

# PART I: Context of the Study and Approach

## I. 1 Context and Objectives of the Study

The current regulation, **Regulation (EC) 1475/95, on motor vehicle distribution and after-sales servicing expires on 30 September 2002**. On 15 November 2000, the Commission adopted a report assessing the regulation<sup>31</sup>.

A few months ago, the European Commission began to determine whether the current Block Exemption should be extended, amended or whether a new legislative regime should be established.

Various initiatives have been taken, including:

- A report commissioned from Autopolis in November 2000 analysing the natural link between sales and after-sales service;
- A report on car price differentials in the European Union commissioned from the Katholieke Universiteit Leuven (KUL) and the Centre for Economic Policy Research (CEPR);
- A hearing in February 2001, where representatives from across the car industry (traditional and potential players) together with consumer groups expressed their views on the report mentioned above and on the implementation of a new legislative regime for car distribution<sup>32</sup>.

From the hearing that took place in February 2001, it is evident that:

- Most **traditional players** in the car distribution industry are much in favour of the current Block Exemption;
- Other traditional players such as **independent repairers and spare parts suppliers** who are more active in after-sales service want the new legislative regime to provide the right answers for competition in the after-sales sector;
- New entrants (or would be new entrants) such as Internet players, the retail and financial sectors, are interested in entering the market and would therefore like legislation that allowed them to do so;
- Consumers (end consumers and fleet buyers) show much concern about price, choice of distribution channels and their freedom to choose the model they prefer. Consumers have stated they expect legislation that will allow the industry to change more rapidly.

In order to provide practical answers for the evolution of the industry, the Commission has decided to focus on five potential legislative scenarios for car distribution and to observe their impact on different criteria<sup>33</sup>.

The European Commission has selected Andersen to “*help the Commission in its task of describing and analysing the effects of the five legislative scenarios on all the parties involved in the process... in the macro- and microeconomic contexts, as well as the technical and statutory ones ...*”

The objectives of the study are to:

- Describe and analyse the effects of the five scenarios on competition, the market structure<sup>34</sup> and the end consumers;
- Describe and analyse the possible impacts of additional specific legislative options on the vehicle distribution and after-sales industry;
- Identify whether substantial differences might justify a different legislative regime for commercial vehicle distribution<sup>35</sup>.

<sup>31</sup> See the Commission's Internet site: [http://europa.eu.int/comm/competition/car\\_sector](http://europa.eu.int/comm/competition/car_sector)

<sup>32</sup> See the Commission's Internet site: [http://europa.eu.int/comm/competition/car\\_sector](http://europa.eu.int/comm/competition/car_sector). The Autopolis and KUL/CEPR reports are also available on the Commission's site.

<sup>33</sup> See the Commission's Internet site: [http://europa.eu.int/comm/competition/car\\_sector](http://europa.eu.int/comm/competition/car_sector)

<sup>34</sup> Impact on the different parties involved, warranties and recalls, product safety, quality and cost of distribution, employment and SME's.

<sup>35</sup> Commercial vehicles with a gross weight of over 6 tons (gross vehicle weight).

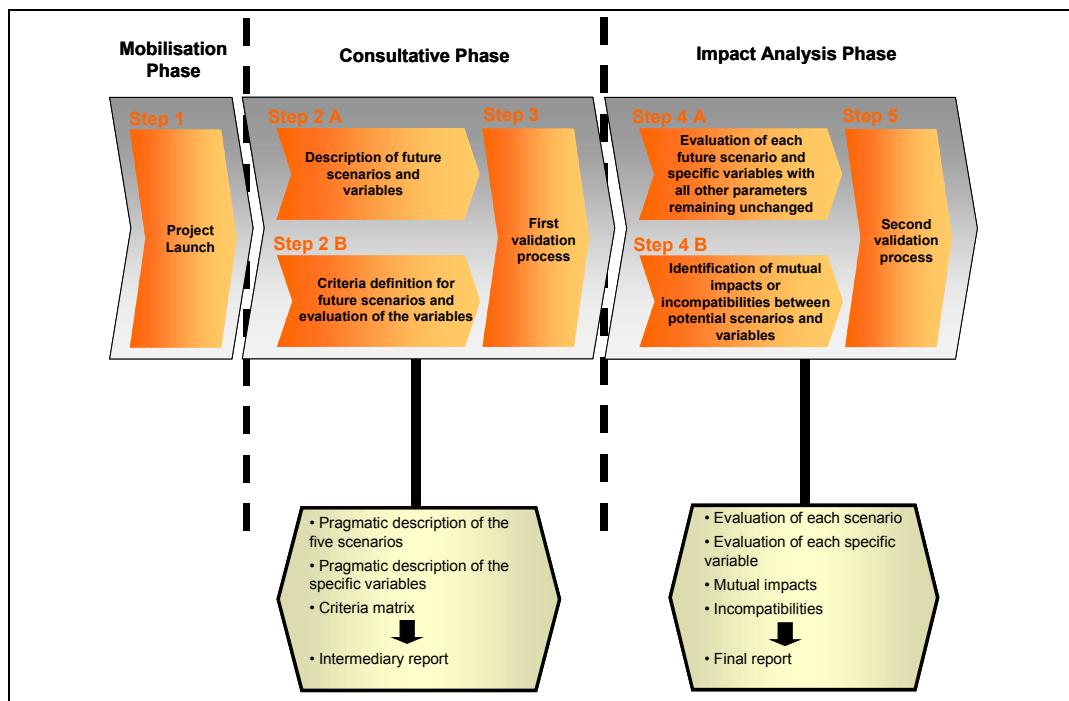
## I. 2 Approach of the Study

The following are the main features of the approach of the Andersen study:

- A **consultative process**<sup>36</sup>: the qualitative and quantitative<sup>37</sup> aspects of the legislative options laid down by the Commission have been discussed with major industry players in various European countries<sup>38</sup>;
- A **market-based approach**: founded on an in-depth analysis of the factors and emerging trends involved in the sales and after-sales markets;
- A **dynamic and system-based impact assessment** that is based on 'systems thinking' technique;
- A **quantification of indicators** that are central to the industry;
- A **sensitivity analysis of the impact of each legislative option**, which highlights the impact of the legislative options taken alone and combined.

The whole project involved three different phases:

- **Qualitative understanding** of the two main aspects of the scenarios (territorial exclusivity and selectivity) and the ten different variables relating to distribution and after-sales servicing in the motor vehicle industry. An interim report has been produced containing a description of each scenario and variable as well as the position of each stakeholder;
- **Quantitative information gathering** from desk-based research and a questionnaire sent to the major stakeholders. The purpose of the questionnaire was to highlight the quantitative impact of the scenarios and variables on several criteria such as the number of players, the vehicles sold, margins, prices and employment.
- **Analytical process** making intensive use of the systems dynamics tool to assess short- and long-term impacts of variables in combination and decision trees in order to eliminate irrelevant combinations. This process guarantees completeness and comparability.



- Diagram I.1 -

<sup>36</sup> During this study, meetings were held with 42 players.

<sup>37</sup> No statistical study to ensure data quality has been carried out. This aspect was checked during consultative meetings with industry players.

<sup>38</sup> Several Andersen Offices have been involved (London, Turin, Paris, Frankfurt and Brussels).

## I.3 Report Structure

The final report consists of three parts structured as follows:

### Part II: Industry Dynamics

On the one hand, this part aims to achieve an adequate understanding of the **current characteristics of the distribution and after-sales service markets**, and on the other, to provide a **dynamic impact analysis framework**. It is based on a summary of the qualitative interviews, the quantitative data collected and on the systems-based analysis. It identifies potential areas for improvement and risk factors that any new legislative regime should take into account.

### Part III: Legislative Options

This chapter provides an **understanding and analysis of the five legislative scenarios for distribution together with the various specific issues** (referred to as ‘variables’ in the context of this study) defined by the Commission in the Terms of Reference. The principle is to isolate the impact of each scenario or variable. The study assesses the extent to which these legislative options meet the set areas for improvement. It also reveals imbalances or other undesirable situations that are likely to arise.

### Part IV: Market Outcomes

The last part attempts to determine the **long-term market outcomes for the industry** through a comprehensive examination of possible developments of the system. These are described in detail and evaluated using the impact matrix described in the Terms of Reference.

**Finally, a matrix is used to define a link between market outcomes and the legislative approach in Part III. This results in a large number of possible legislative scenario and variable combinations.**

This approach facilitates a **market-driven** analytical study, a **quantification** of the impact and a clear **sensitivity analysis** of each variable.

The detailed analytical process will be further explained as an introduction to each part of the report.

## PART II: Industry Dynamics

### II. 1 Introduction

The Terms of Reference state that changes in the industry should be evaluated according to different **impact criteria or indicators** that may be structured in three planes:

- **Areas of competition**<sup>39</sup>, more specifically:
  - **Intra-brand competition**: competition between distribution or service players in terms of products of the same brand;
  - **Inter-brand competition**: competition between groups of manufacturers<sup>40</sup>;
  - **Market integration**: the level of integration of European markets evidenced by the level to which selling prices (excluding tax) of new vehicles have converged;
  - **After-sales competition**: competition between players in the after-sales service market.
- **Customer satisfaction**<sup>41</sup> centres around four main factors:
  - **Product innovation**: number of brands, models, options, and the launch cycle of new models. This aspect reflects the consumers' need for choice;
  - **Customer-tailored contact**: a specific response adapted to the needs of each category of consumer, ready access to information, the opportunity for a test drive, access to the entire network of 'official' repairers, choice of spare parts;
  - **Reliability**: reliable delivery, coverage of service outlets, value for money of specialised repair, safety, warranty and recalls of the vehicle supplied;
  - **Price**: the price level of sales of new vehicles and the various after-sales service activities, price transparency and comparability bearing in mind the Euro and on-line price comparisons.
- The **positions of the six categories of players**<sup>42</sup> in the industry whose expectations may be summarised as follows:
  - **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** (sales and after-sales service) work to optimise their activities and protect their investments;
  - **New entrants** (or would-be new entrants to the industry) want to penetrate certain markets (particularly distribution of new vehicles);
  - **Other after-sales players** (independent repairers) seek to sustain their market share;
  - **Spare parts manufactures** (makers of spare parts and diagnostic systems) besides protecting their investments, spare parts manufacturers seek to derive additional revenue from second-fit parts;
  - **Consumers** are looking for total satisfaction of their needs (sales and after-sales) of which there is a great diversity. Fleet buyers, for instance, have specific needs.

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<sup>39</sup> Paragraph (1) of the Terms of Reference.

<sup>40</sup> The analysis of inter-brand competition will be carried out on the aggregation of all segments considered as one Community-level market.

<sup>41</sup> Consumer satisfaction is referred to in paragraphs (17), (18) and (24) of the Terms of Reference.

<sup>42</sup> Paragraphs (19) and (25) of the Terms of Reference.

Part II is intended to define the **impact analysis framework** and is structured as follows:

- Part II.2. describes the **current situation** on the sales and after-sales markets and highlights the key trends and issues;
- Part II.3. presents a **system-based reference model** whose components are the main impact criteria defined by the Commission. Andersen has developed this model on the basis of discussions and analyses carried out in the course of the study. It is structured around four inter-related generic loops that are characteristic of the industry. For each of these loops, the analysis gives a quantification of the current situation using key indicators.
- The conclusion summarises the main **areas for improvement and the risk factors** that should be considered when assessing the effects of any new legislative regime.

Furthermore, to make this report more readable, the various numerical analyses and the information collected at meetings with the main players have been brought together in the appendices. Only the key points and summaries of quantification are included in the following parts<sup>43</sup>.

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<sup>43</sup> Previous reading of the appendices is required.

## II. 2 Overview of the Sales and After-Sales Markets

### II.2.1 Sales Market

#### II.2.1.A. Preliminary remarks

Analysis of the automobile industry is inconceivable unless its basic characteristics are taken into account. Because a vehicle is so common, it is often regarded as a mass-market, large volume product. In fact, **the car is a unique product** since:

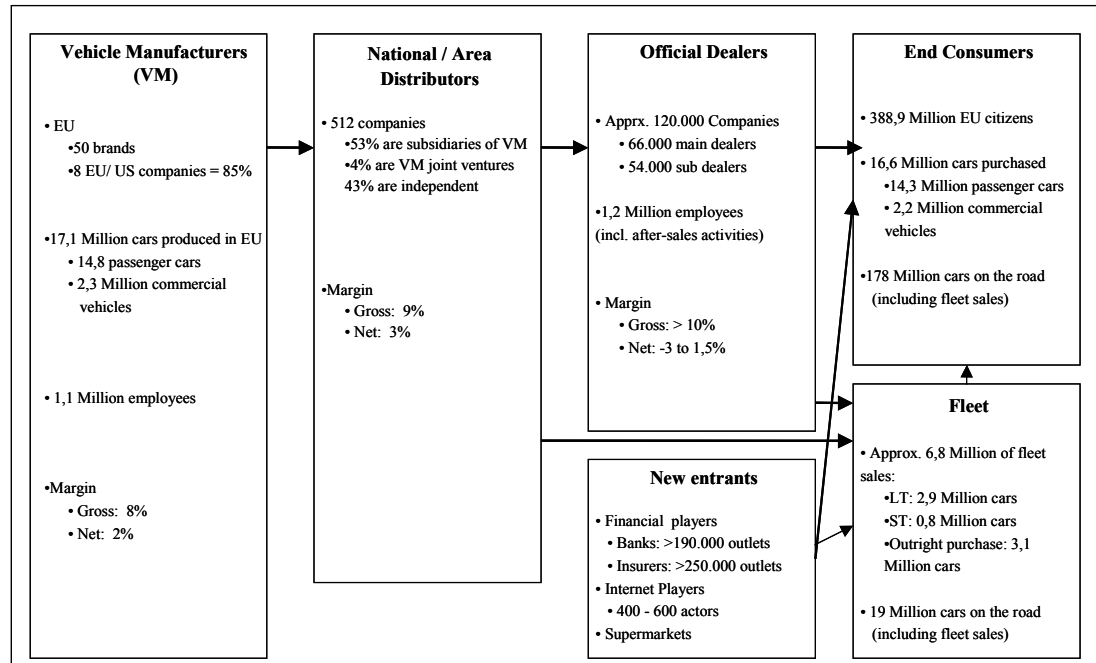
- It has a strong influence on its users' way of life (mobility and organisation of tasks);
- It requires major investment (+/- 18,000 Euro);
- Its life expectancy is increasing (currently to more than seven years);
- Its everyday use is becoming simpler although its complexity is increasing;
- Its use and maintenance require increasingly specialised service.

The industry processes still continue to undergo significant production changes (lean production) together, nowadays, with developments in distribution (lean distribution and new players).

## II.2.1.B. Overview of the market<sup>44</sup>

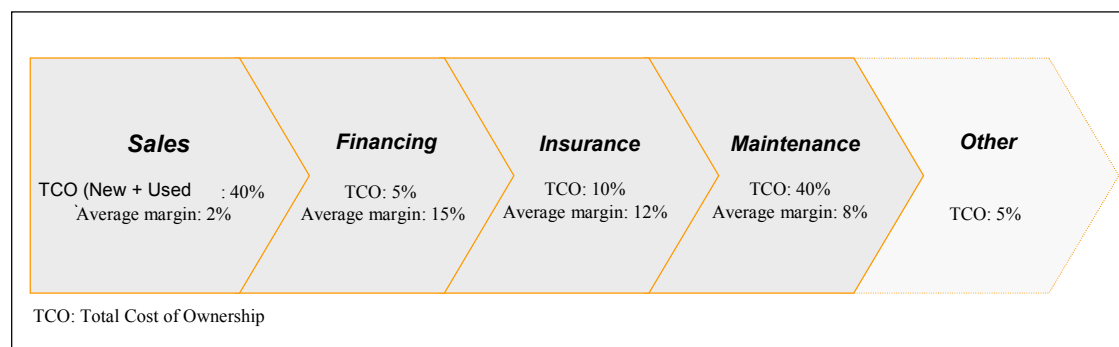
**New car sales is a large stable market.** Distribution is only marginally attractive due to low margin, yet it is a crucial part of the value chain and is in the course of being restructured.

The table below presents key figures about the main players in the sales market:



- Diagram II.1 -

In the car industry, **the purchase price concept is evolving to one of 'Total Cost of Ownership' (TCO)**<sup>45</sup>. This phenomenon is gaining pace thanks to players in other areas of 'TCO' (banks, insurance companies) seeking to profit from their customer contacts by penetrating the car distribution market.



- Diagram II.2 -

**The attractiveness of car sales is consequently diminishing** to the benefit of upstream activities like optimisation of production and projects, but also of downstream activities with high added value either for traditional activities (maintenance, financing...) or for new activities (fleets, leasing...).

<sup>44</sup> Cf. Appendices 1, 2, 3 and 4. All figures for European market in 2000.

<sup>45</sup> TCO = Total Cost of Ownership: it is equal to the total of the costs incurred throughout the life of the vehicle.

## II.2.1.C. Traditional trends

The traditional trends are listed below:

TRENDS	FACTS	IMPLICATIONS	CHALLENGES
<b>CONCENTRATION OF PLAYERS<sup>46</sup></b>	Vehicle manufacturers and parts suppliers: <ul style="list-style-type: none"> <li>- Reduction in the number of groups</li> <li>- Increase in the size of groups</li> <li>- Standardisation of components and production lines and reduction in stocks</li> <li>- Reinforcement of lean production and lean distribution by closer working relationships between players</li> </ul> Dealers: <ul style="list-style-type: none"> <li>- Reduction of the number of dealers and outlets</li> <li>- Distribution cost remains high</li> </ul>	<ul style="list-style-type: none"> <li>- Maximisation of volume</li> <li>- Minimisation of the number of components</li> <li>- Flow optimisation</li> <li>- Optimisation of margins</li> <li>- Integration of Information Technology systems (Dealer Management System - DMS)</li> <li>- Restructuring the network along the lines of a 'Hub and Spoke' organisation.</li> <li>- Optimisation of distribution costs</li> </ul>	<b>Maintaining sufficient competition</b>  <b>Promoting access to information</b>  <b>Maintaining coverage</b>
<b>PROFILE OF DEALERS<sup>47</sup></b>	<ul style="list-style-type: none"> <li>- Changes in dealer shareholding and structures</li> <li>- Reduction in dealer profitability</li> <li>- Increase in dealer training</li> </ul>	<ul style="list-style-type: none"> <li>- Changes in the cost structure</li> <li>- Development of differentiated approach</li> <li>- Development of related products</li> <li>- Emergence of multi-brand groups</li> </ul>	<b>Guaranteeing innovation</b>
<b>PRODUCTS IN DEVELOPMENT<sup>48</sup></b>	<ul style="list-style-type: none"> <li>- Increase in the number of customer segments</li> <li>- Reduction of development time</li> <li>- Increase in the number of models</li> <li>- Accelerated technological developments</li> <li>- Increase in the number of options</li> <li>- Standardisation of some options</li> <li>- Reduction in the price/equipment ratio of base models</li> <li>- Increase in the number of individual customers purchasing multiple vehicles</li> <li>- Development of fleet buyers</li> <li>- Developments in Total Cost of Ownership</li> </ul>	<ul style="list-style-type: none"> <li>- Importance of knowledge</li> <li>- Optimisation of production costs</li> <li>- Products more and more specific</li> <li>- Simplification of some sales processes</li> <li>- Network restructuring</li> <li>- Increase in segmentation and customer knowledge</li> <li>- Investment in added-value businesses</li> </ul>	<b>Guaranteeing access to knowledge</b>  <b>Allowing new practices</b>

- Table II.1 -

**The traditional players have become aware of customer volatility and the potential for development in car distribution.** They are therefore preparing for an increase in competition by:

- Adapting their service to the clientele (ISO certification, organisation, amalgamation, new services);
- Increasing the features of each product (technology, options, image);
- Integrating collection of information from each of the players (Dealer Management System – DMS).

The current network is thus progressively better controlled and better adapted to competition. Currently, the biggest challenge for manufacturers is to capture customers (via Customer Relationship Management and Data Mining types of projects) in order to better compete with potential new entrants who already have contact with customers (mass-marketers, large distributors) and/or better knowledge of their behaviour (financial players, Internet).

<sup>46</sup> Cf. Appendices 1 (Sales Market) and 2 (Current Sales Players (Dealers)).

<sup>47</sup> Cf. Appendix 2 (Current Sales Players (Dealers)).

<sup>48</sup> Cf. Appendices 4 (Fleet Market) and 5 (Car Segmentation).



## II.2.1.D. New trends

The new trends are listed below:

TRENDS	FACTS	IMPLICATIONS	CHALLENGES
<b>CUSTOMER SEGMENTATION<sup>49</sup></b>	<ul style="list-style-type: none"> <li>- Segments differ in volume and profitability</li> <li>- Consumers value the individuality of their vehicles</li> <li>- Vehicle range are extended to cover consumer needs</li> </ul>	<ul style="list-style-type: none"> <li>- Price, service and volume depend on the segment</li> <li>- Reinforcement of distribution conditions</li> <li>- Reinforcement of barriers to the market</li> </ul>	<b>Taking account of the increased complexity of distribution</b>
<b>NEW PLAYERS<sup>50</sup></b>	<ul style="list-style-type: none"> <li>- Increase in demand for independent information</li> <li>- Increase in the information available via multiple channels</li> </ul>	<ul style="list-style-type: none"> <li>- Reinforcement of independent players</li> </ul>	<b>Promoting some competition and an innovation threshold</b>
<b>Internet</b>	<ul style="list-style-type: none"> <li>- Few Internet transactions</li> <li>- The Internet is involved in the sales process as an information channel</li> <li>- Considerable Internet presence of players and purchasers</li> <li>- Growing presence in 'Business to Business' relationships ('B to B') (sales and after-sales markets)</li> </ul>	<ul style="list-style-type: none"> <li>- Use of the Internet to distribute information</li> </ul>	
<b>Mass-distribution (supermarkets and car supermarkets)</b>	<ul style="list-style-type: none"> <li>- Growing interest in mass-marketing of cars</li> <li>- Increase in the ability of mass-distribution players to distribute cars</li> <li>- Mass-distribution cannot meet all the criteria</li> </ul>	<ul style="list-style-type: none"> <li>- Interest by mass-distribution but: <ul style="list-style-type: none"> <li>- In specific segments</li> <li>- In partnership with manufacturers</li> <li>- In higher risk business</li> </ul> </li> </ul>	
<b>Financial players</b>	<ul style="list-style-type: none"> <li>- Financial players offer two of the four components of TCO<sup>51</sup> (Total Cost of Ownership)</li> <li>- Financial players go for certain segments with relevant customer knowledge</li> <li>- Partners and products already exist</li> </ul>	<ul style="list-style-type: none"> <li>- Interest of financial players but: <ul style="list-style-type: none"> <li>- Mainly in selling their financial products while limiting their involvement in car distribution</li> </ul> </li> </ul>	
<b>Fleet companies</b>	<ul style="list-style-type: none"> <li>- Fleets are already major players that are becoming more than customers</li> <li>- Individual solutions are developing: diversification of services</li> <li>- A profitable approach</li> <li>- European players</li> <li>- Concentration</li> </ul>	<ul style="list-style-type: none"> <li>- Interest by fleets in: <ul style="list-style-type: none"> <li>- Maintaining their presence</li> <li>- Negotiating overall contracts</li> </ul> </li> </ul>	
<b>Other</b>	<ul style="list-style-type: none"> <li>- Specialisation of other sectors in particular techniques (administration, cross-border intermediary ...)</li> </ul>	<ul style="list-style-type: none"> <li>- Optimisation of production costs</li> </ul>	

- Table II.2 -

**The market has already taken on some new practices such as fleets and the use of parallel distribution channels.** Two things, however, are apparent. First, some players are concentrating on only particular activities in the value chain. Second, the Internet is being used as an information channel rather than as a transaction tool. New players such as banks, insurance companies and supermarkets would be more attractive to consumers than virtual tools at the point of sale level.

<sup>49</sup> Cf. Appendix 5 (Car Segmentation).

<sup>50</sup> Cf. Appendices 3 (New Entrants into the Sales Market) and 4 (Fleet Market).

<sup>51</sup> Financing and insurance together account for 15% of TCO with an average margin of 12 - 15% - See Diagram II.2

The various **business models of new entrants** will be analysed in greater detail in Part IV. For the time being, their development may be summarised as follows:

The Internet:

- The Internet induces a major change in behaviour that clearly influences the process of buying a vehicle. This is because the Internet is used as a channel for obtaining information and making comparison easier;
- The Internet plays only a very small role at the point of sale since it does not facilitate the sales agreement;
- Just like the Euro, the Internet will make comparison between vehicles easier as well as making the transfer of information between players easier (sales and after-sales).

Mass-distribution:

- These companies have developed a number of skills involving motor vehicle products (sale of particular products/services, performance of certain tasks) and have increasing European coverage;
- They want to capture an additional share of this substantial slice of the household budget<sup>52</sup>;
- Following factors may help these players to succeed:
  - A concentration on products that require limited support and space and that tie up few financial resources;
  - Sufficient price discounts attract customers (minimum 10%) and cover charges (+/- 5%) generate a margin (except if the product is used only as a to attract customers).

Financial players:

- These players have already developed some initiatives and wish to extend them to all their motoring products including package financing (such as maintenance)
- They wish above all to preserve and develop their core business and see car distribution as a means of penetrating upstream markets.
- They do not want to develop additional skills in order to offer the sales agreement and delivery of the vehicles but seek to involve themselves.

Fleet companies:

- These already have a strong presence (40% of sales) although delivery of the vehicle is still done by the dealer;
- They are having an ever greater influence on the behaviour of their customers – and not only in after-sales activities;
- They seek to optimise every link in the value chain by developing specific partnerships for fuel cards, tyres, insurance;
- They are beginning to offer structures at the European level whose use can be maximised. They are capable not only of satisfying certain of their customers' needs but also of enabling market-wide tendering;
- Service outlets that are partners of the major fleet companies may gain business from after-sales work done on cars registered to fleet buyers.

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<sup>52</sup> Household budget, after food and excluding investments.

## II.2.1.E. Customers and markets

<i>Passenger car sales per segment (2000)</i>								
Segments:	A	B	M1	M2	M3	H	Others	Total in millions
Car registered								147,8
New car sales	5,8%	14,7%	27,0%	20,2%	7,6%		24,6%	14,8
Used car sales								32,88

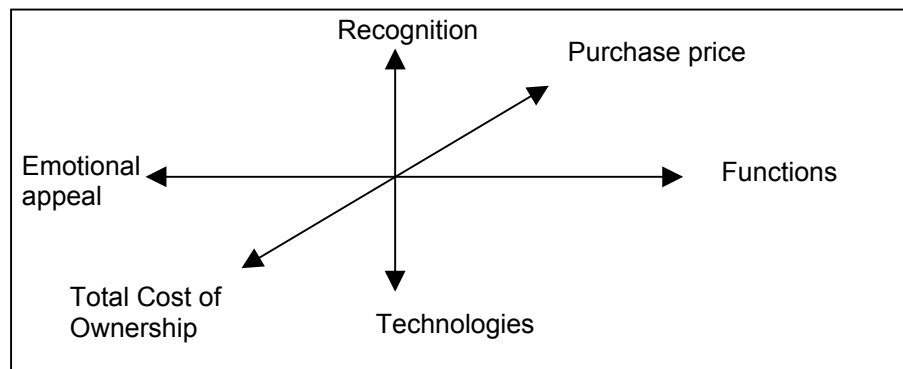
Source: Andersen estimation; VDA 2001 data report; Distribution Automobile; Datamonitor: The impact of Vehicle Manufacturers in the European Aftermarket 2000 - Western Europe

- Table II.3<sup>53</sup> -

The traditional segmentation illustrated above is changing, as it needs to take account of the greater importance of such factors as:

- Customer needs are becoming more and more specific (to cover 90% of customer needs, a manufacturer must often offer 30 different versions<sup>54</sup>). These needs vary according to customer categories (for example, private and corporate customers);
- The availability of alternative channels (other networks, the Internet, long-range contacts...) and the availability of mixed products like maintenance, fleet management, fuel or products specific to cars (insurance, financing ...) <sup>55</sup>;
- The emergence of some segments in which the car is regarded as a commodity (basic models and end-of-life models)

In the majority of segments, there is greater specificity of expectations arising from increasing complexity in segmentation, such as shown below:



- Diagram II.3 -

The example in the diagram above highlights the increasing complexity of segmentation. Customer categories are differentiated according to their preferences and interests, which includes functional needs and price, but also includes the image of the vehicle, degree of technological advancement and the 'Total Cost of Ownership'.

The evolution of customer segmentation has an impact on the diversity of products.

<sup>53</sup> This is the most generally used segmentation. It defines the smallest (economy) models (Lupo, 106...) as Type A, sub-compacts (VW Polo, Ford Fiesta...) as Type B, compacts (Fiat Stilo, Ford Focus, VW Golf...) as Type M1, medium (Alfa Romeo 156; BMW 3 series; Audi A4;...) as Type M2, premium (Peugeot 607, BMW 5 series, Audi A6...) as Type M3, luxury models as Type H (Audi A8, Mercedes S-Class, BMW 7 series ...), with utility vehicles, off-road vehicles, MPVs, minibuses ... in others.

<sup>54</sup> Cf. Appendix 5 (Car Segmentation).

<sup>55</sup> Cf. Appendix 3 (New Entrants into the Sales Market).

In addition, certain countries differ from others because of:

- National tax system that gives rise to price differences<sup>56</sup>;
- The presence of domestic manufacturers who often have an advantageous market position (on the basis of their network and/or preference for domestic brands)<sup>57</sup> with higher prices as a result;
- A population density that allows for different coverage and behaviour<sup>58</sup>;
- Greater or lesser use of alternative channels.

#### II.2.1.F. Summary of the current situation (sales)

**Car distribution is evolving** and the challenge it faces is not simply the increase in competition for each player, but also its ability to promote the following:

- Mastery of knowledge that is more and more specific and specialised (cf. increase in technical skills and integration of new technologies);
- The integration of new forms of distribution that seek above all to draw value from customer contacts and to make what is on offer more tempting (the sole factor capable of regenerating growth in demand);
- The freedom to sell vehicles across countries, which is particularly impaired by the absence of tax harmonisation. Manufacturers do in fact tend to set their prices by country taking taxation into account in such a way as to preserve their margins or market share.

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<sup>56</sup> Cf. Appendices 1 (Sales Market) and 9 (Taxation).

<sup>57</sup> Belgium, the Netherlands and Denmark may be considered the markets with the most undistorted competition since none of them have domestic manufacturers.

<sup>58</sup> Cf. Appendix 2 (Current Sales Players (Dealers)).

## II.2.2 After-sales market

### II.2.2.A. Preliminary remarks

For several reasons, the after-sales services market is a **complex** one characterised by the following factors:

- Strong interdependence between distribution of spare parts and service activities (maintenance, repair and body work);
- A multiplicity of players with different skills (specialists vs. generalists vs. niche players), conflicting interests (mass distribution vs. specialised service), different customer strategies (access to customers vs. increased retention).

The following external factors also influence the market:

- The increase in the number of vehicles and their increasing average age<sup>59</sup>;
- Regulatory pressure on technical controls and environmental measures;
- The sophistication of vehicles and similarly their components;
- The increasing reliability of vehicles and their components<sup>60</sup>;
- The increasing number of models and versions<sup>61</sup>.

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<sup>59</sup> Cf. Appendix 1 (Sales Market).

<sup>60</sup> Cf. Appendix 7 (After-Sales Customers).

<sup>61</sup> Cf. Appendix 5 (Car Segmentation).

## II.2.2.B. Overview of the market<sup>62</sup>

Due to high margins, after-sales servicing is a **market with growing attractiveness**.

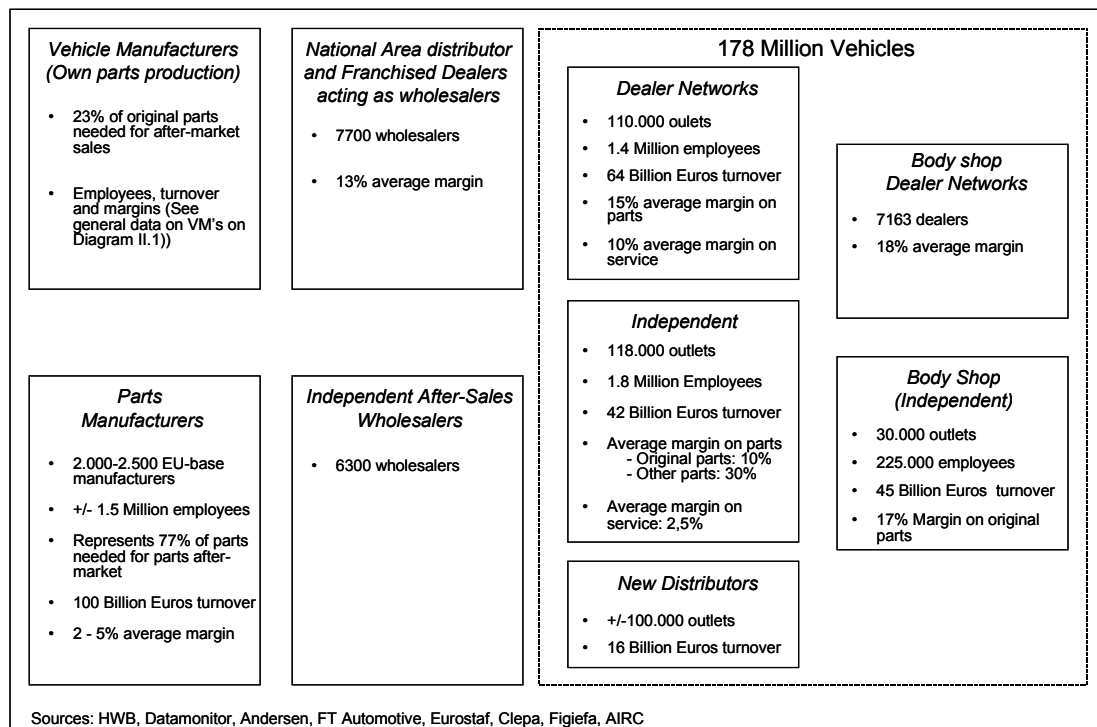
The European after-sales market is a large one in so far as:

- Today, there are more than 170 million private and commercial vehicles on the road in Europe;
- The total market is estimated to have a value of one third of that of the market for new cars;
- Margins are most commonly between three and six times higher than those found in sales;
- It represents an excellent opportunity for frequent direct contact with the customer.

Nevertheless, sales agreements that bring together the acquisition and use of the vehicle should take into account the following characteristics of the market:

- The need to go through the manufacturer's network to benefit from the warranty;
- The vigorous competition already present in the after-sales market in terms of both number and type of players;
- The impact of fleets, which are increasingly directing their customers towards favoured players;
- The technical development of cars and the increasing need for information.

The table below presents key figures about the after-sales market:



- Diagram II.4 -

<sup>62</sup> Cf. Appendices 6 (After-Sales Market) and 8 (After-Sales Players).

The table below reflects the market for spare parts distribution and performance of services, built up around four main activities:

Supplier turnover and profit contribution		
(2000)	% of Total After-Sales Market	Billion Euro
Accident and repair work	37,3%	46,0
Parts and accessories	35,7%	44,4
Services	21,7%	27,1
Tires	5,3%	6,7
TOTAL	100,0%	124,2

Source: Impact of VM's in the European Aftermarket, Datamonitor, 2000

- Table II.4 -

### II.2.2.C. Traditional trends

The table below lists traditional trends:

TRENDS	FACTS	IMPLICATIONS	CHALLENGES
<b>FREQUENCY OF VISITS<sup>63</sup></b>	<ul style="list-style-type: none"> <li>- In just over five years we have gone from a system of services every 5,000 km to over 20,000 km in some car classes.</li> <li>- Increase in dealer investments because of the sophistication of equipment and training of new types of technician</li> </ul>	<ul style="list-style-type: none"> <li>- Less frequent but more technical jobs and hence after-sales activities that are shrinking and becoming specialised</li> <li>- Given technological progress and the self-diagnostic systems that are becoming widespread, this trend can only increase</li> </ul>	<b>Allowing new practices</b>
<b>REPOSITIONING OF PLAYERS<sup>64</sup></b>	<ul style="list-style-type: none"> <li>- Extensive segmentation of the after-sales market between a dozen participants</li> <li>- Large scale development of 'fast-fit' repair chains in Europe</li> <li>- Counter-attack on after-sales service by <b>manufacturers</b> using different strategies including developing fast-fit type operations</li> <li>- <b>Spare parts manufacturers</b> are subject to strong upstream pressure on margins to meet manufacturers' price demands and downstream because of manufacturers repositioning in after-sales service</li> </ul>	<ul style="list-style-type: none"> <li>- Establishment of a true product/market match meeting the needs of different customers for after-sales services (menu pricing system, fast servicing without appointment ...)</li> <li>- Extension of the offer of maintenance for any brand</li> <li>- Fundamental reorganisation of the network of after-sales dealerships along 'Hub and Spoke' lines</li> <li>- Increase in direct sales (making use of the direct access of spares manufacturers to end customers) and control of distribution costs by conventional channels by using the Internet/intranet</li> </ul>	<b>Adapting the market structures</b>  <b>Guaranteeing access to information</b>  <b>Maintaining sufficient competition</b>

- Table II.5 -

**The after-sales market has already been subjected to pressure from:**

- Greater professionalism requirements in product development and less frequent customer contact;
- The increase in the number of players and the development of alternative solutions.

The prospects for development of the sector are currently founded on:

- Continuing to restructure the traditional networks in order to keep and then recover market share;
- The progress of other players towards more complex work and products in order to preserve profitability.

<sup>63</sup> Cf. Appendix 7 (After-Sales Customers).

<sup>64</sup> Cf. Appendix 8 (After-Sales Players).

## II.2.2.D. New trends

The new trends are listed below:

TRENDS	FACTS	IMPLICATIONS	CHALLENGES
<b>DEVELOPMENT OF THE FLEET AFTER-SALES MARKET<sup>65</sup></b>	<ul style="list-style-type: none"> <li>- Reorganisation of fast-fit repair chains and independents</li> <li>- Appearance of new players in this market with their offers structured around various partners who carry out service</li> <li>- Internationalisation of the after-sales networks for all players</li> </ul>	<ul style="list-style-type: none"> <li>- Additional threat to the dealer network, which sees competition in its 'natural' market</li> </ul>	<b>Promoting market integration</b>
<b>THE IMPORTANCE OF PARALLEL AFTER-SALES SERVICES<sup>66</sup></b>	<ul style="list-style-type: none"> <li>- Slender margins on sales have given rise to services such as sales of accessories and finance that are not directly linked to the after-sales servicing.</li> </ul>	<ul style="list-style-type: none"> <li>- Increase in customer retention at dealer level on expiry of the warranty period</li> <li>- Need to develop partnerships to offer these services</li> </ul>	<b>Providing a framework that allows these services to develop</b>

- Table II.6 -

**The impact of fleet players' growing market share reinforces competition between types of player and quality of service.** The major challenge in after-sales is to guarantee close working relationships between all groups of players and an acceptable level of services (quality, coverage and price).

<sup>65</sup> Cf. Appendices 4 (Fleet market) and 8 (After-Sales Players).

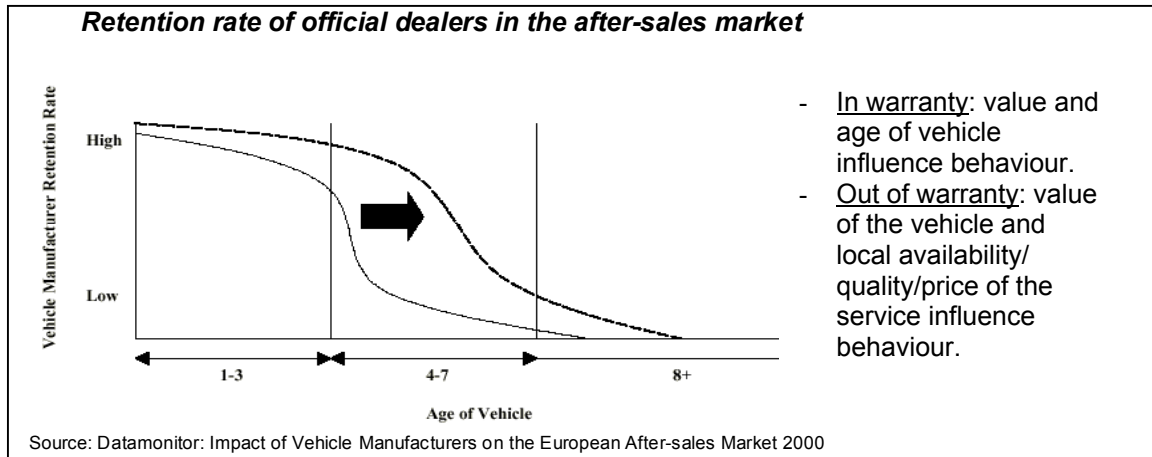
<sup>66</sup> See also Appendices 6 (After-Sales Market), 7 (After-Sales Customers) and 8 (After-Sales Players).



## II.2.2.E. Customers and markets

Today, the need to be present on the servicing market is considered to be fundamental by many players in the sector. This is not only a result of attractive margins and the frequency of customer contact – which is higher than in sales activities – but also because consumers have extended their requirements for satisfaction to the services which accompany the sale and possession of a car.

Customer behaviour changes over time (a significant share of vehicles that are more than four years old are lost to the official networks) and depends on the price of the vehicle, the type of work, and the owner. This trend is illustrated below and shows the impact of increasing the warranty period on customer retention by the official networks.



- Diagram II.5 -

Aside from providing services and repairing major breakdowns, the manufacturers' network remains an important player.

Finally, it should be noted that servicing coverage and choice are not uniform across Europe<sup>67</sup>. For example, distribution between the major customer types (private, corporate and fleet) varies according to urban vs. rural areas.

<sup>67</sup> Cf. Appendix 5 (Car Segmentation).

#### II.2.2.F. Summary of the current situation (after-sales)

The various after-sales players, be they dealers, independent repairers, manufacturers, spare parts manufacturers, parts suppliers, or specialised retailers, **all realise the strategic importance of the after-sales market and its link with sales activities** (sales agreement, 'Total Cost of Ownership' and warranty). Nevertheless, its development is putting pressure on various players since:

- Vehicles are ever more complex;
- There are tools that are brand-specific;
- Performance is increasingly dependent on investments in tools and best practices (e.g. databases of technical problems and diagnostic tools);
- There is vigorous competition.

Against such a background the major developments in the market revolve around:

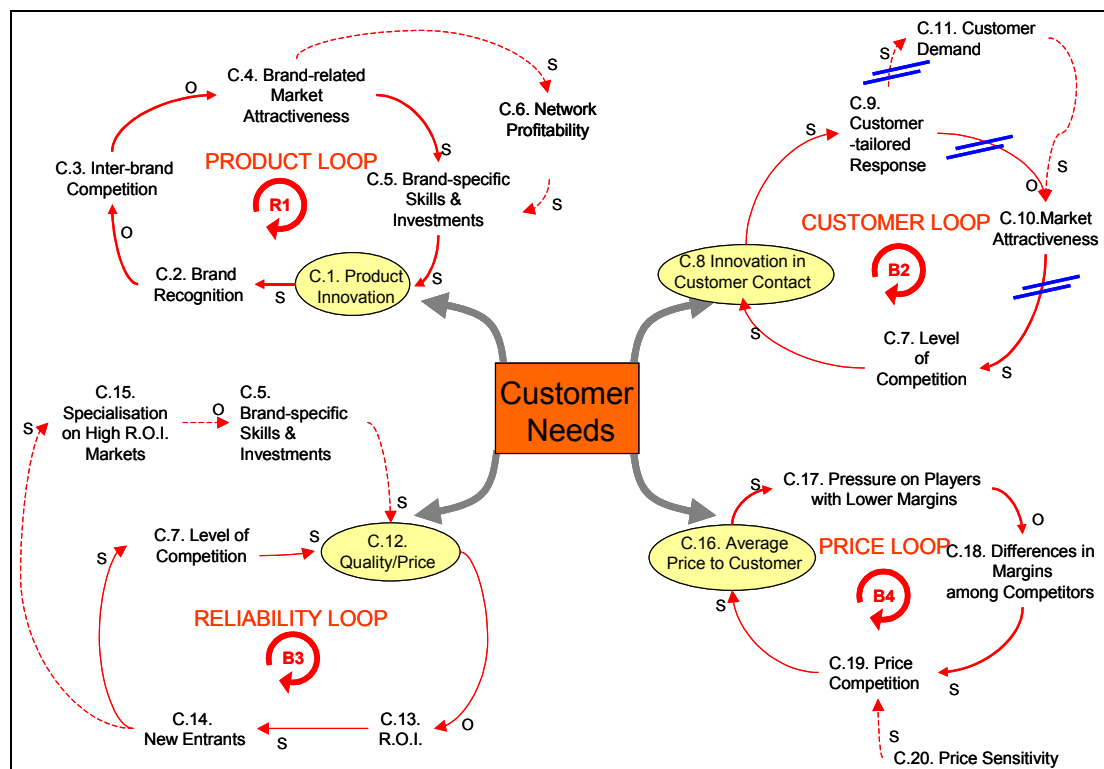
- Manufacturers re-positioning downstream;
- The desire of spare parts manufacturers to have access to final customers;
- The greater part the Internet will play in making information available and facilitating transactions;
- The extension of the range of activities of the 'new forms' of specialised distribution so as to be able to offer more complex repairs to models that are becoming more and more specific;
- The advent of a system of parallel services for managing various intermediaries and drawing value from customer contact;
- The need for all players to have access to the information and tools necessary to carry out ever more technical and brand-specific operations.

## II.3 Industry Causal Loops

From field research, Andersen has developed a system-based reference model, using the methodology of "system dynamics". This technique aims to analyse the cause and effect relationships between components. This way of thinking makes it easier to understand complex situations or systems. The 'causal loop diagrams' are chains of causes and effects that link components. These loops provide the simplification of reality necessary for analysing direct and long-term effects of any legislative change, regarded as external factors influencing the system.

The model below constitutes the central element and matrix of the report. **The four causal loops that are interrelated constitute a comprehensive framework to assess current and possible long-term states of the sales and after-sales markets.** They integrate the four dimensions of customer satisfaction and competition indicators.

The diagram below depicts the reference model:



- Diagram II.6 -

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. Dotted arrows indicate additional relationships that complement the basic loops. Moreover, although not depicted in this simplified diagram, all loops are interrelated.

The four causal loops illustrated above can be described as follows:

- The '**product loop**' points to the high level of integration within the automobile industry and the effect on innovation of joint investment practices among manufacturers and their official networks;
- The '**customer loop**' illustrates the potential benefits of greater innovation in the area of customer relations and related services;
- The '**reliability loop**' shows how the profitability of the various after-sales activities tends to balance itself out, bringing satisfactory results in terms of the quality/price ratio and the geographical spread of the sales and service outlets;
- The '**price loop**' illustrates the potential benefits of a more systematic price transparency.

Systems diagrams highlight only the most significant links among the various causal relationships that exist, rather than attempting to include all of them<sup>68</sup>. Common components as well as customer satisfaction levels (at the centre of the diagram) interconnect the four loops.

A distinction has to be made between two different types of loops, that is, the "balancing loop" and the "reinforcing loop":

- The balancing (B) loop essentially seeks to reach a level of equilibrium. If this loop is activated or de-activated the system will reach a new equilibrium.
- The reinforcing (R) loop has an exponential function when activated. It creates either a benevolent circle (in the case of a positive loop) or a vicious circle.

In the pages to follow, an in-depth analysis will be made of the following elements:

- The components of the 'loop' and the main relationships linking them;
- The existing levers: influence of external factors (aspects of the current legal framework or practices) and the industry players;
- Assessment of the current situation on the various sales and/or after-sales sub-markets;
- Assessment of the opportunities and risks and the identification of possible areas for improvement.

To conclude, a table will be presented summarising the information under the headings defined as follows:

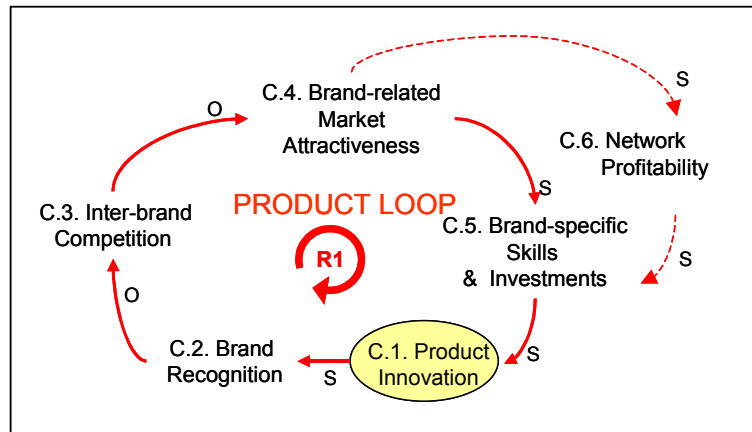
- Type of loop: reinforcing (R) or balancing (B);
- Current level of activation: high, stable or low;
- Current scope: sales and/or after-sales service;
- Quantified key indicators;
- Industry players acting as a driving force;
- Role of existing regulations: driving force, braking effect, neutral;
- Interdependence between loops;
- Impact on customer satisfaction;
- Impact on competition areas;
- Impact on market structure;
- Areas for improvement and risk factors.

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<sup>68</sup> Other components and links could probably be used to portray the industry, but the analysis results and interviews show that the four main loops illustrated provide the analysis with a sufficiently complete and simplified representation of industry trends.

### II.3.1. Product loop

#### II.3.1.A. Definition of the components and links



- Diagram II.7 -

The 'product loop' is a self-reinforcing loop driven by the brand-specific joint investment practices of the manufacturers and their official networks. The strong links between marketing policies sustain and reinforce product innovation and brand recognition levels.

<b>Product Innovation (C1)</b>	The product innovation level of a car manufacturer is reflected in the number of brands, the scope of the range and options and the rate at which it releases new models.
<b>Brand Recognition (C2)</b>	This component reflects the level of brand recognition and differentiation as compared with that of the competitors. The stronger the brand image, the less importance is usually given to the other aspects of customer satisfaction (such as the price, for example), as the 'product' in itself is the most important selection criterion.
<b>Level of Inter-brand Competition (C3)</b>	<p>Inter-brand competition is mainly dealt with in this loop.</p> <p><b>By building up strong brand recognition (C2), manufacturers of strong brands in particular, limit the level of inter-brand competition by creating protected sub-segments.</b></p> <p>While certain manufacturers manage to limit the level of inter-brand competition faced by their brands, <b>the overall level of such competition is generally quite high within the European automobile industry<sup>69</sup>.</b></p>

<sup>69</sup> There are a high number of brands on the market. 30 different brands are present in certain segments, such as the M1/M2 segments. Cf. Appendix 5 (Car Segmentation).

<b>Brand-Related Market Attractiveness (C4)</b>	<p>The level of competition faced by a brand has a direct impact on the attractiveness of the brand-related distribution and service markets.</p> <p>A distinction has to be made within the brand-related distribution and service markets between those markets over which the official networks have 100% control and markets that are more competitive.</p> <p>The <b>fully captive markets</b> include<sup>70</sup> :</p> <ul style="list-style-type: none"> <li>- New vehicle sales,</li> <li>- Original spare parts distribution,</li> <li>- Repairs covered by warranty,</li> <li>- Recall operations,</li> <li>- Complex repairs specific to the brand.</li> </ul> <p><b>Related markets in which competition is present</b> include<sup>71</sup> :</p> <ul style="list-style-type: none"> <li>- Used car sales,</li> <li>- Simple repairs not covered by warranty,</li> <li>- Maintenance.</li> </ul> <p>The degree of brand-related market attractiveness can be estimated by looking at the turnover of such markets, their growth rates, and average profit margins.</p>
<b>C4 -&gt; C6</b>	<p>At present, brand-related market attractiveness (C4) has a direct impact on the profitability of the brand's dealers and repair services. The relationship between C4 and C6 depends <b>on the level of competition (intra-brand and after-sales competition)</b>. This means that the relationship is stronger if:</p> <ul style="list-style-type: none"> <li>- Competition between the brand network dealers is limited;</li> <li>- There are many activities in which official dealers have a monopoly;</li> <li>- The foothold of independent repairers in markets open to competition is limited.</li> </ul>
<b>Network Profitability – (C6)</b>	<p><b>The average profitability of traditional dealers rests on their ability to offer a bundle of distribution and after-sales services</b>, which is required for generating extra profit.</p>
<b>Brand-Specific Skills and Investments – (C5)</b>	<p>The more attractive the brand-related market (C4) and the more profitable the networks are (C6), the more income is generated to support this component (C5). This is reflected in the marketing costs and the level of brand-specific investment:</p> <ul style="list-style-type: none"> <li>- <b>Marketing costs represent 10 to 15% of the overall costs</b> related to the sale of new vehicles while overall <b>distribution costs represent around 30%<sup>72</sup></b>;</li> <li>- <b>Brand-specific investments</b> are funded partly <b>by the manufacturers and importers</b> and partly <b>by the dealers</b>;</li> <li>- <b>The scale of the funds needed for such investments (and the need to invest both in sales and after-sales) constitutes a serious obstacle for new entrants.</b></li> </ul>
<b>C5 -&gt;C1</b>	<p>Product innovation and risk taking are stimulated thanks to the manufacturers' full command of the distribution channels for each model of the vehicle range.</p> <p>Conversely, a fall in the level of brand-specific investment by distributors choosing to focus on the most popular models would weaken the manufacturers' ability to launch new products or to sell models with less requested specifications.</p>

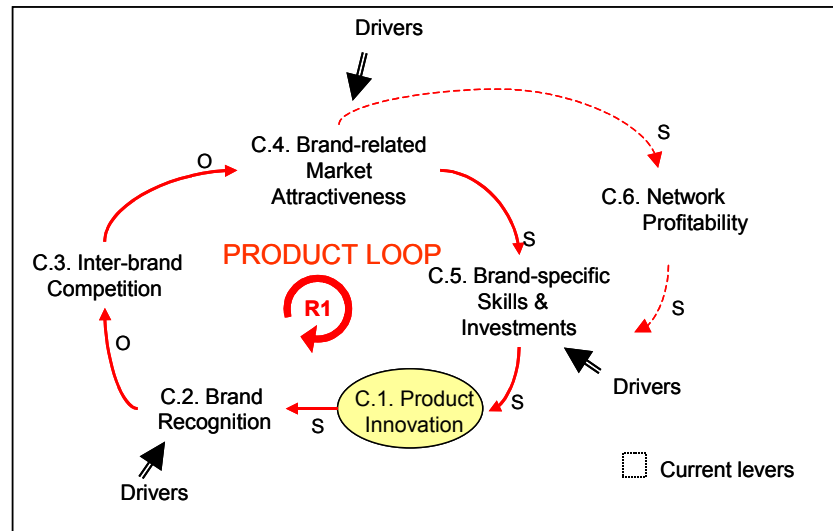
<sup>70</sup> New car sales in 2000: 16.6 million cars. Cf. Appendix 1 (Sales Market); value of spare parts market: 46 billion Euros. Cf. Appendix 6 (After-Sales Market).

<sup>71</sup> See table II.4. for a detailed breakdown of the after-sales sub-markets (repair, parts, service and tyres).

<sup>72</sup> On average, the marketing costs represent about 12% of the cost of a car, which can be broken down as follows: 9% borne by the car manufacturer, 1.3% by the importer, and 1.9% by the dealer ( Cf. Appendix 13 (Modelling Exercise 4- Distribution costs).

### II.3.1.B. External factors

The diagram below illustrates the impact of the various external factors on the 'product loop', whether they are features of the existing distribution system (and the legal framework) or new practices observed in the industry. It also demonstrates whether these factors act as a driving force or have a braking effect on the various loops. A description is given of each of the factors along with an indication of the key industry players.



- Diagram II.8 -

	Influencing factors	Players	Influence		Description
			On :	Impact <sup>73</sup>	
Features of the existing distribution system					
1	Brand exclusivity	Manufacturers	C2	<u>Driving force</u>	The distribution and service channel is a key factor in conveying the values and image related to the brand.
2	Link between sales and after-sales servicing	Manufacturers	C5	<u>Driving force</u>	Under the obligatory sales/after-sales link (all dealers must be able to repair all the brand models), the manufacturers ensure a level of skills and investment in the brand, not only in relation to product knowledge and sales processes but also in terms of service.
3	Method of dealer remuneration	Manufacturers	C5	<u>Driving force</u>	The method of dealer remuneration is usually based on bonuses linked to qualitative criteria as well as to quantitative sales targets. Such payment methods promote loyalty to the manufacturers' marketing policies.
4	Exclusive distribution of original spare parts through the network	Manufacturers	C4 et C6	<u>Driving force</u>	The distribution of original spare parts represents a captive, high profit margin sub-market for the official networks. This factor thus strongly reinforces the attractiveness of brand-related markets <sup>74</sup> .
5	Qualitative selectivity	Manufacturers	C5 et C2	<u>Driving force</u>	The qualitative selection criteria imposed by manufacturers within the context of the current 'Block Exemption' serve to strengthen the level of skills and investment in the brand as well as the brand image.

<sup>73</sup> The factors highlighted or underlined are the most important factors, that is, those with the greatest impact on the loops.

<sup>74</sup> See above the description of this component.

	Influencing factors	Players	Influence		Description
			On :	Impact <sup>75</sup>	
Emerging practices					
6	Quantitative selectivity – sales targets for the whole range	Manufacturers	C5	<u>Driving force</u>	The quantitative selectivity criteria imposed by manufacturers within the framework of the current 'Block Exemption' serve to strengthen the level of skills and investment in the brand, given that they place dealers under the obligation to supply all the models.
7	Territorial exclusivity	Manufacturers and Official Networks	C6	<u>Driving force</u>	Territorial exclusivity granted to the players within the brand networks is key to protecting investments.
8	The Internet	Manufacturers and official networks	C2	Driving force	The Internet represents an additional communication and information tool for manufacturers and their networks and also promotes inter-brand competition.
			C3	Brake	
9	Capture of market share by new entrants	Fleet companies, Potential new entrants, "fast-fit" repair chains	C4	<u>Brake</u>	The erosion of traditional players' market share in the sub-markets historically controlled by the official networks has a major braking effect on the product loop.
			C2	<u>Brake</u>	New entrants tend to weaken the brand image promoted by the official networks.
10	Increased technical complexity	Manufacturers	C5	<u>Driving force</u>	Higher vehicle specification tends to require brand specialists in repair services. It ensures a degree of exclusivity on the tasks brand repairers perform.

- Table II.7 -

<sup>75</sup> The factors highlighted or underlined are the most important factors, that is, those with the greatest impact on the loops.



### II.3.1.C. Current situation

**As it stands, the automobile industry tends to reinforce the level of product innovation** (speeding up the launch of new models, expanding the range) at the same time as **the strategies currently deployed by manufacturers favour joint investments within their networks.**

As shown in Table II.7. above, the **product loop** is **catalysed by the existing legal framework.**

The **official brand networks** form a **key aspect** of this loop. The **fragile** nature of these networks is shown in the analysis of a typical dealer's current profitability (see table below) as well as the impact of lower margins and a decline in their market share. Hence, the key indicators<sup>76</sup> referred to below will form the basis of the impact analysis within the framework of the product loop (R1).

Profitability of Official Networks		Current Situation
P R O D U C T  L O O P	<b>Average size</b>	
	Average number of vehicle sales per dealer and per year	300
	Annual turnover	9 m. Euros
	<b>Product mix (% of turnover)</b>	
	New car sales	55%
	Spare parts	10 to 15%
	Repairs	7 to 10%
	<b>Profitability</b>	
	Global operating margin	1.05%
	Contribution margin on sales of new vehicles	2.9%
	Contribution margin on sales of parts	18%
	Contribution margin on repairs	13%
	General costs (% of turn over)	2%
	Property costs (% of turnover)	1.6%

- Table II.8 -

In 2001, the typical dealer is expected to sell about 300 new and 260 used cars. Although more than half of turnover is generated by new car sales, this element of the product mix represents only 32% of the total contribution margin i.e. the percentage of each sale that remains after the variable costs are subtracted. This can be explained by the low margin (2.5%) on the new car sales, compared with the other elements of the product mix (bodywork, mechanical services and spare parts). This table shows that after-sales activities, more specifically sales of spare parts, bodywork repairs and mechanical services are crucial to the survival of dealers since these three activities contribute about 60% of their total margin. Finally, the operating profit of a typical dealer is expected to amount to only 1.05% of turnover.

<sup>76</sup> A detailed analysis is presented in Appendix 10 (Modelling Exercise 1 – Dealers' Profitability) of the present report.

#### II.3.1.D. Opportunities and risks

##### Risks related to a decrease in the speed of activation of the product loop:

**If a downward trend were to develop, risks would include short-term disruptions and a weakening of the official dealers.**

Limiting the manufacturers' ability to develop an integrated strategy with their official dealers would lead to the implementation of **alternative distribution strategies**. These alternative strategies would focus on investing in other distribution channels by forming partnerships, or on moving in the direction of vertical integration. Such moves would constitute defence strategies aimed at preserving the product loop under a different format.

Nonetheless, in the short term, the weakening of the official dealers, and particularly those of the weaker brands, would have a series of negative repercussions on the geographical coverage of the service outlets, the quality and reliability of service, and the price of complex and brand-specific repair works.

##### Risks related to an increase in the speed of activation of the product loop:

**Risks related to the self-reinforcement of the loop include barriers to the access of new specialised players that would result in reduced competition.**

If a counterbalance to this loop is not established a continuous need for ever-larger investments for entry to the distribution and after-sales markets would occur, as well as the obligation to adopt the integrated business model used by manufacturers and dealers. There is a risk that **the barriers to the access** of specialised players to certain sub-markets would be **reinforced**.

This risk would be all the greater in the after-sales market. The complexity of diagnostic tools and the growing integration of vehicle components and systems tends to limit the access of independent repairers and multi-brand specialists.

Therefore, the shortfall in competition could lead to the formation of oligopolies and to reduced price competition.

### II.3.1.E. Conclusion

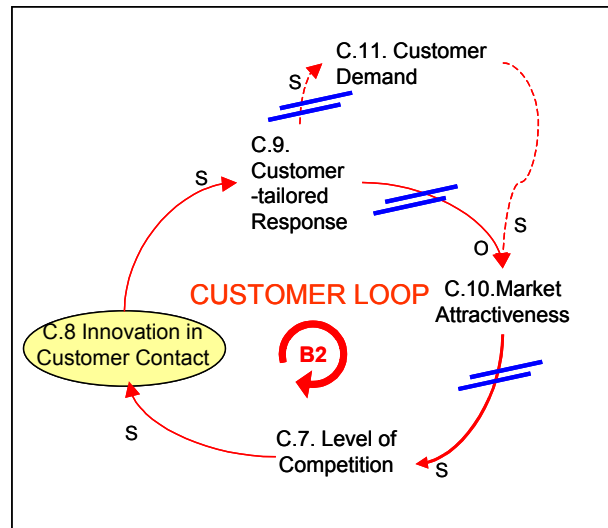
The main features of the product loop can be summarised as follows:

<b>Type of loop</b>	The product loop is a self-reinforcing loop that favours product innovation
<b>Speed of activation</b>	High, based on joint operations between a manufacturer and its network
<b>Focus</b>	Sales and after-sales
<b>Quantified indicators</b>	Profitability of the official dealers
<b>Players that exert a driving force</b>	Manufacturers and official dealers
<b>Influence of regulation</b>	The legislative framework acts as a driving force
<b>Influence on other Loops</b>	<p>This loop tends to:</p> <ul style="list-style-type: none"> <li>• Limit the consumer's sensitivity to the price (C20) and thus limit the level of price competition among brands (impact on B4);</li> <li>• Erect barriers to the sales and after-sales markets for new entrants through the imposition of tough prerequisites on access to the trade (impact on B2);</li> <li>• Reinforce the average level of reliability in the area of after-sales servicing (impact on B3) through strong skills building and brand-specific investment (C5).</li> </ul>
<b>Impact on customer satisfaction</b>	<p>(+) Positive impact on choice          (+) Positive impact on the quality of after-sales service          (-) Negative impact on the average price level</p>
<b>Impact on areas of competition</b>	(-) Decreased inter-brand competition
<b>Impact on market structure</b>	<p>(+/-) Differences in margins among strong and weak brands          (+) Reinforcement of the official dealers' profitability (through the protection of their investments)          (+/-) Erection of access barriers for new entrants</p>
<b>Areas for improvement and risk factors</b>	<p><u>To improve:</u></p> <ul style="list-style-type: none"> <li>• Market access</li> <li>• Distributors gain independence from the marketing policy of the manufacturer</li> </ul> <p><u>To monitor:</u></p> <ul style="list-style-type: none"> <li>• Profitability of brand dealers</li> <li>• Brand policy</li> </ul>

- Table II.9 -

## II.3.2. Customer loop

### II.3.2.A. Definition of the components and links



- Diagram II.9 -

**The customer loop is a balancing loop (B) that seeks stability in the market share of the various distribution and/or service channels.** Depending on how innovation in customer contact affects customer demand, the outcome may simply be a **re-distribution of the market share among the players** or, perhaps, a **change in the demand profile** (marked growth in certain segments or overall increase in demand).

#### Market Attractiveness (C10)

This component refers to one or several distribution and after-sales sub-markets. As previously mentioned in the definition of product loop component C4 (Brand-related market attractiveness), the level of market attractiveness is linked to the turnover and growth levels in those markets as well as the average margins.

For example, **the market for new car sales is less attractive than the after-sales market**, given that margins and growth levels are much lower.

#### C10 -> Level of Competition (C7)

Market attractiveness (C10) gradually affects the level of competition (the delayed impact is represented in the diagram by the double lines that cross the arrow to indicate barriers between components) through the penetration of new entrants. This chain of cause and effect is, however, broken or weakened if access to a market is obstructed. As the markets now stand, the barriers to distribution are very strong while those to after-sales servicing are slightly less strong.

#### C7 -> Innovation in customer contact (C8)

**The level of competition (C7) stimulates market initiative, players' differentiation and innovation in the area of customer relationships.**

**Innovation in Customer Contact (C8)**

**Innovation in customer contact (C8) has taken on a variety of forms:**

- On the after-sales market, 'fast fit' repair chains have met the need for rapid, simple, and low cost operations in certain maintenance and simple repair work areas;
- Some players have focused on the need for total solutions throughout the life of the vehicle based on the 'Total Cost of Ownership';
- Others argue that category management represents a response to the need expressed by some customers for a better framework for comparison of the various brands and products;
- Finally, the emergence of virtual communications has opened up opportunities for innovation in the area of sales processes, contributing to greater information sharing (sales) and facilitating transactions (after-sales).

**Customer-tailored Response (C9)**

The degree of innovation and diversity in distribution and service channels tends to **reinforce customer segmentation** and improve the response to the specific needs of each segment.

**C9 -> Market Attractiveness (C10)**

As supply is brought in line with demand (C9) the market gradually becomes saturated and its attractiveness for potential new entrants diminishes. As a result, the balancing loop goes into reverse until a balance is reached in the market share held by the various channels and players.

**C9 -> Customer Demand (C11)**

This is an 'additional loop' to the balancing loop B2. **A better response to the needs of certain customer segments (C9) may lead to an increase in demand.**

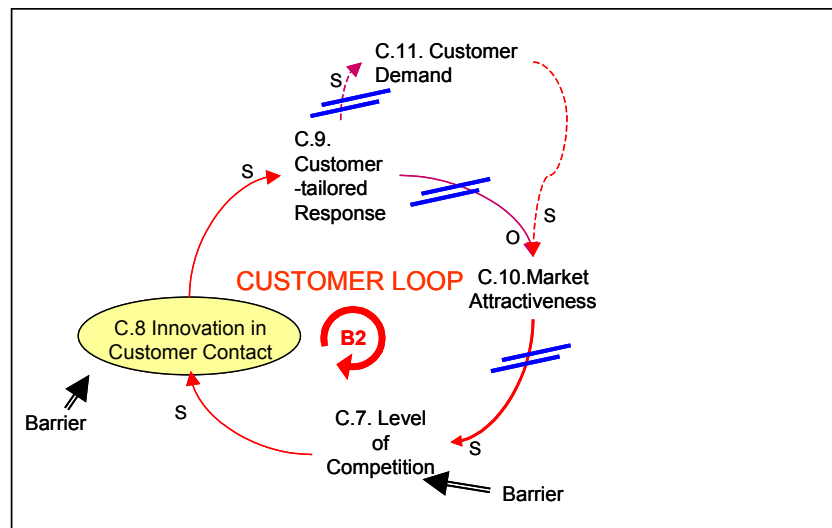
- This effect might be seen in the distribution of new vehicles, although the industry as a whole forecasts weak growth potential for demand.
- In regards to the after-sales market, the knock-on effect would only be felt in the area of ancillary accessory services, since the repair and maintenance markets are related to the sales market.

**C11 -> Market attractiveness (C10)**

Boosting demand (C11) is likely to heighten market attractiveness and thus activate the product loop, as indicated above.

### II.3.2.B. External factors

The external factors and players influencing the customer loop have been identified using the same methodology as the one applied above for the product loop.



- Diagram II.10. -

	Influencing factors	Players	Influence		Description
			On:	Impact <sup>77</sup>	
Features of the current distribution system					
1	Restrictions on multi-branding in distribution	Manufacturers	C8	<u>Brake</u>	Limits the scope for developing alternative business models and leaves initiative up to the traditional players.
2	Link between sales and after-sales servicing	Manufacturers	C7	<u>Brake</u>	Access barrier for other sectors (supermarkets, banking/insurance sector, Internet, ...).
3	Qualitative selection (related to sales processes)	Manufacturers	C7	<u>Brake</u>	Access barrier for players wanting to develop business models based on alternative sales processes (e.g. virtual channels).
4	Obligation to sell the entire range	Manufacturers	C7	<u>Brake</u>	Access barrier for players wanting to develop specific multi-brand responses to specific client segments.
5	Territorial exclusivity	Manufacturers and official networks	C7	<u>Brake</u>	Barrier to competition in the sales market.
6	Method of dealer remuneration	Manufacturers	C8	<u>Brake</u>	Barrier to the development of business models based on low-cost bulk sales.
Emerging practices					
7	Emergence of new business models in the vehicle sales market	Fleet companies	C7 et C8	<u>Driving force</u>	Stimulates innovation through the development of responses <b>more tailored</b> to the specific needs of new customer segments.
8	Emergence of new business models in after-sales servicing	'fast fit' repair chains	C8	<u>Driving force</u>	Better response to customers' need for quick and low cost service.
9	Internet	Manufacturers, networks, fleet companies	C8	Driving force	Integration of new practices already present in other sectors.
10	Direct sales	Manufacturers	C8	Driving force	More tailored response to the specific needs of fleet companies.

- Table II.10 -

<sup>77</sup> The most significant factors appear in bold type and are underlined.

### II.3.2.C. Current situation

The legal and economic barriers that exist in the new vehicle sales market and that would-be new entrants face, result in limited competition and in an **quasi-monopoly controlled by the official networks. Innovation in customer contact therefore relies on the initiatives taken by manufacturers and their official dealers.** There are some emerging initiatives that are intended to better address the needs of fleet companies, such as direct sales, the gradual development of the use of the Internet and the use of call centres as information channels.

**The most substantial innovation in final consumer relationships has been demonstrated in the activities of fleet companies** (leasing and others). Based on the complementary nature of the automobile and financing sectors, these players are able to create value for the end-consumer and provide the final customer with new options. **The experience of fleet companies shows how overall demand for new vehicles can be spurred<sup>78</sup> by providing a more tailored response to the specific needs of the final customer.**

**Other sectors are now showing an interest in investing in car distribution.** These potential new players either already have a client base (supermarkets) or have in-depth knowledge of consumer behaviour (financial sector, Internet). While they are interested in the margins to be gained from distribution, their primary interest lies in the complementary nature of the sectors and the subsequent cross-selling opportunities<sup>79</sup>.

**The speed of activation of the customer loop is much greater in after-sales servicing,** where over recent years many new entrants have fostered rapid innovation in the service offering<sup>80</sup>. Rapid innovation has also been seen in after-sales offerings. However, there is a gradual stabilisation in the players' market shares.

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<sup>78</sup> The development over recent years of fleet companies has boosted the sale of new vehicles by, for example, encouraging some final customer segments to buy a new vehicle rather than a used one.

<sup>79</sup> For example, boosting the sale of insurance products by promoting offers combining car and insurance sales.

<sup>80</sup> Priority given to satisfying customer needs, such as the desire for quick service ('fast fit' repair chains); development of package deals grouping certain after-sales services.

The table below illustrates how the market share is presently allocated among the various players in both sales and after-sales servicing markets:

Market Share		Current Situation
C U S T O M E R  L O O P	<b>Fleet / final consumer (sales)</b>	
	Fleet	40%
	<b>Sales by type of channel</b>	
	Official networks	90 to 98%
	Direct sales	2 to 10%
	Multi-brand dealers (% of network players)	24% on average
	<b>Car sales by segment</b>	
	Segment A/B (smallest economy and sub-compacts models)	23%
	Segment M1/M2 (compacts and medium models)	47%
	Other segments	30%
	<b>Sales by model</b>	
	Standard models and special line	35%
	<b>After-sales service by type of channel</b>	
	Official networks (% of overall market value)	53%
	Independent repairers (% of overall market value)	34%
	Fast fit chains (% of overall market value)	7%
	Other new channels (% of overall market value)	6%
	Official spare parts sold by official networks	63%

- Table II.11<sup>81</sup> -

This table compares the distribution of market share in sales and after-sales among the various players. The different types of segmentation used in this analysis are as follows:

Segmentation by type of consumer: the proportion of fleet buyers

Segmentation by type of distribution player: sales by official networks vs. direct sales by manufacturers.

Segmentation according to product segments: segments A/B (smallest economy and compacts models) vs. segments M1/M2 (sub-compacts and medium models) vs. other segments.

An estimate of the proportion of sales covering standard models and special lines is also mentioned.

In after-sales service, the different channels considered are the official networks; independent repairers; 'fast fit' repair chains; other new channels that are present in servicing.

<sup>81</sup> Cf. Appendix 11 (Modelling Exercise 2 – Market Shares) for a detailed breakdown of the figures and projections. Segment A/B, M1/M2 refers to the general segmentation presented in table II.3. It has also been observed (source = interviews carried out by Andersen) that approximately 35% of the models sold are standard and special series models, in other words, the type of models on which new multi-brand dealerships are most likely to focus.



#### II.3.2.D. Opportunities and risks

##### Risks related to a decrease in the speed of activation of the customer loop:

A decrease in the speed of the activation of the loop would be accompanied by **a lack of innovation in distribution and service structures**. This is likely to affect demand if: a) the artificial barriers continue to halt new distribution modes that provide a more tailored response to the emerging needs of certain client segments; b) the traditional partners (manufacturers and official networks) fail to develop innovative solutions. Manufacturers and their official networks have, however, shown their desire to be innovative in the area of sales processes with a number of recent initiatives such as the setting up of testing centres and the increased use of the Internet as an information tool.

##### Opportunities and risks related to an increase in the speed of activation of the customer loop:

Reinforcing the activation of the loop would most likely put **a strain on the profitability of traditional brand networks**. In the distribution market, when new entrants gain market share, it is likely to weaken the competitive edge of the traditional networks. Furthermore, the impact of market share losses in the service sector would be much greater than in the new vehicle sales market, given the low margins in this area.

**Substantially reinforcing the loop would modify the demand profile.** If the emergence of new business models leads to significant price reductions, a change in the demand profile is likely to occur, particularly in the case of mass-market segments. However, attention should also be drawn to the potential indirect impact of a reduction in the number of models or versions relative to current levels and needs.

### II.3.2.E. Conclusion

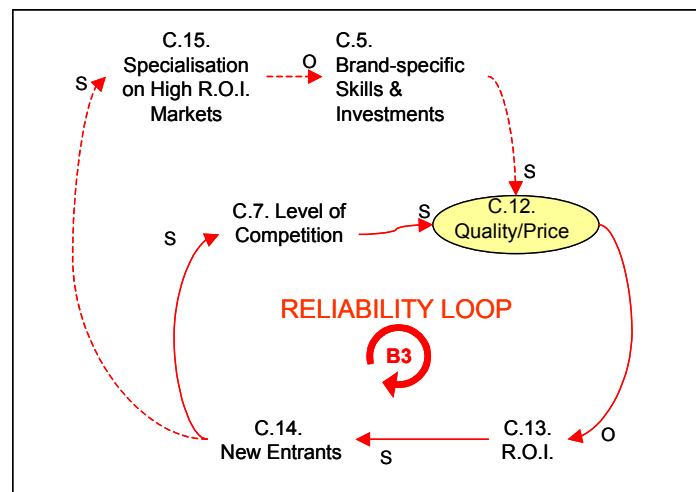
The main features of the customer loop can be summarised as follows:

<b>Type of loop</b>	The customer loop is a balancing loop (B) that seeks equilibrium between the market share of the various channels.
<b>Speed of activation</b>	Higher for the after-sales than the sales sector where the barriers to new entrants imply greater limits on competition
<b>Focus</b>	Sales and after-sales
<b>Quantified indicators</b>	Market share held by the various types of distribution and service channels
<b>Players that exert a driving force</b>	Fleet companies; 'Fast fit' repair chains; New entrants from other sectors.
<b>Influence of regulation</b>	The current legislative framework constitutes a barrier to reinforcing the loop.
<b>Influence on other loops</b>	The customer loop, if free from artificial constraints: <ul style="list-style-type: none"> <li>• Limits the development of the product loop (R1);</li> <li>• Reinforces the impact of the price loop (B4) if innovation is matched with the emergence of new business models along with more attractive price structures.</li> </ul>
<b>Impact on customer satisfaction</b>	(+) Better response to specific customer needs through the development of new Distribution and servicing modes.
<b>Impact on areas of competition</b>	(+) Reinforces intra-brand competition; (+) Reinforces after-sales competition.
<b>Impact on market structure</b>	(-) Reduction in the profitability of the official dealers; (+) More diverse distribution and servicing modes; (+/-) Change in client segmentation.
<b>Areas for improvement and risk factors</b>	The main area for improvement within the customer loop revolves around the lifting of the artificial access barriers to new entrants that want to develop alternative business models, particularly in distribution.

- Table II.12 -

### II.3.3. Reliability loop

#### II.3.3.A. Definition of the components and links



- Diagram II.11 -

This loop illustrates an essential feature of the automobile market. Global service has to be offered for each brand and dense international geographical spread of servicing outlets offering consistent quality and reliability are required. Although sales processes are complex and require even greater reliability (knowledge of the range, vehicle testing, customisation of options...), the reliability loop mainly focuses on after-sales servicing.

The reliability loop (B3) consists of **two opposing loops**. In the first case, there is a **positive loop that is driven by competition** towards a better quality/price ratio. The other one is a **negative loop** in which the **specialisation of new entrants on the most profitable markets is matched with a relative fall in investment in brand-specific expertise** and/or more complex segments and areas that leads to an inferior quality/price ratio on average. This second loop (R3') is a self-reinforcing loop.

<b>New entrants (C14) -&gt; level of competition (C7)</b>	New entrants to after-sales servicing (C14) tend to boost the level of competition on that market.
<b>Quality/price ratio (C12)</b>	Competition in the after-sales market (C7) increases the need to improve the overall quality/price ratio of the various services that are offered (C12).
<b>ROI (C13)</b>	The improvement of the quality/price ratio (C12) puts pressure on the dealers' profitability, as investments have to be boosted and/or prices reduced, thus lowering margins. This weakens the expected Return of Investment (ROI – C13)
<b>C13 -&gt; New entrants (C14)</b>	The weakening of the expected return on investments (C13) tends to slow down the market penetration of new players (C14), which slows down competition and, in turn, reduces the pressure on the quality/price ratio (C12). The market gradually stabilises.

**Specialisation in high ROI markets (C15)**

The link between market penetration by new entrants (C14) and the level of specialisation in high ROI markets (C15) illustrates how **new entrants tend to specialise in the more profitable areas, avoiding the obligation to carry out all maintenance and repair works**. This type of offering only requires limited expertise and investment and generates high volumes. In addition, customer sensitivity to price is high. As a result, the new entrants are able to compete with the traditional players.

**C15 -> Brand-specific skills and investments (C5)**

The specialisation of new entrants in the most attractive markets has a dual impact:

- It weakens the position of the traditional small-scale players (both independent garages and the official dealers);
- It reduces the overall level of brand-specific expertise, skills and investment in the after-sales sector.

In turn, the overall level of investments and skills in the industry is likely to be affected.

**Brand-specific skills and investments (C5)**

The official dealers (and to a lesser extent, the independent garages) are the main guarantors of these skills at present, reinforced by the product loop (R1).

**The complexity of the products tends to raise the level of (human and material) investment required by the official dealers, placing pressure on them to increase in size and to specialise through the development of satellite service outlets<sup>82</sup>.**

**C5 -> Quality/price ratio (C12)**

**The fall in the level of brand-specific investment and skills tends to weaken the quality/price ratio for the complex and specific repair works** not carried out by new entrants, **as well as the complex areas and segments in which there is less competition**.

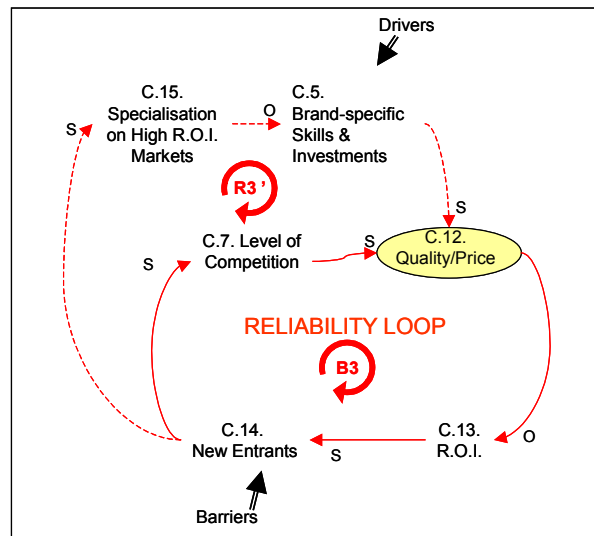
As a result, from the end customers' perspective, there is a dual and simultaneous impact (C12):

- An improvement in the overall quality/price ratio through competition and specialisation, which mainly has the effect of decreasing prices;
- Deterioration in the quality/price ratio for specific and less common services, where the effect is likely to be a drop in quality.

<sup>82</sup> The main advantage of 'Hub and Spoke' organisations of a main dealer and satellite outlets is that the weight of the necessary investments is shared and suitable proximity can be offered.

### II.3.3.B. External factors

The external factors are summarised in the diagram below:



- Diagram II.12 -

	Influencing factors	Players	Influence				Description
			B3 – Overall impact on the level of competition		R3' – Impact on the quality/price ratio of brand-specific and complex servicing		
			On:	Impact	On:	Impact	
Features of the current distribution system							
1	Restrictions on multi-brand after-sales servicing	Manufacturers and official repair services			C5	<u>Driving force</u>	These 4 factors only apply to official repair services; they constitute a means for manufacturers to ensure brand-specific technical investment in repair and maintenance.
2	Territorial exclusivity				C5	Driving force	
3	Link between sales and after-sales servicing				C5	<u>Driving force</u>	
4	Obligation to sell the entire range				C5	<u>Driving force</u>	
5	Official networks' monopoly on the distribution of spare parts	Manufacturers	C7	<u>Brake</u>	(C4)	Indirect impact via C4	This has the greatest impact on the attractiveness of captive, brand-specific markets (component C4 defined in the product loop). The manufacturers' and official networks' hold on spare parts means that attractive margins can be generated from their sale. This situation goes on to influence repair services.

	Influencing factors	Players	Influence				Description
			B3 – Overall impact on the level of competition		R3' – Impact on quality/price ratio of brand-specific and complex servicing		
			On:	Impact	On:	Impact	
6	Access to technical information	Manufacturers	C14	<u>Brake</u>	C5  C15	<u>Brake</u>	Difficult access to technical information (and training) for new entrants and independent repairers reinforces the trend of specialising in high-volume sub-markets, and the lack of expertise and skills.
Emerging practices							
7	Product complexity	Manufacturers	C14	<u>Brake</u>		<u>Brake</u>	The complexity of components and diagnostic tools along with the increasing integration of components and systems constitute the greatest barriers to the entrance of new players to the after-sales sector. This trend also affects the level of investment required (see C5), and reinforces the lack of skills and expertise.
8	Capture of market share by new entrants	New entrants	C14	<u>Driving force</u>	C5	<u>Brake</u>	The new entrants focus on the most profitable and least specific lines of business, thus stimulating price increases and/or reduced quality on more brand-specific or complex repair work. Today, the situation is stabilising and seems to have reached its limit.

- Table II.13 -

### II.3.3.C. Current situation

At present **manufacturers and their networks act as guarantors for the quality of brand-specific and complex repair and maintenance works and ensure a good geographical spread of service outlets.**

The official networks have a 53% share of the after-sales market. **Competition is therefore high and the other repairers guarantee equivalent performance.** However, the **current equilibrium - particularly in the area of more complex services and new, increasingly high-tech, specific models - is threatened by various factors such as the growing complexity of the components and difficult access to information and training.**

Consequently, **if the external factors as they stand today remain unchanged, the level of competition would fall in the medium term, and the position of certain players (especially traditional independent repairers) would be consequently weakened.**

The most important quantifiable indicators to follow are depicted in the table below:

Density of Service Network		Current Situation
R E L I A B I L I T Y  L O O P	<b>Sales service</b>	
	Number of outlets in the official network	106000
	Total number of outlets	106000
	<b>After-sales service</b>	
	Number of "full facility" outlets (sales+after-sales)	106000
	Number of "repair only" outlets	11000
	Number of "(generalist) independant repairer" outlets	118000
	Number of "multi-brand specialist" outlets	100000
	Total number of outlets	335000

- Table II.14<sup>83</sup> -

In the after-sales market, official repairers and independent repairers are estimated to cover 45% and 38% of the total car fleet respectively, the remaining 17% being shared between new channels (e.g. fast fit chains). The number of outlets is almost evenly divided between the different repair channels: 35% for both official and independent repairers and 30% for new channels.

<sup>83</sup> Source: Cf. Appendix 12 (Modelling Exercise 3 – Geographic Coverage).

#### II.3.3.D. Opportunities and risks

##### Opportunities and risks related to an increase in the speed of activation of the reliability loop:

**The advantages of a reinforcement of this loop are the rise in levels of competition on all after-sales sub-markets and the subsequent improvement in the quality/price ratio for consumers.** More specifically, the opportunities for increased competition would lie essentially in:

- The original spare parts distribution processes;
- Easier access to more complex and brand-specific repair work for specialised independent repair outlets.

Increase in the level of competition may however lead to serious risks. Indeed, a weakening of the position of official repair outlets at a rate that is too rapid would **alter the quality/price ratio for brand-specific repair work and reduce the service outlets' coverage.**

##### Risks related to a decrease in the speed of activation of the reliability loop:

If the technical and economic barriers to access to specialised repair and maintenance work were kept in place, **the survival of small independent repairers would be threatened.**



### II.3.3.E. Conclusion

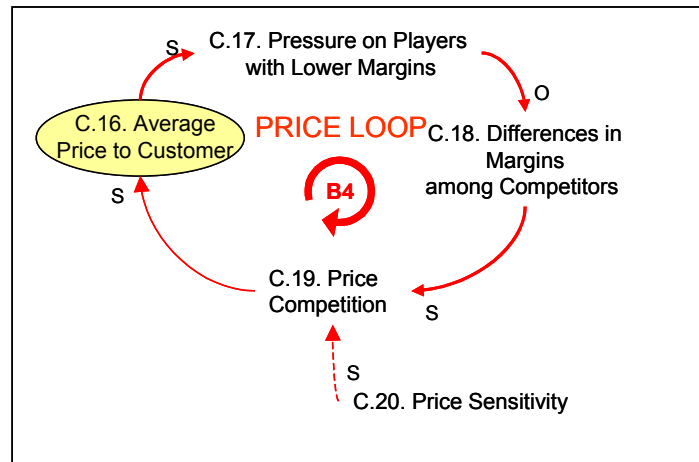
The main features of the reliability loop can be summarised as follows:

<b>Type of loop</b>	The reliability loop seeks a balance (B) around a certain quality/price ratio.
<b>Speed of activation</b>	Currently stable
<b>Focus</b>	After-sales
<b>Quantified indicators</b>	Density of service outlets
<b>Players that exert a driving force</b>	Two types of player exert substantial pressure on the reliability loop: <ul style="list-style-type: none"> <li>• Manufacturers and official networks exert pressure to ensure reliability in all areas of after-sales servicing;</li> <li>• New entrants to the after-sales market exert competitive pressure.</li> </ul>
<b>Influence of regulation</b>	The legislative framework tends to protect reliability of servicing.
<b>Influence on other loops</b>	The reliability loop is closely interlinked with the product loop (R1).
<b>Impact on customer needs</b>	Effects on the quality/price ratio include: <ul style="list-style-type: none"> <li>(+) Reduced prices for simple repair and maintenance works;</li> <li>(-) Likelihood of increased prices for complex and specialised repairs;</li> <li>(-) Difficulties in maintaining the geographical spread of service outlets.</li> </ul>
<b>Impact on areas of competition</b>	(+) Increases after-sales competition
<b>Impact on market structure</b>	(+/-) Tendency to weaken the position of repairers that do not specialise in a specific brand or type of service (+/-) Concentration of dealers
<b>Areas for improvement</b>	<u>To improve:</u> <ul style="list-style-type: none"> <li>• Competition in the after-sales market and access to skills and spare parts to repairers who are not part of the official brand networks.</li> </ul> <u>To monitor:</u> <ul style="list-style-type: none"> <li>• Protection of independent repairers;</li> <li>• Coverage and reliability.</li> </ul>

- Table II.15 -

### II.3.4. Price loop

#### II.3.4.A. Definition of the components and links



- Diagram II.13 -

**The price loop is a balancing loop (B) that seeks equilibrium around a certain price for the final customer (C16) by the law of supply and demand.**

#### Level of price competition (C19)

C19 reflects the extent to which distributors use price to win the customer over. As illustrated in the diagram this component is influenced by various factors:

- The activation level of the product loop (R1) and, in turn, the level of inter-brand competition;
- The existence of differences in margins among distributors, which allows them to develop substantially different price positioning;
- Consumer price sensitivity;
- The consumer's ability to negotiate the prices;
- The level of price transparency on the market.

The level of competition may vary on the basis of:

- The geographical location (high-density vs. low-density areas);
- The market segment (maintenance vs. complex and brand-specific repairs; mass-market car segments vs. luxury car segments).

#### Average consumer price (C16)

The level of price competition (C19) influences the average price offered to the customer (C16). **Depending on consumer price sensitivity, the average price may affect demand:**

- In vehicle sales, there is a trade-off between new and used vehicles based on the purchase price and the 'Total Cost of Ownership'. Since consumers generally prefer to buy new vehicles, their buying behaviour may be influenced if either of these two factors are more conducive with a previously owned vehicle;
- In after-sales the average price has less of an impact on demand.

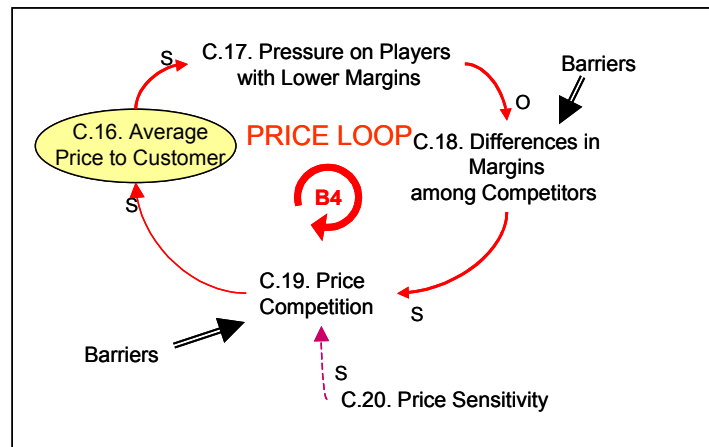
#### C16 -> pressure on players with lower margins (C17)

**The average discount rate that is offered to the customer (C16) exerts pressure on the dealers with the lowest profit margins (C17).**

<b>C17 -&gt; differences in margins among competitors (C18)</b>	<p>The pressure on the margin (C17) tends to foster the convergence of margins among distributors (C18), as those with the lowest margins are gradually forced out of the market.</p> <p><b>Differences in margins are influenced by:</b></p> <ul style="list-style-type: none"><li>- <b>The size of the dealers</b> (the bigger ones are able to benefit from economies of scale);</li><li>- <b>The ability of new entrants to develop business models with lower cost structures;</b></li><li>- <b>The effects of volume can either favour or disfavour the type of remuneration method.</b></li></ul>
<b>C18 -&gt; level of price competition (C19)</b>	<p>A reduction in the differences in price among distributors tends to limit their ability to face price competition. The loop therefore goes into reverse until a new balance is reached around a new price equilibrium.</p>

### II.3.4.B. External factors

The diagram and the table below describes the main external factors that influence the price loop (B4):



- Diagram II.14 -

	Influencing factors	Players	Influence		Description
			On:	Impact <sup>84</sup>	
Features of the current distribution system					
1	Recommended price	Manufacturers	C19	Brake	Manufacturers use country-based recommended prices as a way of exerting control over their products' price positioning. However, since giving discounts is common practice within the industry, the recommended price works more as a price transparency tool than as a major barrier to price competition.
2	Method of dealer remuneration	Manufacturers	C18	<u>Brake</u>	The method of dealer remuneration applied by manufacturers is currently based on the following principles: <ul style="list-style-type: none"><li>- Fixed margin per model;</li><li>- Identical remuneration method for all.</li></ul> This practice promotes a balance in distributors' margins and favours quality over price.
3	Constraint on the number of dealers within the official networks	Manufacturers	C19	Brake	The ability of manufacturers to limit the number of official dealers has a direct braking effect on intra-brand competition. However, this reduction would naturally occur through the exclusion of the weakest from the market (C17).
4	Territorial exclusivity	Manufacturers and official networks	C19	Brake	
5	Taxation differences in Europe	National laws	C19	<u>Brake</u>	Taxation differences are one of the factors that limit European market integration and the ability to compare prices.

<sup>84</sup> The most significant influences are highlighted and underlined.

Influencing factors		Players	Influence		Description
			On:	Impact	
Emerging practices					
6	Price sensitivity	Consumers	C19	<u>Driving force</u>	In regard to the sale of vehicles, consumer price sensitivity varies according to the segment and brand (influence of the product loop R1 via the brand image component (C2)). As regards after-sales servicing, price sensitivity is greater in maintenance and in minor repair works than in brand-specific and complex repair works.
7	Different cost structures	Manufacturers, independent distributors and after-sales service providers	C18	<u>Driving force</u>	In the sales market, the mono-channel distribution strategy promoted by manufacturers gives rise to a relatively identical cost structure among all dealers. The major groups, however, are able to benefit from economies of scale and thus lower their costs. In the after-sales sector, the 'fast fit' repair chains have been successful in achieving particularly low costs for certain types of repair work or high-volume maintenance services. They also benefit from the fact that they do not require highly specialised skills. In the case of complex repairs the situation is more complicated given the difficulty in creating synergies between services and/or brands due to the specific technical factors involved.
8	Internet	All	C19	<u>Driving force</u>	The Internet acts as an information tool that increases price transparency.
9	Multi-branding	New entrants or multi-brand distribution groups	C19  C18	Driving force  <u>Driving force</u>	In ways that are very different, the Internet and multi-brand distribution provide customers with more independent information and makes it easier for them to compare offers.  Furthermore, multi-branding is also a way of ensuring better returns on investments and giving the dealers a better competitive advantage in terms of costs.
10	Bundling of services	Fleet companies, banking/insurance	C19	<u>Brake</u>	The practice of bundling services tends to alter the notion of the price. Indeed, the purchasing decision is no longer solely based on the vehicle's purchase price but on the 'Total Cost of Ownership', including maintenance costs, insurance, financing...
11	Parallel imports	Intermediaries	C19	Driving force	Parallel imports and intermediaries boost the integration of European markets. Such practices are, however, limited, and involve only small volumes.
12	Centralised negotiation	Fleet companies, large-scale distribution	C19	<u>Driving force</u>	Centralised negotiation by distributors with the power to negotiate is a way of promoting competition between distributors, as well as manufacturers. Fleet companies use this negotiating tool <sup>85</sup> .

- Table II.16 -

<sup>85</sup> The fleet company market represents 40% of new vehicle sales. According to projections, they are expected to secure 50% of the market within the next five years. Cf. Appendix 4 (Fleet Market). Four or five of Europe's major players control 80% of the leasing market. Fleet companies exert pressure on all the components of the Total Cost of Ownership (purchasing price, maintenance...).

### II.3.4.C. Current situation

In the sales market it is common practice to provide customers with a discount. **The consumer price (C16) for a new car is on average discounted by 8%<sup>86</sup> from the manufacturer's suggested retail price.** This price competition in the area of retail sales is likely to be boosted by:

- **Pressure from inter-brand competition<sup>87</sup>** through the influence of the product loop (R1) on the level of price competition (C19);
- **Pressure from intra-brand competition** through the influence of the customer loop (B2) on margin differentials among competitors (C18). However, as the situation currently stands, the pressure on distributors from the same brand to compete is limited<sup>88</sup> given that distributors' margins are very similar as well as being quite low. Their ability to offer discounts above the market average of 8% is also limited.

**On the after-sales market, and particularly in the case of maintenance and simple repair services not covered by warranty, the activation level of the price loop is much higher.** Indeed, independent repairers or 'fast fit' repair chains have developed much lower cost structures than the official repairers (impact of the reliability loop B3 on margin differentials C18), and are therefore able to sell at competitive average prices. Over recent years, such competition has brought substantial pressure to bear on the official dealers, which have seen considerable erosion of their overall margins and their market share in this area<sup>89</sup>.

If the speed of activation remains slow, the price loop guarantees the consumer a degree of price transparency and to some extent re-balances the players' market share. At a slightly greater speed of activation, the same loop exerts decisive pressure on the weakest players and subsequently develops **market exclusion and player concentration mechanisms**.

The main quantifiable indicators that relate to this loop are outlined in the table below:

Structure of Distribution Costs		Current Situation
P R I C E  L O O P	<b>New vehicles (% of total price)</b>	
	Production costs	61%
	Marketing costs	12%
	Customer discounts	8%
	Building and related costs	2%
	Other distribution costs	10.4%
	Manufacturers'margins	2.5%
	Distributors'margins (importers + dealers)	4%
	<b>Spare parts</b>	
	Suppliers'margins	5%
	Others'margins	30 to 32%

- Table II. 17<sup>90</sup> -

<sup>86</sup> This figure represents the average discount given by dealers to their customers. A distinction should be made between the discounts to end consumers (6 to 7%) and those given to fleet companies (10 to 11%), given that the latter represent around 40% of dealers' overall sales volume (source = summary of the interviews and questionnaires of key industry players carried out by Andersen).

<sup>87</sup> Up to 30 different brands exist within certain car segments (segments M1 and M2) (Cf. Appendix 5 (Car Segmentation)).

<sup>88</sup> Although some 30% of distributors' sales are currently made outside their home territory this figure could see a substantial increase in densely populated urban areas (source = summary of the interviews and questionnaires of key industry players carried out by Andersen).

<sup>89</sup> A significant proportion of maintenance services performed beyond the term covered by warranty escape the official networks.

<sup>90</sup> Cf. Appendix 13 (Modelling Exercise 4 – Distribution Costs).

#### II.3.4.D. Opportunities and risks

##### Risks related to an increase of the speed of activation of the price loop:

The most important risk would be a **concentration of players** that would result in the search for better margins. In the long run, this could limit competition and lead to an increase in price levels. This would also lead to the exclusion of niche market players, and possibly a subsequent reduction in the level of service, quality, and reliability.

A difference can already be seen between the level of competition within simple car segments or densely populated areas and within more specific car segments or less densely populated areas. A totally free market that would allow prices to be based on the laws of supply and demand could lead to **higher price levels in the more complex segments and areas**. Likewise, different margin levels exist within the different segments (low margins in segments A/B; intermediate margins in segments M1/M2; and high margins in the other segments). Consequently, if the price loop were to evolve more naturally, the **differences in price in the various client segments** would be strengthened.

**A strong increase in price competition resulting from an acceleration of the price loop would under certain conditions lead to an overall growth in demand for mass-market segments.** The reaction of the automobile industry may be an even greater concentration of car models and versions. The features of the industry would change along with consumer behaviour characterised by a limited variety of models and low prices.

Traditionally, price competition practices within the industry have, above all, stimulated product differentiation, investments in marketing, and the building of strong brand recognition. However, the price loop could constitute a threat to the product loop (R1) if it grows and is combined with constraints on the manufacturers' freedom to pursue their distribution policy. If such a situation were to develop, the most likely outcome would be a **reduction in the vehicle ranges** and a **limitation of consumer choice**.

#### II.3.4.E. Conclusion

The main features of the price loop can be summarised as follows:






<b>Type of loop</b>	The price loop seeks a balance (B) around a consumer price level.
<b>Speed of activation</b>	<p>This loop's activation level currently varies according to the market (sales or after-sales), as follows:</p> <ul style="list-style-type: none"> <li>- In certain sub-markets (such as simple repairs and maintenance) the market works in a very natural and competitive way and prices reach an equilibrium on the basis of the law of supply and demand;</li> <li>- In the case of other sub-markets (brand-specific complex repairs, for example) price competition is limited.</li> </ul>
<b>Quantified indicators</b>	Profitability and cost structures of the various players
<b>Focus</b>	Sales and after-sales
<b>Players that exert a driving force</b>	<p>Fleet companies</p> <p>'Fast fit' repair chains</p>
<b>Influence of regulation</b>	The current legislative framework tends to put a brake on the natural activation of the price loop
<b>Influence on other loops</b>	The price loop (B4) operates in opposition to the product loop (R1). Intense activation of the product loop tends to limit the activation of the price loop, while intense activation of the price loop tends to slow the innovation rate as well as brand differentiation that are essential components of the product loop.
<b>Impact on customer needs and demand</b>	(+/-) Impact on the average price level varies according to the segments and geographical areas
<b>Impact on areas of competition</b>	<p>(+) Increases inter-brand competition;</p> <p>(+) Increases intra-brand competition;</p> <p>(+) Decreases market integration;</p> <p>(++) Strongly increases competition in after-sales servicing.</p>
<b>Impact on market structure</b>	<p>(-) Sales: concentration of dealers</p> <p>(-) After-sales: reduction in the profitability of official repairers</p>
<b>Areas for improvement and risk factors</b>	<p>The main areas likely to improve the natural workings of this loop are as follows:</p> <ul style="list-style-type: none"> <li>- The freedom for distributors to develop price competition in the sale of new vehicles;</li> <li>- The broadening of after-sales competition to new markets (brand-specific repairs in particular) – see the reliability loop (B3);</li> <li>- Increased innovation in new vehicle sales processes, likely to encourage alternative, lower cost structures. See the customer loop B2;</li> <li>- Increased price convergence within European market.</li> </ul> <p>The main risk factors are:</p> <ul style="list-style-type: none"> <li>- The risk of a decrease in the level of specification of products;</li> <li>- The risk of a reduction of the number of players.</li> </ul>

- Table II.18.-



### II.3.5. Interrelationships

The table below summarises how the four industry causal loops are interrelated:

	CUSTOMER LOOP 	RELIABILITY LOOP 	PRICE LOOP 
PRODUCT LOOP 	Opposition	Opposition	Opposition
CUSTOMER LOOP 			Mutually reinforcing

- Table II. 19 -

The description of the four causal loops shows that the **product loop (R1) represents the engine room of the industry today and tends to stabilise the three other loops**. The product loop is characterised by the following:

- It stabilises the customer loop (B2) by erecting access barriers in the form of high brand-specific investment requirements (C5), which limit the level of competition (C7);
- It stabilises the reliability loop (B3) by ensuring high levels of investment in the area of after-sales servicing (C5) and thus secures a high level of service coverage and a good quality/price ratio for brand-specific repairs (C12);
- It limits the level of price competition (C19) in the industry through brand recognition, thus stabilising the price loop (B4).

Conversely, the study reveals that **the three other loops, if boosted by new legislative levers for example, could stop the development of the product loop (R1) by weakening the official dealers' profitability**. The following explains how these three loops could affect the official dealers' profitability (C6):

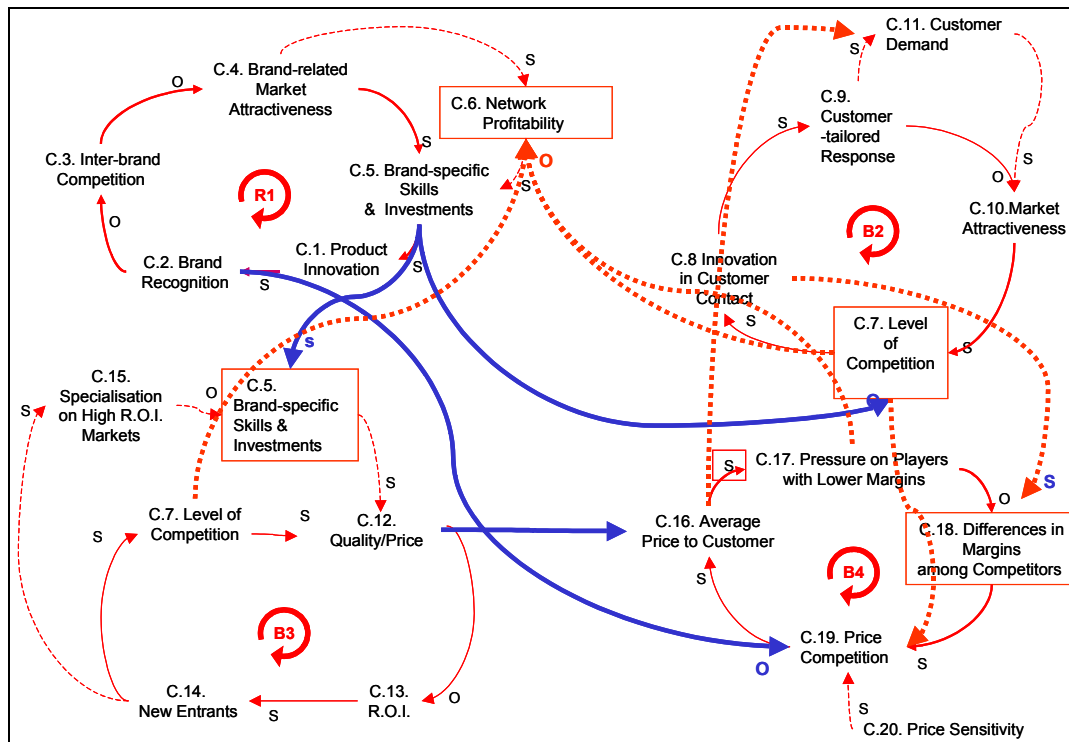
- The price loop, where competition exerts pressure on margins, would tend to weaken the position of the least profitable players (C17). This would subsequently increase the pressure on the profitability of the traditional dealers (C6);
- The customer loop, when activated, would tend to reinforce the intra-brand competition (C7 of the customer loop B2) among official dealers or between the official dealers and independent players. This directly affects the 'official' players' market share and average margin and thus would also increase the pressure on their profitability (C6);
- Likewise, the reliability loop, when activated, would tend to reinforce competition in the after-sales market (C7 of the reliability loop B3) between the official dealers and independent repairers. This exerts additional pressure on the official dealers' profitability (C6).

Finally, the study reveals that the **price loop and the customer loop reinforce each other**. These loops are, in fact, very strongly interrelated. The activation of the customer loop (B2) has a dual impact on the price loop:

- **Direct impact:** increased intra-brand competition (C7 of the customer loop B2) reinforces price competition (C19 of the price loop B4) between dealers. This promotes transparency but could, in extreme cases, lead to price wars;
- **Structural impact:** the emergence of new distribution forms (C8) tends to diversify the dealers' cost structures, giving rise to differences in margins among them (C18). This has a structural impact (in the long run) on price competition.

On the other hand, consumer price reductions in certain segments (C16 of the price loop B4) are likely to lead to a rise in the demand within these segments (C11), strengthening their attractiveness (C10) and thus boosting intra-brand competition (C7). If this cause and effect relationship is over-stimulated, there is a risk that demand would be simplified and the proportion of sales of the most popular or standard models would be increased.

These interrelationships are illustrated in the diagram below:



- Diagram II.15 -

All the relationships referred to above are illustrated in the diagram. The continuous arrows indicate the relationships that tend to 'maintain the current level of activation of the loops. Maintaining the current level of activation practically means a stabilisation of the loops B2, B3 and B4. The dotted arrows indicate the relationships that tend to upset the balance of the existing system (braking effect on R1 and the mutual reinforcement of B2 and B4).

## II.4 Conclusion

Aimed at providing insight into the workings of the industry, this part of the study has allowed us to define the impact analysis framework and identify the major trends in the sales and after-sales markets.

The key findings are summarised below.

### II.4.1. The sales and after-sales markets are different yet inter-dependent

Automobile distribution and servicing markets focus on a **complex and specific product with strong innovation**. Reliability and 'value for money' of service throughout the life cycle of the vehicle are of primary importance. Therefore, 'Total Cost of Ownership' is essential to the purchasing decision, and after-sales services are often incorporated into sales contracts.

**Segmentation practices** are becoming increasingly elaborate in both markets. However, the type of segmentation in use differs between distribution and servicing (where the age of the vehicle is essential).

**Cost pressure** is increasing, leading to greater reinforcement of the concentration trend.

Sales and after-sales markets feature **different levels of competition, profitability and innovation**. Indeed:

- The sales market is increasingly forced to assimilate new needs and new practices and to adjust to the competition from new industry players (some of which are already active);
- The after-sales market is facing stronger re-positioning of players, behaviour changes, extension of the service range to parallel activities while still having to ensure a certain level of service.

These common and different trends are summarised in the table below:

SALES		AFTER-SALES	
Strong product innovation in both the range of models and the repair and maintenance complexity			
« Total Cost of Ownership » key to the purchasing decision		Geographical coverage and quality standards are consumer requirements	
Dealers ' profitability based on the bundling of various products and services		Specialised players enter specific profitable segments with a multi-brand proposition	
Customer segmentation as a key driver of competitive positioning and for facilitating improved contact with customers			
Growing cost pressure and investment requirements are fueling concentration trend and dealers ' size			
Barriers to new entrants and to innovation in the sales process		High penetration of new entrants and effective competition	
Limited European market integration		Growing internationalisation of the offer	

- Diagram II. 16 -

## II.4.2. Four loops are used to depict industry dynamics

Four causal loop diagrams, which are inter-related, constitute a tool to understand industry dynamics.





**Manufacturers and their official networks are the drivers of a 'product loop'.** This **self-reinforcing loop** points to the effect on product innovation and brand recognition of **strongly integrated relationships** between manufacturers and their networks. This is the dominant loop within today's industry.

The other players – independent repairers, 'fast-fit' repair chains and would-be new entrants in distribution - drive the 'reliability loop', the 'customer loop' and the 'price loop'. These loops tend to stabilise the product loop through the introduction of more competition.

Four sets of quantified indicators have been identified<sup>91</sup>, featuring the major challenges faced by the industry, that are:

- The **profitability and size of an average official dealer** (Modelling Exercise 1);
- The **margins and market shares** of the manufacturers, official networks and other distribution channels (Modelling Exercise 2);
- The **coverage** of services and degree of specialisation (Modelling Exercise 3);
- The **structure of the distribution costs** (Modelling Exercise 4).

The table below summarises the characteristics of each of the four loops and allows comparisons to be drawn:

	 <b>PRODUCT LOOP</b>	 <b>CUSTOMER LOOP</b>	 <b>RELIABILITY LOOP</b>	 <b>PRICE LOOP</b>
Type of loop:	<u>Self-reinforcing</u>	<u>Balancing Loop</u>	<u>Balancing Loop</u>	<u>Balancing Loop</u>
Speed of activation:	High	After-sales: stable Sales: Less stable	Stable	Stable
Focus:	Sales and after-sales	Sales After-sales	After-sales	Sales and After-sales
Quantified indicators:	Profitability of dealers	Market size, share and margins	Point of service density in brand-specific repair	Cost structure
Industry players acting as a driving force:	Traditional players	Sales or after-sales New entrants	Traditional and new entrants	New entrants in After-sales
Role of existing regulations:	Driving force	Brake	Stabilises	Brake
Interdependence between loops:	Stabilises B2, B3 et B4	Slows down R1 Reinforces B4	Slows down R1	Slows down R1 Reinforces B2
Impact on customer satisfaction:	(+) Product choice	(+) Channel choice	(+/-) Quality/price of service	(+/-) Price
Impact on competition objectives	(-) Inter-brand	(+) Intra-brand (+) After-sales	(+) After-sales	(+) Market integration
Impact on market structure	(+/-) Strong versus weak brands (+) Network profitability (+/-) Barriers to the entry	(-) Network profitability (+) New distribution forms (+/-) Customer segmentation changes	(+/-) Specialisation	(-) Concentration (-) Network profitability

- Table II.20 -

<sup>91</sup> The Modelling Exercises presented in appendix 10 to 13 allow us to quantify the current situation. Account is taken of the indicators generally used in the examination of such issues (accessible data common to all the industry players).

The current speed at which **the loops evolve** depends on various external factors and on the practices introduced by the players (traditional, independent, and/or emerging). The table below summarises the driving and braking effects that external factors such as regulation have on the reference system.

Influencing factors	Players	Impact on the product loop R1 (product innovation)	Impact on the customer loop B2 (customer-tailored response)	Impact on the reliability loop B3 (overall quality/price)	Impact on the reliability loop B3 (quality/price on specialised repair)	Impact on the price loop B4 (price to customer)
<b>Features of the current distribution system</b>						
Brand exclusivity	Manufacturers	<u>Driving force</u>	<u>Brake</u>		<u>Driving force</u>	<u>Brake</u>
Link between sales and after-sales	Manufacturers	<u>Driving force</u>	<u>Brake</u>		<u>Driving force</u>	
Method of dealer remuneration	Manufacturers	<u>Driving force</u>	<u>Brake</u>			<u>Brake</u>
Exclusive distribution of original spare parts	Manufacturers	<u>Driving force</u>		<u>Brake</u>		
Qualitative selection criteria	Manufacturers	<u>Driving force</u>	<u>Brake</u>		<u>Driving force</u>	
Quantitative selection criteria – sales targets covering the entire range	Manufacturers	<u>Driving force</u>	<u>Brake</u>		<u>Driving force</u>	
Territorial exclusivity	Manufacturers and official networks	<u>Driving force</u>	<u>Brake</u>		Driving force	Brake
Access barriers to technical information	Manufacturers	Driving force		<u>Brake</u>	<u>Brake</u>	
Recommended prices	Manufacturers					Brake
Limitation of the number of players within official networks	Manufacturers					Brake
Different taxation laws within Europe	National laws					<u>Brake</u>
<b>Emerging practices</b>						
Direct sales	Manufacturers		Driving force			
Technical complexity	Manufacturers	<u>Driving force</u>		<u>Brake</u>	<u>Brake</u>	
Internet	Manufacturers and official networks	Driving force	Driving force			<u>Driving force</u>
Capture of market shares by new entrants	Fleet companies, new entrants, 'fast fit' repair chains	<u>Brake</u>	<u>Driving force</u>	<u>Driving force</u>	<u>Brake</u>	<u>Driving force</u>
Price sensitivity	Consumers					<u>Driving force</u>
Bundling of services	Fleet companies, banking/insurance sector		<u>Driving force</u>			<u>Brake</u>
Parallel imports	Intermediaries					Driving force
Centralised negotiation	Fleet companies, large-scale distribution					<u>Driving force</u>
Multi-branding	New entrants or multi-brand distribution groups	Brake	<u>Driving force</u>			<u>Driving force</u>
Different cost structures	New entrants		<u>Driving force</u>			<u>Driving force</u>

- Table II.21 -

### II.4.3. Intra-brand competition and competition in after-sales servicing need to be monitored

Assessment of current levels of competition within the four areas of competition is summarised hereunder<sup>92</sup>:

Areas of competition	Current level of competition
<b>Inter-brand</b> Estimate based on the number of brands and brands per segment	<b>High</b>
<b>Intra-brand</b> Estimate based on the number of channels with more than 5% market share and on the number of competitors per area	<b>Low</b>
<b>After-sales</b> Estimate based on the after-sales market share of official dealers and other players and on the number of competitors per area	<b>Medium</b>
<b>Market integration</b> Estimate based on the evolution of price convergence in the EU	<b>Low</b>

- Table II.22-

**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 statement<sup>93</sup>. 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 old<sup>94</sup>, 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.

<sup>92</sup> It should be noted that the competition indicators are taken within the European market as a whole. The estimations are not valid for every car segment and smaller geographical areas (country/region). The levels of the various indicators shown above are estimates that are based on the numerical data available for the current situation and on interviews carried out by Andersen in the course of the study.

<sup>93</sup> 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.

<sup>94</sup> 77% of the 180 Million cars in Western Europe are more than four years old.

#### II.4.4. Customer satisfaction rests on both the sale itself and on the after-sales service

The table below describes the assessment that was made on the various areas of customer needs' satisfaction<sup>95</sup>:

Customer satisfaction	Current level of satisfaction
<b>Product innovation</b> Estimate based on the number of brands, models, customer segments and on the average time to launch new products	High
<b>Customer-tailored contact</b> Qualitative indicator used to assess the level of response to the specific needs of each category of consumer	Low
<b>Reliability</b> Qualitative indicator used to assess the level of experience and reliability of the service players	Medium
<b>Price</b> Estimate based on the future price level for new vehicles, spare parts and repair	Medium

- Table II.23 -

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

It has to be noted that:

- The choice made by customers when purchasing a vehicle not only depends on the purchase price but also on the 'Total Cost of Ownership';
- The inclusion of a package deal in the sales proposal is high on the list of the qualitative aspects of customer satisfaction, along with image, quality and comfort, etc. Importance is likewise given to the coverage provided by service outlets, as well as other qualitative aspects such as expertise.

<sup>95</sup> The levels of the various indicators shown above are estimates that are based on the numerical data available for the current situation and on interviews carried out by Andersen in the course of the study.

#### II.4.5. The market structure is fragmented and integrated

The table below shows whether the current situation is favourable or unfavourable to each of the six categories of players<sup>96</sup>.

Positions of the groups of players	Current position
<b>Car manufacturers</b> Estimate based on the ability of manufacturers to maintain control over their marketing policy, along with integration of their various partners and regard for safety throughout the life of the vehicle	<b>Favourable</b>
<b>Official dealers</b> Estimate based on prospects of increase in profitability of official dealers	<b>Favourable</b>
<b>New entrants</b> Estimate based on prospects of access to the distribution market for new entrants	<b>Unfavourable</b>
<b>Parts suppliers</b> Estimate based on the ability of these players to capture spare parts market share and to obtain higher margins	<b>Unfavourable</b>
<b>Independent after-sales players</b> Estimate based on the prospects of access to different after-sales markets (including specific repairs) for independent repairers	<b>Unfavourable</b>
<b>Consumers</b> Estimate based on the evolution of customer satisfaction factors	<b>Neutral</b>

- Table II.24 -

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' organisations.

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.

<sup>96</sup> The levels of the various indicators shown above are estimates that are based on the numerical data available for the current situation and on interviews carried out by Andersen in the course of the study.



#### II.4.6. Potential areas for improvement and risk factors are highlighted for further review of the legislative scheme

Based on the review of the current situation, potential areas for improvement and risk factors have been identified. These different features form the structure for analysing legislative scenarios and variables.

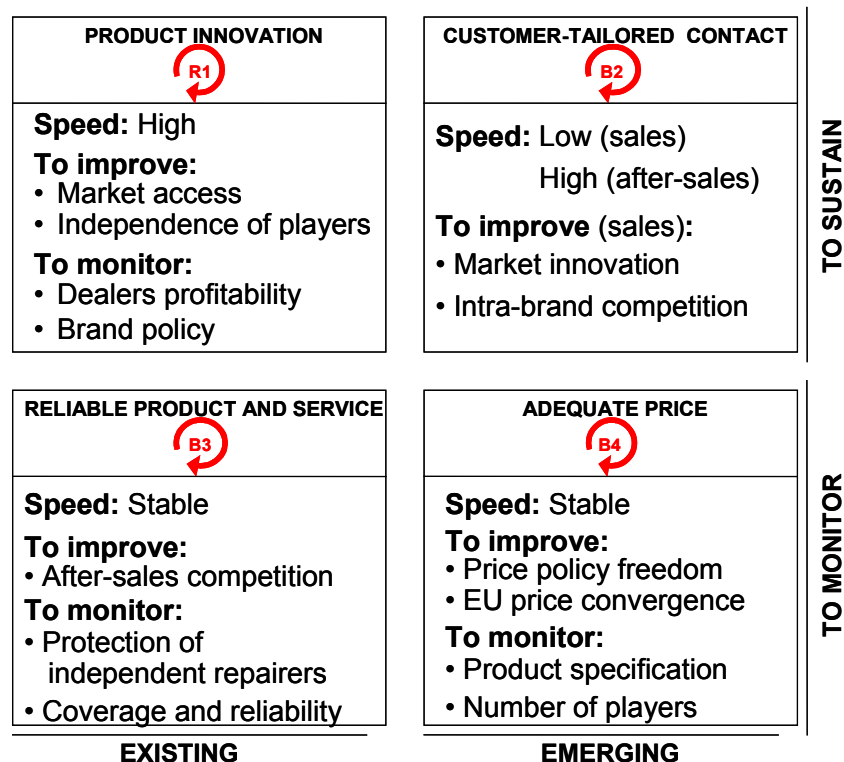
**Five areas for improvement and likely developments could be considered to be possible objectives for a new legislative scheme:**

- 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, in order to sustain price competition;
- Increased price transparency and harmonisation within Europe.

**However, any attempts to address the areas of improvement mentioned above should be made bearing in mind underlying risk factors. These risk areas 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 the official dealers;
- The eviction of independent players from the market (spare parts manufacturers/independent distributors);
- A decline in the density of network coverage and in service quality;
- Standardisation of the automobile industry;
- An excessively rapid increase in the concentration of the players.

The current situation and the areas to monitor are outlined in the following illustrations:



- Diagram II.17 -