

**European Commission
Directorate General - Competition**

***Study on the impact of possible future legislative
scenarios for motor vehicle distribution on all parties
concerned***

Final Report



3 December 2001

Table of Contents

EXECUTIVE SUMMARY	1
 PART I: CONTEXT OF THE STUDY AND APPROACH	 37
I.1 Context and Objectives of the Study	37
I.2 Approach of the Study	38
I.3 Report Structure	39
 PART II: INDUSTRY DYNAMICS	 40
II.1 Introduction	40
II.2 Overview of Sales and After-Sales Markets	42
II.2.1 Sales market	42
II.2.2 After-sales market	49
II.3 Industry Causal Loops	55
II.3.1 Product loop	57
II.3.2 Customer loop	64
II.3.3 Reliability loop	71
II.3.4 Price loop	78
II.3.5 Interrelationships	85
II.4 Conclusion	87
 PART III: LEGISLATIVE OPTIONS	 94
III.1 Introduction	94
III.2 Legislative Scenarios for Distribution	96
III.2.1 Current legislative framework projected forward to 2005	98
III.2.2 Scenario 5 and 5A – limited territorial exclusivity – full selectivity	105
III.2.3 Scenario 4 – qualitative and quantitative selectivity	112
III.2.4 Scenario 3 and 3A – qualitative selectivity only	120
III.2.5 Scenario 2 – territorial exclusivity	127
III.2.6 Scenario 1 – 'free for all'	133
III.2.7 Summary of the scenarios analysis	135

III.3 Variables	141
III.3.1 The link between sales and after-sales	142
III.3.2 Restrictions on multi-branding in distribution	152
III.3.3 Access to technical information and diagnostic equipment	159
III.3.4 Access to the trade and multi-branding in after-sales servicing	161
III.3.5 Distribution of original spare parts	164
III.3.6 Method of dealer remuneration	167
III.3.7 'First come first served', intermediaries, and availability clauses	170
III.3.8. Direct sales by manufacturers	175
III.3.9 Summary of the variables analysis	177
III.4 Conclusion	185
PART IV: MARKET OUTCOMES	189
IV.1 Introduction	189
IV.2 Activation Levels of the Loops	191
IV.2.1 Customer loop (B2)	191
IV.2.2 Reliability loop (B3)	197
IV.2.3 Price loop (B4)	203
IV.2.4 Product loop (R1)	206
IV.3 Market Outcomes	210
IV.3.1 Identification of possible outcomes	210
IV.3.2 Description of possible outcomes	211
IV.3.3 Key indicators	215
IV.3.4 Evaluation	220
IV.4 Conclusion	224
APPENDICES	236
PART I: FACT SHEETS	237
Appendix 1: Sales Market	238
Appendix 2: Current Sales Players (dealers)	240
Appendix 3: New Entrants into the Sales Market	242
Appendix 4: Fleet Market	246
Appendix 5: Car Segmentation	248
Appendix 6: After-Sales Market	250
Appendix 7: After-Sales Customers	252
Appendix 8: After-Sales Players	254
Appendix 9: Taxation	258
PART II: MODELLING EXERCISES	259
Appendix 10: Modelling Exercise 1 – Dealers Profitability	265
Appendix 11: Modelling Exercise 2 – Market Shares	304
Appendix 12: Modelling Exercise 3 – Geographic Coverage	310
Appendix 13: Modelling Exercise 4 – Distribution Costs	322

PART III: COMMERCIAL VEHICLES	337
Appendix 14: Commercial Vehicles	337
PART IV: OTHERS	343
Appendix 15: Glossary of Terms and Abbreviations	343
Appendix 16: Sources and References	349

Executive Summary

1. Introduction

1.1. Context and objectives

The current Regulation (EC) 1475/95 on motor vehicle distribution and after-sales servicing expires on 30 September 2002.

In light of this expiry date, the European Commission has begun to review the current legal framework in the motor vehicle industry, and has identified five potential legislative scenarios for new car distribution, after-sales servicing and spare parts distribution.

The **five legislative scenarios** are based on various combinations of two central components of the present system – 'territorial exclusivity' and 'selectivity'. The five legislative scenarios are as follows¹:

- **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 **ten specific issues**² (**referred to in this study as variables**) such as breaking the link between sales and after-sales servicing, changing the conditions for multi-branding or improving the access to technical information for independent repairers.

The Commission has selected Andersen to **analyse the impact** of the scenarios and the variables **on competition and on every type of industry player, including various consumer categories**. **The Andersen study does not set out to make recommendations** on a new legislative framework.

First, this summary describes the analytical instruments that were used in order to assess the **current market situation**. Second, it explains the main **impacts identified for the scenarios and variables taken in isolation**. Finally, the summary provides an overview of the **three most likely long-term market outcomes** that would result from the most realistic combinations of scenarios and variables.

In addition, the findings concerning **commercial vehicles** are presented at the end of the summary. The purpose is to identify whether substantial differences in market situation might justify a different regulatory regime for these types of vehicles.

¹ The scenarios are defined in the Terms of Reference that are available on the Commission's Internet site: http://europa.eu.int/comm/competition/car_sector.

² See Page 23 of the present summary where the full list of variables is displayed.

1.2. Framework for the impact assessment

The Commission has identified three areas of impact in the Terms of Reference. As explained below, these include competition, consumer satisfaction and the positions of the industry players.

The areas of competition	<p>The areas of competition relate to intra-brand competition between sales or service players for products from the same manufacturer, to inter-brand competition between different manufacturers, to European market integration and to competition in after-sales servicing.</p>
Consumer satisfaction	<p>Consumer satisfaction includes closely interrelated factors from both sales and after-sales servicing. Consumer choice when buying is not only based on the purchase price, but is increasingly based on the 'Total Cost of Ownership' (TCO) i.e. the direct and indirect costs incurred throughout the life of the vehicle. As an illustration, the purchase price of a new car accounts for about 40% of the 'TCO' whilst maintenance costs account for 40% and financing and other costs for the remaining 20%.</p> <p>In the study, consumer satisfaction is based on the four essential features listed below:</p> <ul style="list-style-type: none"> - Product innovation: the number of brands, models, options, and the launch cycle of new models. This aspect reflects the consumer's need for choice; - Customer-tailored contact: a specific response to the needs of each category of consumer. It includes easy access to technical information, the opportunity to conduct a test drive, access to the entire network of official repairers and a choice in spare parts; - Reliability: includes reliable delivery, service outlet coverage, value for money of specialised repairs, safety, warranties and recalls on the vehicles supplied; - Price: includes the price level of new vehicles and the various after-sales services as well as price transparency and comparability, bearing in mind comparisons made easier by the Euro and on-line price comparisons.
The positions of the players	<p>There are six main categories of players in the industry who have the following diverging expectations and needs:</p> <ul style="list-style-type: none"> - Manufacturers seek to maintain control over their marketing policy, to optimise working relationships with their distribution and service partners as well as to guarantee safety throughout the life of the vehicle; - Official networks, composed of about 100.000 dealers and sub-dealers for all brands (an average of 15.000 for the major brands), want to optimise their activities and protect their investments; - New entrants (or would-be new entrants) to the industry would like to enter certain markets, especially the sale of new vehicles; - Other after-sales players, such as traditional independent repairers (100.000 outlets and 34% of the market value) or 'fast fit' repair chains (8% share of the market value and growing), attempt to maximise and guarantee their market position within the greatest possible range of services. Access to technical information and spares is of critical importance; - Spare parts manufacturers (manufacturers of spares and diagnostic systems), besides protecting their investments, try to maximise market share (sale of parts for the after-sales market account for 13% of the spare parts manufacturers' turnover); - Consumers have increasingly diverse needs. For instance, fleet buyers, who manage 10% of the 180 mios of cars in Europe and 40% of the cars purchased in the last years, have specific needs.

2. Current Market Situation

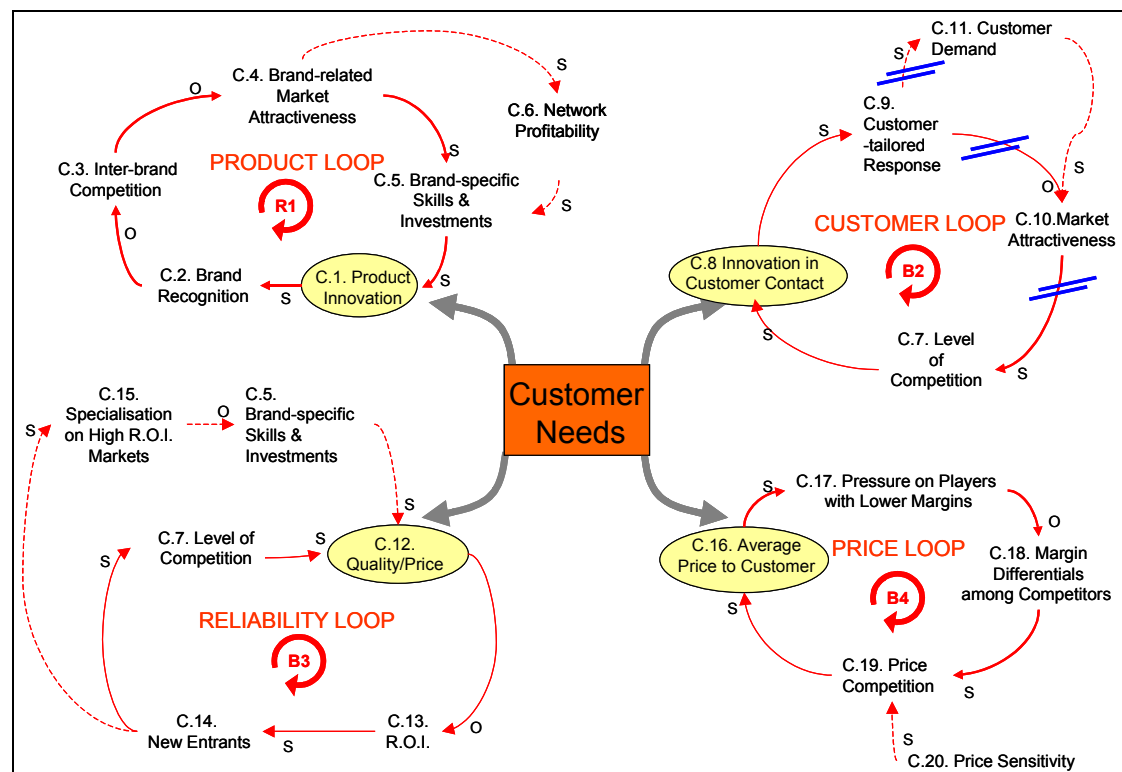
A comprehensive understanding of current sales and after-sales servicing features is the essential first step of an impact study. It provides a reference point for comparing impacts. It helps isolate 'natural trends', which are likely to occur without any intervention, from trends that would be created or enabled by a legislative change.

2.1. System-based reference model

Based on interviews and written questionnaires distributed to major industry players and consumers, **Andersen has developed a system-based reference model whose components are the main impact criteria defined by the Commission**, such as competition and customer satisfaction.

The system-based technique aims to analyse the cause and effect relationships between components, including the various players' behaviour and reactions. This way of thinking provides **the simplification of reality necessary for analysing the direct and long-term effects of any legislative change**. These changes can be regarded as external factors that influence the system.

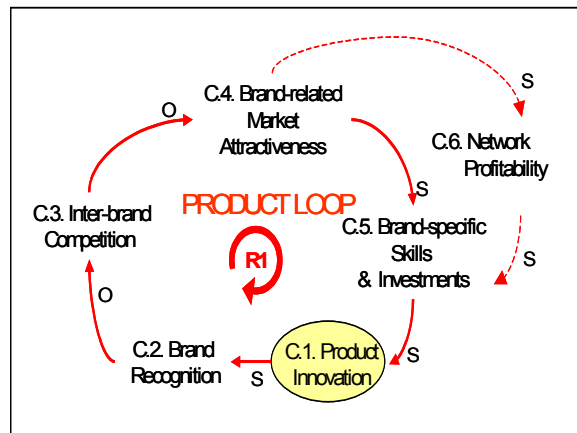
The reference model is composed of four basic 'causal loop diagrams' ('product loop', 'customer loop', 'reliability loop' and 'price loop'). These 'causal loops' are interrelated and serve as a comprehensive framework to assess current and possible long-term states of the sales and after-sales markets. The diagram below depicts the model:



The arrows specify the (direct or indirect) links between the various components. The arrows marked with an "S" ('same') denote that the two variables evolve in the same way (for example, if component C1 increases, then component C2 would also increase). The arrows marked with an "O" ('opposite') denote that the two variables evolve in opposite ways. The double lines that cross the arrows indicate a delay in the impact of one component on the other. Some components are found in several loops. Although not depicted in this simplified diagram, all loops are interrelated.

The four basic loops studied are the product loop, the customer loop, the reliability loop and the price loop. These are described below:

The product loop (R1):



PRODUCT INNOVATION
<p>Speed: High</p> <p>To improve:</p> <ul style="list-style-type: none"> • Market access • Independence of players <p>To monitor:</p> <ul style="list-style-type: none"> • Dealers profitability • Brand policy
<p>Influence of regulation:</p> <p>Driving force</p> <p>Quantified indicator:</p> <p>Profitability of brand networks</p> <p>Driving players:</p> <p>Manufacturers and official networks</p>

The product loop is a self-reinforcing loop that **operates like a 'benevolent circle'**. This loop is **driven by the joint brand-specific investment practices (C5) of car manufacturers and their official network** and is protected by the current regulation. These investments in the brand and the strong links between marketing policies sustain and reinforce product innovation (C1) and brand recognition levels (C2). Manufacturers of strong brands in particular, limit the level of inter-brand competition (C3) by creating protected sub-segments. This helps to enhance brand-related market attractiveness (C4) by creating markets that the official networks completely control. These captive markets include, for example, new vehicle sales, original spare parts distribution, repairs covered by warranty, recall operations and complex repairs that are brand-specific. The ability to capture revenue based on diversified products and services helps to sustain the profitability of brand networks (C6) and, in turn, sustains the level of brand-specific skills and investments within the networks (C5). The loop is self-reinforced because these investments foster product innovation (C1).

For example, product innovation (C1) associated with the creation of a new type of car such as sport utility vehicles (SUVs) helps sustain brand recognition (C2) as well creating a protected sub-segment where competition between brands is less intense. In turn, it generates related maintenance and repair markets that are attractive to dealers (C4), which helps to reinforce network profitability (C6). In turn, profitable dealers have more revenues to invest in the brand and to increase skills (C5). This loop in turn makes it possible to continually invest in new product innovation projects (C1).

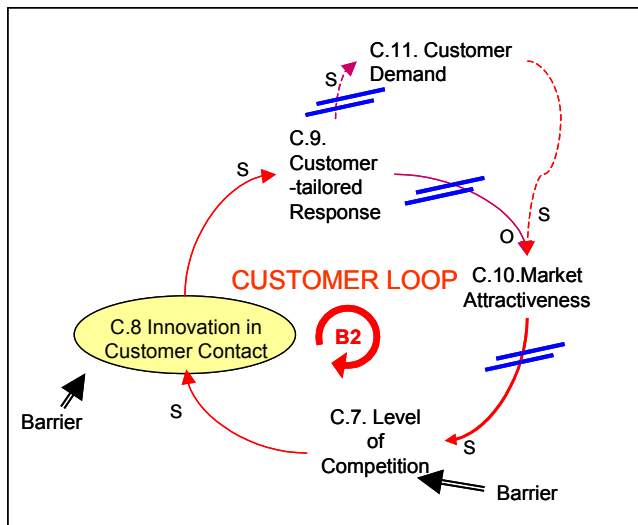
The profitability of brand networks (C6) is a central, but fragile, element of this loop. The current profitability of a typical dealer is low (approximately 1%), even though it is protected from competition. Dealers are vulnerable to erosion of market share and/or margins in the different activities of their 'product mix' that are mostly composed of new and used car sales, spare parts sales, and repair. While car sales account for more than half of the turnover, after-sales services provide the highest margins (after-sales services account for about 60% of the total margin while sales account for less than 30%) and sustain overall profitability³.

Strong activation of the product loop tends to erect barriers to new entrants because it requires new distributors to follow a traditional dealership model for distributing cars.

The 'product loop' highlights the close working relationships between manufacturers and their networks and the effect these relationships have on product innovation. At present, the product loop is strongly activated and is essential to the functioning of the industry. It also tends to stabilise the other three loops. Any attempt to re-shape automobile distribution should take into account the possible risks of a decrease in the activation of this loop.

³ According to Andersen estimations, in 2001, the typical average dealer is expected to sell about 300 new and 260 used cars. Although more than half of the turnover is generated from new car sales, this element of the product mix represents only about 30% of the total contribution margin. This can be explained by the low net margin (2 to 3%) on the new car sales, compared with the other elements of the product mix (bodywork, mechanical services and spare parts) for which the average net margin varies between 8% and 18%. After-sales activities, more specifically sales of spare parts, bodywork repairs and mechanical services are crucial to the survival of dealerships since these three activities represent roughly 60% of their total margin. A detailed sensitivity analysis of the various factors is presented in Appendix 10 (Modelling Exercise 1 – Dealers Profitability) of the present report.

The customer loop (B2):



CUSTOMER-TAILORED CONTACT

Speed: Low (sales) High (after-sales)
To improve (sales): <ul style="list-style-type: none"> • Market innovation • Intra-brand competition
Influence of regulation: Barrier
Quantified indicator: Market shares of various channels
Driving players: Independent players Fleet companies

The customer loop describes how **increased intra-brand competition (C7) stimulates market initiatives, differentiation among players and innovation in managing customer relationships (C8)**. Because responses are more tailored to the needs of the customers (C9), consumer needs tend to be more fully addressed. This then leads to decreased market attractiveness (C10) for additional new entrants and to a re-distribution of market share among traditional and new players. After a while, the level of intra-brand competition (C7) tends to slow down. It shows that the customer loop is a 'balancing loop' where intra-brand competition tends to stabilise. In some situations, tailored responses to some specific customer needs (C9) may lead to an overall increase in customer demand (C14).

The current legal and economic framework for new vehicle sales allows only official dealers to sell cars. Therefore, manufacturers and their networks are the main drivers of innovation in customer contact (C8). The use of the Internet or call centres as information channels or sales channels for specific segments relies on their initiatives.

In addition, important innovation has come about through fleet companies, even though they are primarily considered to be customers of the official dealers⁴. These players offer vehicle usage based on additional services (leasing, invoicing, fuel cards) and on a new concept ('Total Cost of Ownership'). By addressing these emerging needs, fleet companies were able to capture 40% of the sales and, to some extent, have stimulated overall demand for new vehicles in the last few years. This illustrates how an activation of the customer loop may lead to market growth.

⁴ Therefore, for example, delivery of new cars takes place within an official outlet.

In the after-sales market the customer loop operates more naturally and the growth of new entrants has been considerable. The service offers of many new entrants, such as 'fast fit' repair chains, are very innovative.

However, there has been a progressive stabilisation in the distribution of market share. The current situation could be characterised as follows:

- Official networks have 53% of the overall market value⁵;
- Independent repairers have 34% and 'fast fit' repair chains have 6%;
- The remaining 7% is distributed amongst other players such as car supermarkets, spare parts distributors.

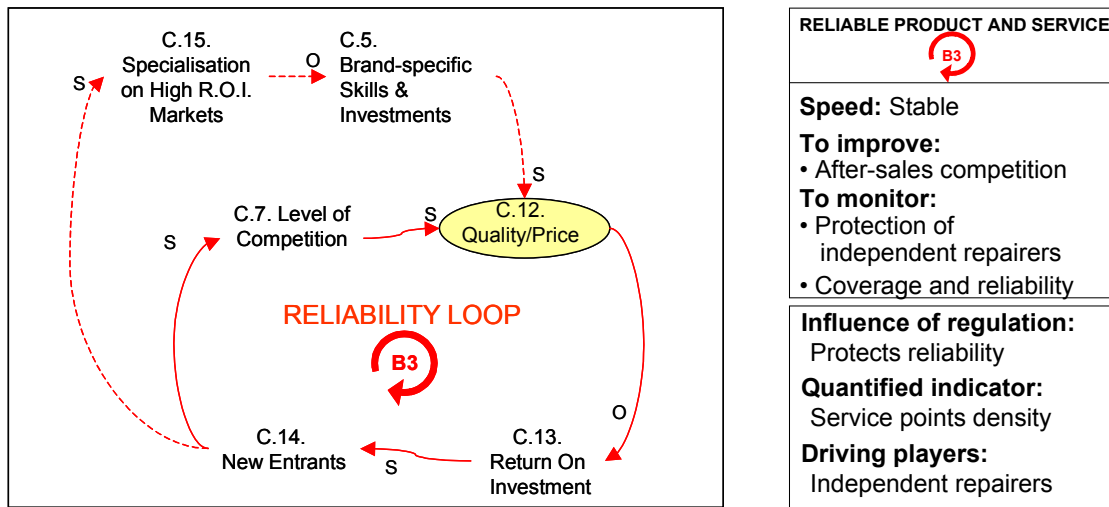
Since car components are tending to become increasingly technically complex, competition may come under threat in the future. This trend would be reinforced if independent repairers did not have sufficient access to the technical information necessary for repairing vehicles. This illustrates that, **in the customer loop, the distribution of market share is stabilising over the long-term**⁶.

Currently, the customer loop is activated in the after-sales market, which means that competition and innovation are present. However, the new car sales market remains driven by only one form of distribution. The best way to stimulate the customer loop would be to remove the access barriers for new entrants who want to develop alternative business models, especially in the realm of new car distribution. The various alternative distribution forms may include supermarkets, car supermarkets, the Internet, banks, and multi-brand new entrants. Some new entrants would either concentrate on volume sales of some standard models while others would use new car sales as a way to attract customers to their main business.

⁵ The average 53% market share of official networks is a figure that strongly decreases for vehicles older than 4 years that are no longer covered by a warranty.

⁶ The likely evolution of market share in the servicing market has been analysed in the study and developed in the 'Modelling Exercise' that is presented in Appendix 12 (Market share).

The reliability loop (B3):



The reliability loop depicts two combined loops with opposing effects that are related to the level of value for money in after-sales servicing.

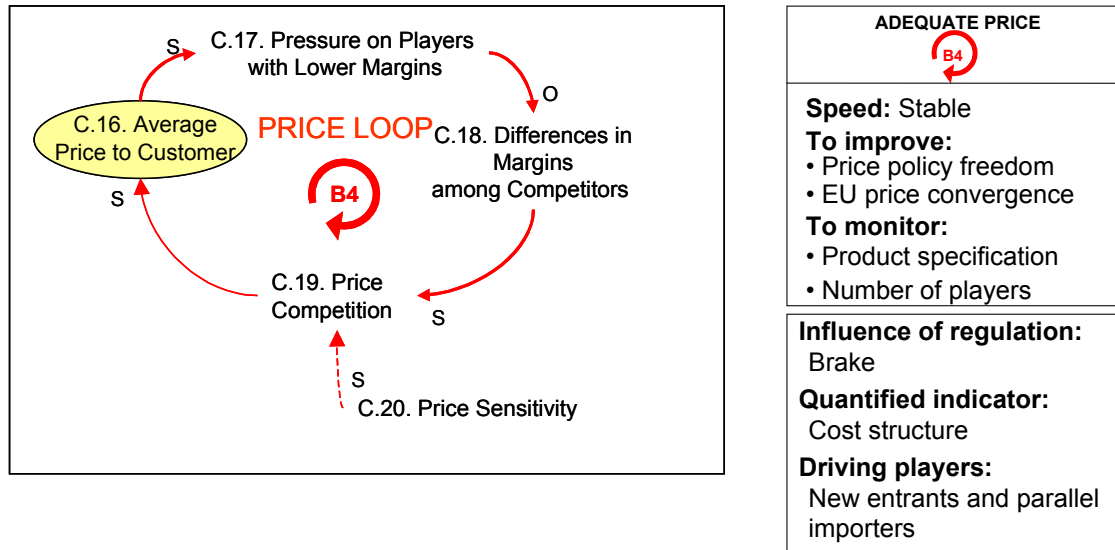
- **The first loop is driven by competition between players that offer repair and maintenance services to the end consumer (C7).** Increased competition tends to **improve value for money for the final customer (C12)**. However, an increase in the quality/price ratio (C12) tends to decrease the return on investment repairers can expect (C13), which limits market penetration by additional new entrants (C14) and stabilises competition (C7). It shows that the reliability loop is a 'balancing loop' that progressively stabilises the level of competition and the level of value for money. Although there is competition on the after-sales market⁷, various factors, especially the increased technical complexity of vehicles and vehicle servicing, constitute threats to the current level of competition, especially for the traditional independent repairers.
- In addition to this basic loop, new entrants (C14) tend to **specialise in the most profitable markets (C15)**. This causes divestment of brand-specific expertise (C5) and in the most specialised segments or remote geographical areas. This leads in turn to deterioration in the quality/price ratio (C12), especially for brand-specific and complex repair. **At present, the manufacturers and their networks stabilise the reliability loop** by guaranteeing sufficient brand-specific skills and investment (C5) as described in the 'product loop'. **They help to safeguard the quality of brand-specific and complex repair work and to ensure geographical coverage⁸.**

The reliability loop illustrates an essential feature of the car industry. The industry is expected to have international coverage of service points and homogeneity in terms of quality and reliability in sales and after-sales activities. Increased competition in after-sales servicing would improve the value for money of the most frequent maintenance and repair jobs. However, market penetration of new entrants might also lead to a deterioration of the quality/price ratio for the most brand-specific and complex services or to a weakening of the geographical coverage.

⁷ The market share of official networks (average 53%) has drastically decreased for vehicles more than four years old, which are not covered by warranty.

⁸ The 106.000 official repairer outlets represent approximately 45% of the total number of outlets in Europe (335.000). Independent repairers, that are mainly multi-brand, represent about 100.000 service outlets.

The price loop (B4):



The price loop brings to light the **potential impact of more systematic price competition** (C19), which tends to decrease the average price to the customer (C16) and creates pressure on the dealers with the lowest margins (C17). Adaptation among the competitors results in convergence of the margins (C18), which in turn decreases price competition (C19). Like the customer and the reliability loops, this price loop is thus a 'balancing loop'.

For information, and based on the present situation in the sales market, the consumer price is on average discounted by 8% compared to the manufacturer's recommended price. Distribution costs account for about 30% of the final price of a car and are partially supported by both manufacturers and importers mainly for marketing and network management. The cost to the dealers of running their dealerships represents only between 10 and 15% of the price of a car.

In the after-sales market, and especially for simple, out of warranty maintenance and repair jobs, **this loop is more intensely activated because the independent players have a leaner cost structure than the official repairers and can therefore offer more attractive prices.**

At average intensity, this loop would bring about a certain price convergence for the final consumer. It would also allow for re-balancing of the players' market shares. **At a higher intensity, 'price wars' would result and decisive pressure on the weakest players would be exerted.** This could force them out of the market and would lead to a concentration of players. However, the level of price competition is likely to vary depending on the attractiveness of segments or geographical areas.

At present, concerning sales activities, the price loop is stabilised at a low level of activation. **If it were to be activated, this loop might have the effect of weakening the official dealers' profitability** and, in turn, slowing the product loop (R1). It is notable, however, that **the customer loop and the price loop reinforce each other and have a positive impact on intra-brand competition.**

2.2. Areas for improvement and risk factors

Based on the assessment of the current four industry causal loops, it is possible to describe the main features of the current situation. These features include:

The areas of competition

- **In general terms, inter-brand competition between groups of manufacturers in Europe is effective.** The high number of different brands and the number of brands present in each segment of the European automobile market are examples that lend support this statement⁹. Nevertheless, manufacturers are constantly trying to develop new car sub-segments in order to temporarily decrease this competition.
- **Intra-brand competition is limited by several factors.** As the sale of new vehicles is restricted to the traditional official dealers, it de facto limits competition between distribution channels. Moreover, as the cost structures of dealers in the same network tend to be similar, price competition is limited. However, intra-brand competition exists to some extent amongst official dealers, since significant proportions of sales take place outside the dealer's territory, particularly in densely populated areas. These factors are reinforced by the activities of fleet consumers.
- There is **real competition in after-sales servicing**, especially for vehicles that are more than four years old¹⁰, when the official networks co-exist with independent multi-brand repairers, 'fast fit' repair chains, and other service players. This competition is now stabilising, however, and **is likely to decrease** if all players do not have equal access to the technical information necessary for maintaining and repairing vehicles. This effect is due to specifications that are more elaborate and to the increasing complexity of vehicle technology.
- In terms of car sales, **market integration**, characterised by the level of price convergence in Europe, **is limited**. The sales outside a dealer's territory and the actions of intermediaries are not strong enough to compensate for the lack of tax harmonisation and to have a significant effect on price differentials throughout Europe.

Consumer satisfaction

Satisfaction of consumers' needs has reached an equilibrium where reliability is achieved, choice and product innovation are high, and where consumer prices are stable. **Improvement within the current legal regime would only come through a more diversified response to the specific needs of each category of player and/or through a structural reduction in distribution costs.**

The positions of the players

The sales and after-sales markets can be regarded as generally fragmented. The official networks consist of a large number (more than 100.000 outlets) of small players (a typical main dealer does not sell more than 300 cars a year and few of them operate several outlets). Usually, dealers have low profitability and their activities are based on bundling services. However, they are increasingly leaning towards concentration (about 5% decrease in the number of sub-dealers in the past 3 years) and the use of 'Hub and Spoke' organisations¹¹.

Strong working relationships between players are currently an important feature of the industry. **Manufacturers and their networks jointly implement sales and service strategies.** However, the new entrants and would-be new entrants are mainly large players who favour specialised, non-integrated business models i.e. multi-brand sales or sales focused on certain car segments.

⁹ This is the case for the European market as a whole. In Europe, there are 50 brands available, about 250 models and between 2000 and 4000 versions.

¹⁰ 77% of the 180 Million cars in Western Europe are more than four years old.

¹¹ 'Satellite organisation of outlets' refers to the 'hub and spoke' concept where specialised service outlets are centred around a main dealer. Currently, about 10% of the total number of outlets are satellites of a main dealer.

If the legal framework were to remain unchanged over the next five years, the level of competition, the market structure and the extent to which consumer needs are satisfied would still undergo natural and progressive development.

This development would include concentration among dealers, increased number of 'hub and spoke' organisations, some innovation in contact between the customer and the official networks, better integration of new entrants (like fleet companies, banks or insurance companies), greater integration of national markets and price convergence. There would be even greater product complexity, pressures on traditional independent repairers and a likely specialisation of new players in after-sales service.

However, the study has identified **five potential areas for improvement**, which would allow a more natural development of the above 'causal loops'. These areas for improvement are:

- Increased independence of official dealers and other distributors from manufacturers' marketing policies;
- Access for additional new entrants to the distribution market and more innovation in distribution channels;
- Greater market access and competition in after-sales servicing;
- Increased freedom of positioning in terms of price for distributors;
- Increased price transparency and convergence within Europe.

A change in the legislative regime aiming at addressing one or another of these areas for improvement should also take into account the underlying risk factors. The study highlights **six risk factors**, which are:

- A loss of control by manufacturers over the processes and the players throughout the value chain;
- A structural and significant decline in the profitability of official dealers;
- Independent repairers being forced out of the market;
- A decline in the density of network coverage and in service quality;
- Standardisation in the car industry;
- An excessively rapid increase in the concentration of players.

These findings form the structure for analysing the five legislative scenarios and the ten variables identified by the Commission.

Current market situation: key findings

The assessment of the current situation serves as a point of reference for evaluating the impact of possible modifications to the legal framework.

Automobile distribution is a market where **manufacturers and their official networks jointly invest in the brand**, which leads to self-reinforcing product innovation. Most distribution and servicing networks are being restructured according to a trend towards concentration, outlet specialisation, increased technical complexity and the emergence of alternative channels like fleet players. Official dealers are mostly small or medium-sized players and are a critical yet fragile element for the dynamism of the industry.

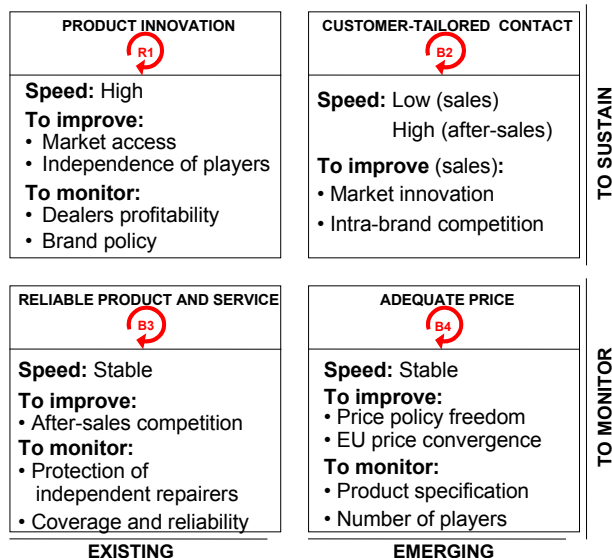
Although strongly interdependent, sales and after-sales servicing markets have different features. **After-sales service is the most competitive, strategic and profitable market.** However, the market is currently reaching limits in terms of the number of players and profitability.

In depth analysis of the cause and effect relationships within the industry reveals some lack of competition and **some barriers to emerging trends and new business models.** Factors that would accelerate current improvements include more diversified formats of distribution, more natural price competition, more integrated national markets as well as greater market access for additional new entrants.

If the existing legislative framework is kept unchanged, the natural progressive developments of the industry that are likely to occur in the coming years would only partially address these needs. In addition, manufacturers would be the main driving force for the speed of these changes.

However, if the structure of competition is to be modified, the disruption that the changes may cause in the market should be carefully monitored. **Major risks include the sustainability of the quality/price ratio, the coverage of after-sales servicing, the level of product innovation and the survival of the small and medium-sized traditional official dealers and independent repairers.**

As illustrated below, potential areas for improvement and risk factors form the structure for analysing the five legislative scenarios and the ten variables identified by the Commission.

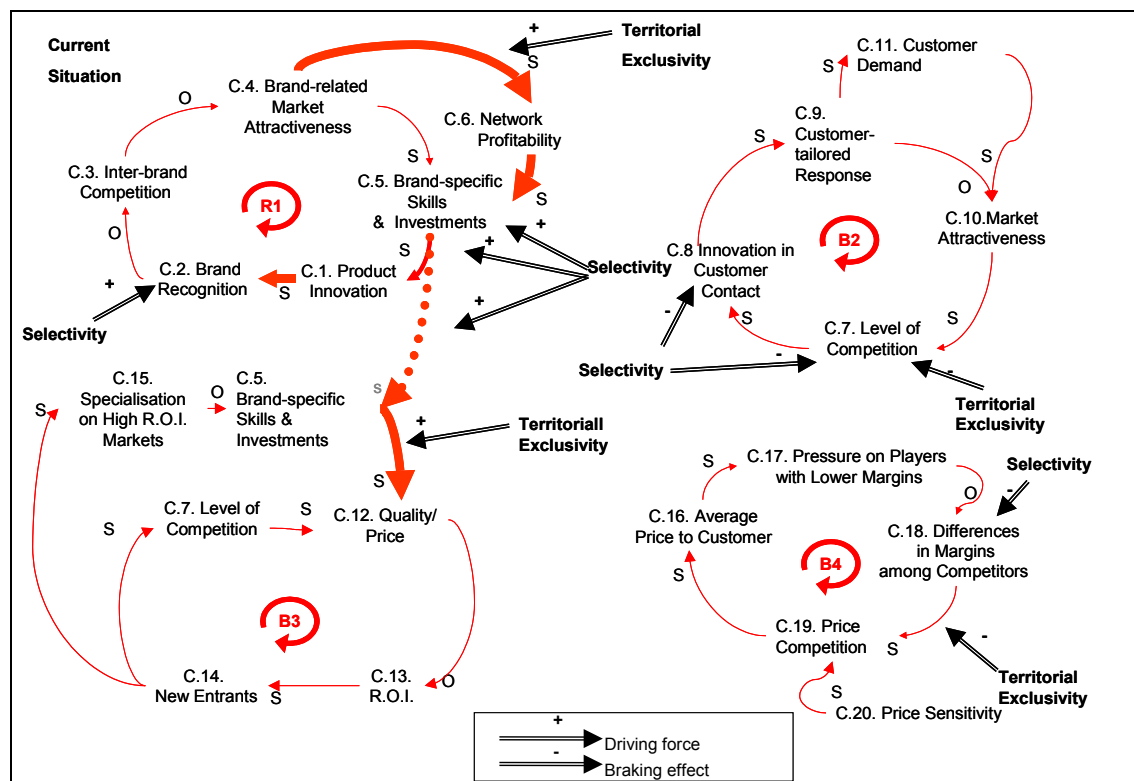


3. Analysis of the Legislative Scenarios and Variables

3.1. Analysis of the five legislative scenarios

Based on the understanding of the present situation, the five scenarios are analysed comparatively by subjecting them to a situation in which the current legislative framework is prolonged to 2005.

The diagram below illustrates the effects of 'selectivity' and 'exclusivity'¹²:



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.

The current regulation provides a system of selective and exclusive distribution and **protects and sustains the product and reliability loops**:

- **Territorial exclusivity** ensures efficient distribution of investment (C5) over the territory concerned and safeguards the profitability of the official dealers (C6);
- **Selectivity** is a tool the manufacturer uses to control marketing policy (C2) and sales volume.

Both of these factors tend to reinforce close, long-term relationships between the manufacturers and their networks. However, territorial exclusivity and selectivity **tend to brake the customer and price loops** through limiting intra-brand competition (C7) and price competition (C19). The level of innovation in customer contact (C8) and the ability of competing distributors to differentiate on price (C18) are both limited.

¹² **'Selectivity'** means that dealers are chosen using product-based qualitative and/or quantitative criteria defined and applied in a non-discriminatory manner by the manufacturer. **'Territorial exclusivity'** means that the manufacturer sells his goods exclusively to one distributor within a given territory, and therefore assigns a territory exclusively to one distributor.

The main conclusions, made with all the other elements of the legal framework remaining unchanged, are presented starting from Scenario 5, as this is the most similar to the current framework.

Scenarios 5 and 5A:

'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.'

The only difference with the current system is that there would be a **less strict definition of the concept of territorial exclusivity**. Official distributors would not be allowed to open sales or service outlets outside their territory. They may however conduct active sales outside their specific territory and use personalised publicity (e.g. tele-marketing, e-mail, direct mail, door to door, etc).

The main impacts of the scenario are as follows:

- Scenario 5 would offer some de-compartmentalisation of geographical 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 trend of concentration among distributors would be somewhat reinforced under the impact of **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 development of the industry** that would occur if the current legal framework were 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.

Sub-scenario:

In addition, a sub-scenario 5A has been taken into account where exclusivity would be restricted to five years, in order to protect initial investments of newly established dealers. This scenario would be closer to Scenario 4 where territorial exclusivity is removed. Indeed, in practice, the main geographical areas where established dealers are operating would be open to competition from additional new entrants, while some specific territories, mainly new geographical markets for a given brand, could be allocated exclusively to one dealer during a certain period. **This option may be an efficient way to combine incentives to invest in new or less attractive areas and a more competitive market structure in high penetration regions.**

Scenario 4:

'A selective distribution system based on qualitative and quantitative criteria, 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 that are designed to reach a minimum sales volume and cover the entire range. However, in this scenario, territory can no longer serve as a basis for determining these targets.

The most important impact areas include:

- The most direct impact of the abolition of territorial exclusivity would be the co-existence of various distributors within a same geographical area, 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 retention of strict selection criteria by the manufacturers would remain a means of preventing the development of new distribution formats.
- In addition, 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 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 have 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, development of marketing costs borne increasingly by the distributors and **increased differentials in cost profiles among types of players**.

In the short run, Scenario 4 would generate market instability and increased price competition. The weakest players would progressively be excluded from the market. These disruptions caused in the short and medium term might weaken the reliability loop.

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

- Manufacturers would be in a position to limit the impact on their marketing strategies and on service reliability. They would therefore use various other means such as qualitative and quantitative selection criteria or remuneration methods.
- The impact for established traditional dealers would be significant. The average size of a dealer is likely to increase as is the number of 'hub and spoke' organisations.

Scenarios 3 and 3A:

'A selective distribution system based only on qualitative criteria.'

In Scenario 3, the selection of dealers is purely based on qualitative criteria that are linked to the nature of the product and the requirements for promoting the brand. Any player meeting the criteria can sell new vehicles and spare parts. The manufacturer is responsible for organising vehicle allocation in a non-discriminatory way. The main difference between Scenario 4 and Scenario 3 is that there are no longer sales targets. In addition, manufacturers have no control over where outlets are located.

The main impacts are outlined below:

- **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.**
- Although there would be fewer constraints in terms of sales targets compared with Scenario 4, in **Scenario 3 there would only be a slight increase in innovation in distribution forms.** Penetration of additional new entrants and the development of new business models would remain limited. The obligation to sell the entire vehicle range as well as the compulsory link between sales and after-sales servicing would be maintained using qualitative selection criteria. 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. Although manufacturers would not be able to limit the number of players in each territory, **the industry would automatically adapt and tend to naturally limit the number of distributors in the long term.**

Scenario 3 would reinforce the trends of concentration and specialisation described for Scenario 4, and would increase the likelihood of short-term disruption. Time would be necessary to allow the various players to assimilate these new practices.

In addition, **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 range - and the method of dealer remuneration that manufacturers are allowed to use.

Sub-scenario:

Due to the ambiguous nature of qualitative selection criteria, which 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, for example, restricting the obligation to sell and display the entire vehicle range. The impact of this scenario would be the same as described above, but more marked in particular for the development of new business models. The disruption in the relationship between the manufacturers and their official networks would be more pronounced.

Scenario 2:

'An exclusive distribution system in which the manufacturer agrees to sell new vehicles only to a single distributor within a well-defined territory.'

In Scenario 2, **all types of qualitative criteria may be used when drawing up dealership agreements**. The criteria may vary from one territory to the next and are left to the discretion of the manufacturer. Even if manufacturers 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**. For the remainder, allocation of vehicles should be done in a non-discriminatory manner according to supplementary requests from official dealers.

The main effect of Scenario 2 would be to **broaden the possibilities of parallel imports that are currently limited to intermediaries**. This would, especially in the short and medium term, accelerate price convergence between countries and enable greater market integration. The study highlights several limitations to this impact including the following:

- 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.

Scenario 1:

'A system in which independent car distributors have the right to purchase new vehicles from manufacturers or their official distribution networks.'

Scenario 1 is a system of **'free' distribution** in which selectivity and exclusivity are 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 is 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 are left to the discretion of the manufacturer.

The main consequence of Scenario 1 would be the following:

- Scenario 1 would lead towards a **diversification of distribution strategies on the part of the manufacturers**. The **official networks would also face significant instability** given that they would have to operate in an uncertain contractual context.
- It is also noticeable that, whereas other scenarios open the market somewhat, **this scenario does not increase market access**. 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.

Comparative assessment:

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.

The comparative assessment of the scenarios on the three impact areas defined by the Commission can be summarised as follows:

- | | |
|-------------------------------------|---|
| The areas of competition | <ul style="list-style-type: none"> • Inter-brand competition¹³ 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. |
| Consumer satisfaction | <ul style="list-style-type: none"> • 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. |
| The positions of the players | <ul style="list-style-type: none"> • 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 most of the scenarios, pressure on the smallest and weakest players is apparent. There is likely to be an increase in the critical mass necessary to ensure profitability. Acceleration of the trend towards concentration is expected, especially in Scenarios 3 and 4. • For the biggest players, Scenarios 3 and 4 may 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 3 and 4 would lead to progressive specialisation of the players in sales and/or after-sales markets. Increased differentiation in the market positioning of players is to be expected, particularly between 'repair only' outlets, large full facility dealers and 'hub and spoke' arrangements. |

¹³ The competition has been assessed by looking at the European market as a whole.

- **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.
- **Scenario 3 and mainly Scenario 3A tend to weaken the working relationships between manufacturers and the distribution players.** The increase in intra-brand competition and the differences in its nature over 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 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 and the quality of service.**
- **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 run a dealership would remain a significant barrier to entry.

Analysis of the legislative scenarios: key findings

The diagram below depicts the main characteristics of the five legislative scenarios defined by the Commission and their variants:

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)

Analysis of the legislative scenarios and sub-scenarios taken in isolation reveals that:

- **Scenario 5** would slightly reinforce current developments in the industry.
- **Scenario 4** would introduce some structural changes to the market structure. These would include increased concentration and internationalisation of markets; a specialisation trend that would create pressure on the link between sales and after-sales servicing and fiercer price competition. In the short term, some market instability would occur and allow the development of new business models.
- **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.
- **Scenario 3**, in addition to the effects of Scenario 4, would somewhat threaten the integrated nature of working relationships between manufacturers and their networks. This might lead to a decrease in the rate of innovation, especially among the weaker 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 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 1** would be difficult to enforce legally, in a market structure where no manufacturer is in a dominant position. Such a scenario would not address the defined improvement objectives, and there would be serious repercussions, in particular for the weakest players.
- **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 really allows the 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.

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.

3.2. Analysis of the ten variables and evaluation of their possible impact

All ten variables defined in the Terms of Reference have been studied¹⁴. 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 individual sales targets used for allocating vehicles to distributors;
- Availability clauses;
- The role of intermediaries;
- Direct sales by car manufacturers.

For each variable, various legislative options have been underlined. Their contribution to the areas for improvement has been assessed as well as the risks they may create.

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:	<u>Broken</u> <u>Reorganised</u> <u>Unchanged</u>	<u>Full multi-branding</u> <u>Unchanged</u>	<u>Several sets of criteria</u> <u>Unchanged</u>	<u>Facilitated</u> <u>Unchanged</u>

¹⁴ See Section III.3 of the study.

The link between sales and after-sales servicing:

In the present system, every official distributor is obliged to be an official repairer and vice-versa¹⁵. This compulsory link between sales and after-sales servicing is currently being questioned¹⁶. 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:

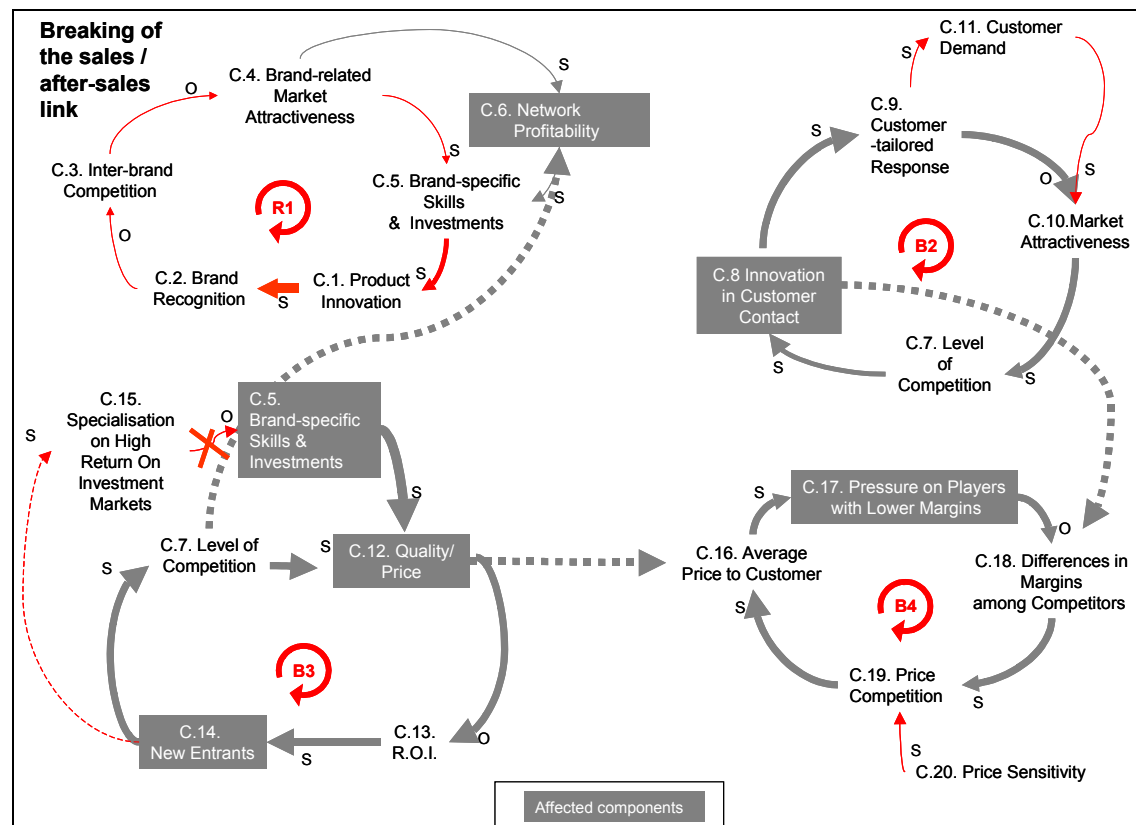
- **Breaking the sales/after-sales link, especially in the context of a scenario that abolishes territorial exclusivity**, would enable market penetration by new players specialising in distribution and would enable the development of new forms of distribution. It would also promote the development of 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.

¹⁵ A 100% of sales outlets are currently 'official'. These official outlets represent 33% of the total number of after-sales outlets but account for 53% of after sales market value.

¹⁶ See the Autopolis study that is published on the site of the Commission. This study concluded that the link between sales and after-sales servicing was not natural.

The diagram below illustrates¹⁷ the impact of breaking the sales/after-sales link on the four industry causal loops:



The components highlighted (in grey) are those affected by a broken sales/after-sales link. The diagram also illustrates (in bold) the relationships reinforced by breaking the link. It depicts how three of the four loops (namely the reliability loop B3, the price loop B4 and the customer loop B2) are accelerated by this variable.

¹⁷ Detailed impact analyses are provided in the report.

Multi-branding:

In the present situation, manufacturers can impose certain conditions that limit multi-branding in sales¹⁸.

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. 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**¹⁹.
- 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 additional²⁰ 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.

¹⁸ Separate sales premises, separate management and separate legal entity and in such a manner that no confusion of brands is possible.

¹⁹ Currently, multi-brand practices represent on average about 24% of outlets in Europe although differences exist among countries.

²⁰ The Internet is increasingly satisfying this need for comparison by providing easy access to information. Currently, the use of the Internet as a transactional tool remains however limited in Europe.

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**'²¹, '**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.

²¹ Distribution costs account for 65% of the final price of the spare part. This explains why spare parts account for such a high proportion of the profitability of after-sales players.

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**²² and the **role of intermediaries**²³ 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.

²² Clause that 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.

²³ Intermediaries act on behalf of final consumers in whose name they purchase or collect a specified vehicle.

Analysis of the legislative variables: key findings

Among the ten variables that are studied, four are critical. These variables are legally feasible, potentially have significant impact on the market structure and generate opposing positions among players. These variables are:

- **The link between sales and after-sales servicing:**

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.

- **The regulation of multi-branding:**

Without modification of the remainder of the legal framework, lifting the restrictions on multi-branding alone would only have a moderate impact on the industry. The development of multi-brand dealers would remain limited to some large players and to specific geographical areas.

However, in combination with other scenarios or variables, multi-branding is an essential prerequisite to the development of customer-tailored distribution formats and alternative business models.

- **The opportunity to regulate diversity of channels:**

The use of different sets of criteria for the selection of dealers and for dealer remuneration methods would allow for the co-existence of different sales and service channels, while allowing manufacturers to keep sufficient control over their marketing policies.

- **The group of variables that are related to after-sales servicing:**





Variables such as the distribution of original spare parts, access to the trade and access to technical information represent decisive levers on the level of competition in after-sales servicing, which is the most profitable market. However, side effects such as the weakening of official dealers' profitability may lead to deterioration in the reliability of service and the quality/price ratio for brand-specific repair.

For the other variables that are less critical, manufacturers should still be allowed to freely determine the method of dealer remuneration. Vehicle allocation should remain unchanged. Direct sales, the role of intermediaries and availability clauses should be maintained and clarified.

It is important to stress that a regulation based solely on one scenario or one variable would not fundamentally change developments currently underway in the industry. However, the combination of several variables with each other or with another scenario influences the market structure and characteristics of automobile distribution and servicing. By retaining only the most relevant scenarios, together with the most critical variables, and analysing the consistency of the scenario-variable combinations, a great number of different possible legislative combinations have been identified. These combinations lead to three different market outcomes, which are called the 'Status quo', 'Multi-channel' and 'Mass-selling' for the purpose of the study.

4. Market Outcomes

When combined, the scenarios and variables would modify the speed of the industry causal loops. In the long term, these developments can result in **only three different market outcomes** – 'Status quo', 'Multi-channel' and 'Mass-selling'²⁴. However, in the medium term, a state of instability may occur. This instability would mean that the four industry loops would face temporary disruptions. The table below shows the speed of activation of each loop in each of the market outcome:

Loops	Speed	Possible long-term developments	Status quo	Multi-channel	Mass-selling
PRODUCT LOOP 	Lower	Weakening of brand image and product innovation			X
	Same	Jointly managed marketing strategy between manufacturers and sales and service players	X	X	
CUSTOMER LOOP 	Very high	Domination of distribution by multi-branding (new entrants and evolution of traditional players)			X
	Higher	Co-existence of various distribution channels		X	
	Same	Domination of distribution by official networks and manufacturers' channels	X		
RELIABILITY LOOP 	Higher	Standardisation and specialisation in after-sales service and weakening of brand-specific networks to the benefit of specialised multi-brand players		X	X
	Same	Reinforcement of the official networks to the detriment of small independent players	X		
PRICE LOOP 	Higher	Change in consumer demand profile (more sales falling within mass-market segments)			X
	Same	Price competition limited to certain segments or temporary situations of price differences	X	X	

The Andersen study analyses how each legislative combination of relevant scenarios and variables tend to lead to one of the market outcomes. The table below highlights these conclusions²⁵:

Legislative Scenarios	Sale / after-sales link	Multi-branding (sales and after sales)	Diversity of channels	After-sales variables	Market outcomes
Scenario 3A (minimum qualitative Selection criteria)	Broken	Full multi-branding	Unchanged	unchanged others 'Mass-selling'
Scenario 4 (full selectivity - no exclusivity)	Reorganised	Full multi-branding	Several sets of criteria	Facilitatedothers 'Multi-channel'
Scenario 5 (limited territorial Exclusivity)	Unchanged	Unchanged	Unchanged	Unchangedothers 'Status quo'

²⁴ Part IV of the study is dedicated to the analysis of the combined effect of scenarios and variables and to the likely long-term market outcomes.

²⁵ This diagram only provides a visual representation of the legislative combinations and of some market outcomes. A comprehensive table in the conclusion of the study lists these combinations.

The three market outcomes are:

Status quo

In the 'Status quo' outcome, **close relationships and integrated operations would remain between manufacturers and their networks.**

The speed of the four basic loops would not be changed in the long term, but current trends in the industry would be sustained, such as:

- Network reorganisation and concentration;
- Increase in distributors' marketing costs;
- Reduction in after-sales competition;
- Slight innovation in the approach to customers;
- Slight improvement in the level of market integration.

For example, the following legislative combinations would lead to such a market outcome:

- A combination based on Scenario 5A (i.e. selective, exclusive distribution, but with limited territorial exclusivity) with the relevant variables remaining unchanged;
- The combination of Scenario 4 (i.e. selective distribution with both qualitative and quantitative criteria) with a reorganisation of the sales/after-sales link while all other variables remain unchanged.

Multi-channel

In the 'Multi-channel' market outcome, **distribution and service formats would be diversified and manufacturers would manage co-existing channels.**

Certain trends towards innovation and openness that favour the consumer would be accelerated. This would mean that trends already identified in the 'Status quo' would be reinforced, while new trends would appear, like better integration of new business models, increased customer segmentation, strong diversification of the players' market positioning and upward pressure on marketing costs. However, the re-distribution of market share between players and the arrival of new entrants may lead to instability in the short-term.

For example, a combination of Scenario 4 (selective distribution based on quantitative and qualitative criteria) along with the reorganisation of the sales/after-sales link and with a lifting of all restrictions on multi-branding for new entrants would lead to a 'Multi-channel' market outcome. However, this would only occur if different sets of criteria are defined and reasonably applied for each channel.

Mass-selling

In the 'Mass-selling' market outcome, **the concentration of players would increase, product ranges would shrink while sales and service processes would become more standardised.**

Such a market outcome would bring major changes in the market positions of the players, reinforcement of new entrants, changes in the level of sales and after-sales competition and in demand characteristics. These changes would lead to different points of equilibrium for the four industry loops. The most important effect would be that the product loop would enter a downward trend.

For example, combining Scenario 3A (selective distribution based on purely qualitative minimum standards defined by the regulator) with a broken sales/after-sales link, full multi-branding, and facilitation of the after-sales variables would lead to a 'Mass-selling' situation.

The comparative assessment of the three market outcomes on the impact areas defined by the Commission is summarised below²⁶:

The areas of competition

- The 'Mass-selling' situation is likely to have the largest impact on inter-brand competition because large multi-brand mass-market distributors might capture up to 30% of the market share in new car sales. Inter-brand competition would remain effective in the other market outcomes.
- Intra-brand competition would be most effective in the 'Multi-channel' situation because of the higher number of players on the one hand and their more diversified market positions on the other. In the current situation, there is an average of 32 sales outlets per 1000km² in the European Union. In a 'Multi-channel' situation, market entry of new players may increase this density although the number of traditional official outlets is likely to decrease. Competing channels would include 'mass-market' players (which may capture up to 15% of the market shares), niche players (who would focus on innovative offerings or on specific car or customer segments), and direct sales from manufacturers.

In the 'Status quo' situation, intra-brand competition would not be significantly modified. The number of sales outlets would progressively decrease due to network reorganisation. The market share of fleet companies, who would remain the only real independent alternative, would progressively increase from 40% to 50%.

Intra-brand competition would be reinforced in the 'Mass-selling' outcome. However, over time, the concentration of players and the development of multi-brand practices would reduce the number of players, which may eventually lead to less effective intra-brand competition than in a 'Multi-channel' outcome.

- The search for economies of scale in the 'Mass-selling' outcome would cause a major decrease in the number of traditional independent repairers (the 100.000 independent service outlets in Europe might face a 30% decrease) and would reinforce the growth of new large servicing players such as repair chains. Competition in after-sales servicing would increase between branded repair outlets and multi-brand specialists.

In the 'Status quo' situation, there would be a slight decrease in after-sales competition due to the reinforcement and specialisation of official dealers. The number of official 'repair only' outlets would progressively increase.

In the 'Multi-channel' situation, independent repairers would be better able to defend their positions, thanks to improved access to technical information, greater specialisation, and relationships with independent sales channels. Competition in after-sales servicing would be reinforced.

- The level of integration between European markets and convergence of pre-tax prices is likely to increase within the three market outcomes.

Areas of competition	Current situation	Status quo	Multi-channel	Mass-selling
Inter-brand	High	=	=	+
Intra-brand	Low	=/+	+	+
After-sales	Medium	=/-	+	+
Market intergation	Low	+	+	+

²⁶ A detailed assessment of the three market outcomes is provided in the study and is illustrated by quantified modelling exercises in the appendices 11 to 14, where possible evolutions of market shares, dealers' profitability, coverage of service outlets and structures of distribution costs are studied.

Consumer satisfaction

- The **'Status quo'** situation would best guarantee diversified product ranges thanks to highly integrated distribution practices and manufacturers' strategies. Specifically, the financial risk related to the launch of new models is minimised and thereby promotes diversification in the product range. In the **'Multi-channel'** outcome, the level of product innovation should not be affected.
The **'Mass-selling'** outcome involves a certain risk of product range shrinkage and a slowing of the innovation cycle.
- The importance given to marketing efforts – which are currently 12% of the distribution costs-, **customer relationships and channel innovation initiatives should increase further**. In the 'Status quo' outcome manufacturers and their networks would largely dominate such initiatives whereas in 'Multi-channel' and 'Mass-selling' situations, different players would reinforce such trends.
- The levels of reliability, safety and service quality should in the long term remain satisfactory in all three outcomes although the levels of price may differ. After the period of instability in the 'Mass-selling' situation, no market outcome would bring about a major safety risk in the long term since players tend to adapt their strategies and their prices to satisfy this essential factor.
- The cost structures of the various players and the average price of new cars would differ according to the market outcomes.
In the **'Mass-selling'** situation, the search for economies of scale, specialisation in distribution and simplified sales processes where the product becomes a commodity would allow certain types of players to develop cost structures that are more competitive than those of traditional players (5 to 10% decrease). In this highly competitive situation, all players' distribution cost structures are likely to converge through rationalisation and concentration.
In the **'Status quo'** outcome an estimated 2-5% rationalisation of distribution costs would take place and be partially reflected in consumer prices.
In the **'Multi-channel'** outcome, the differences between the market positions of the various players are greater. This situation would lead to more varied distribution costs. In turn, while the average price of a new car would remain stable, price decreases could be reached in some specific customer segments.
- The prices of original spare parts and the margins would decrease in both the 'Multi-channel' and 'Mass-selling' outcomes, following a certain liberalisation of this market.

Customer satisfaction	Current situation	Status quo	Multi-channel	Mass-selling
Product innovation	High	=/+	=	-
Customer-tailored contact	Low	=/+	++	=
Reliability	Medium	=	=	=
Price decrease	Medium	+	=	++

The positions of the players

- **Reorganisation of the traditional official networks would occur in every market outcome.** Reorganisation would include promoting size on the one hand and specialisation on the other. However, **these effects are the most marked in the 'Mass-selling' market outcome.**
- **Traditional 'generalist' independent repairers face pressure in all market outcomes.** Both the increasing specialisation of the networks (particularly in the 'Status quo' outcome) and of players such as fast-fit repair chains (especially in 'Mass-selling') would weaken their position.
- **Market share by type of player varies according to the type of market outcome²⁷.**
The 'Multi-channel' situation is the only one that would truly offer diversified sales process and products possibilities to fulfil the needs of all consumer segments. These include co-existence of full-facility companies (distribution and after-sales servicing) and companies combining sales and other types of ancillary service (fleet companies might, for example, operate increasingly independently of official networks). In addition, market entry by companies focusing on high sales volumes of cars at a low price (an estimated market penetration of 15%) is likely to occur as well as the emergence of new niches in specific areas.
 In the **'Status quo'** outcome, the traditional official networks would continue to dominate distribution and drive innovative initiatives.
 The **'Mass-selling'** situation would tend to standardise the sales process and would be dominated by larger multi-brand companies.
- **Establishing 'lean distribution' is made easier in the 'Status quo' situation, which is characterised by stable and long-term relationships between the manufacturer and their network.** In the two other outcomes, the changes in market structures are likely to slow down the mechanism in the short term.

Positions of the groups of players	Current position	Status quo	Multi-channel	Mass-selling
Car manufacturers	Favourable	=	=	-
Current official dealers	Favourable	=	-	-
New entrants	Unfavourable	=	+	+
Parts suppliers	Unfavourable	=	+	+
Independent after-sales players	Unfavourable	=	+	+
Consumers	Neutral	=	+	-

All estimated figures that are provided in this assessment of the three likely long-term market outcomes are based on four quantified 'Modelling Exercises' carried out by Andersen. These relate to 'dealer profitability', 'market shares', 'geographic coverage' and 'distribution costs'.

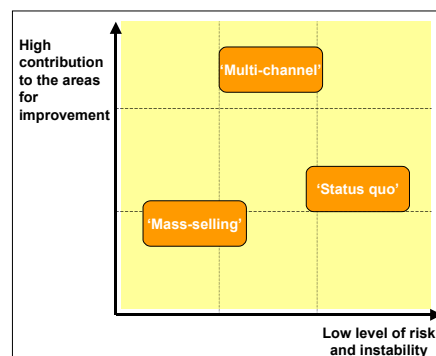
²⁷ Cf. Appendix 11:(Modelling Exercise 2 - Market Share).

Market outcomes: key findings

A system-based analysis of the impact of the scenarios and variables on the industry reveals that, in the long term, industry developments can result in only three market outcomes. In the meantime, however, an unstable situation may appear. These market outcomes are:

- The **'Status quo'** outcome, in which manufacturers and their official network would continue to jointly invest in the brand, would allow for progressive developments such as slight innovation in customer contact and a decrease in distribution costs. This market outcome is also the less risky one.
- The **'Multi-channel'** outcome would more rapidly address the variety of customer needs. Manufacturers would be forced to manage the co-existence of different channels for car sales and servicing. A new equilibrium of market share among players would be reached. Such a market outcome would, however, include risks of disruption in the short-term.
- The third market outcome, **'Mass-selling'** would include standardisation and concentration in the automobile distribution industry. This situation would create a decrease in the level of product innovation, a standardisation of the sales process, and a reduction in the vehicle ranges. This outcome would generate a more significant price decrease. However, it is likely that the other areas of customer satisfaction would be altered.

The diagram below represents the level of contribution that each of the market outcomes provides to the set areas for improvement as well as the level of risk and instability:



Some examples of legislative combinations leading to market outcomes are described below:

- Scenario 5 combined with a complete lifting of the restrictions on multi-branding would lead to a 'Status quo' outcome;
- Scenario 4, combined with a reorganisation of the link between sales and after-sales with all other factors remaining unchanged would also lead to a 'Status quo' outcome;
- Scenario 4 with a reorganisation of the link between sales and after-sales servicing and with a system of several sets of criteria for selection and remuneration would lead to a 'Multi-channel' outcome;
- Scenario 3A with a reorganisation of the link between sales and after-sales and a complete lifting of multi-branding restrictions would lead to a 'Mass-selling' outcome.

The detailed evaluation of the three market outcomes provides the Commission with a comprehensive view of potential future outcomes of the industry that may result from changes in the legislative regime. This allows an impact comparison together with the sensitivity analysis to be performed for the various legislative combinations. More generally, the impact reference model is an analytical tool to help the Commission in its task of determining future legislation applicable to vehicle sales after September 2002.

5. Commercial Vehicles²⁸

Commercial vehicles fundamentally differ from passenger cars²⁹. The most important features which set the commercial vehicles market apart from that of passenger cars include the following:

- **Professional users** who have specific servicing requirements that are related to the intensive use of the vehicles;
- Significant technical complexity of the product leading to **complexity in service**;
- While light commercial vehicles are usually distributed by the same channels as passenger cars, **heavy lorries have a separate distribution network** with lower density but a higher level of investment.

Unlike the passenger car sector, **all players** involved in the commercial vehicles industry **favour a selective and exclusive distribution** system that protects the high initial investments of the dealers and guarantees sufficient density and reliability of the distribution and service network³⁰.

Overall, the features of the market for light commercial vehicles are closer to those of the market for passenger car distribution and servicing. Some manufacturers offer the full range of commercial vehicles (from light vehicles of less than three tons to heavy lorries) while some others are specialised in one or more categories. Therefore, creating distinct legislation would lead to a situation where some dealerships would be bound by two different sets of legal rules.

Conclusions regarding the variables can be summarised as follows:

- **Link between sales and after-sales, access to technical information and spare parts distribution**

Due to the long distances involved and the intensive use of the vehicles, an international network consisting of fast and efficient assistance and repair services is of primary importance. Therefore, all parties favour preserving a situation where distributors are obliged to provide after-sales servicing and 'repair only' players are authorised.

In addition, guaranteeing access to technical information for independent repairers and ensuring high reliability of spare parts are essential.

- **Multi-branding**

Commercial vehicle users do not consider multi-branding to be an essential issue because of the technical complexity of the vehicles, the limited choice and the high loyalty to the brand. However, multi-brand operations might be a solution for some players to expand their volume of sales and service operations.

- **Method of dealer remuneration and vehicle allocation system**

Method of dealer remuneration for commercial vehicles significantly differs from that for passenger cars. Remuneration is more based on volume, and discounts to the customer tend to be higher.

For light commercial vehicles, vehicle allocation to dealers takes place through a scheduling plan defined by the dealers themselves. Heavy lorries are manufactured on a made-to-order basis.

There would be no need for any specific amendment to the current regulation regarding these two variables.

To conclude, the main features of the markets for commercial vehicles are different from those for passenger cars. However, the market for light commercial vehicles may be considered as closer to that for passenger cars.

²⁸ These findings are presented in the Appendix 14 (Commercial Vehicles) of the study.

²⁹ Commercial vehicles are usually segmented in three categories: light commercial vehicles (0-6 Tonnes Gross Vehicle Weight "GVW"), medium commercial vehicles (6-16 T GVW), and heavy commercial vehicles (above 16 T GVW).

³⁰ The average investment is between €2 and 4 million.