for improvement as well as the risks they may create have been assessed.

At the end of this analysis, **only critical variables and options have been retained for combination with the scenarios**. These include legally valid options, with a potentially significant impact on the market structure and on which no consensus has been reached between the various groups of players. Four groups of variables are considered critical.

The table summarises the various legislative options selected for each of the four critical variable groups:

| | Sales/after-sales link | Multi-branding (sales and after-sales) | Channel diversity | After-sales variables |
|-----------------------------|---|---|--|---|
| Legislative options: | <div>Broken</div> <div>Reorganised</div> <div>Unchanged</div> | <div>Full multi-branding</div> <div>Unchanged</div> | <div>Several sets of criteria</div> <div>Unchanged</div> | <div>Facilitated</div> <div>Unchanged</div> |

- Table III.40 -

Some legislative options are not critical for one or more of the following reasons:

- The method of dealer remuneration (regulation of remuneration based on volume)¹⁶⁰ and the 'first come, first served' principle for allocating vehicles to distributors are not critical because they have **limited legal validity**;
- The 'multi-distributors' option, the regulation of the role of intermediaries, and availability clauses are not critical options because their **impact is limited** (options with little relevance to the areas for improvement and limited risk);
- Direct sales are not critical because there is **considerable consensus** among players in the industry regarding the need for a better definition of the practice, which should remain limited.

¹⁶⁰ The analysis also highlights the dangerous nature of regulation of the remuneration system. This is capable, particularly through volume discounts, of destroying manufacturers' control of their marketing policy.

III.3.9.D. Summary of the variables analysis

The link between sales and after-sales servicing:

In the present system, every official distributor is obliged to be an official repairer and vice-versa. The Terms of Reference propose a situation where the two businesses would be carried out separately and sales and servicing players would be selected according to different criteria (the option called 'breaking of the link' in the study). Besides these two extremes, the Andersen study introduces an additional option, which is the **'reorganisation of the link'**. This option would entail obliging **distributors** who sell new cars to offer after-sales servicing although they would not be obliged to provide the service themselves. They **may choose to have a partnership with one or more official repairers**.

The impact of breaking the sales/after-sales link is described as follows:

- **Breaking the sales/after-sales link, especially in the context of a scenario that abolishes territorial exclusivity**, would enable market penetration by new players specialising in distribution and would enable the development of new forms of distribution. It would also promote the development of official 'repair only' players. This **would address competition objectives both in sales and after-sales servicing more fundamentally than in any of the legislative scenarios taken alone**.
- **It would also entail a major structural change in the industry** and would lead to a re-distribution of market share among players. It would also promote various forms of distribution and levels of specialisation. With this new market structure in sales and after-sales, **the organisation of responsibility within the value chain would be very complex and could lead to a compromise in terms of reliability**
- In the short term, the 'product loop' would be slowed by the reduction in the profitability of traditional sales and after-sales dealers and by investment differentials between geographical areas. **This would require manufacturers to adapt substantially in order to counteract the fluctuations and in order to maintain the current level of value for money**.
- In addition, differences in the structure of the distribution costs of the players are likely to intensify **price competition but would also speed up the negative trends of standardisation and concentration**.
- The likely duration of the **period of instability** before a new equilibrium was reached would depend on the reactions of the traditional players.

Breaking the link between sales and after-sales would have major negative impacts. **'Reorganisation' of this link appears to be an option that encourages the progressive opening up of markets, while limiting instability and negative effects**. Competition would be promoted in both sales and after-sales servicing. The re-positioning of players in the market would occur more slowly and service coverage would not be compromised. Reorganisation of the link would reduce cost differentials between different players and would stabilise price competition at a lower level.

Multi-branding:

In the present situation, manufacturers can impose certain conditions that limit multi-branding in sales¹⁶¹.

The impact on the industry of lifting the existing restrictions on multi-branding (called 'full multi-branding' in the study) **would be moderate in the context of the current overall legislative framework** or in the context of Scenario 5.

¹⁶¹ Separate sales premises, separate management and separate legal entity and in such a manner that no confusion of brands is possible.

The impacts would include the following:

- Some distributors would opt for a multi-brand business. It would provide them with increased independence from manufacturers as well as increased return on their investments. However, because of the large size of the investments involved, **only large-scale distributors would be able to develop a multi-brand operation**. Multi-branding would also be a **solution for low-density areas**.
- Because manufacturers would keep control over the qualitative and quantitative selection criteria, **product innovation and brand differentiation would not be significantly affected**.
- Multi-branding would **slightly increase price competition**, by providing additional comparability and by allowing multi-brand players to develop more competitive distribution cost structures. However, territorial exclusivity would limit the opportunities for price competition, and the economies of scale that multi-brand dealers would be able to reach would remain limited.

However, when combined with a reorganisation of the sales/after-sales link and limited selection criteria (Scenario 3A), the impact of 'full multi-branding' may be significant. In such a context, multi-branding is a **prerequisite for the development of alternative business models**. These new business models would include multi-brand sales of selected standard 'best selling' models from various brands. Multi-branding may, because of its cost advantages, become the dominant practice. This would considerably accelerate the mechanisms that cause concentration among the players and, in the long term, would increase inter-brand competition. It would also lead to pressure on the level of product innovation.

Channel diversity:

Reorganising the sales/after-sales link and opening up opportunities to develop multi-brand businesses are prerequisites for the market re-positioning of players. Likewise, they are conditions for an acceleration of the transformation from a single channel industry into a multi-channel one. In these two cases, a possible legal alternative might be **to allow or to impose the co-existence** (separate criteria, separate remuneration methods) **of different channels** (sales and after-sales single brand companies versus multi-brand players specialising in sales). This alternative has been considered in this study as an additional variable.

The legislative options selected for the 'channel diversity' variable are maintaining the present system of identical conditions for everyone or **accommodating the coexistence of several sets of criteria**. The manufacturer would have the opportunity or may be obliged to distribute vehicles via different channels such as physical and virtual ones; single brand and multi-brand ones; sales/after-sales ones and those specialising in sales or service.

The main impacts of such a system are:

- The manufacturers would keep control over their marketing policies through strict selection criteria and remuneration methods.
- New entrants would enter the market and stimulate the development of alternative distribution formats while the existence of traditional players would be maintained for certain categories of customer.

After-sales variables:

'Distribution of original spare parts', 'access to the trade' and 'access to technical information' are variables which have a similar impact and can be linked together in a single **after-sales variables group**.

The alternative legislative option studied for these after-sales variables is to **adapt the existing legal framework in order to ensure competition**. This **'facilitation'** may include, for example, easier access to information, certification for independent repairers and legislative review of spare parts distribution.

Unlike the legislative scenarios, which only have a limited impact on the after-sales market, this option would stimulate after-sales competition and modify industry practices. It may however lead to a reduction in the coverage of service outlets, a reduction in the value for money of servicing – and of brand-specific repair in particular - by weakening the official dealers' profitability.

Other variables:

The other variables are considered less likely to change the impact of the legislative scenarios. The legislative options are assumed to remain the same or to be amended in accordance with suggestions made by the players. These remaining variables include those listed below:

- The **'method of dealer remuneration'** is an essential instrument that manufacturers use to manage their distribution strategies. Altering manufacturers' freedom to determine these methods would generate considerable changes in the industry. However, it appears difficult to regulate this practice.

Regarding this variable, it has been assumed for the remainder of the impact study that the manufacturers would continue to freely determine the method of remuneration.

- Three other variables – the **'first come, first served' principle**, the **availability clause** and **the role of intermediaries** would have a similar impact and would accelerate European integration.

For the remainder of the impact study, the following legislative options have been selected for these three variables: unchanged vehicle allocation system, role of intermediaries retained and clarified, availability clauses unchanged.

Note, however, that although changing the vehicle allocation method would have only limited practicability, this would have been a means to improve European integration.

- As far as **direct sales** are concerned, manufacturers should be allowed to continue this practice, but its features should be defined more precisely.

Hence, for the impact analysis it has been assumed that this would continue to be a permitted practice, but using well-defined customer categories.

III.4. Conclusion

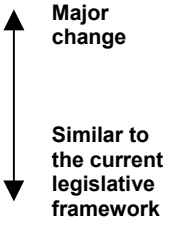
The purpose of Part III was to analyse the various legislative options (the scenarios and variables) put forward by the Commission. Conclusions on the scenarios and variables taken in isolation have been developed in Sections III.2.7. and III.3.9. Therefore, they will not be discussed in the conclusion.

The aim of the following pages is to define possible legislative combinations. Selected combinations that have been highlighted during the review of scenarios and variables will be further analysed.

III.4.1. Combining relevant scenarios with critical variables

The analysis of scenarios and variables made it possible to identify the scenarios and variables relevant to retain for further combinations.

An overview of the combinations of the most relevant and varied scenarios along with the legislative options that have been retained is depicted as follows:

| Distribution scenarios | Sales/after-sales link | Multi-branding (sales and after-sales) | Diversity of channels | After-sales variables | |
|------------------------|------------------------|--|--------------------------|-----------------------|--|
| Scenario 3A | Broken | Full Multi-branding | Several sets of criteria | Facilitated |  |
| Scenario 4 | Reorganised | Unchanged | Unchanged | Unchanged | |
| Scenario 5 | Unchanged | | | | |

- Table III.41 -

The table below depicts how these various options could be combined into an overall legislative framework:

| Legislative Scenarios | Sale/after-sales link | Multi-branding (sales and after-sales) | Diversity of channels | After-sales variables |
|---|-----------------------|--|--------------------------|-----------------------|
| Scenario 3A (minimum qualitative Selection criteria) | Broken | Full multi-branding | Unchanged | unchanged |
| Scenario 4 (full selectivity - no exclusivity) | Reorganised | Full multi-branding | Several sets of criteria | Facilitated |
| Scenario 5 (limited territorial Exclusivity) | Unchanged | Unchanged | Unchanged | Unchanged |

- Table III.42 -

The total number of combinations would lead to an unmanageable number of possibilities (almost a hundred). However, by examining the most relevant combinations alongside those whose impacts would be very similar, their number can be reduced without compromising the comprehensive nature of the study.

Some combinations have been eliminated because they are irrelevant. For example, in Scenario 5 (retaining territorial exclusivity), breaking or reorganising the sales/after-sales link and the diversity of channels are all factors that are impractical to consider. In Scenario 3A (selective distribution system based only on strictly regulated qualitative criteria), it is assumed that the sales/after-sales link is reorganised or broken since only minimum selection criteria are allowed. For the same reason, multi-branding is allowed and there is a single set of criteria.

The table below provides eight legislative combinations that can serve as examples for highlighting impacts. These combinations were analysed in the sections of the study that address the scenarios and variables.

| Legislative Combinations | | | | | |
|--------------------------|-----------|------------------------|---------------------|--------------------------|-----------------------|
| # | Scenarios | Sales/after-sales link | Multi-branding | Channel diversity | After-sales variables |
| 1 ¹⁶² | 5 | Unchanged | Unchanged | Unchanged | Unchanged |
| 2 ¹⁶³ | 5 | Unchanged | Unchanged | Unchanged | Facilitation |
| 3 ¹⁶⁴ | 5 | Unchanged | Full multi-branding | Unchanged | Unchanged |
| 4 ¹⁶⁵ | 4 | Unchanged | Unchanged | Unchanged | Unchanged |
| 5 ¹⁶⁶ | 4 | Broken | Unchanged | Unchanged | Unchanged |
| 6 ¹⁶⁷ | 4 | Reorganised | Full multi-branding | Several sets of criteria | Unchanged |
| 7 ¹⁶⁸ | 3 | Unchanged | Unchanged | Unchanged | Unchanged |
| 8 ¹⁶⁹ | 3A | Reorganised | Full multi-branding | Unchanged | Unchanged |

- Table III.43 -

¹⁶² A detailed analysis of this combination was carried out in Part III.2. within the analysis of Scenario 5 (comparative analysis with the current situation projected forward to 2005).

¹⁶³ An analysis of the impacts on the system of changing the after-sales variables was carried out in Part III.3. when those variable were examined.

¹⁶⁴ This combination was analysed in Part III.3. when the multi-branding variable was examined.

¹⁶⁵ A detailed analysis of this combination was carried out in Part III.2. within the analysis of Scenario 4 (comparative analysis with Scenario 5).

¹⁶⁶ This combination was analysed in the examination of the sales/after-sales link variable in Part III.3.

¹⁶⁷ This combination was analysed in the examination of the multi-branding variable in Part III.3.

¹⁶⁸ A detailed analysis of this combination was carried out in Part III.2. within the analysis of Scenario 3 (in comparison with Scenario 4).

¹⁶⁹ This combination was analysed in the examination of the multi-branding variable in Part III.3.

III.4.2. Analysis of selected legislative combinations

The main conclusions to be drawn from these eight legislative combinations are described in the table below:

| Legislative Combinations | Impact on the speed of activation of the loops | Industry developments |
|---|---|--|
| Current legislative situation projected forward to 2005 | R1 : High B2 : Low (sales) High (after-sales) B3 : Stable B4 : Stable | <ul style="list-style-type: none"> - Reduction in competition in after-sales servicing - Slight cost rationalisation - Tendency towards concentration and reorganisation of networks - Innovation in channels |
| 1. Scenario 5 | R1 : = B2 : = B3 : = B4 : +/- Slight temporary increase | Same impact on current situation, but : <ul style="list-style-type: none"> - Increase in marketing costs for distributors - Intensified marketing initiatives and CRM - Faster integration of European markets - Intensified concentration |
| 2. Scenario 5 with full multi-branding | R1 : = B2 : = B3 : = B4 : +/- Slight temporary increase | Same impact as Scenario 5, but : <ul style="list-style-type: none"> - In some geographical area or for some brands, multi-branding players will develop |
| 3. Scenario 5 facilitating after-sales variables | R1 : -/= B2 : = B3 : + B4 : +/- Slight temporary increase | Same impact as Scenario 5, but: <ul style="list-style-type: none"> - Competition in after-sales servicing is increased - The loss of parts of the after-sales market causes - pressure on the profitability of the official networks |

- Table III.44 -

Within these examples, it is notable that speed of activation of the industry causal loops would not be greatly affected in the long term. The industry would tend to come back to a balance that is similar to the present situation.

Other examples are displayed below:

| Legislative Combinations | Impact on the speed of activation of the loops | Industry developments |
|--|---|---|
| 4. Scenario 4 | R1 : = B2 : = B3 : +/- Temporary disturbances B4 : +/- Short-term stimulation | Same impact as Scenario 5, but : - Specialisation of players in sales or after-sales service and pressures on the sales/after-sales link - Strong stimulation of competition within networks, but no appearance of competing channels - Emergence of multi-site and more international players - Instability in cover of service points - The impact of cost rationalisation is less and the increase in marketing costs for distributors more marked |
| 5. Scenario 4 and breaking of sales/after-sales link | R1 : +/- Weakening but long term stabilisation B2 : + Acceleration in both sales and after-sales B3 : +/- New balance with increased competition between channels B4 : + New balance | Same impact as Scenario 4, but : - Major disturbance of the profitability of traditional official players (full facility) - Intra-brand competition increases more strongly as specialisation is greater which generates different cost structures as between players - Competition in after-sales increases over all services - Greater reduction in distribution players and repositioning of some players solely on after-sales market |
| 6. Scenario 4, reorganisation of the sales/after-sales link; distinct sets of criteria | R1 : +/- B2 : +/- B3 : = B4 : +/- | - New multi-brand entrants develop lean cost structures, capture market share, and create pressure on traditional players |
| 7. Scenario 3 | R1 : +/- B2 : = B3 : +/- Temporary disturbances B4 : +/- | Same impact as Scenario 4, but: - In the short-term, arrival of new entrants - Network management costs higher for manufacturers - Emergence of inter-brand innovation differentials in products |
| 8. Scenario 3A with reorganisation of the sales/after-sales link and full multi-branding | R1 : - B2 : +/- B3 : +/- Unstable B4 : + | Same impact as Scenario 3 and Scenario 4 with reorganisation of the sales/after-sales link, but : - In the long term, reduction in the level of intra-brand competition linked to a reduction in the number of players; - Growth in the proportion of mass-market segments in distribution and a tendency for the number of ranges to reduce. |

- Table III.45 -

In other cases (e.g. 6, 7 and 8) more structural changes may be seen. These include:

- Changes in the market positioning of players and the development of more diverse market positions;
- Penetration by new entrants (new types of players);
- A change in the level of competition, whether in distribution or after-sales service;
- A change in consumer demand (reinforcement of the mass-market segments).

Part IV of the report entails a systematic analysis of these structural changes in the industry as well as the link with combinations of scenarios and variables.