Instituto Superior de Ciências do Trabalho e da Empresa

MARKET DEVELOPMENTS IN AUTOMOTIVE RETAILING AND AFTER-SALES SECTORS FOLLOWING THE ENTRY OF THE NEW BLOCK EXEMPTION REGULATION.

by

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I would never have got this far had it not been for my loved ones' support, patience and pestering and my coordinator's insistence. There are many more to thank, and I thank you all too.

Thank you.

EXECUTIVE SUMMARY

The new Block Exemption Regulation concerning the way in which vehicle manufacturers distribute their products in Europe took full effect on the 1st of October 2003. Three years on, relationships between manufacturers, dealers, and all other automotive industry players have started to show signs of change. Over these past three years dealership groups have consolidated, multi-branding increased, and the after-sales market has become stronger in relation to their rivals, the dealerships. However, in essence, the scale of change the European Commission, and consumers, hoped for has not yet occurred. Manufacturers continue to be the stronger party regarding the relationships they have with their dealership networks and the after-sales market. Though most opted for a selective dealership distribution network, aimed at giving dealerships more autonomy, the shift in power from the manufacturer to the dealer is barely visible.

Additionally, the changes that have occurred are believed, by most, to be due to the continual saturation of the European Automotive market and the quantity of economies trying to recover from ongoing recession, and not due to the new Block Exemption Regulation itself. Yet, what the new regulation has allowed is for dealers with difficulties to find easier solutions to their problems (e.g. consolidation, change in structure or sale), consumers to shop more easily and after-sales service quality standards to increase due to stronger competition.

Key words: Block Exemption Regulation; Competition Policy; European Union; Liberalisation.

JEL Classification System: K20; L0.

RESUMO

As normas que vieram alterar o Block Exemption, relativamente á forma como os fabricantes de veículos automóveis distribuem os seus produtos na Europa, entraram em vigôr em 1 de Outubro de 2003. Decorridos três anos, o relacionamento entre produtores, concessionários e as outras entidades envolvidas no comércio de veículos automóveis, começa a mostrar alguns sinais de mudança. Ao longo desses três anos verificou-se uma cada vez maior concentração de concessionários em grupos distribuidores, a exclusividade tem vindo gradualmente a dar lugar a um cada vez maior número de representações multimarca e as oficinas independentes e negociantes de peças têm-se vindo a tornar mais fortes.

Contudo, a grande mudança que a Comissão Europeia e os consumidores esperavam, ainda não aconteceu. Os fabricantes continuam a dominar as relações com as suas redes de concessionários e com o mercado de pós-venda. Apesar de a maioria dos fabricantes terem optado por um critério de distribuição selectiva, que dá maior autonomia aos seus concessionários, a relação de forças entre essas duas entidades quase não se alterou. De acordo com vários analistas, as mudanças que tiveram lugar deveram-se mais a uma grande saturação do mercado automóvel europeu, e á fragilidade da sua economia, do que á nova regulamentação do Block Exemption. Mas, pode dizer-se que a nova regulamentação criou condições mais favoráveis para concessionários em dificuldade (oportunidade de integrar-se num grupo, mudar a sua estrutura ou vender o negócio), maior facilidade para os clientes escolherem o produto que pretendem e maior conveniência e condições em termos de assistência pós-venda, em consequência do aumento de concorrência entre as várias partes envolvidas.

Palavras Chave: Block Exemption; Concorrência; União Europeia; Liberalização.

JEL Classification System: K20; L0.

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GLOSSARY

Authorised repairer – An outlet that belongs to the network of "official" providers of repair and maintenance services put in place by a supplier (vehicle manufacturer or its importer).

BER – Block Exemption Regulation – regulatory guidelines regarding the way Original Equipment Manufacturers' (OEM) distribute their products.

Dealership – (also referred to as Dealer) A franchise outlet authorised to sell specified items in a certain area with or without exclusivity.

Independent repairer – An outlet that does not belong to the manufacturer's or importer's network. Examples include local garages, auto-centres, fast-fitters and tyre specialists.

Marque – Brand name (french for "brand"), most commonly used for automobile brands. For example, Chevrolet is the marque for the Corvette model of sports car.

OEM – Original Equipment Manufacturer – an automotive manufacturer (also referred to as carmaker).

Shareholder - One who has a share or an interest in an enterprise. In this particular study it encompasses anyone (individual or enterprise) that has an interest in the Automotive Industry.

Chapter 1 - Introduction

1.1. BACKGROUND

The new Block Exemption Regulation (BER) regarding the way in which vehicle manufacturers distribute their products in Europe has been in effect for over three years and relationships amongst the main players have begun to show signs of change. The new BER aims at transforming the way in which consumers shop for, buy and seek after-sales service for both new and used cars, as competing dealers, independent repairers and new entrants make different choices about the brands they represent.

The European Commission's aim in revising the BER is to ensure that consumers get a better deal, not just when they buy a new car but for the duration of the ownership of that vehicle (after-sales services currently account for about 40% of the total cost of owning a car over its lifetime). In essence, to further open competition across the automotive industry's value chain and ultimately change the rules of the game. Accordingly, the new regulation has been designed to accomplish several objectives:

- To promote intra-brand competition and price harmonisation across the European Union;
- To give dealers more independence from vehicle manufacturers (OEM)
- To liberalise the provision of after-sales services and the procurement of spare parts.

It covers passenger cars, light commercial vehicles, trucks, buses and coaches and it applies in all the EU member states as well as Norway, Iceland and Liechtenstein.

The new BER has caused serious impacts on how all the Stakeholders in the Automotive industry have to play the game from now on. The competitive landscape has, and will still further, suffer very serious changes and all players in the automotive marketplace need to consider the strategic turns they need to make in order to cope with this new future. These turns include everything from rethinking their fundamental business strategy to redesigning the structure and systems that drive an organization[1]. These changes should already be formulated and hopefully, in order to proactively prepare for this new business environment, these changes should already be securely in action.

Nevertheless, the new BER will undoubtedly cause detours and dead ends for some players, as the industry consolidates and competitive pressures expand. But hopefully, for those that have already proactively faced the challenge, further growth and success can be expected.

The impact of the new BER upon the industry and its key players is extremely important and should be carefully studied. My strong personal interest in the Automotive Industry has provided me with the perfect opportunity to do just that.

1.2. THESIS OUTLINE

In order to clearly understand the issues caused by the new BER, and answer the questions previously stated, the study has been structured in the following manner:

Chapter 1 and **2** highlight the purpose of the study, the approaches taken and provide a brief introduction to the subject. **Chapter 3** discusses the European Union and covers the evolution of the Block Exemption Regulation from its early beginnings in 1985 to its most recent changes in 2002.

In **Chapter 4** an overview of the Global Automotive Industry is presented followed by an intense study of the European Automotive Industry using Porter's Five Forces of Competitive Framework.

The expected impact of the new BER upon the Automotive Industry is discussed in **Chapter 5**, focusing individually on the three main players (OEM, dealerships and

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[1] Accenture (2002). European Community Block Exemptions: A New Roadmap for Competition in the Automotive Marketplace.

repairers). Additionally, an overview of the expected outcomes regarding consumers is highlighted at the end of both **chapter 5** and **6.**

As an enhancement to the previous chapter and taking a more practical view on the subject, **Chapter 6** analyses the actual impact of the new BER. The following testimonials have been introduced in this chapter; An OEM (Ford Lusitana), and two Dealerships (Expofor and FIAAL).

Chapter 2 – Objective and Methodology

2.1. OBJECTIVE

The objective of this thesis is to answer the following question: *How is the new Block Exemption Regulation going to affect each of the Automotive Industry's stakeholders?*

Thus, my focus is on:

> **"Market Developments in the Automotive Retailing and After-Sales Sectors Following the Entry of the new Block Exemption Regulation".**

The purpose of this study however, was not only to analyse whether the European Union Commission's objectives have been met but, more precisely, what the reflections of Regulation Nº 1400/2002 have been so far upon the industry, in particular on the following three key players:

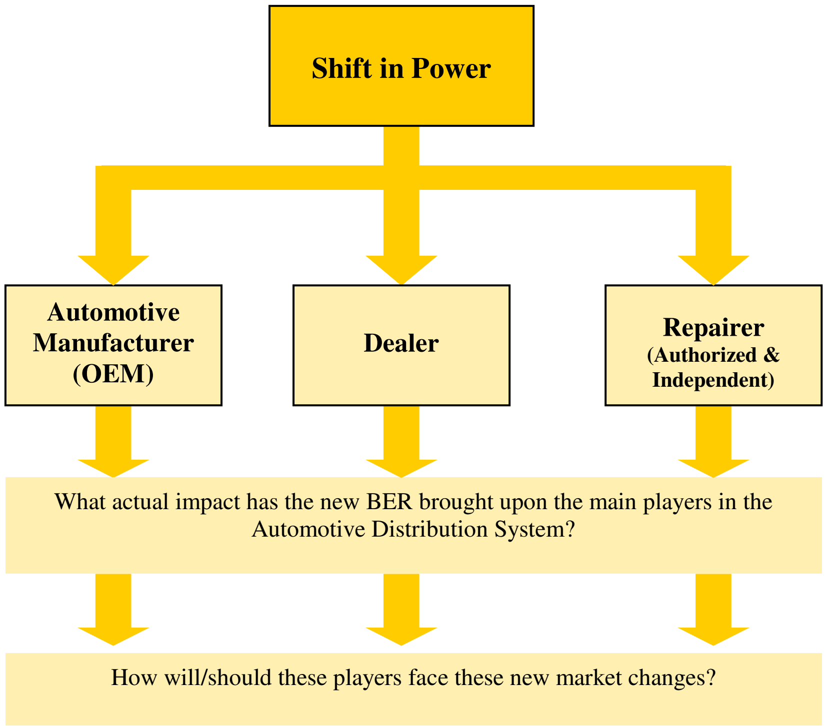
- **Original Equipment Manufacturers (OEM)**
- **Dealerships**
- **Repairers**

The affects of the new regulation on consumers has also been included but, as they are not the main focus of the study, they were not analysed in such depth.

In essence, the thesis analyses whether there has been a shift in power from OEMs to the other stakeholders and answers the following questions (see figure 1):

1. What actual impact has the new BER brought upon the main players in the Automotive Distribution System?
2. How will/should these players face these new market changes?

Figure 1: Thesis Objective



Subsequently, the following issues also arose:

- How do the involved players position themselves with regard to the BER practices?
- How is a multinational company within the automotive industry, currently pursuing its internal organisation in the EU?
- How will a multinational company within the automotive industry match its internal organisation with the EU's BER practices in the future?

2.2. METHODOLOGY

All data regarding the case studies was gathered via personal interviews with key people in each of the companies analysed. Statistical information was kindly provided by Ford Lusitana and ACAP (Associação do Comercio Automóvel de Portugal).

All other information was gathered through careful analysis of existent studies, as well as through careful personal observation and experience.

The first step in this thesis was to provide an introduction to European legislation and its competition policy, subsequently creating a platform on which the Block Exemption Regulation was created and has continued to evolve. An analysis of the whole automotive industry follows, looking at who the market leaders are, and issues regarding world sales and production of vehicles. Having provided the necessary background, from here on the study becomes more detailed and begins to answer the questions mentioned previously.

The new Block Exemption Regulation affects various different players, usually referred to as main players throughout the text. However, the main view-point studied has been the OEM's. They are the players with most influential power, and usually the first movers on any important decisions. They are expected to react first to any market changes, and what other players do after this initial stage is usually regarded as subsequent adaptations. However, the other three main players - dealers, repairers and consumers (to a lesser extent) – are also analysed. I personally believe that any study excluding these other players would not be well-rounded or complete.

No study is complete without both a theoretical and a practical analysis of the external and internal environment. A testimony seemed to be the most appropriate research design, as my main research problem revolves around the affects of the new BER upon its main players. No better way to analyse the new BER's, its background, implementation and effects, than by recording opinions from the various different players themselves.

The core company chosen was Ford Lusitana, Ford Motor Company's subsidiary in Portugal. Ford Motor Company is a multinational company, the second largest car manufacturer in the world, with a strong presence in the European market. Its powerful brand both in Europe and abroad, and the fact that it manufacturers vehicles for almost every segment in the automotive market, made it the ideal company to study the effects of the new BER. However, as we will see later in the text, the new BER does not only affect OEMs. Other stakeholders, such as dealerships and repairers, have also been obliged to make decisions regarding the new rules and I took the opportunity to study two Ford dealerships (Expofor and Fiaal), two different dealerships with very approaches towards the new market changes. Regarding repairers, I chose to focus on independent repairers, mostly Auto-Centres. Auto-centres are "betting" all over the country, with strong marketing campaigns, and as Portugal previously depended greatly on independent repair shops, it will be interesting to view the evolution of this new retailing format.

As Ford Lusitana is part of Ford Motor Company, it is important to state that national decisions are strongly influenced by bigger international decision makers, at European or American Ford headquarters. Consequently, the following study will sometimes reflect the decisions of Ford Motor Company as an international group, and not only Ford Lusitana's, its national subsidiary.

Chapter 3 – European Union and European Union Competition Policy

3.1. EUROPEAN UNION COMPETITION POLICY

The European Economic Community has been in existence since the signing of the Treaty of Rome in 1957 (The EEC Treaty). The EEC Treaty was designed to create a Common Market based on a full economic union between its Member States. The six original EEC Member States were France, Germany, Italy, Belgium, The Netherlands, and Luxembourg. In 1973 the UK, Denmark and Ireland also joined. Greece joined with effect from 1981 followed by Spain and Portugal in 1986, and Austria, Finland and Sweden in 1996. In 2004 ten more countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia and Cyprus) joined increasing the total membership to 25.

This enlargement of the EEC meant a wider political, not only economic, union. In order to clarify its wider mission, the EEC Treaty was renamed the European Community Treaty (EC Treaty) hence, broadening the scope of the Treaty to include social, monetary, political and other matters.

3.1.1. Source of EU Competition Policy

European Law derives from four main sources:

I. Articles of the EC Treaty;
II. Regulations and Directives issued under the authority of the EC Treaty;
III. Decisions and Notices issued by the Commission;
IV. Judgments of the Court of First Instance and the European Court of Justice.

The objectives of the EU's competition policy are to restrict unilateral operations at national levels and to support competition and efficiency in order to benefit the EU as a whole. Consequently, the aim is to enlarge and protect free trade within EU boundaries, not national boundaries. The main points of the policy are as follows:

- Restrict organisations from engaging in price fixing, cartels, as well as any other anti-competitive operations hence, encouraging price competition and preventing monopolistic behaviour;
- Control the size of organisations entering into mergers and/or acquisitions and therefore making sure that competition is not eliminated and monopolistic or oligopolistic behaviours are not created;
- Hinder organisations from abusing positions of market dominance. The aim is to increase the number of players and reduce inefficiencies, as well as offering lower prices and better quality to the consumer. This includes state-owned monopolies;
- Prevent state aid to local organisations that would originate an unfair advantage in comparison to others.

In order to reach its objectives, the EU has to work alongside with national Governments and other local organisations to ensure that operations preventing competition and free trade are prohibited and the creation of oligopolies minimised.

Articles 81 to 82 of the EU Treaty contain rules governing competition. Article 81(1) prohibits all agreements between one or more organisations/institutions, decisions by trade associations and concerted practices that may affect trade between Member States and which have as their objective or effect the prevention, restriction or distortion of competition within the Common Market. Article 81(3) provides for a limited number of cases where the prohibition of article 81(1) may not be applicable in certain circumstances. These are known as Block Exemption Regulations.

Article 82 prohibits the abuse by one or more organisations/institutions of a dominant position within the common market, or in a substantial part of it, which affects trade between Member States (the abusive power of monopoly). In relation to Article 82, it is not possible to be exempted.

3.1.2. Implications of the EU Treaty.

The implications of the EU Treaty and the consequential creation of the Single European Act are potentially vast. As the EU succeeds in establishing a single market, member states can expect further significant gains from the free flow of trade and investment. The lower costs of doing business implied by the Single European Act will benefit EU companies (and Non-EU companies present within the EU border) as will the potential economies of scale of serving a single market of over 350 million consumers.

Nevertheless, as a result of the Single European Act, many EU companies are facing increased competitive pressure. The removal of administrative trade barriers, existent many times to protect national companies for example, has increased competition, resulting in the closure of many previously "strong" national companies. The ultimate goals however, are the benefits the consumers will reap from this increased competitive environment. Consumers, for example, will benefit from the lower prices caused by a more competitive market. Companies will also benefit, as the increased competitive pressures force them to become more efficient and therefore more effective international competitors. Hence attaining the ultimate goal, enabling them to expand their market within the EU and, also, go head-to-head with their U.S. and Asian rivals in the world marketplace.

Even so, the shift toward a single market has not been as fast as many would like, or as slow as some, more protected, industries would like. Several years after the Single European Act became EU law, there have been a number of delays in applying the act to certain industries. The insurance industry, for example, was exempt until July 1994 and investment services were not liberalized until January 1996. Another such case is the automotive industry, whose Block Exemption Regulation has only presently been changed (process began in 2002 and ends in 2005).

3.2. BLOCK EXEMPTION REGULATION (BER)

In 1985 the EC introduced its first exemption decision regarding motor vehicle distribution and servicing agreements. The objective of the agreement was to provide guidelines for the Original Equipment Manufacturers' (OEM) distribution systems. As the sale of vehicles differs somewhat from the sale of other goods and involves a high consumer investment, it is a highly technological product requiring specialized technicians and tools and it demands a high level of guarantee and security for the consumer, it was considered to merit a regime of its own. The Regulation was originally based on the following three assumptions[2]:

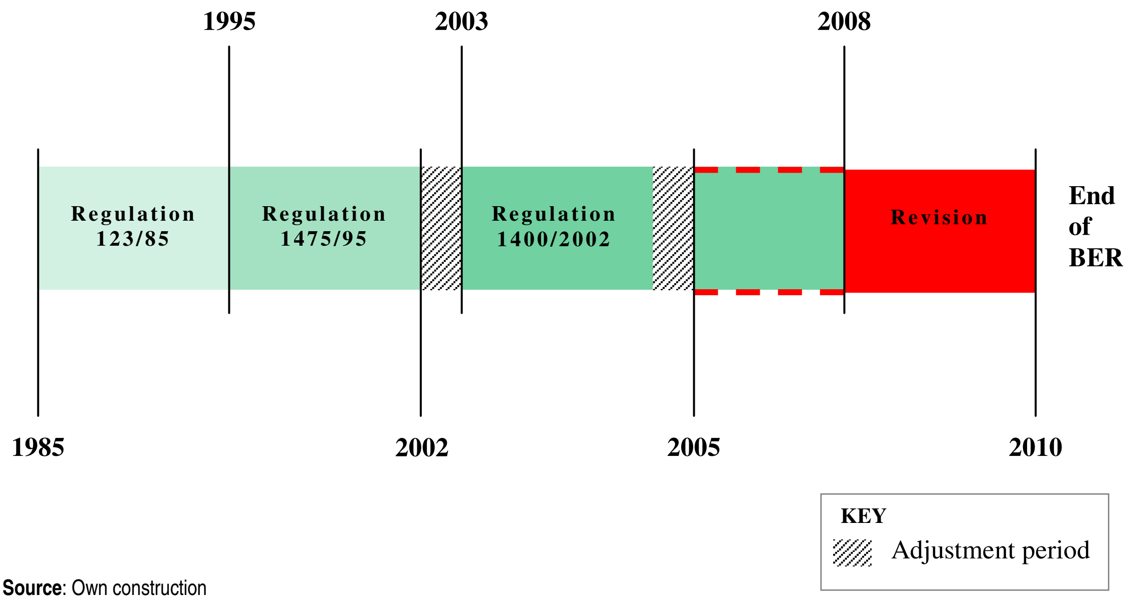
1. That the competition within the European Automotive industry was effective;
2. The automotive dealers had to provide after-sales services;
3. Brand specialists were needed for repairing motor vehicles.

3.2.1. Evolution of the BER.

The BER has changed and improved throughout the years (see figure 2 below). The ultimate goal of these changes has been to enhance the legal structure of the automotive industry, make it more competitive and harmonize the various stakeholders' interests. The first important change came in 1995 when the E.C. implemented a modified BER, Regulation 1475/95, involving a transition period of one year. This modification was due to the EC's observation of certain malpractices, namely the will of some manufacturers to maintain protected territories, which led to heavy fines applied to those OEM's, and the need to improve the Single Market Policy and further enable efficient competition.

[2] www.autointell.com, September 2001

Figure 2: BER Timeline



Source: Own construction

The BER 1475/95 on motor vehicle distribution and servicing agreements provided detailed EU competition rules for the automotive industry. It gave OEMs the right to sell vehicles selectively and exclusively through a dealership network.

The four major objectives for the creation of Regulation 1475/95 were:

1. Increase efficiency of the automotive distribution and service to the advantage of the consumers and to enhance competition amongst OEMs as well as within the distribution systems (the dealership networks);
2. Allow consumers to benefit from the Single Market;
3. Strengthen dealers' independence (hence, decrease their dependence) from the OEMs, including their competitiveness;
4. Allow all stakeholders the ability to compete efficiently in the after-sales market.

Regulation 1475/95 lasted for seven years. It expired on September 30th 2002 and was replaced by Regulation 1400/2002 on July 31st 2002 (*hereafter referred to as the "new regulation"* or *new BER*).

The new regulation, which entered into force on October 1st 2002, introduced a number of substantial changes regarding the exemption of distribution agreements for new motor vehicles and spare parts, as well as for the provision of repair and maintenance services by authorised and independent repairers. These repairers now also include other independent operators such as on-road assistance operators, distributors of spare parts and providers of training for repairers. The EC has, however, introduced transition periods to allow the given stakeholders enough time to adapt to the new regulatory policies, as shown in Figure 1. The first of these transition periods was from October 2002 to October 2003, year in which most of the provision should have taken place. Another transition phase entails the prohibition of dealers in a selective distribution system of opening additional outlets elsewhere in the EU until October 2005[3].

3.2.2. Objectives and Scope of Regulation 1400/2002

The evaluation report adopted by the EC on November 15th 2000 concluded that Regulation 1475/95 did not achieve its principle aims[4], mentioned previously. Applying the general vertical block exemption regulation (Regulation 2790/1999) would also not resolve all the problems identified in the evaluation report, meaning the principal aims would still not be met. Hence, the introduction of the new BER 1400/2002, in place until 2010, although based on the same non-prescriptive approach as Regulation 2790/1999, is regarded as having a stricter approach towards competition.

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[3] More details about selective and exclusive distribution discussed later on in the chapter.

[4] EC Directorate General for Competition (2002). *Distribution and Servicing of Motor Vehicles in the European Union – Explanatory Brochure*.

In relation to the **distribution of new motor vehicles**, the new Regulation is built around the following principles[5]:

- Banning the combination of selective and exclusive distribution allowed by Regulation 1475/95. To benefit from the new Regulation, OEMs have to choose between creating selective and exclusive distribution systems when appointing their distributors;

- Reinforcing competition between dealers in different Member States (intra-brand competition) and improving market integration in particular by not exempting distribution agreements which restrict passive sales, by not exempting distribution agreements in selective distribution systems which restrict active sales, and by not exempting clauses (commonly referred to as "Location clauses") prohibiting dealers in selective distribution systems from establishing additional outlets elsewhere in the Common Market;

- Removing the obligation for the same company to carry out both sales and servicing by not exempting agreements that do not allow dealers to subcontract servicing and repair to authorised repairers who belong to the authorised repair network of the brand in question and who therefore fulfil the OEMs' quality standards;

- Facilitating multi-branding by not exempting restrictions on the sale of motor vehicles of different brands by one dealer. Suppliers may however impose an obligation for motor vehicles of different brands to be exhibited in different areas of the same showroom;

- Maintaining the "availability clause" by not exempting agreements that limit a dealer's ability to sell cars with different specifications to the equivalent models within the dealer's contract range. This should make it possible for a consumer to obtain vehicles from a dealer in another Member State with the specifications

[5] EC Directorate General for Competition (2002). *Distribution and Servicing of Motor Vehicles in the European Union – Explanatory Brochure*, Chapter 3.

current in the consumer's home Member State. For example, allowing UK and Irish consumers to buy new right-hand-drive cars in mainland Europe;

- Supporting the use of intermediaries or purchasing agents by consumers. These operators are an important tool to help consumers to buy a vehicle in another part of the Common Market;

- Strengthening dealers' independence from OEMs, both stimulating multi-brand sales and by strengthening minimum standards if contractual protection and by allowing them to realise the value that they have built up by giving them the freedom to sell their businesses to other dealers authorised to sell the same brand.

In sum, Regulation 1400/2002 sets up a regime that should stimulate the development of innovative distribution methods and thereby enhance competition.

Regarding **repair and maintenance of motor vehicles**, Regulation 1400/2002 is based in the same stricter approach, while retaining certain elements of the previous Regulation 1475/95, since Regulation 2790/1999 does not contain provisions sufficiently adapted to repair and maintenance of motor vehicles. Given the size of consumer expenditure on repair and maintenance (figures available show that the purchase price and the cost of repairing and maintaining a car each account for about 40% of the total cost of ownership[6]), it is important to ensure that they can choose between different alternatives and that all operators (dealers, authorised repairers, independent repairers including body shops, fast fit chains and service centres) can offer good quality services and thereby contribute to vehicle safety and reliability.

Consequently, in relation to repair and maintenance, Regulation 1400/2002 pursues the following aims[7]:

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[6] EC Directorate General for Competition (2002). *Distribution and Servicing of Motor Vehicles in the European Union – Explanatory Brochure*.

[7] EC Directorate General for Competition (2002). *Distribution and Servicing of Motor Vehicles in the European Union – Explanatory Brochure,* Chapter 3.

- Allow OEMs to set selection criteria for authorised repairers, so long as these do not prevent the exercise of any rights enshrined in the Regulation;

- Ensure that if a supplier of new motor vehicles sets qualitative criteria for the authorised repairers belonging to its network, all operators who fulfil those criteria can join the network. This approach will enhance competition between authorised repairers by making sure that operators with the necessary technical expertise can establish themselves wherever there is a business opportunity;

- Improve authorised repairers' access to spare parts, which compete with parts sold by the OEMs;

- Preserve and reinforce the competitive position of the independent repairers; these currently carry out on average 50% of all repairs on motor vehicles[8]. The Regulation improves their position by reinforcing their ability to gain access to spare parts and technical information in line with technical advances, especially in the field of electronic devices and diagnostic equipment. The access right is also extended to training and to all types of tools since access to all four of these elements is necessary if an operator is to be able to provide after sales services. A desirable and important side effect of this wider access is to encourage improvement in independent repairers' technical skills, to the benefit of road safety and consumers in general.

Taking all these elements into account, Regulation 1400/2002 reinforces competition on the markets for the distribution of the new motor vehicles and for the provision of after sales services.

Regulation 1400/2002 expires in the 31st of May 2010. From 2002 until 2008, the European Commission is expected to monitor the effects of the new Block Exemption Regulation on a regular basis, with particular regard to its effect on competition in the motor vehicle retailing and after-sales servicing within the European Union. This will

[8] Accenture (2001). *Study on the Impact of Legislative Scenarios on Motor Vehicle Distribution,* September.

include regular monitoring of price differentials within the Single market as well as on the structure and level of concentration of motor vehicle distribution. As with the previous regulation, the Commission will carry out an evaluation of the impact of the new regulation before it expires and will present a report no later than May 31st 2008.

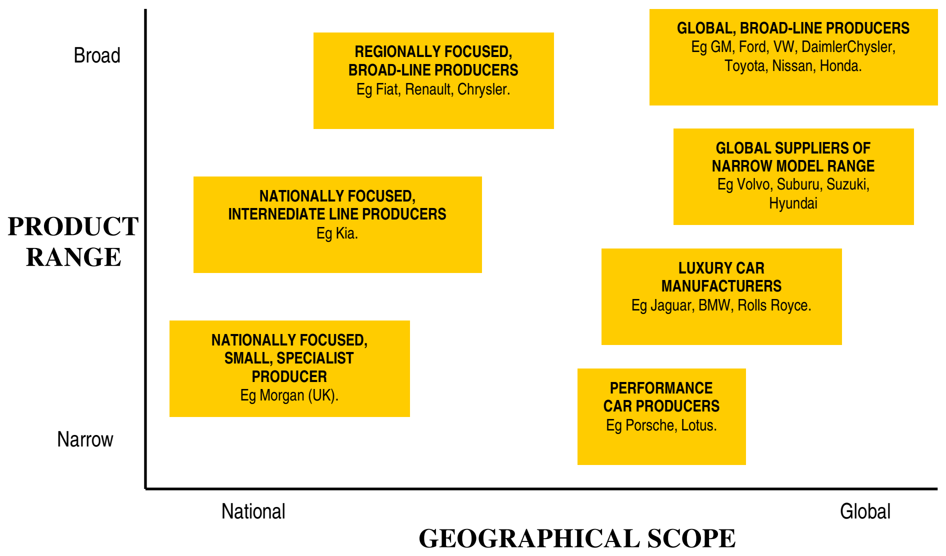
Chapter 4 – The Automotive Industry

4.1. GLOBAL AUTOMOTIVE INDUSTRY – an overview

The automotive industry is often thought of as one of the most global of all industries[9]. However, though its products have spread around the world, and are in most cases considered global companies, in certain aspects, the industry is more regional than global, as certain brands still have a stronger presence, usually in their homeland, in some markets more than others. For example, Ford is very strong in the USA and Volkswagen in Europe.

Nevertheless, the majority are still considered global manufacturers; some more so than others, opting for wider or narrower product ranges, as show in the figure below.

Figure 3: Strategic Groups within Global Automotive Industry



Source: Grant, R., 2005, *Contemporary Strategy Analysis, Fifth Editions* (Blackwell Publishing), p125.

[9] Humphrey, J. (2003). *The Global Automotive Industry Value Chain: What Prospects for Upgrading by Developing Countries*, United Nations industrial development organization.

As the figure shows, some companies have opted for a broader product range, such as Ford, whilst others are more nationally focused and opt for a narrow product range, such as Morgan and Porsche. However, this figure shows each car marque individually. If we were to look at the Brand as a whole, Jaguar, for example, has a limited product range but belongs to Ford, which itself is a global broad-line manufacturer. This is a strong tendency in the global automotive market – to increase the company's product range by buying or merging with companies that offer different product ranges. For example, Ford bought Jaguar, which provided it with an upscale vehicle, and Mazda, providing it with lower cost vehicles.

Hence, globally, the automotive industry is highly concentrated, with a small number of companies accounting for a significant share of production and sales. While there were some new entrants amongst the manufacturers in the 20-30 years up to the 1990s (including firms such as Hyundai in the Republic of Korea and Proton in Malaysia), the effect of the East Asian crisis was that the prospects of these challengers to the dominance of the established manufacturers were undermined. Competition between the Triad producers has led to further concentration.

Greater price transparency, increased competition, rising consumer expectations and quality improvements are all contributing to the squeeze of profitability on vehicle manufacturers. In the USA, domestic vehicle manufacturers have been forced to maintain incentive schemes to keep volumes up[10]. It's costing them dearly, yet their market shares are falling and whenever they try to push prices back up, they have trouble in making them stick.

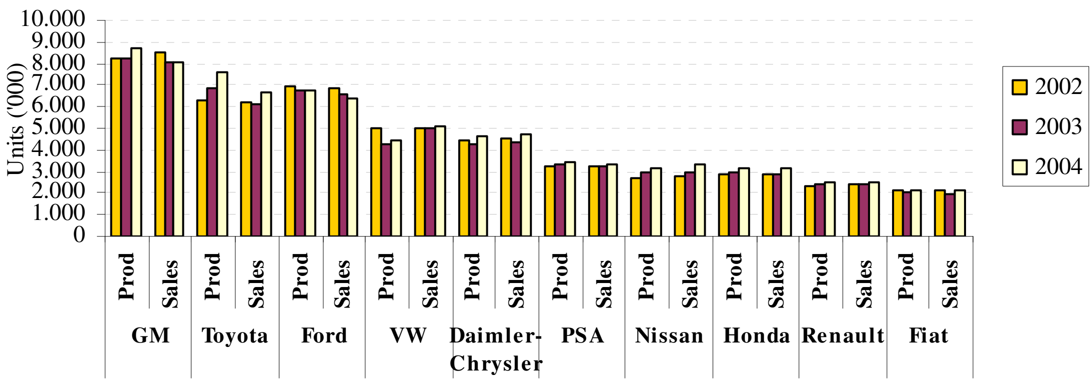
4.1.1. Production and Sales

Excess capacity in the global automotive industry is also hindering the industry's growth. With the prospect of seeing sales fall even further, it is not surprising that some

[10] Just-auto.com (2004). *The automotive industry in 2004 – strategic challenges and opportunities ahead*, January.

manufacturers are facing financial problems. Figure 4 below shows the evolution of the world's automotive production and sales from 2002 to 2004.

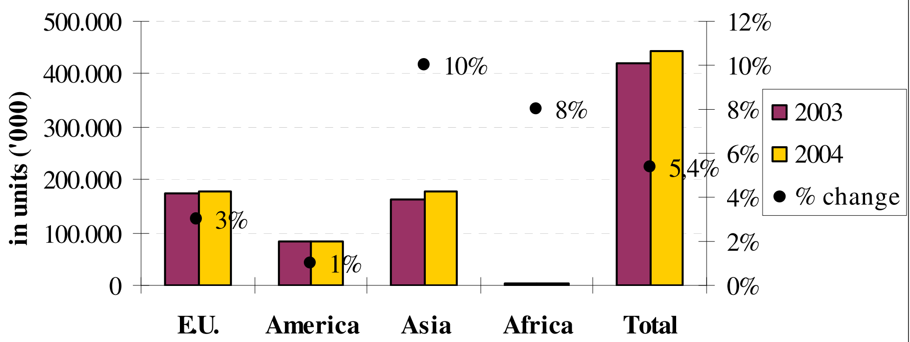
Figure 4: Worldwide Vehicle Production and Sales



Source: Automotive News Europe (2005). *2005 Global Market Data Book*, June 27th.

When analysing each region individually, as shown in figure 5, there has been a small increase in production from one year to the other throughout Europe and America, with the exception of Asia (includes Oceania) and Africa that have seen a significant increase in production (10% and 8% respectively). As the cost of doing business continues to rise in Europe and particularly North America, production is expected to wind down even further in the coming years.

Figure 5: WorldWide Production of Motor Vehicles per region



Source: OICA (2005). *Correspondents survey*).

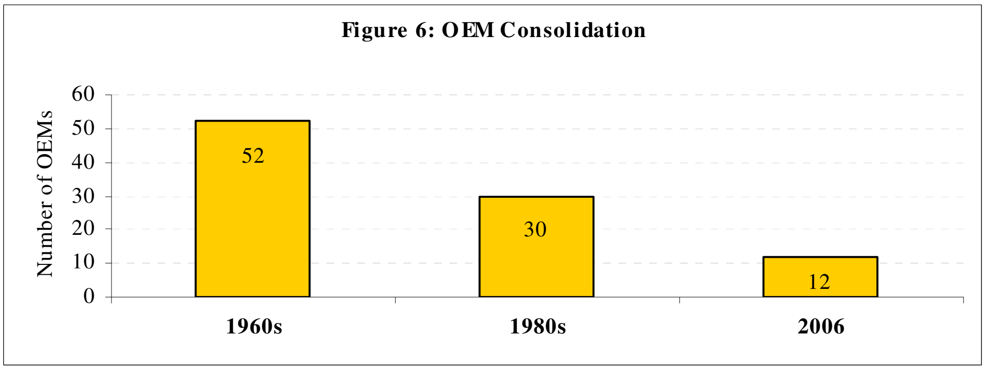
4.1.2. Competition

Throughout its history, the automotive industry has undergone mergers and acquisitions (M&A). Relatively recent M&As include the control of Chrysler (1998) and Mitsubishi (2000) by Daimler-Benz; the purchases of Jaguar (1998), Volvo (1999) and Land Rover (2000) by Ford; and of Seat (1986) and Skoda (1990) by Volkswagen. Even more recently, it has been mentioned that talks are undergoing between GM and Renault-Nissan to review the benefits of a potential alliance. Manufacturers have also used M&As to enter expanding markets such as Korea, for example, Renault's purchase of Samsung (2000), General Motors purchase of Daewoo (2003), and Daimler-Chrysler's 20% stake in Hyundai. Some analysts predict that only six global producers will survive: two in Europe, two in Japan, and two in the US. This prediction is fast becoming true in Japan and in the US, but Europe still retains six major car and five major truck producers (VW Group, PSA Group, Renault, Fiat Group, BMW Group).

Yet, not all consolidations have been successful. The best-known recent failure is probably the BMW purchase of Rover in 1994 that ended in 2000. Other consolidations are still yet to be judged upon. Some however have been successful, such as the Seat and Skoda purchases by Volkswagen and the Renault/Nissan alliance. Alternative strategies, such as alliances on particular models or engines, are also emerging. Examples include the cooperation between Peugeot-Citroen and Toyota to build a new small car in Kolin in the Czech Republic; Or that between GM and Fiat to share platforms, engine and transmission operations. Peugeot-Citroen is also working with Fiat on passenger vans, and with BMW and Ford on engines. It may be that a web of cooperative ventures will become a prevalent pattern for European car assemblers.

In 2004, according to a report "Extinction of the predator" published in The Economist (2005), 10 companies alone produced more than 1 million vehicles each. A total of 58 brands survive amongst the ten largest manufacturers. In fact, if their affiliates as well as their wholly-owned companies are counted, the top five company alliances account for 75% of the global market, while adding the next five takes this to as much as 90%.

The degree of concentration in the global automotive industry in 2006 is shown in the graph below. As shown, the level of concentration from the 1960s to today has been drastic. In just over 40 years the number of vehicle manufacturers has decreased by 77%.



Source: Accenture (2006). *High Performance in the Automotive Supplier Industry*, January 31st.

Further consolidation, in today's environment, seems unavoidable. The global automotive industry is unquestionably one of the most competitive industries in the world, and all signs indicate that it will only get tougher.

4.2. EUROPEAN AUTOMOTIVE INDUSTRY

4.2.1. General Environment

The automotive industry is often depicted as "the engine of Europe" because of its economical and social importance and the historical role it has played in the development of the European Union[11]. The European automotive industry is a key player in the European Union of the 21st Century. It is an essential part of the economic backbone of Europe due to its contribution to the overall economy and because it generates significant activity for other industries, such as components, electronics, informatics etc. It contributes to the strength and competitiveness of Europe through fiscal revenue, external trade, research and innovation.

[11] www.acea.be - ACEA mission statement.

The automotive manufacturing industry is a huge contributor to the EU's prosperity, accounting for 3% of EU GDP and 7.5% of total EU manufacturing. The sector is a major source of employment (2 million direct jobs, supporting an additional 10 million indirect jobs), a significant investor, a key contributor to the European trade balance, a major player in R&D expenditure and an important source of fiscal revenue. Other economic inputs include:

- *16.9 million vehicles produced of worldwide production;*
- *33 billion € in investment;*
- *19 billion € in R&D expenditure (5% of OEM's turnover)*
- *340 billion € of tax revenue (all taxes from Motor Vehicles)*

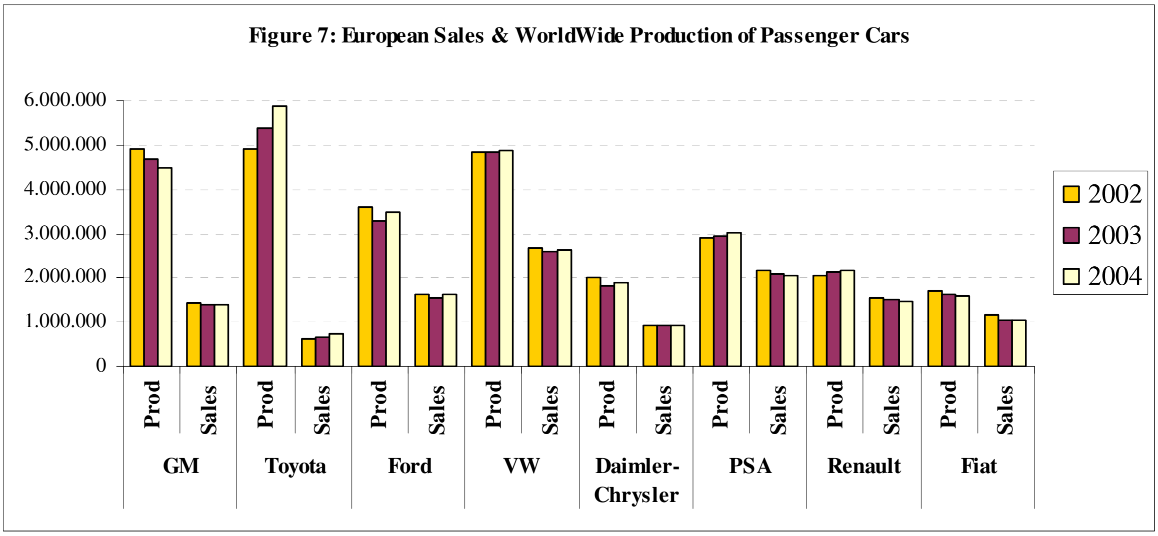
However, while Europe's automotive manufacturers have increased their productivity and competitiveness, the conditions in which they operate has worsened, and the overall economic environment remains challenging. Domestically, the EU automotive market is the most competitive and least profitable in the world due, in large part, to the costs of doing business in Europe and the increasingly complex, dense and (often) conflicting set of regulations weighing on the industry. Also, the sustained weakness in the dollar and the strength of the Euro has created an extremely difficult environment for exports and weak growth has led to reduced consumer and business confidence.

The continued stagnation of the economies of Continental Europe has lead to uncertainty over future growth and employment, creating a difficult environment for new vehicle sales. The taxation burden placed on vehicles is also rising. High oil prices have also increased pressure on the market. This, together with the increasing use of sur-charges to deter vehicle use, particularly in cities, has added to the operating costs that users face and may cause them to defer the purchase of a new vehicle.

Balancing the regulatory burden and working to remove international trade barriers is essential to enable European automotive manufacturers to maximise their potential contribution to the EU economy, as well as increase market competitiveness in the consumer's favour, as well as their own.

According to Ivan Hodac (Secretary General of Association of European Automobile Manufacturers), in the 2004 European Automobile Industry Report, "The EU automotive industry operates in the most competitive market in the world. While adopting a more measured approach to regulation would certainly help the industry compete on a more level basis with its American and Asian counterparts, other areas of policy also require attention if the industry is to realise its potential contribution to economic growth and exports. The rapid completion of the Internal Market in the automotive sector, including fiscal harmonization of vehicle and fuel taxes, alongside further development of efficient road infrastructure is essential. Although the industry already spends 5% of its turnover on R&D, further measures to promote R&D and the take-up of new technologies should also be a priority. In addition, the failure of the WTO talks should not stand in the way of renewed efforts to improve the market access of European products in worldwide markets. Lastly, more flexible labour conditions to boost competitiveness should be considered".

The historic event of the enlargement of the EU to 25 member states during 2004 poses both challenges and opportunities for the automotive industry. According to the 2004 European Automotive Industry Report by ACEA, "Under enlargement and the prosperity that it will bring to new Member States and their citizens, automotive manufacturers in both the EU 15 and the new Member States are anticipating rapid growth in the market for new vehicles. Some estimates suggest that the market may grow by up to 150% over the next 15 years". However, not all stakeholders are as optimistic. As the figures in graph below show, most OEM's European sales have fallen or stagnated from 2002 to 2004. (Note: these figures do not include the new E.U. members). Meanwhile, worldwide production, in most cases, continues to increase.



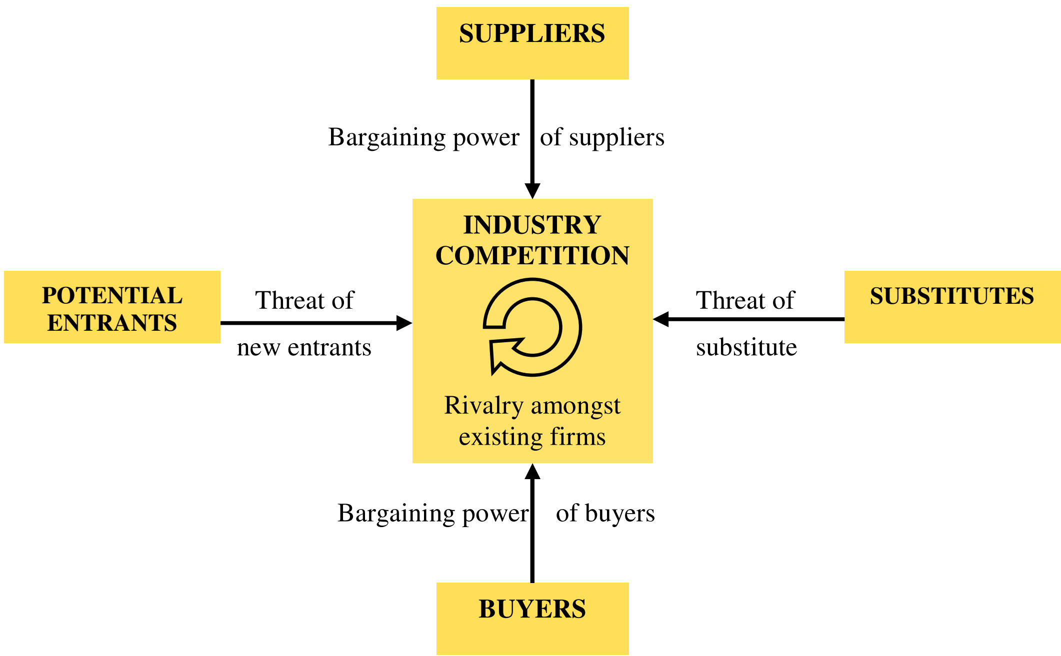
Source: ACAP (Associação do Comércio Automóvel de Portugal)

The European Commission believes that the new Member States will have a positive impact on the number of sales, as well as the number of vehicles produced, within the European Union. The new Member States can still offer lower production costs and therefore entice further production within their country boundaries. However, the query still remains: The new EU members may make a difference but when will this change begin to show? Hopefully, as soon as possible, in order to reverse the market stagnation presently being felt throughout the world.

4.2.2. Porter's Five Forces of Competition Framework

There are many features in an industry that determine the intensity of competition and the level of profitability. A helpful, widely used framework for classifying and analysing these factors is the one developed by Michael Porter. Porter's Five Forces of Competition framework views the profitability of an industry as determined by five sources of competitive pressure. These five forces of competition include three sources of "horizontal" competition (Competition from substitutes, competition from entrants, and competition from established rivals) and two sources of "vertical" competition (bargaining power of suppliers and buyers). These five points are analysed in more depth below, <u>from a Manufacturers point of view.</u>

Figure 8: Porter's Five Forces of Competition framework



Source: Grant, R., 2005, *Contemporary Strategy Analysis, Fifth Editions* (Blackwell Publishing), p74.

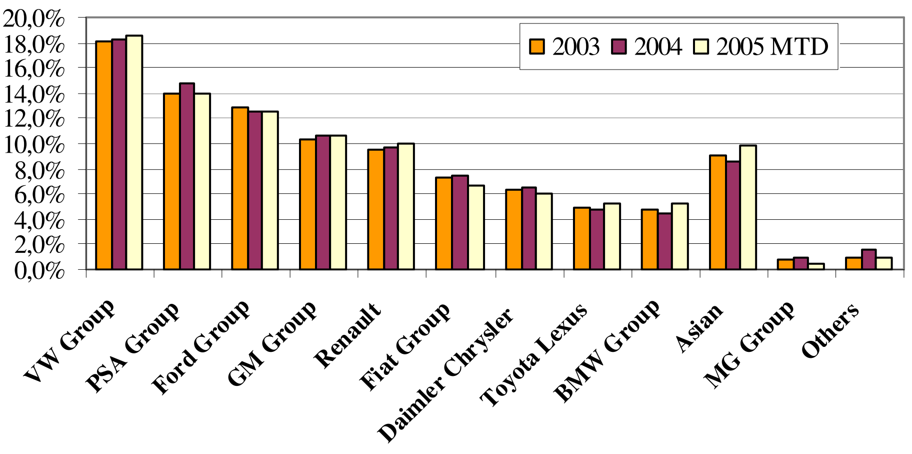
Rivalry amongst Existing Firms

In general, the level of competition and profitability within an industry is determined by the organisations within the market itself. We can analyse four factors that play an important role in determining the nature and intensity of competition within the Automotive Industry, as follows:

Concentration – As stated previously in the "Global Automotive Industry" at the beginning of this chapter, globally, the automotive industry remains highly concentrated, with a small number of companies accounting for a significant share of production and sales. The degree of concentration in the global automotive industry in 2004 is shown in figure 6 on page 30. The European automotive industry has undergone the same level of consolidation, with only three major players in the European market (PSA Group, Renault and Fiat) remaining.

Diversity of Competitors – The extent to which organisations can avoid price competition depends greatly on how similar they are in relation to objectives, costs, and strategies. The intense competition felt in the European Automotive industry is partly due to the different national origins, costs, strategies and management styles of competing organisations. Figure 8 below summarises the market share of the top 11 manufacturers in the European market. Unlike the global market share, the figure below shows that the strongest manufacturers in Europe are the "national" manufacturers (VW Group, Germany; PSA Group, France).

Figure 9: Market share (EU15+EFTA)



Source: ACAP (Associação do Comércio Automóvel de Portugal).

The European automotive industry suffers intense competition and therefore, requires operations to be carried out with maximum efficiency. The key to remain competitive is large-scale production to reduce the value of fixed costs per vehicle. With increasingly sophisticated vehicles and rising investment costs, the optimum economic scale increases. Companies have thought to achieve economics by maximising volumes and standardising parts across their model ranges. The outcomes are investments in high capacity, an on-going trend towards mergers and acquisitions, as shown previously, and a rising number of cooperative ventures. Such examples include the sharing of R&D costs, and construction platforms.

Product Differentiation – The more similar the products amongst rival organisations, the more likely customers will shop around for substitutes, increasing the probability of organisations cutting prices in order to increase sales. Though aesthetically the products within the automotive market are different, they do have some similar characteristics (e.g. engine sizes) and are segmented as such (e.g. Segment B includes the Ford Fiesta or the VW Polo; Segment C includes the Ford Focus or the VW Golf).

Cost Conditions and Over Capacity – Excess capacity, as seen in the European Automotive market, can cause increased price competition. Economies of scale can also lead to price wars, as organisation fight to gain the cost benefits derived from greater volume. Generally, companies have the tendency to be over confident in sales predictions. Fiat, Ford and GM's subsidiary Opel have all seen sales fall over the last few years resulting in cut backs, including plant closures and almost 45.000 layoffs or redundancies. GM has closed the Luton factory (UK) and reduced production at Antwerp (Belgium) and Bochum (Germany) with layoffs totalling 20.000. Ford has closed five out of eleven European plants, ended car production at Dagenham (UK) and closed the shift at Genk (Belgium), resulting in 3.000 redundancies. Portugal has also recently seen car manufacturers, such as GM, and suppliers, closing manufacturing plants within its borders. Unfortunately, further closures will still undoubtedly occur.

The capacity issue has a strong influence on industry economics, as vehicle prices are calculated on forecast capacities and reduced capacity means higher unit costs. Vehicle makers, therefore, often attempt a balancing act where a proportion of the excess is discounted heavily through the dealerships. Another solution is through cut-price deals to rent-a-car and leasing companies.

However, the picture is complex. Excess capacity in some plants is mirrored by shortages elsewhere. Volvo, another part of Ford, is expanding production in its Ghent (Belgium) plant and taking on 800 additional workers. Others suffer from capacity shortages when sales are high. Peugeot-Citroen, for example, on the basis of two shifts, is operating at 117%. Another success story, BMW's production (UK), is running at maximum for the plant. Also, some spare capacity and versatility is necessary – as shown by Volkswagen's ability to shift Polo production from Bratislava (Czech Republic) to Spain when sales of the Touareg SUV exceeded forecasts.

Threat of Entry

The threat of entry within the Automotive industry is someone limited, greatly due to the vast capital requirements needed to enter. The most relevant sources of barriers to entry into the Automotive market are highlighted next.

<u>Capital requirements</u> – entering the automotive industry requires huge capital costs involved in establishing R&D, production and distribution. Nevertheless, there have been a number of new Asian brands that have managed to enter the market through innovation (hybrid engines etc.), and significantly lower prices due to low labour costs and reduced R&D costs.

<u>Economies of Scale</u> – In industries that are capital and research or advertising intensive, as in the case of the automotive industry, efficiency requires large-scale operations. The barrier for new entrants is that they are faced with either, entering on a small scale and accepting high unit costs, or entering on a large scale and running the risk of under-utilised capacity whilst building up sales capacity, never knowing whether they will actually manage to penetrate the market or not. In the automotive market, it is believed that, to be a low-cost producer, sales of over four million vehicles a year are necessary (GRANT, 2005). These economies of scale requirements have deterred entry into the industry so that the only new entrants in recent decades have been state-supported companies (e.g. Proton of Malaysia and Maruti of India) or companies that gambled that low input costs would

offset their scale inefficiency (e.g. Samsung and Ssangyong of Korea, both of which faced great difficulties in 2000). The main source of scale economies is new product development costs and, as the developing and launching of a new model averages at over $1.5 billion (GRANT, 2005), the entry barrier is extremely high.

Distribution Channels – Access to distribution channels and, in the case of the automotive industry, the cost of building new distribution channels incurs huge research and investment costs. As an example, the creation of a distribution channel will include costs such as stock depots, sales outlets, logistics, to mention but a few.

Governmental and Legal barriers – Focusing on the European Union, for example, Asian and other foreign producers wishing to enter the European market may be hindered by politics, quota issues, lobbying etc, including tax restriction discussed below. As Europe is a prime automotive market for any manufacturer, not managing to successfully enter the market may bring about the whole company's collapse. Yet, the actual attempt at entering the European market itself can lead to the company's collapse.

Prices - A fierce obstacle (or window of opportunity) within the European automotive market are the different cross-border price wars, driven mostly by different car taxes among Member States. It is believed, however, that this will tend to harmonise at a short to medium time level.

The European Commission's latest report on car prices shows new car prices continuing to converge across the enlarged EU. New Member States are responsible for this convergence, while convergence in older Members seems to have peaked.

Competition Commissioner Nellie Kroes commented (http://europa.eu, 2006), "Price convergence for cars continues to improve in the EU, especially in the new Member States. However, price differences for certain models remain significant and consumers should not hesitate to make competition play so as to benefit from good deals that still exist when buying aboard".

EU competition rules for the motor vehicle sector aim, in particular at removing obstacles to parallel imports throughout the EU. The Commission has already brought several cases against car manufacturers who were limiting parallel imports of cars and will continue to do so.

But the doubt still remains – will prices in Europe ultimately come closer to harmonisation? There are some strong factors working for and against this idea.

Factors favouring price harmonisation:

- Legal pressures
- BER changes could encourage new distribution channels that might exploit any price differences
- Consumer pressures
- Competition between markets
- Influence of Pan-European Fleets and Leasing Companies
- Internet

Factors working against price harmonisation:

- Varying economies
- Taxation variations
- Currency fluctuations
- Potential loss of revenue by the industry due to reduction of prices and residual values.

We do not yet have a single European economy. Whilst Spain and Italy have relatively low prices, the price of a car in relation to disposable income is high. Therefore, manufacturers will inevitably have to ensure their products are affordable in each market, which may work against harmonisation. Profit margins also hinder price harmonisation. Figures from Price Waterhouse Coopers (YARROW, 2001) show that dealers and manufacturers make on average less than 2% and suppliers 4%. Therefore, any significant drops in sales income could have a dramatic effect on some manufacturers.

Therefore, if price harmonisation does occur, it will be a key driver for manufacturers to change the way cars are sold and distributed in the future in a way which reduced distribution costs and hence increases profitability.

Taxation - The reform of passenger car taxation within the EU has been on the agenda for some time now. The current confusing and disparate collection on national taxation regimes works against the proper functioning of the internal market and disadvantages both consumers and manufacturers alike.

The EU Commission's proposal to abolish registration taxes is one that most stakeholders welcome. Registration taxes not only distort prices between the Member States but they also tend to contradict policy goals by slowing down the renewal of older vehicles with new safer and more environmentally friendly ones. Manufacturers also suffer additional costs through the existence of registration taxes, arising from the necessity to produce slight variations in model types to meet diverse tax-related technical thresholds.

One alternative, placed by ACEA (2005), to replace vehicle registration tax is what they call the "user pays" principle. The principle suggests that cars are taxed according to the extent to which they are used and that an annual circulation charge may also be a necessary element to a taxation system.

Figure 10: Motor Vehicle Taxation Levels in the EU
(Tax as a % of the net price of the car)

	A	B	D	DK	E	F	FIN	GB	GR	H	I	IRL	NL	P	PL	S
Other	10,0	4,0%	0,0%	173,0	12,0	0,0%	29,0	0,0%	40,0	35,0	1,0%	36,0	35,0	60,0	3,0%	7,0%
Tax	20,0	21,0	16,0	25,0	16,0	16,6	22,0	17,5	18,0	25,0	20,0	21,0	19,0	21,0	22,0	25,0

Source: ACEA – European Automobile Manufacturers Association (2005). *European Automobile Industry Report*.

Taxation is one of but not the only driver of price differences. Inevitably when taxation varies from as low as 28% in Spain to over 60% in Portugal and Denmark, manufacturers themselves adjust their pre-tax prices to reflect this and to make the retail prices affordable for the local economy. The different taxation levels throughout the European Union are shown in the figure above.

Retaliation – Barriers to entry also depend on the entrants' expectations as to possible retaliation by established organisations. Retaliation against a new entrant may include aggressive price-cutting, increased advertising and/or sales promotion. In order to avoid this type of behaviour by already established organisations, new entrants may opt to enter market niches first, on a small scale. For example, Daimler Chrysler first entered the Portuguese market with only one vehicle model, the Cherokee Jeep. Only now, several years later, have they slowly introduced their other models.

Competition from Substitutes

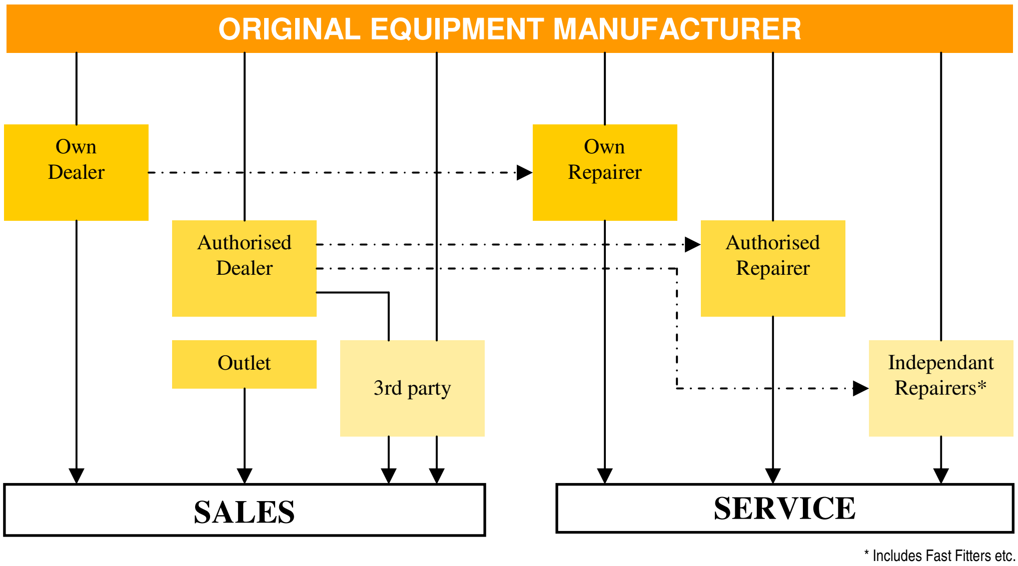
The price customers are willing to pay for an automobile partially depends on the availability of substitute products. The absence of close substitutes for a product means that customers are relatively insensitive to price. On the other hand, if a product has close substitutes, customers will switch to substitutes in response to price increases for the product. In the automotive industry, substitute products include other means of public and private transport.

Bargaining Power of Buyers

Bargaining power of buyers is the extent to which buyers of the products in an industry have the ability to influence the suppliers. Regarding automobiles, consumers have a large variety of products to choose from, and now supposedly, with the new BER, a large variety of markets, they have an important power over the supplier.

Generally, however, due to the entry of the new BER and the serious issues OEM's are facing with excess capacity, the selection (type) of distribution outlets of new vehicles and after-sales servicing has enlarged somewhat and consumers now have various options when looking to buy or service a vehicle. As figure 11 below shows, OEMs can channel their products through an OEM owned dealership, an authorised dealership, or a third party, such as an auto-centre. And, nowadays, OEMs have to content with the fact that all manufacturers can use the same sales outlets, and that consumers have a variety of brands, prices ranges and services readily available in one sole location. With such a vast array of choices the result may be sellers looking for buyers and not the other way round.

Figure 11: Sales and Servicing Vehicle Distribution



Source: Adaptation from Accenture (2002). *European Community Block Exemptions: A New Roadmap for Competition in the Automotive Marketplace*.

Bargaining Power of Suppliers

Contrary to the situations stated above, in this particular analysis the buyer is the OEM and the supplier, parts suppliers, such as Bosch and Delphi. But, regardless of the role changes, the bargaining power of suppliers is somewhat similar to the bargaining power of buyers. In this case, it relates to the extent to which suppliers have the ability to influence potential buyers. Once again, due to the large variety of products and markets, the buyer has the upper hand. However, this power is not as straight-lined as it seems.

Following the crisis in the 1970s and 1980s, at a time when the potential of Japanese imports was a concern, European manufacturers sought to improve quality and reduce costs by rationalising the supply base (European Monitoring Centre on Change, 2004). Vehicle makers reduced the numbers of direct suppliers and gave more responsibility to a small group of large suppliers. In many instances, this resulted in the outsourcing of whole modules (areas of the cars such as interiors or corners) or systems (functions of the car such as braking and steering). These are often pre-assembled by large suppliers who have, in turn, integrated the purchase assembly of components from smaller suppliers and sub-contractors.

European vehicle manufacturers have also outsourced high value design and engineering functions. This has lead to the development of an industry segment providing design and engineering services. The case study company AVL (Austria), is an example of a firm that has benefited from this trend. Others include EDAG Engineering (Germany) and Ricardo (UK). Another group of companies offer full production facilities in addition to design and engineering services. These firms, such as Magna Steyr (Austria), Karmann (Germany), Matra (France), Bertone and Pinin Farina (Italy) and Mayflower (UK), have the capacity to develop and build the small volume niche vehicles that are popular with European consumers.

As suppliers continue to consolidate, driven in part by the vehicle manufacturer's strategies to reduce supplier numbers, important technologies and know-how is gained but greater dependency is also created. Therefore, a mutual dependency is created. However, as recent developments in the automotive supply industry have shown, suppliers do not have the financial stability to have the upper hand. Suppliers are more dependant on OEMs than OEMs on suppliers. An OEM has the power to change supplier at any given time, and with such a negative economy as Europe is facing at present, it will find another supplier easily. A supplier finding another OEM, on the other hand, will not be easy.

The different tier suppliers and their role in the automotive industry are highlighted below.

Suppliers

Global mega-suppliers – These firms supply major systems to the assemblers. They are sometimes referred as "tier 05" suppliers, because they are closer to the assemblers than the 1st tier suppliers. These companies need to have global coverage, in order to follow their customers to various locations around the world. They need design and innovation capabilities in order to provide "black-box" solutions for the requirements of their customers. Black-box solutions are solutions created by the suppliers using their own technology to meet the performance and interface requirements set by assemblers.

1st-Tier Suppliers – These are firms, which supply direct to the assemblers. Some of these suppliers have evolved into global mega-suppliers. 1st tier suppliers require design and innovation capabilities, but their global reach may be more limited.

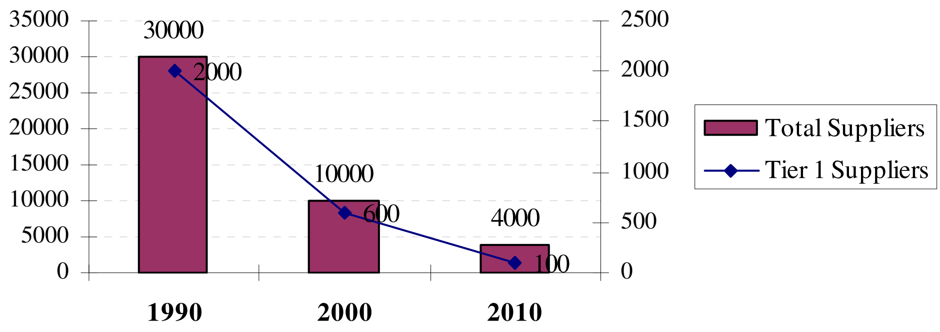
2nd-Tier Suppliers – These firms will often work to designs provided by assemblers or global mega-suppliers. They require process-engineering skills in order to meet cost and flexibility requirements. In addition, the ability to meet quality requirements and obtain quality certifications (ISO 9000 and increasingly QS 9000) is essential for remaining in the market. These firms may supply just one market, but there is some evidence of increasing internationalisation.

3rd-Tier Suppliers – These firms supply basic products. In most cases, only rudimentary engineering skills are required. A study by Leite (1997) of skills and training at different parts of the automotive value chain in Brazil showed that in the 3rd tier of the component chain, skill levels and investments in training were limited. At this point in the chain, firms compete predominantly on price.

After-market – A further important segment of the automotive value chain is the market for replacement parts. This is the sector that many firms in developing countries first moved into. Even before local assembly sectors were developed. Nowadays, there is an international trade in after-market products. Firms in this section compete predominately on price. Access to cheaper raw materials and process-engineering skills is important. Innovation is not required because designs are copied from the existing components, but reverse engineering capability and competence to translate designs into detailed drawings are important.

As stated, consolidation has not only affected OEMs. Trends in outsourcing and the logical benefits from scale have led to even further major consolidations in the supply industry. And, under the constant cost pressures from automakers, the trend of supplier consolidation is likely to go further. The evolution of the number of automotive Tier 1 suppliers and Total Suppliers is shown in figure12 below.

Figure 12: Supplier Consolidation



Source: Accenture (2006). *High Performance in the Automotive Supplier Industry*, January 31st .

As the figure above shows, the supplier industry will continue to restructure itself and further consolidation is expected to take place, with a 40% estimated reduction in the total number of suppliers by 2010.

In conclusion, with ever increasing barriers to entry, and fiercer competition, the European Automotive Industry seems highly unattractive. Yet, it is a strategic market of great importance and no manufacturer can afford to ignore it. The market is saturated, production costs are increasing, but manufacturers will have to grin and bear it, or dissolve. Some may "survive" by dissolving into other companies, by forming further strategic alliances, but others may take advantage of those in difficulties and acquire them as a fast track entrance into such an important market.

4.3. EUROPEAN AUTOMOTIVE INDUSTRY – SWOT Analysis

Strengths

The European automotive industry is an extremely competitive industry. Its consumers are highly demanding, resulting in the creation of innovative and precision engineered products, especially in the premium and high performance sectors. The automotive industry is present in all world markets, and is particularly strong in emerging markets. The

European Automotive market has a strong presence in the premium and high performance sectors (for example BMW, Mercedes, Ferrari, etc.) which further drive innovation and are highly profitable. Regarding its suppliers, previously a strong independent supply base, OEMs have recently shown a more stable financial standing than most of its suppliers. In 2006 alone we have seen number one suppliers such as Delphi, go under and only survive due to the large stakes OEMs have in the supply business.

Weaknesses

The two main weaknesses involve the continual difficulty in matching Japanese quality and the inability to design and create vehicles that "work" across all markets, especially those that are compatible in Europe and the U.S. The failure of European and Asian manufacturers in entering the U.S. market due to the lack of appropriate products (with the exception of premium products such as Mercedes and Lexus) is hindering further growth.

Opportunities

There is a vast array of opportunities within the European automotive markets. With the enlargement of the E.U. and the opening up of the Chinese market, new markets have emerged creating ideal market conditions for growth. This includes not only sales but the opportunity for future economies of scale and innovation through cooperative ventures with these "new" countries, as well as, exporting of high value services such as design and know-how (engineering, recycling expertise, etc.). If a proactive approach towards these market changes is taken, the European Automotive industry will have the potential to gain further external economies through strategic networks.

Threats

But if the road to success was as simple as discussed in the paragraph above, all manufacturers and suppliers would be following the same path. Unfortunately, they are not, because too many companies are in a weak financial position. And to aggravate this further, the emergence of the new markets has its positive sides (as mentioned above), but also poses a serious threat towards European manufacturing plants. For example, plant capacity in new markets may be underutilised, and therefore may emphasise capacity issues in Western Europe. If plants, for example, in China and India are being underutilised but show that producing a spare part or vehicle there is cheaper than in Western Europe, the manufacturer may transfer its production to the lower cost area, and therefore endanger European production even further. The same applies to small scale suppliers, those lower down in the supply chain, also threatened with competition from low cost locations.

Other examples of threats within the European Automotive industry include further market consolidation. There are still some smaller scale manufacturers (for example, BMW) and suppliers that are still relatively vulnerable to takeover. Additionally, takeovers can cause loss of technological know-how including core competencies, especially in the supply industry.

Chapter 5 – Expected Impact of the new B.E.R. upon the Automotive Industry

The new Block Exemption Regulation affects all the automotive industry's main players, especially the following: the manufacturers, the dealerships, the repairers, and consequently, the consumers. Chapter 5 discusses the expected effect of the regulation on each player individually, in relation to each one's internal and external environment. The following chapter (chapter 6) will analyse what has actually occurred so far, rather than what was expected.

In summary, a company's internal environment includes its goals and values, resources and capabilities, and its structure and systems. In the study below, this has been narrowed down and the analysis focuses mostly on sales, after-sales, and its managerial structure.

Its external environment consists of a whole range of economic, social, political and technological factors that influence a company's decisions and its performance. Generally, a company's most important external environment is its industry and most importantly, the creation of relationships between the company and its external stakeholders; its competitors, suppliers, and customers. A positive relationship between the company and its stakeholders will enable it to work efficiently and prosper. A more detailed analysis of the external environment (the automotive industry) was provided previously in chapter 4 but the most important factors will be reiterated below. Additionally, "consumers" will be discussed separately at the end of the chapter.

5.1. ORIGINAL EQUIPMENT MANUFACTURERS

Under the new BER, OEMs will retain the right to select dealers, but have to choose between two different distribution systems, exclusive or selective distribution, discussed later on in this chapter. Whichever distribution system an OEM chooses, they will find it a more challenging task to control their distribution networks than they did prior to the new BER.

Yet, the new BER has many more implications than the restructuring of its distribution network. OEMs have historically had the upper hand in their relationship with the dealerships and tended to "push" their products onto the dealers. Additionally, OEM's have, for example, traditionally protected and controlled the investments their dealers made, most of the time with the aid of the location clauses in their dealership contracts. Though this may have hindered growth of some more proactive dealerships, it also protected them from competing dealerships. The selective distribution system, chosen by all manufacturers except Suzuki, has removed this market protection, and therefore increased the levels of risk the dealers are prone to. Hence, OEMs will have one less enticing feature to offer their dealers, as they can no longer guarantee a return on their investment via the means of territory exclusivity.

Now OEMs are also limited as to what ways they can further attract their dealers and impose criteria that they must comply with. Previously, for example, OEMs typically relied on tightly written contracts to manage their dealership networks but the new BER is hoping to give dealers much greater independence.

The balance of power between the two parties will also affect how OEMs compensate dealers. In the past, OEMs used a wide range of incentives such as interest rate subsidies on inventory and cost breaks on investments in new technology in order to stimulate the market and rid themselves of surplus inventory. Now, however, they cannot simply push the product down the dealer pipeline. As the relationship between the two parties changes, many of the traditional devices OEMs used to boost the market will no longer be suitable. Other methods will, and have already been, envisioned.

Sales

The new BER will also have profound consequences on how new vehicles are marketed and sold. The major change involves multi-branding – Dealers can now sell competing products in the same showroom, as long as they abide by each manufacturer's display criteria, such as minimum showroom size. With the loosening of the rules on multi-branding, OEMs will be able to sell through more outlets, though their products will be subject to greater competition – both between manufacturers and between brands.

According to a report published by Price Waterhouse Coopers (2003), OEMs are divided in their attitude to this risk. Some of the newer OEMs (such as the Japanese and South Korean manufacturers) welcome the move because they believe it will open up retail spaces that have previously been closed to them. But many of the larger, more established OEMs do not wish to see their vehicles displayed in the same location as smaller or less prestigious models because they fear it will have a negative impact on their brand identity and destroy the traditional emphasis on knowledgeable sales people who promote the positive features of the product on offer.

But, greater competition and loss of brand protection are not the only risks. The whole "act" of selling vehicles may suffer an even more "frightening" challenge – for example, a retailer's brand becoming more important than the OEMs brand and hence, the quality of a display becoming more important than the product itself. The automotive industry may well undergo a similar shift to a classic retailing model, in which OEMs purchase floor space to ensure their vehicles are properly displayed, as traditionally takes place with supermarket products, for example. Different OEMs would then have to fight both for space and for the most favourable locations and product displays in the retail outlet.

After-sales and servicing

Changes in after-sales servicing will also pay its toll on the OEM. First, OEMs will be unable to ensure that all the elements of sale and service are available everywhere. Second, they will assume an increased legal risk. An OEMs guarantee continues to apply regardless of where a new car is sold or where it is serviced, as long as it's serviced by an authorised repairer. As OEMs will have less control over their sales and service networks, they will inevitably find themselves a lot more exposed. Also, as profit margins on after-sales servicing are much higher than in sales and, hence, competition to service new cars gets stronger, after-sales servicing is likely to become a major battlefield. This might have a negative effect on the OEM´s effort in maintaining its brand identity.

Management

The ultimate changes the new BER will cause affect the way in which the OEMs will face these managerial and financial risks. To begin with, OEMs will have to work harder to reach their customers and retain their loyalty. Currently, a customer usually buys a vehicle because a particular manufacturer makes it, but the OEM retains little information on that customer beyond the point of sale. However, as classic retailing increase the strength of the retailer's brand, the relationship between manufacturer and customer is in danger of becoming even more obsolete. Accordingly, OEMs will need to collaborate more closely with their new retail networks to get greater access to customer information and, ideally, set up systems that enable authorised retailers and after-sales service providers to share details of a vehicle's service history. OEMs tend to employ few people with a backgound in retailing, but if they are to help their retailers compete in a much more aggressive environment, they will need to acquire the necessary retailing expertise.

But, the presumed greater ease with which consumers can buy across borders has more serious implications. It could create a situation in which different parts of the same OEMs network are in competition with each other. OEMs have traditionally adjusted new vehicle prices to reduce the impact of a number of factors, including different tax regimes and different economies – a feasible activity while cross-border sales were relatively small. But parallel importing has increased substantially in the past few years and consumers can now go to countries where list prices have been kept low because taxes are high. This can have a major impact on how OEMs set sales targets. The result may be, setting sales and bonus targets for the whole EU rather than for each dealership individually. Cross-border trading may make market demand predictions an even harder task than it already is.

These are all the initial signs indicating that the OEM's competitive environment will become even more challenging. According to the European Commission, one of the objectives of the new BER is to reduce the power the OEMs have over the dealerships, giving dealers more independence and more room for manoeuvre. But, in doing so, the dealership will also become more vulnerable to outside pressures from stronger and more organised networks.

5.2. DEALERS

One of the European Commission's main aims in establishing the new BER is to allow dealers more flexibility and independence. Having said this, dealers will ultiamtely have to be much more proactive in understanding the market. Their risk exposure will increase as competition, especially in after-sales, is likely to become a lot more aggressive.

Sales and Distribution

Under the previous regulation, distribution was controlled and limited by the OEM. With the introduction of the new Regulation, distribution is now the operative word in car sales and servicing. Though the OEM will have full power to select its authorised dealership network, opting for either an *exclusive* or a *selective* distribution, the dealers can now decide what they do from this stage on. The differences between the two distribution schemes are highlighted below.

Exclusive Distribution	**Selective Distribution**
- Each dealership is given a predefined territory; - The dealer may not actively entice customers outside of his territory, though may sell to these customers if contacted by them; - The dealer may sell to non-authorised outlets including independent sales outlets, supermarkets, Internet etc; - Dealers are entirely free to sell actively within territories that are not subject to exclusive distribution and passively into other distributor's exclusive territories.	- The OEM may select its distributors using qualitative and quantitative criteria; - Dealers may sell actively and passively to any end consumer; - Dealer may open additional sales or delivery outlets for the distribution of new vehicles wherever selective distribution is used (but cannot close or move its initial outlet without prior consent from the OEM).

The option for a dealership to maintain its own sales territory, and therefore face lower competitive forces within the authorised dealership network, is the main difference between the two distribution channels. Though, at a quick glance, *exclusive* distribution may sound like the best option for the dealer, this territorial "protection" can be side-stepped by some more proactive dealers by selling directly to resellers, or establishing, reseller operations themselves, hence, re-kindering competitive forces.

By choosing the *selective* option, distribution should cover a wider scope, as territorial controls are taken away from the OEM and the responsibility placed on the Dealer. Nevertheless, the OEM still chooses the number of dealers they wish to sell through.

Selective Distribution

Likely Outcomes

- Increased competition between dealerships;
- Increased pressure due to increased competition;
- Dealership market consolidation;
- Creation of multi-brand dealerships across Europe;
- Dealers locating themselves anywhere within European borders.

All OEMs have opted for the *selective* distribution system, excluding Suzuki, the only manufacturer to opt for an *exclusive* distribution system.

Many dealers will also opt to sell and service multiple brands. Previsoulsy, dealers were not allowed to do so unless they set up separate showrooms, with separate back-office processes, accounting systems etc. Now, however, they can sell multiple brands in the same show room, using the same back-office processes. Nevertheless, each OEM whose brand they sell can insist that their products are displayed in a "brand-specific" area and represent up to 30% of the supply of new cars (Price Waterhouse Coopers, 2003). Now, due to these changes, multi-brand retailers will hopefully be able to diversify their risk and reduce the danger of seeing sales volumes fall because they are tied down to an ageing or unsuccessful product range. By having more than one brand, portfolio risk is expectantly lowered. As the sales of one brand falls, the other brands can make up for it. For example, a dealer selling Land Rover and Ford; when sales for Land Rover jeeps are low, regular passenger car sales, such as Ford's, can even out the sales chart; as sales of brands A, B and C fluctuate, the average number of units sold evens out, reducing large periods of extreme situations (a drastic increase or decrease in sales) and therefore risk. However, this depends on how complementary each brand is, how effective the brand portfolio is – whether, when one brand is low in sales, the other brand makes up for it. Therefore, dealers that continue to sell just one brand will be more dependant than ever on quality and continuing consumer appeal of the products made by the OEM they represent.

Unavoidably, small dealers will find themselves at a disadvantage. The larger dealer networks have already established relationships with numerous manufacturers but small dealers have no experience in managing multiple relationships with OEMs. Financial resources and retailing expertise on which big organisations rely on, is also not one of their strengths, and risk therefore increased. Nevertheless, as in any market or product, niches do exist and are usually a great opportunity for those willing to face the challenge.

The introduction of multi-branding has yet other implications. Currently, consumers select a car because it is made by a particular manufacturer and then, typically, shop around to find the best price. However, when they can compare different brands within the same showroom without having to go from one dealer to another, the retailer's brand becomes much more important than the manufacturer's brand, as stated previously. It is therefore expected that the most successful retailers will create a portfolio of brands that reinforce their own brand identities.

After-sales and servicing

With the removal of the obligatory link between sales and servicing, dealers can now sell new cars without servicing them (although they have to supply their customers with the name and address of an authorised repairer operating in the area). Likewise, they can service new cars without selling them. They can also remain with both operations as before.

Theoretically, most dealers will want to maintain their after-sales services, largely because the profit margins on after-sales servicing are much higher than on sales of new cars. Improvements in the way cars are designed and produced also have made after-sales servicing an increasingly appealing business – both for OEMs and for dealers/repairers. As car life spans increase, so does the probability of after-sales servicing.

Management

The changes introduced by the new BER will also have an impact on the skills Dealerships require. The choices they make will determine the sort of skills they need, be they the entrepreneurial skills required to grow a business or the organisationsal skills required to run an already large operation. Presumably, most dealers will be faced with trying to manage a wider range of activities and obviously, those with a more stable financial framework will be in a better position than those that do not.

The emerging new market of alternative forms of car ownership – short, medium, and long term leasing, for example – can also cause changes within a dealership. Dealerships behind such operations will want to protect their investment and may impose restriction in the contract, such as where the car has to be serviced.

Changing market environment

Predictions state that retailers that continue to offer after-sales servicing will find the market much tougher. With higher profit margins than in sales, after-sales is a highly attractive and a relatively easier market to enter. Investment requirements for after-sales servicing are much lower than for a sales outlet, especially if the infrastructure already exists. For example, if a Ford dealer wishes to incorporate Land Rover after-sales into it's dealership, a few Land Rover work-bays, some allocated mechanics, some additional machines, and little more, will do the job. Coversely, if it were to opt for Land Rover sales, an extension to the present show room would be needed, sales people allocated, stock bought, etc. Hence, the after-sales market will not only attract other deaelrs but also other new authorised and independent repairers.

The European Union Commission states that one of the main changes the new BER will bring to the dealership network is the decrease in control that the OEM will have over each Dealership, especially in terms of outlet location. According to Andrew Tongue (2005), ICDP consultant, the exclusion of the location clause from the dealership contract is "removing geography from the sales contract between the OEM and the Dealer". Andrew Tongue also highlighted three possible scenarios following the extraction of the location clause, the most probable one being the "down-the-road" scenario.

SCENARIO	DESCRIPTION	TRUE OR FALSE?
European Scope	Dealers open new outlets across Europe (E.G. Portuguese Dealer opens an outlet in France).	Large barriers to entry. Though prices are harmonising across Europe other barriers still exists, especially cultural. Too unpredictable a scenario.
Cross-Border	Dealers open new oulets on the other side of their borders, though still close to home (E.G. Portuguese Dealer opens an outlet in Spain).	Still many barriers to entry including business environment and language. May occur in certain European sub-regions such as Benelux countires and the Iberian Peninsula.
Down-the-road	Dealer opens new outlets within national borders, presumably within a small radius.	"Stronger will squeeze the weeker". Dealers will open new outlets or buy weeker dealers.

As shown, Dealers ultimately have two alternatives/approaches for the new market structure they are about to encompass. They can either face the new challenges in an opportunistic or strategic way.

ALTERNATIVE APPROACHES	
Opportunisitic	**Strategic**
- Proactive approach - Seek out others' weaknesses - Seek effective use of resources (space, investment etc.)	- Reactive approach - Change corporate strategic approach - Larger groups may tend to opt for this soltuion

The ICDP expects that most dealers will opt for the opportunisitc approach though this can be expected to vary from country to country, mainly due to each country's "cultural dealership" culture. The opportunistic view is extremely challenging especially regarding the use of financial and managerial resources. As much as it can be a success, its failure can be devastating. Many companies in different industries try to take on too much and fail because they have lost track of the small details. However, when they do manage to keep track, these companies are also the ones to reap the larger benefits. On the contrary, the strategic approach suggest a more careful and studied approach to the market changes.

However, as history has also shown, this strategy also fails, as companies become too reactive and not proactive enough. If the majority of the other companies are taking a more proactive approach to the market changes, it may be more dangerous to lag behind than to risk moving ahead.

Competition

From October 2005 onwards dealers under the selective distribution regime are free to open secondary outlets anywhere in the common market where selective distribution applies. Though, at first glance, this seems a positive change for dealers, as they are now allowed to enter any market they wish too, unfortunately they will also have to compete directly with other retailers selling the same brands in the same areas in which they trade. Their previously helpful “location clause” is no longer present to protect them, or anyone else.

But, rival dealers are not the only competitive danger. Competition can also arise directly from the OEM itself, if it too decides to open their own retail outlets, as Mercedes, BMW and Volkswagen have already done. The greatest threat towards traditional dealers in OEMs opting for this solution is that, when a manufacturer sells its own goods, it can obviously cut margins to a greater extent than a pure retailer. A price war would be an extremely suicidal option for any dealer to undertake and therefore traditional dealers will have to find other weapons to compete with. Nevertheless, though some OEMs have opted for this solution, it has been on a very small scale, and mainly to maintain certain strategic locations and not to compete with their own network.

Supposedly, dealers in a selective distribution regime, will be able to operate more freely and therefore decrease the legal risks of violating the terms of their contractual agreement with the OEM. On the other hand, they will face much greater competition in the marketplace. Hopefully, however, this will force dealers to create a better and more competitive environment, in its employee’s and customer’s favour.

Suppliers

Regarding the previous control suppliers (OEMs) had over their dealership network, the new BER allows a supplier to agree with its dealer on sales targets based on a given geographical area which may be smaller than the common market. However, now, such agreed sales targets may not be used to limit deliveries of new motor vehicles to dealers. Nor may product allocation, dealer remuneration or bonus schemes be based on whether or not a vehicle is sold within the agreed geographical area. Additionally, the concept of "supplier" has also changes somewhat. Dealers can now buy from their traditional suppliers (OEMs) or from other dealers, throughout the whole of the European Union. Hence, the previous upper-hand relationship suppliers had with their dealers will expectantly be positively minimised allowing dealers more flexibility and hopefully more proactive behaviour.

5.3. REPAIRERS

Under the old BER , dealers were obligated by the terms of their contracts to provide after-sales repair and servicing as well as showrooms. In return, they got exclusive access to technical information, diagnostic equipment and special tools from the manufacturers they represented. This included the right to perform repairs under guarantee and be reimbursed. However, under the new BER, this situation has somewhat changed. Dealers can now sell cars without servicing them, resulting in the creation of a whole new category of repairers – those that are approved by a particular manufacturer and can call themselves "authorised" repairers.

The new rules also specify that every manufacturer must provide equal access to technical information (including training, software, tools etc.) for all operators involved in repair, training and technical assistance, regardless of whether they are authorised or independent. Additionally, any independent repairer that wants to become an authorised repairer and fulfills a manufacturer's qualitative criteria is free to do so. A clearer description of each of the servicing outlet options is discussed below.

Authorised repairers

An authorised repairer is an entity that belongs to the network of "official" providers of repair and maintenance service put in place by a supplier (OEM or its importer).

Financially, authorised repairers enjoy a substantial advantage over dealers – lower investment costs. Showrooms involve a huge financial investment on the dealers behalf, a cost that a repairer does not incur. Moreover, not only are the entry costs much lower, the profit margins earned on after-sales servicing are much higher than those from selling cars. Research conducted by the investment bank Goldman Sachs and automotive consultancy autoPOLIS suggests that, on average, new cars account for 60% of sales but only 20% of EBIT (earning before interest and taxes); on the other hand, service labour and spare parts account for only 20% of sales but 50% of EBIT (Price Waterhouse Coopers, 2003).

Many dealers that lose their contract agreements may decide to become authorised repairers and, as OEMs consolidate their distribution network as a result of the new regulations, the number of dealers operating in EU is expected to fall further. Some ex-dealers may decide to join multi-brand repair networks, set up by certain OEMs in an effort to maintain their share of the after-sales servicing market. For example, both Renault and Citroen have launched new garage networks (called Motrio and Eurorepar respectively) which service all makes of cars, primarily for ex-dealers with which they still want to do business.

Independent Repairers

One of the main aims of the new BER was to create the conditions for effective competition in the motor vehicle repair and maintenance markets, and to enable all operators in those markets, including independent repairers, to offer high quality services. Effective competition is in the interest of consumers and allows them to choose between alternative providers of repair and maintenance services, including those authorised by the OEM and those in the independent sector.

It is thought that most independent repairers will probably remain independent, especially if the privilages dealers and authorised repairers enjoy regarding warranty works are removed. In December 2003, the UK Office of Fair Trading (OFT) argued that the restrictions which some OEMs impose, requiring customers to have their cars serviced by a dealer or authorised repairer while under warranty goes against the principles underlying the new BER. Accordingly, the OFT has called on all OEMs and dealers to remove any such constraints, and to give consumers clearer information about the terms and conditions of their warranties.

The practice of selling cars with lengthy servicing agreements that can only be redeemed by going to a dealer or authorised repairer has also been declared anti-competitive in Denmark, Finland and Greece. Hence, if the competition authorities in other Member States take the same position, independent repairers will be able to compete far more effectively for all routine servicing work from the moment the car is sold. So far this has not happened in most European Union countries, including Portugal, but it is expected to happen shortly.

Management

The new BER has added implications regarding recruitment and training. OEMs and dealers already invest a considerable amount of time and money in technical training, but any indepedant repairer that wishes to be authorised will now have to invest heavily in training as well. However, if this training is provided by the OEM to its authorised repairers for free, it must also be free for independent repairers. In the long term, hopefully, this will improve the quality of service provided by all repairers, including fast-fit chains, autocenters and independent garages. But, it will also require a significant financial investment on the repairer's behalf. With such significant changes occuring in the market place, repairers will have to improve their Human Resource skills – employing more qualified technical and managerial people. A corner shop repairer, for example, will no longer be able to survive in such an environment. Those organised, and that invest wisely, however, should be able to keep up with the others.

Competition (New players)

The most significant implication due to the new BER will, without a doubt, bring about the appearance of new players in the after-sales market, including organisations eager to enter the market for the first time. This has already begun to happen, where leading component suppliers Delphi, Bosch and Valeo have set up automotive servicing centers in France and other major markets around Europe, including Portugal.

Mergers and acquisitions will also aid in creating new types of players in this market. Currently, the independent repair market is very fragmented as it encompasses thousands of small independent garages and small chains. Fast-fit and national auto chains already control more than 50% of the European market for minor equipment replacements (tyres, brake pads etc)[12] and further consolidation seems almost certain.

Private equity firms, most of which invest for a maximum of five years, also own a number of fast-fit operations and autocenters. These include Nationwide Automitve Centers (owned by NBGI), ATU (owned by Doughty Hanson) and Kwik-Fit (previously owned by Ford). Companies such as these could be attractive to, for example, Japanese trading houses involved in the manufacturing of automotive components (such as Mitsubishi), or any vehicle manufacturer keen to secure a place in the European after-sales repair and servicing market.

5.4. CONSUMERS

The main source of the Commissions policy for the motor vehicle sector is the need to increase the benefits that distribution systems bring to the consumer. By enticing greater competition in vehicle sales, servicing and repair, and the sale of spare parts, the new Block Exemption Regulation aims at promoting consumer choice.

Although the new BER is not aimed at bringing about price harmonisation, it contains a number of measures to make it easier for consumers to exercise their Single Market right – consumers can now take advantage of price and tax differentials between the various Member States more easily and buy their vehicle where it suits them best. Why? Import barriers have been lowered considerably over the past couple of years, and consumers can now register a new vehicle only once it has arrived at its destination, rather than having to register it in the country of origin and then at its destination. For example, if a consumer were to buy a vehicle in Spain, the vehicle would be allocated a temporary registration

[12] Price Waterhouse Coopers (2003). *Gentlemen's dispute or bar room brawl? Part Six: The impact of the new block exemption regulation on repairers.*

(usually a three month registration) and then only be officially registered at its final destination. Additionally, by promoting active sales, opening additional outlets, and by clarifying the use of the Internet, the new regulation makes it easier for dealers to sell to consumers wherever they wish, within the European market.

Purchasing a new vehicle

As we have seen, one of the European Commissions fundamental achievements is to allow consumer's total freedom when buying a vehicle within the E.U. The new BER reinforces the consumer's right to buy a vehicle in any Member State, taking full advantage of different market situations (price, availability, choice, etc). An OEM or importer may never restrict a dealer from selling to any consumer who contacts him directly, through an intermediary, or via the Internet. If a supplier were to tell a dealer not to sell to consumers from other E.U. countries, by deterring him/her in any form whatsoever, would be seen as a serious restriction of competition, and an infringement of EC competition rules. Several companies have been caught and fined for doing so, in the last couple of years. Another example of anti-competitive behaviour involves price fixing by Ford dealerships in Ireland. Documents were found showing that dealers were fixing prices within the network and now the case has been taken to court.

Access to after-sales servicing

In order for competition to work properly, in the consumer's favour, the new BER highlights that the consumer should be able to take the vehicle to any authorised repairer within the supplier's network anywhere in the E.U. Hence, authorised repairers are obligated to repair all vehicles of the brand in question, to honour warranties, perform free servicing and carry out recall work regardless of where the car was bought.

If a consumer wishes to have his/her vehicle repairers by an independent repairer during the manufacturer's warranty period the warranty may be lost if the work carried out is faulty. Unfortunately in most countries within Europe, manufacturer's still do not accept repairs done by independent repairers and usually the warranty is lost. However, the Commission, as well as local governments, are hoping to change this, allowing independent repairers to carry out repairs without the loss of warranty.

5.5. SUMMARY OF MAIN EXPECTED IMPACTS

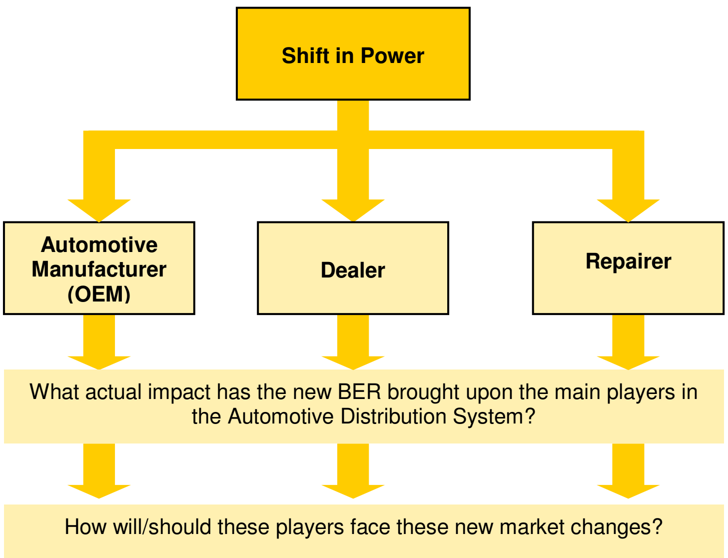
The main impacts expected on each of the main players are highlighted below.

	Table 1: Summary of Expected Impact
OEM	**Sales** - introduction of new new retail formats (multi-branding) - fiercer competition - loss of brand protection **After-sales servicing** - can no longer force dealers to have a service outlet - loss of control over network - increased exposure **Management** - further loss of consumer loyalty - need for new skills - OEMs brand will become obsolete and the retailers brand will become more important
DEALER	**Sales** - increased power in decision making processes with the exclusion of the location clause - more vulnerability due to the exclusion of the location clause - Fiercer competition - larger multi-branding dealers will appear the single branded dealerships expected to decrease **After-sales servicing** - fiercer competition due to higher profit margins and the ease of entry into the market **Management** - need for higher qualified technical and managerial expertise
REPAIRER	**Sales** - increased power in decision making process **Management** - option – become an authorised or an independent repairer - any independent repairer matching the required criteria can become an authorised repairer - Those not willing to become authorised will have to invest heavily in training to keep up
CONSUMER	- Increased choice regarding the sales and servicing of vehicles

Chapter 6 – Actual Impact of the New B.E.R. upon the Automotive Industry

Almost three years hence, has the new Block Exemption Regulation regulating the sales and servicing of vehicles, shown any signs of changing market practices? According to the European Commission, the changes were intended to increase competition in the consumer's benefit by reducing the control OEMs have over dealerships, promoting inter-brand competition, liberlising the after-sales market and ultimately harmonising prices across Europe. How many of these objectives, if any, have been acieved so far?

Though it is still too early to assess the full impact of the new regulation, some noticeable changes have already occured. This chapter analyses the actual, up-to-date, impact the new regulation has caused on its main players and how they can/should face these new market developments, following the parameters mentioned in chapter 2 under thesis objectives highlighted next:



The use of testimonials has been introduced in this chapter to further clarify the implications the new regulation has had.

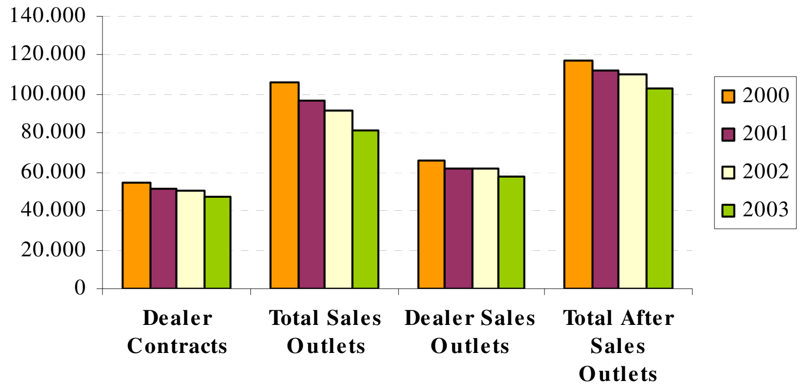
6.1. ORIGINAL EQUIPMENT MANUFACTURERS

6.1.1. “What actual impact has the new BER brought upon the Manufacturer (OEMs)?”

The greatest impact of the new BER for the OEM has been on management, especially in relation to skills. The new regulation has brought about the need for new tools, such as increased infromation transfer, required knowledge in the field of legislation and overall training (informing teams about the new rules of the game).

One of the first, most significant changes was the reduction in the distribution network. Most manufacturers with long established brands began reducing their networks immediately. From 2003-2004, for example, General Motors, Seat and Citroen reduced their European networks by 871, 713 and 622 outlets respectively. Conversely, some of the newer, less established names have been expanding. Skoda signed up 799 more main and sub-dealers, while Hyundai acquired another 295 outlets and Kia another 163[13].

Figure 13: Reduction of the number of outlets in Europe (2000-2003) - CECRA



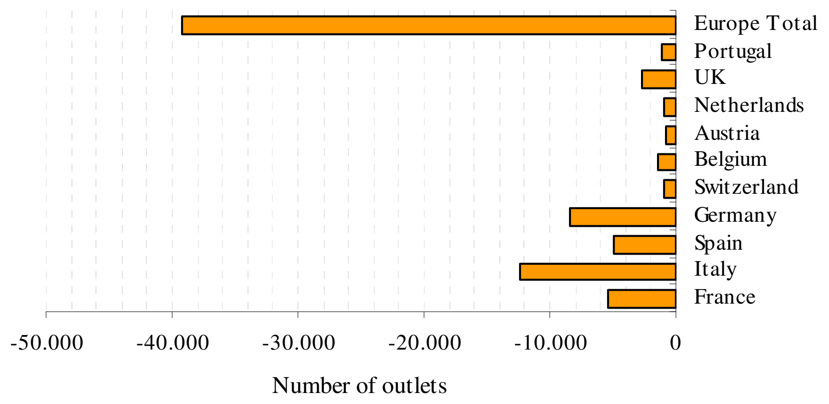
Source: CECRA, 2004.

The figure above shows the reduction in the number of contracts and outlets from 2000 to 2003. According to Datamonitor (figure 14 below), the number of outlets will continue to decrease, in total for the countries mentioned, by 39,232. These “outlets” include sales as

[13] Price Waterhouse Coopers (2005). *Bar room brawl spills onto the streets. Part one*.

well as after-sales. But what do OEMs wish to achieve by this? Ultimately they are looking to increase the dealership's "captive" area – by reducing the number of outlets, but maintaining or increasing sales (of vehicles and repairs), the number of sales per outlet increases - consequently building a stronger and, hopefully, more profitable dealership network.

Figure 14: Estimated changes in Oulets (2003-2008)



Source: Datamonitor (2005). *Car Aftermarket in Europe – Datamonitor View*.

As consolidation continues to take place throughout the global automotive industry, competition grows fiercer. According to Datamonitor (2005), OEM networks hold the largest share, in terms of value, of the aftermarket across the ten countries mentioned in the figures above. And, though this will continue to be the case, they predict that this share will soon start showing signs of decline. More precisely, Datamonitor estimates that the decline in revenues will be €2.0 billion over the period 2003-08. The majority of the decline is believed to be focused on secondary dealer outlets and agents, rather than on the main dealer network.

Yet, further consolidation is not the only source of competitive threat. Competition now arises in different forms, from different places than before. Previously, brands competed in the streets, but now, with the new set of rules, brands now also compete behind showroom doors. Different brands can now share the same show room, and it is entirely the OEM's responsibility to impose the correct criteria, making sure that his brand is displayed in the most effective way possible. This criteria is set by the OEM and has to be carefully studied in order to protect the brand whilst, at the same time, maintaining it's attractiveness in the sellers' (dealers) and customers' eyes.

And difficult times will remain – as market stagnation continues, and comeptition rises, life will get tougher and tougher for the OEM. However, most OEMs continue to blame the market for the difficulties they are facing, and not the new regulation.

All OEMs will have to (or have so already) think carefully on what operational steps to take to prepare for the changes caused by the new BER. Fortunately, they are not alone in this challenge. Due to the uproar caused by the new BER, discussion and support groups such as CARS21 were created.

CARS 21[14]
The EU Commission launched CARS 21, a Competitive Automotive Regulatory System for the 21st Century. Discussions through 2004 with the EU Commission and a number of national Governments led to the launch in January 2005 of this high-level multi-stakeholder group, which includes representatives from the industry, the European Commission, the European Parliament. Member States, NGOs, and Trade Unions. The group is tasked with making concrete recommendations to increase the European Automotive industry's worldwide competitiveness and maximise its societal benefits through sustainable mobility. The CARS 21 members are expected to submit their proposals to the European Commission by the end of 2005 on how an integrated approach to competitiveness – one which meets both the needs of policy development and the industry – might be developed and adopted.

CARS 21 members believe that it should be seen as a valuable opportunity to develop a simple, coherent, cost-effective and stable EU regulatory framework for the Automotive sector. Having this in mind, CARS 21 members' aim will be to:

- ❑ Reduce the cost of regulation and promote market-driven solutions;
- ❑ Simplify legislation;
- ❑ Ensure that forthcoming regulatory proposals are formulated in a reasonable, uniform, predictable and carefully planned manner;
- ❑ Prevent the incompatibility and impact of legislation.

[14] ACEA – European Automobile Manufacturers Association (2005). *European Automobile Industry Report*

6.1.2. "How will (and should) OEMs face these new market changes?"

Having analysed the impact of the new BER upon the OEM, a closer look is taken at the steps the OEMs can follow in order to capitalise on these changes.

To begin with, price will remain a sensitive issue. Though the threat has not been too eminent yet, manufacturers may need to try harder in levelling prices across Europe to minimise cross-border competition. To do so, OEMs will have to establish stronger central European teams that constantly analyse the market changes occurring due to the new BER and other market dynamics. Highlighted next are some of the most important steps OEMs need to consider.

Proactive strategic thinking

As the selling environment becomes increasingly competitive, OEMs can no longer sit and wait for changes to happen. Proactive strategic behaviour is the only way to maintain in business in such a market. Control will have to be on everyone's number one priority list – if an OEM closes its eyes for too long, it may jeopardise its lifespan.

Control over the network is one example. Most manufacturers have ultimately reduced their network, but this does not mean that the mission is accomplished. Once they have reduced it they must maintain on top of it, examining faults, strengths, and areas for improvement. Some manufactures are already doing so, some in different forms than others. For example, only a handful of retail outlets across Europe are owned by OEMs. One way to maintain control of a network distribution channel could be by purchasing dealerships and allow OEMs to dictate sales practices. Traditionally, French manufacturers (Renault, Peugeot/Citroen) opted for this solution, meaning they compete directly against their own dealers. On the contrary, American manufacturers normally work exclusively through dealers (few attempts to do otherwise have failed) and Germans and Japanese tend to use either importers or a mixed system. However, in most cases across Europe, manufacturers have so far chosen to control their networks differently, through the use of strict variable margin schemes – setting criteria, (for example, levels of stock and service requirements) that the dealer must achieve in order to receive additional margins on sales.

Ford, for example, has a 6% base margin but a dealer can increase this by another 6.5% by abiding by certain criteria.

Another suggestion for OEMs has to do with becoming more like retailers than regular car manufacturers. For example, in other industries, the relationship between the corporate owner and a franchise outlet is strong, with the owner providing everything from shared services – like accounting and marketing – to office space and equipment. OEMs could follow the model of other retailers - creating stronger relationships with their dealer networks – by offering synergies and efficiencies that could result in larger gains for both.

Strategic alliances are also another solution. Over the last decade and a half, one of the most important features of the development of international business has been the increase in the number of joint ventures and other strategic alliances across national borders. Japanese and American automotive companies are perfect examples of this. Despite the intense competition between them, there has been a noticeable growth in collaborative arrangements between them. GM, for example, has strong ties with Fiat (provides technology and components), Suzuki (supplies GM with small cars), as well as many others. Some of these relationships are through consolidation, others through strategic alliances. But, I wish to highlight that buying out a company (consolidation) is not always the best solution. As the GM example shows, a strategic alliance can lead to the same results, and yet, in the process, be a cheaper and less risky path to take.

New Sales Approaches

OEMs can diversification in various forms – by multi-branding or by changing their "selling approach".

With dealers offering a variety of brands, OEMs need to ensure that their models will "shine" in such environments. Offering larger margins is an impossibility in today's automotive market and therefore, OEMs have to rethinking brand standards for dealers. This involves carefully drawn out showroom criteria as well as providing excellent sales training, including motivation. Sales personnel can be training correctly, but motivation is the key word. They may know how to sell the product, but they need to be willing to do so, otherwise they could lead a potential customer towards another brand on display in the same showroom. Motivation includes psychological motivation as well as financial motivators that do not include the exchange of physical cash (for example, point award system, promotions, gifts, etc).

However, OEMs can decide to take sales to a new playing field entirely. OEMs could consider other alternatives to the traditional sale of cars. One such alternative is to offer mobility solutions to customers – rather than buying a car and being tied down with that responsibility for many years to come, OEMs can, through their dealership network, offer services that include everything from car leasing with packaged repair and insurance to extras like vacation planning. Ford, for example, has an “Options” program that allows a customer to buy only half the car (with or without financing), and then only in two years time decide whether he wants to keep it, exchange it, or sell it.

Consumer Loyalty

As relationships between the dealership and the customer increases, but between the OEM and customers continues to diminish, different forms of keeping contact have to be developed. The use of e-commerce and Direct Mail are the most common forms used to maintain contact with customers, and to collect powerful information that yields insights on their buying behaviour. All manufacturers are present on the web, some more proactively than others. But being present is not enough – potential customers will enter the site and leave, without leaving any information behind. One way to avoid this is by asking for relevant information when a viewer asks to sign up for the newsletter, or a test-drive, for example. A simple home or email address, and some straight forward personal facts (name, age and occupation, for example) can lead to a whole world of opportunities for an OEM. A potential client database can be worth millions. It is the initial source for targeted direct-mail and any other marketing activities created by the OEM to maintain contact with its customers.

Also, with the eminent threat of the dealership brand becoming stronger than the OEM’s, it is vital to keep the OEM-customer relationship life-line alive. Additional examples include advertising incentives, increased warranty periods, periodical offers, etc.

Testimonial A

OEM: Ford Motor Company – The Group

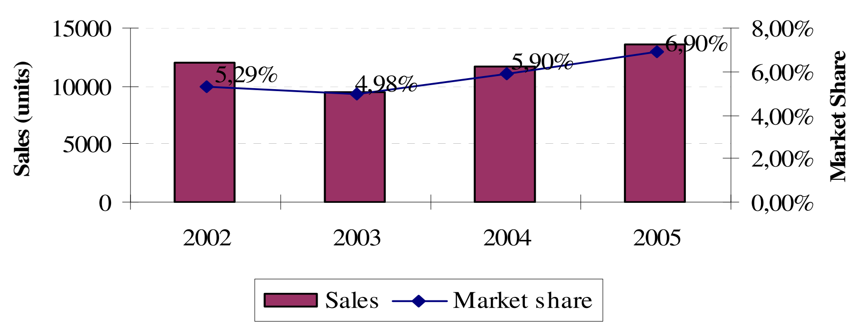
Ford Motor Company (commonly known as just Ford) was launched from a converted wagon factory, with $28.000 cash from 12 investors in 1903. During its early years, the company produced a mere handful of cars a day at the Ford factory on Mack Evenue in Detroit. Today, Ford manufacturers over 8.000 vehicles a day (over 3 million per annum) and has major manufacturing operations in North America, South America, Africa, Europe and several other locations including India and Australia. In recent years Ford has acquired Aston Martin, Daimler, Jaguar, Volvo Cars, and Land Rover, as well as a controlling share of Mazda.

Initially Ford models sold outside the US were essentially versions of those sold on the home market, but later on there were vast differences between those sold in the US and those sold in Europe.

Ford Lusitana

When Ford Motor Company established it's national subsidiary (Ford Lusitana) in Portugal, in 1932, the brand was already widely known across the country. Throughout it's 70 plus years in Portugal, Ford has made significant investments in the country, including the creation of Ford Electronica, Visteon and AutoEuropa. It has seen good and bad days, as any automotive company has, and undergone several changes in the process.

Figure 15: Sales & Market Share of Passenger Vehicles - Ford Portugal



Source: Ford Lusitana

One of the most important changes, the restructuring of its dealership network, was completed in 2002, as a proactive approach towards the new Block Exemption Regulation. In doing so, in due time, Ford Lusitana hopes to have minimised the impact of the new BER on its dealership network.

The basic aim underlying this restructuring process was to reduce the number of Dealers and therefore increase the area each Dealer represents. Additionally, hopefully, to harmonise quality standards trhoughout the network. Ford Lusitana did drastically reduce it's number of dealers from 49 in 2000 to it's present 34. Though theoretically the "location clause" has ceased to exist, it is not a certainty that new competition will emerge. As discussed previously, the barriers to entry are extremely high, especially regarding investment levels.

Regardless of whether these optimistic outcomes remain a reality, according to Ford Lusitana's former president, Filipe Barbeitos, "we thoroughly discussed the changes and concluded that the philosophy behind the project was correct. The additional support and strength given to the new dealerships, with a larger area of intervention, has been a source of protection for the current network, and will hopefully create better conditions for a greater return on their investment".

Presently, out of the 34 dealerships, 15 are single-brand dealers and the other 19 are multi-brand dealers. Hence, over 50% of Ford Portugal's network has other brands within the Ford portfolio (Mazda, Jaguar etc.) represented in their dealerships, or other entirely new brands (Peugeot, Fiat etc.).

Implications

According to Raul Moita, Operations Director at Ford Lusitana, the impacts of the new BER are barely visible. Factors such as client satisfaction have risen, and complaints lowered, since 2003, but Ford believes that these positive changes are not a result of the new BER but of the dynamics of an extremely competitive market. Likewise, dealers' return on investment is deteriorating, with no sign of recovery in the near future.

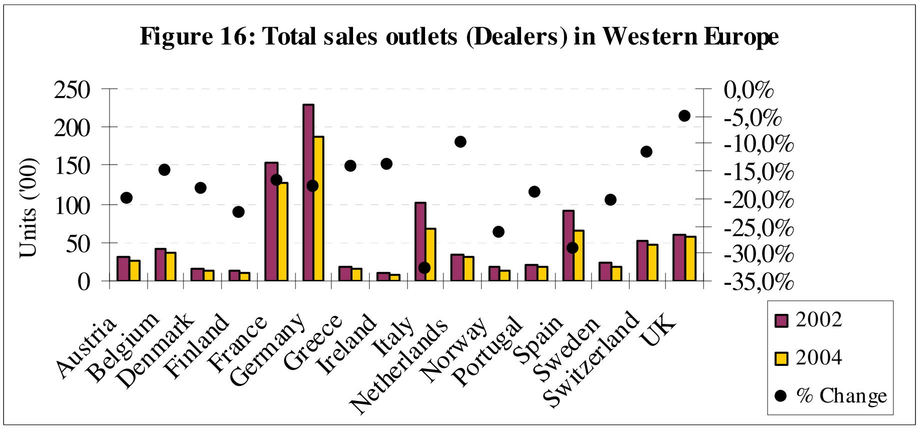
The Future

Market conditions for most businesses across Europe, and especially Portugal, are presently unfavourable. In Raul Moita's opinion, the gainers of the new BER will be the clients and the losers, the dealers, especially the smaller ones. He also adds that, regarding the OEMs, contrary to what the EU Commission was hoping for, there will be very little change. The power will still remain in their hands, as control gets tighter and barriers to entry stricter. As for the independent repairers and auto-centers, Raul states that it will depend on "their financial capacity to adapt to new technology".

6.2. DEALERSHIPS

6.2.1. "What actual impact has the new BER brought upon the dealership?"

The latest issue of the *GMAP European Car Distribution Handbook* (Price Waterhouse Cooper, 2005) confirms that the dealership network has reduced dramatically. The numbers, per country, are shown in the figure below.



Source: Price Waterhouse Coopers (2005). *Bar room brawl spills onto the streets. Part one*.

By far the biggest drop took place in 2002-2003, when 12% of all dealers dissappeared from the scene, as OEMs began the task of reorganising their distribution networks. This reduction is most noticeable in Italy and Spain, markets where sub-dealers prevail. In the past two years alone, over 12,000 sub-dealers have been removed from the OEMs network, while another 14,000 have been converted into main dealers. The number of dealers in Germany has also fallen substantially, although the country still has by far the largest concentration of sales outlets.

The consolidation of the dealership network means that many consumers will have to travel further when they want to shop around for a new car. However, the reduction in the number of dealers has placed the survivors on a stronger financial footing. According to the latest review by Price Waterhouse Coopers (2005), average sales per main dealer rose to a record high of 341 cars in 2003 (the latest year for which figures are available).

A growing number of dealers are also opting to buyout other dealerships. In fact, dealer groups are already common in Britain, Austria and Holland. Automotive Management magazine reports, for example, that about 550 British companies collectively own over 3,300 outlets - close to 60% of the UK total. But that trend appears to be spreading. The GMAP European Car Distribution Handbook 2004 estimates that as few as 35,000 companies may operate the 51,499 independent main dealerships that currently exist in Western Europe[15].

As predicted by most, the dealership network consolidated but what the European Commission foresaw, and did not happen, was the introduction of new forms of retailing. Many, however, have been daring enough to cease the challenge, but have unfortunately been forced to rethink their steps. In 2003, for example, Virgin Cars, the online retailer backed by entrepreneur Sir Richard Branson, launched the world's first car department store, offering 25 automotive brands – grouped by themes like "crowd pleasers", "two-wheels", "thrills" and "first class" – under one roof . Unavoidably, less than one year later, in february 2004, it merged with Motor Solutions, another British Internet retailer. As in most countries across Europe, consumers proved reluctant to change their buying habits and the company sold fewer than 7,000 cars in 2003.

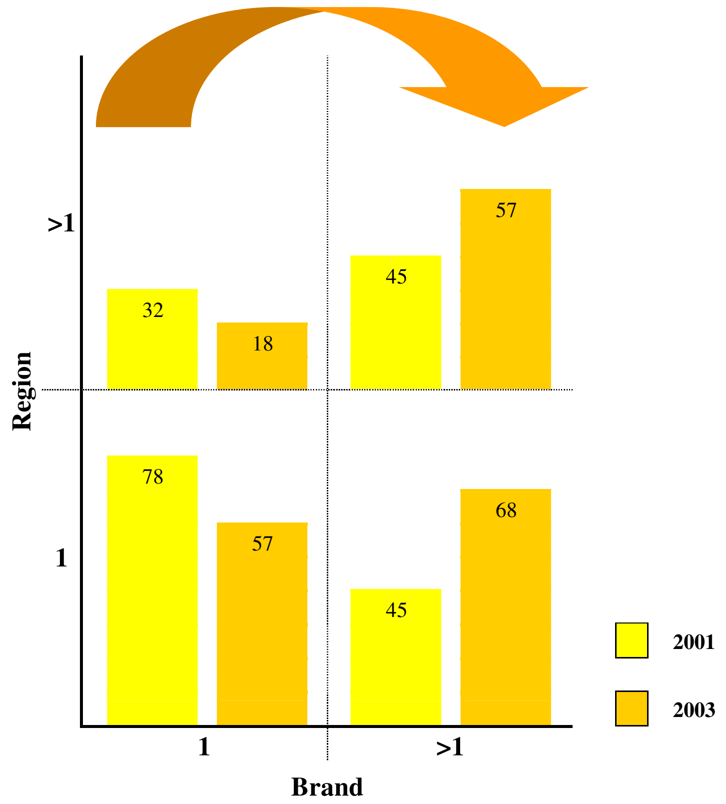
German mega-catalogue retailer Quelle (now Karstadt-Quelle) had found the going almost equally tough. In June 2003, it joined forces with Carplus Online to lauch an Internet shop

[15] Price Waterhouse Coopers (2005). *Bar room brawl spills onto the streets. Part one*.

selling Ford, Volkswagen, Nissan and Mercedes-Benz cars at discounts of as much as 22%. But turnoever fell by 11,3% in 2004, and the company is now planning to enter the leasing business in an attempt to win more customers.

According to a reference quoted in the report "Bar room Brawl Spills onto the Streets (Price Waterhouse Coopers, 2005) "over 70% of all main dealers in Western Europe probably sold only one brand, and over 80% probably sold the brands of only one vehicle manufacturer". However, some change has been noticed. According to the statistics presented at a "Block Exemption" explanatory conference held by ACAP in Lisbon in 2005, there are some signs that the number of single-brand dealers is decreasing but than multi-brand dealerships are increasing. Though only four countries were analysed, similar figures show this to be the trend throughout the whole of Europe.

Figure 17: Single & Multi Dealer Growth



Source: ICDP, 2005 (n=200; Top 50 Dealers of 4 countries. Countries analysed: France, UK, Germany, Italy)

Unfortunately, there is a lack of information regarding the exact number of single-brand and multi-brand dealerships across Europe and therefore different opinions arise. However, it seems reasonable to assume that most dealers still sell a single marque but are moving towards handling two or more brands from the same carmaker, such as Toyota and Lexus, but not those of other manufacturers – presumably because the market is tough enough as it is and partly because they fear the response of the carmakers that supply them. Nevertheless, in the long run, consumers have become the losers in this situation. The vast majority of consumers will still have to buy their new cars from conventional dealer outlets. They also have to visit more than one dealer to sample the products of different manufacturers.

Ultimately though, not as many new comers, or new concepts, arose from the introduction of the new regulation, as expected. Most retailers still seem to remain hesitant, possiblily due to the fact that the automotive industry is so complex. The barriers to entry are high, and those already in the market (including consumers) seem to be too reluctant to change their behaviour. And, on the whole, whatever mishaps and difficulties have arrisen so far, it is still too early to predict the full outcome the new regulation has had upon the dealerships. Some will opt to sit and wait, and watch others, whilst some may decide to take a risk, as Virgin and Quelle did, hoping to avoid the mistakes those before them made.

6.2.2. "How will (and should) dealerships face these new market changes?"

Dealerships have an increasingly tougher environment to work in. Unlike what the European Commission predicted, dealers are even less independent than they were prior to the new regulation. With the use of pre-set criteria (allowed by the E.C.), OEMs now have an even tighter control over their network. Next are some suggestions as to what dealerships need to do to face the challenge.

Strategic thinking and skills

Without strategic thinking a dealership will not survive long in the market as it is today. In order to survive the challenge dealers have to continue tightening their belts and keep a sharp eye on business.

Additionally, without the proper skills, they will not reach the required strategic thinking. Characteristically OEMs and dealerships employ few people with a background in typical retailing. Usually their employess are, above anything else, manufacturers, but if they wish to succeed, they will have to acquire new skills. The choices they make will determine the sort of skills they need, be they the entrepreneurial skills required to grow a business or the organisational skills required to run an already large operation. But almost all dealers will have to manage a wider range of activities and, clearly those that already have the professional and financial know-how to do these things will be in a stronger position that those that do not.

Consumer loyalty

As in the case of the OEM-customer relationship, dealers have to focus on preserving their relationship with their customers. Efforts such as offering financial services, courtesy cars, rentals, leasing (etc) are but a few examples of what dealers can do to create and, most importantly, maintain this relationship. For example, some larger European dealers are investing in software to help them manage the relationship with their customers more proactively – allowing them to share vehicle and customer data across the network, for example. Ford, for example, set up an extranet to facilitate communication amongst it's network and has used it to gather information on its dealerships and customers. Furthermore, it has created incentive schemes (point systems) to reward the dealers that proactively use the system.

Dealership brand identity

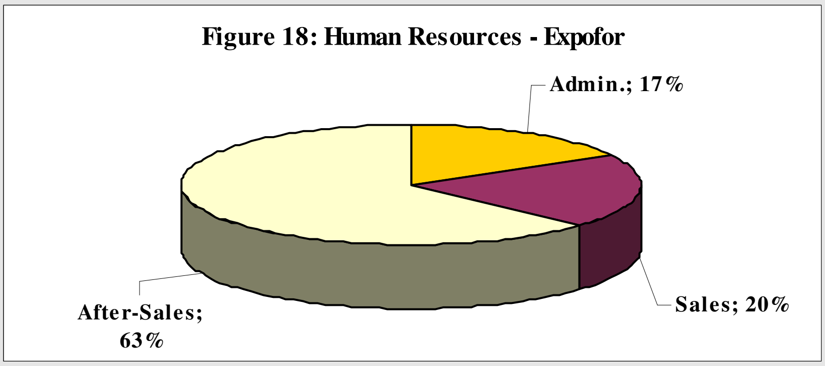
Dealers need to be much more proactive about understanding the market because, with the introduction of multi-branding, buying patterns have changed. Typically customers selected a vehicle because it was made by a particular manufacturer and then shopped around to find the best deal. However, more recently, in multi-brand dealerships, customers can now compare different marques in the same showroom. The result? Brand competition has become a totally different ball game. Different brands can now share the same room, back offices and staff. Consequently, the retailer's brand is becoming more important than the manufacturer's brand. Therefore, the most proactive dealers will develop a collection of brands that reinforce their own brand identity.

Testimonial B

DEALERSHIPS: Single Branded – Expofor

Located close to the heart of what was once EXPO ´98 trading grounds, Expofor is carefully situated in one of Lisbon's newest and most prosperous areas. Built in 1998 in a modern, eye-catching architectural structure, with over 6.000m2 of covered, and 3.300m2 unconvered area, Expofor is one of Ford's finest dealerships.

The dealership is run by four partners, Francisco Lavrador being the senior partner and Managing Director, owning 65.5% of the shares. It has over 100 employees shared out as follows:

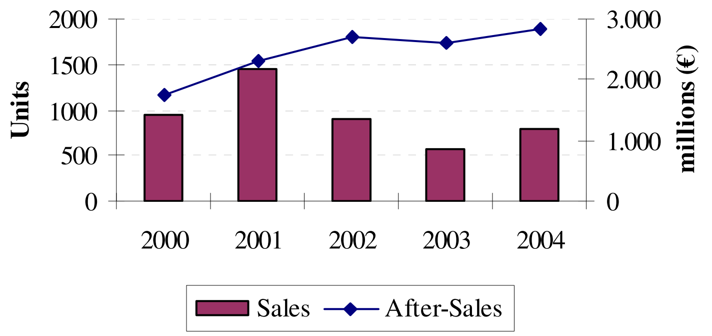


Source: Expofor

Finacially, Expofor has been one of the most stable dealerships, focusing strongly on rigurous cost and quality controls.

The evolution in sales and after-sales is shown below.

Figure 19: Sales and After-Sales Expofor



Source: Expofor

As the graphs above show, though vehicle sales have somewhat remained the same (with the exception of 2001 where there was a significant increase due to rent-a-car sales). In relation to after-sales, there has been a steady increase. To further highlight the growing importance of after-sales, though they only account for 24% of business volume, they represent 71% of total revenues (in 2005). Hence, the Human Resource efforts/allocations (63% of all personnel) allocated to this segment. However, as Francisco Lavrador, Managing Director of Expofor, highlights, "it is the most profitable area but also the most threatening in terms of competition". To highlight a threat, for example, under the previous market rules, a dealer was almost guaranteed a visit or two by the owner of a new vehicle in the vehicle's first two years of life, due to the fact that only the OEM network could stamp the vehicle's warranty booklet. Now, however, this rule too will soon be abolished making a dealer's situation even more vulnerable.

Implications

According to Francisco Lavrador, the impacts of the new BER upon Expofor, and the industry in Portugal as a whole have been "minimalistic". With the exception of an increased number of repairers in the North, competition has not changed in pattern, "competition is still 'natural', not due to any changes implemented by the new BER". However, it seems clear that Ford Lusitana is trying to encourage Expofor to open an additional sales outlet within Lisbon, but, tight cost controls and weariness in investing such large amounts has put this project on hold for the time being. Nevertheless, talks are on the way to include a new after-sales brand into the company's portfolio. As stated previously, such investments are much lower and profit margins much higher. Using

Francisco Lavrador's own words, "all we need to do is put a few people in new uniforms, allocate a couple of work bays and we are more than two thirds of the way there".

The Future

Expofor's main focus is to grow steadily and maintain its tight management control over business. Increased revenues and customer satisfaction are their main long-term goals.

As for the new BER, they believe that the trend in moving towards multi-branding will continue but as far as shifts in power and an increase in new players, these predictions will not occur. The automobile market is one of extremely high investment and no matter what, OEMs will always maintain their power, in one way or another, and dealers will just have to find new ways to manage risk in the best way possible. Furthermore, Francisco Lavrador believes that the European Union's ultimate goal, to benefit the final consumer by increasing competition, will not be fulfilled.

Testimonial C

DEALERSHIPS: Multi-branded – FIAAL

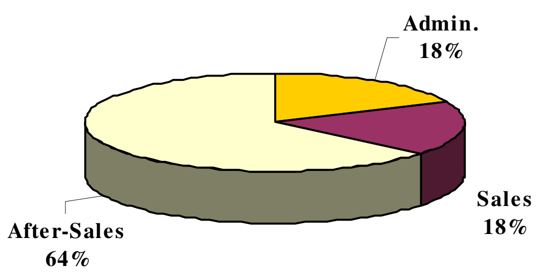
Anibal Guerreiro, majority sahreholder of FIAAL has been in business with Ford Lusitana for more than 60 years. FIAAL is the largest Ford dealership in Portugal and the only one in the Algarve district, covering a populated area of about 330 thousand inhabitants. It began in 1941 as a Ford dealership, subsequently adding to its Portfolio; Volvo in 1971, Mazda in 1988 and Land Rover Jaguar in 2002. It's Subsidiary FORPORTIL, inaugurated in 1981, began with Ford and Volvo in that same year, and Mazda in 2004.

FIAAL is situated on prime land, on the main road to Faro's International Airport and

1km from the center of the city. FIAAL dealership alone has 8.000m2 of covered area, and an additional 4.000m2 at the FORFORTIL location, as well as 3 more sales outlets in Tavira, Loulé and Faro city center. In addition, it (FIAAL and FORPORTIL together) has over 40.000m2 of uncovered area for parking, stock and other services. It is without a doubt an eye-catching dealership, and a prime example for Ford Lusitana.

With 125 employees, though a higher number than in EXPOFOR, the allocation is very similar, as the chart below shows.

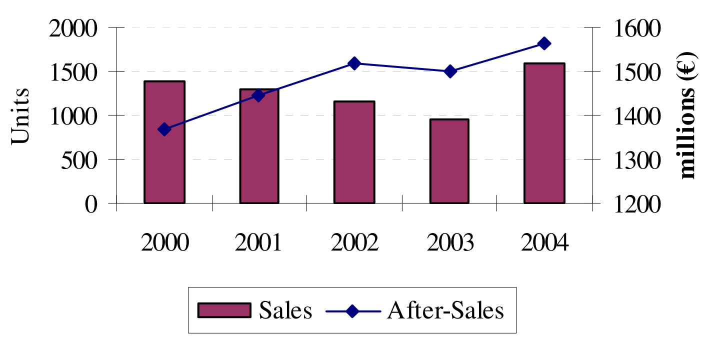
Figure 20: Human Resources - FIAAL



Source: FIAAL.

FIAAL is a benchmark for any dealership. Its successfulness is achieved through great quality and cost controls but also through empathy between employees and shareholders. As Anibal Guerreiro highlights, "you cannot ask for someone to follow something if you yourself do not follow it". The evolution in sales and after-sales is shown below.

Figure 21: Sales and After-Sales FIAAL



Source: Ford Lusitana

The figures above are somewhat different from those in EXPOFOR. FIAAL is set in the heart of Portugal's tourist district which affects the nature of FIAAL's business. For example, sales are much higher because, on average, FIAAL sells over 600 vehicles to rent-a-car and another 600 to fleets. This kind of sale increases sales figures and decreases after-sales figures, because there is little post-sale relationship created after the sale. Once the vehicle is sold to a rent-a-car company, it's life span there is little over 6 months and then it is distributed throughout the whole of Portugal and resold through Ford's used-cars network. In essence, this means that over 1200 vehicles sold by FIAAL are highly unlikely to enter the dealership for any sort of after-sales servicing.

Implications

FIAAL has almost all of Ford's brands under its roof, but not as a result of the new BER. FIAAL has been a multi-brand dealership since its early beginnings in 1941 and will remain so, determined to maintain its long-lasting relationship with Ford Motor Company, and Ford Motor Company alone. As Anibal states, "we do not wish to leave the Ford family".

Anibal Guerreiro has a very conservative view on the new BER, and does not fully agree that competition is getting fiercer because of the new rules. He believes that the market, throughout the whole of Europe, that once had a lot to offer those willing to invest, has changed considerably. A market that only 5 to 6 years ago promised a 4 to 5% return is now facing figures as low as 1% and, in some cases, even lower. Furthermore, he states, "those that are already in business are facing crippling financial difficulties, and it is highlighly unlikely that any new player will arise. At least for the time being". He also suspects that 50% of the already existant deaelrships will go out of business but that, on the whole, "our most fiered competitors will be the same ones as always, but they will be stronger".

Presently FIAAL's competitors are all the other brands located in the whole of the Algarve. Unlike the Center and the North of Portugal, customers in the Algarve travel longer distances to get to their disired destinations. For example, for someone in Lisbon, to travel 20km, it could take over 1 hour and he/she may think twice about doing so. On the contrary, due to the lower population density and "psychologically perceived" closer distances, customers will cross the whole of the Algarve without thinking twice. However, Anibal Guerreiro's reknown reputation enables FIAAL to have an 18% market share in the Algarve, much higher than Ford's usual 6%. According to Anibal, "as competition gets tougher, quality has to be duplicated". And FIAAL is a optimum example of accomplishing such high standards. FIAAL was awarded the "Quality Award" in 1994, 1995 and 2000 and "Best Dealership Award" in 1988 and 2001.

Regarding customers, as margins get tighter and tighter, Anibal believes that the most jeopardised stakeholder will be the customer. One of the EU's aims was to lower prices but "if prices are lowered even further and margins squeezed even tighter, the customers will gain in the short-term, but loose in the long-term. The sale price may be lower but eventually so will the service quality. Tightening margins even further will have extremely damaging effects on quality and therefore on long-term customer relationships".

The Future

FIAAL's future will not change significantly, in terms of expansion or multi-branding. Customer Service levels are already within the top best, if not the best, and constant efforts are made to continue upholding these excellent quality standards. As for retrun on investment and increasing revenues, FIAAL hopes there will be sunnier days, but until then the company has to remain steady and sound.

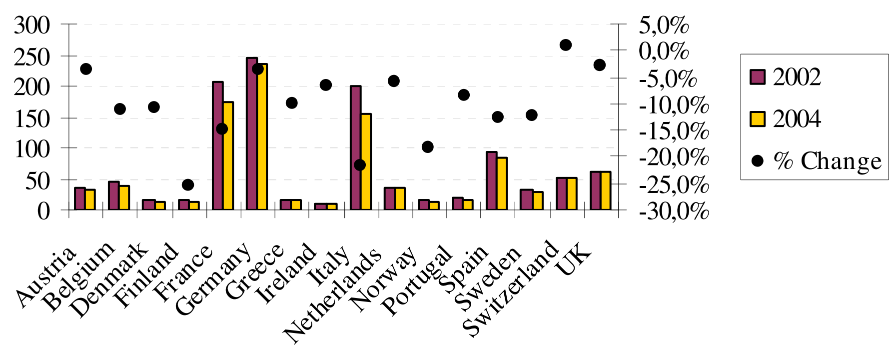
6.3. REPAIRERS

6.3.1. "What actual impact has the new BER brought upon the repairer?"

The experience of buying a vehicle has changed somewhat, but what about servicing that vehicle? As stated previously, by removing the previous mandatory link between sales and after-sales servicing, the European Commission created a new category of repairers – authorised repairers – that are approved by the OEMs. These authorised repairers no longer have to be directly linked with sales outlets, and vise verser, creating opportunities for new players, as well as established dealerships that wish to expand. Also, independent repairers now have equal access to technical information (including training, software, tools and equipment), making competition more dynamic .

Yet, once again, signs that the European Commission achieved its objectives is still extremely debatable. In January 2004, 72% of all Western European dealers offered both sales and servicing facilities; only 3% chose to stop repairing cars, presumably due to the fact that, in most countries, servicing is far more profitable than selling new cars. Most importantly, though, it is also a means of maintaining contact with customers and stimulating repeat business. On the whole, the total number of service outlets in Western Europe fell by 12,171 - or 11% - between 2002 and 2004, according to the GMAP Car Distribution Hanbook 2004. In comparison, between 1997 and 2002, the number fell by just 10,222 (9%). Figures from 2002 to 2004 can be seen in the figure below.

Figure 22: Total service outlets in Western Europe



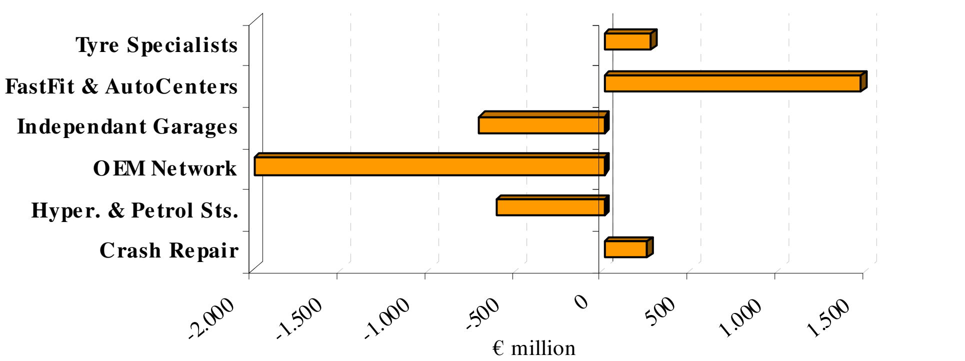
Source: Price Waterhouse Coopers (2005). *Bar room brawl spills onto the streets. Part one*.

The overall drop in the number of service outlets is partly due to the OEMs having raised their standards, making it more expensive for authorised repairers to stay in business and far too expensive for the majority of independent repairers to become authorised. In comparison with the reduction in sales outlets (figure 16) however, the decrease has been significantly less – presumably because people are willing to travel more miles to buy a new vehicle but are not willing to do so if they merely want to service it. The opnetary commitment is lower, and therefore, so is the consumers effort.

So, competition has become fiercer, the number of repairers has decreased, but the costs of repairing a vehicle have not. In April 2004, for example, the UK Office of Fair Trading estimated that average cost of having a car serviced by a dealer was 71% higher than it was at an independent garage – and are no signs indicating that this situation will change in the near future. Similarly, the consulting firm Grupo Interprofisional de Productos Automóviles (Price Waterhouse Coopers, 2005) reports that in Spain repair charges at dealers are as much as 20% more expensive than those at independent garages.

But, whilst on the topic about money, the figure below shows the change in revenues of different after-sales outlets according to a DATAMONITOR survey. As shown, autocenters and fastfitters seem to be the gainers in this market segment so far, and the OEM network the losers. These results are a reflection of the physical growth of the market – the gainers (fast fitters, autocenters, tyre specialists, etc) are expanding rapidly throughout the market, whilst the losers (OEM network, independent garages, etc.) are drastically retracting.

Figure 23: Change in Revenues of different Outlets



Source: Datamonitor (2005). *Car Aftermarket in Europe – Datamonitor View*.

Additionally, the increase in publicity efforts of the gainers above mentioned (fast-fitters, autocenters, etc) over the last year is undeniable. Outdoor advertising has noticeably increased as well as the word "service" on already established dealerships and repairers. For example, previously, dealerships merely had their logo on the front of their show rooms – now, it is common to see the word "Service" after the manufacturers brand.

Examples include BMW Service and MINI Service. Also, the number of emerging authorised repairers, such as SEAT Service, have also been considerable.

In relation to auto-centers, all seem to be expanding throughout the country at an alarming rate. An overview of the five most important players in the Portuguese market is shown below.

Table 2: Overview of auto-centre growth in Portugal

	Year established	Nb. Of operations	Add. future operations
Precision	2001	26	2*
Bosch Car Service	N/A	63	N/A
Midas	1999	16	N/A
Norauto	1996	6	1**
CarLife	2005	3	30

* under constuction.

** inaugurated in 2006.

Not only are these independent repairers beginning to advertise, they are proactively looking for new land and/or independent repairers wanting to become part of a chain, through further advertising efforts, Internet communication and real-estate prospectors.

6.3.2. "How will (and should) repairers face these new market changes?"

Growth of large fast-fitting chains and auto-centres is an increasing threat to smaller independent garages, as well as to an OEMs network of authorised repairers. Ford, for example, is trying hard to avoid the loss of sales to this growing market segment. One example of the campaigns they have launched in the past few months is one in which they say they will match any repairer's service estimate. Though no consumer has yet faced the challenge, reports state that consumer trust in the Ford brand has risen through the use of such campaigns. Below are more suggestions as to how repairers can face the changes in the marketplace.

Consumer loyalty

As with OEMs and dealerships, repairers will have to draw customers to them and keep them. The most effective way to draw customers is through advertising and promotional efforts and unfortunately not every repairer will have the financial resources to do so. Large fast-fitting and auto-centers will be the ones to gain most, simply due to the fact that they are the ones that can invest the most. Through marketing efforts, such as promotional discounts, repairers can create and maintain a database that will aid them in targeting potential customers next time round. This, added by quality service, will allow repairers to get all that much closer to it's customers, and hopefully make them loyal to their brand.

However, with such marketing efforts from the OEMs network, fast-fitters (etc), smaller players will find the marketplace tougher than ever before.

Networking

But, with such marketing efforts from the OEMs network, fast-fitters (etc), smaller players will find the marketplace tougher than ever before. But, there are solutions for smaller players. Repair networks such as Bosch Car Service, are networls made up of small independent repairers, with the added advantage that each garage is still individually owned, but belongs to a large organisation. Advertising and marketing efforts therefore, are the mother company's responsibility and financial burden, and not the repairer's. In relation to the repairer-customer relationship, it is a win-win solution; the repairer belongs to a large organisation and the customer has increased trust in the service due to the brand displayed on the top of the garage door.

6.4. CONSUMERS

6.4.1. "What actual impact has the new BER brought upon the consumer?"

The most significant change most consumers were hoping for was in terms of price. According to ACEA, price differences, based on May 1st 2005 figures, have continually decreased during the past year, since the new Member States joined the EU, with the average standard deviation of prices between the 25 national markets falling from 6.9% in May 2004 to 6.4% in November 2004 and 6.3% in May 2005[16]. However, prices for particular models between the cheapest and the most expensive Member States can still be substantial.

Yet, contrary to what many wish to believe, the fluctuations in the exchange rates of the currencies used by the States outside the Euro zone played a far larger part in reducing the price differential than did the regulation itself. As Robin Goodyer of eurocarprice.com points out, the new regulation has played little, if any, part in the price convergence that has taken place so far; and the expansion of the EU has increased the number of operating currencies within the EU, making the goal of price harmonisation more difficult.

Price convergence has obviously affected consumers in different countries in different ways. It has resulted in below-average price rises in the UK, Norway and other states with relatively high pre-tax prices. Conversely, it has resulted in above-average price increases in Denmark, the Netherlands and other states with relatively low pre-tax prices.

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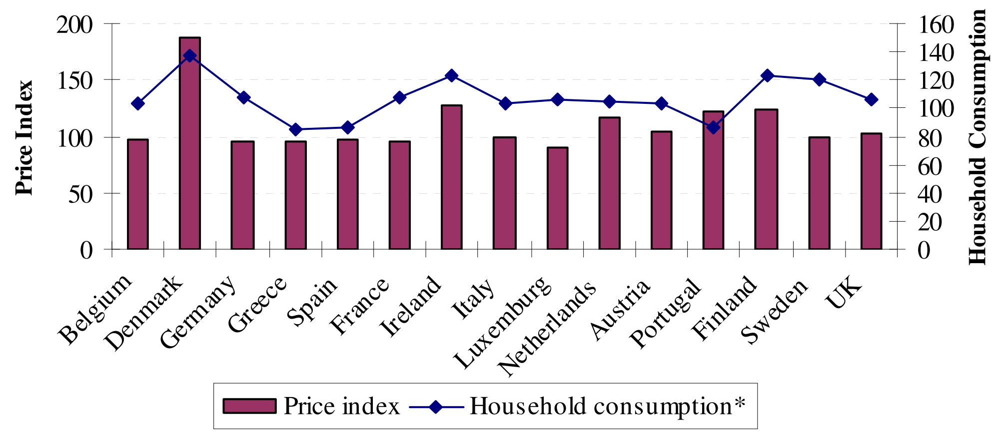
[16] ACEA, "Competition: convergence of car prices improves within EU while constant in the euro zone", 1st August 2005..

Figure 24: Price level indices of new passenger cars for EU15 - 2004



* **Household Consumption** = Private household consumption expenditure on consumer goods and services.

Source: Adapted from Leetmaa, Peeter, "Relative price levels for new passenger cars in Europe for 2004", Statistics in Focus, March 2006.

The figure above compares the price level index[17] for passenger cars with private household consumption expenditure. For passenger cars the price levels, compared to the EU average (EU15 average=100), vary from 91% in Luxembourg to 187% in Denmark. Apart from Denmark, the impact of high taxes is visible in Finland (124%), Ireland (127%), Portugal (123%) and the Netherlands (116%). However, there is no straightforward correlation between tax rates and price level differences. In countries with high tax rates for car purchases, car producers tend to charge lower pre-tax prices, and therefore pass-on the taxes only partially to consumers.

6.4.2. "How will (and should) consumers face these new market changes?"

The regulation changes were made to favour the consumers. Unfortunately, little change has been felt. But hopefully, in the near future, consumers will enjoy better service - as manufacturers continue to demand higher standards of performance from their dealers - and lower servicing costs - as manufacturers compete to engineer vehicles that need less frequent servicing.

Additionally, changes regarding availability will also be more noticeable – for example, consumers living in affluent urban areas will enjoy greater choice and lower prices because

[17] Price level index = indicator of the comparative order of magnitude of the price level in one country in relation to others.

the consolidation of the traditional dealer network and the removal of the territorial restrictions on where dealers can sell will promote the development of large multi-franchise dealers which compete intensively for their custom. But consumers living in rural areas could end up having to travel long distances or buy from a retailer with a local monopoly.

6.4. SUMMARY OF KEY CHANGES

The BER, previously protecting OEMs from European antitrust legislation, has undergone serious changes, affecting all the stakeholders involved in the sales and servicing of vehicles. Outlined below is a brief summary of the impact of the new BER, upon these stakeholders:

Table 3: Summary of Actual Impact

	Impact	Solutions
OEM	- Increased consolidation; - Increased competition; - Dramatic reduction in the number of dealer contracts and outlets.	- Need for proactive strategic thinking; - Focus on control; - Further strategic alliences; - Increase consumer loyalty.
DEALER	- Increased consolidation; - Increased competition; - Rise and fall of alternative forms of retailing; - Lack of new comers.	- Need for strategic thinking and skills; - Focus on consumer loyalty.
REPAIRER	- Increased consolidation; - Increased competition; - Lack of independent repairers wanting to become authorised; - Increase in revenues for fastfitters, autocenters and typre sepcialists; Decrease in revenues for other repair formats; - Increase in publicity efforts.	- Focus on consumer loyatly; - Networking – alternative solution for independent repairers
CONSUMER	- Leveling out of prices due to currency fluctuations (not BER); - Reduction in the number of places to buy and service vehicle.	- Can expect increased quality standards; - Lower servicing costs due to less frequent servicing.

Chapter 7 – Conclusion

Having looked at the evolution of the Block Exemption Regulation, competition in the automotive industry, and compared the expected impact of the new BER with the actual present day outcomes, three years down the line, what can be concluded? Have there been any significant changes in the automotive market since the introduction of the new Block Exemption regulation in 2003? Furthermore, do the main players have anything to fear?

The statistics in the previous chapter show that there have been some changes, regarding the number of sales and service outlets and some attempts at changing the way customers buy and service cars, but the outcomes the European Commission was expecting have not ultimately occurred.

There has been an extremely limited shift in power, if any at all. Most manufacturers have taken all the necessary strategic steps to remain in full control over their dealership network. Some, according to many dealers, have more control than they used to. Dealerships are facing even more challenging days, many giving up due to drastic financial difficulties and not, in most cases, due to the new BER. Fortunately for OEMs and unfortunately for the dealership network, this trend in power is expected to remain.

In relation to consumers, though at first glance they seem to have a larger array of choice, in truth, they are little better off than they were previously, regarding the purchasing of new vehicles. But, contrary to the sales market, the after-sales market is the only market showing any positive sign of pro-activity. With the reduction in the number of independent repairers and strengthening of auto-centres and fast-fitters in the market, service quality standards have risen significantly. Also, unlike the sales of new vehicles, the after-sales market has seen a positive growth in the number of new players – especially in franchised auto-centres and other strategic groups (such as Bosch car service). Alas, an additional player the dealership must fear.

Though the drastic reduction in the number of outlets can be viewed as a strong indicator that the new regulation is doing its job, most players will agree that this has been the cause of a highly competitive market suffering from intense competition and reduced margins, rather than the result of the new rules. Furthermore, contrary to what the European Commission wished, new retailers are not piling into the market, dealers are not running to sell multiple brands and independent retailers have not lined up to get authorized.

True, it takes time to change an industry as large and complex as the automotive industry and also, to change consumer behaviour, but still, in three years, a lot more was expected.

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Appendix

Appendix 1 – OEM Interview Guideline

INTRODUCTION

1. Name

2. Company name AND Position you hold

3. Approximate number of years in the company?

4. In general, what have been the most significant impacts on Ford since the implementation of the new BER?

DEALERSHIPS

1. Have there been any significant quantitative difference in the number of dealerships over the past 3 years?

2. Has there been any significant qualitative difference in the dealerships over the past 3 years? (e.g. customer satisfaction, number of complaints etc)

3. Are Official Ford Dealers looking to expand (in terms of locations and multi-branding, please specify which) in the near future?

4. Is it of Ford Motor Company's interest that the dealership network should expand in terms of location?

5. Is it of Ford Motor Company's interest that the dealership network should expand in terms of the number of brands it represents?

6. A report published by HWB International reported that, "*over 70% of all main dealers in Western Europe sell only one brand, and over 80% sell the brands of only one vehicle manufacturer*". Do you agree? And do you believe this to be the case in Portugal?

AFTER-SALES AND SERVICE

1. What is the approximate qualitative value of Ford's after-sale market in Portugal?

2. Does Ford Portugal have strategies to "preserve" the after-sales market? What are these strategies (unless confidential)

3. What are the results?

4. Some manufacturers have set up service outlets (e.g. Renault "Minute"; VW "Stop & Go"). Is Ford Motor Company going to follow this trend?

SUMMARY

1. Please highlight some of the key changes Ford will be undergoing in the next year, regarding its distribution network.

2. Please highlight some of the key changes Ford will be undergoing in the next 3 years, regarding its distribution network.

3. In the long run, what benefits, or downfalls, do you think the new legislation (BER) will bring to the following stakeholders:

A. Manufacturers
B. Dealerships
C. Independent Repairers
D. Customers

Appendix 2 – Dealership Interview Guideline

INTRODUCTION

1. Name

2. Company name AND Position you hold

3. Approximate number of years in the company?

4. In general, what have been the most significant changes at your Dealership since the implementation of the new BER?

DEALERSHIP

1. Have there been any significant qualitative difference in your dealerships over the past 3 years? (e.g. customer satisfaction, number of complaints, etc)

2. Has or is your Dealership looking to expand in terms of sales outlets and /or number of brands it represents?

3. If so, what are the advantages your foresee by doing so?

4. Have you had Ford's support in doing so?

5. Have you felt a significant difference in competition?

6. Has the new BER brought significant changes to the market?

7. A report published by HWB International reported that, "*over 70% of all main dealers in Western Europe sell only one brand, and over 80% sell the brands of only one vehicle manufacturer*". Do you agree? And do you believe this to be the case in Portugal?

AFTER-SALES AND SERVICE

1. What is the approximate qualitative value of your after-sale market?

2. On which do you believe the largest impact of the new legislation (BER) will be on - Sales Market or the After-Sales Market?

3. Has or is your Dealership looking to expand in terms of after-sales servicing and /or number of brands it services?

4. Have you done so already?

SUMMARY

1. Please highlight the most important objectives your Dealership is wishing to accomplish this year.

2. Please highlight the most important objectives your Dealership is wishing to accomplish in the next 3 years.

3. In the long run, what benefits, or downfalls, do you think the new legislation (BER) will bring to the following stakeholders:

A. Manufacturers
B. Dealerships
C. Independent Repairers
D. D. Customers

Appendix 3 – After-Sales Interview Guideline

INTRODUCTION

1. Name

2. Company name AND Position you hold

3. Approximate number of years in the company?

4. In general terms, what has been the most significant impact caused by the BER on after-sales in Portugal?

5. In general terms, what has been the most significant impact caused by the BER on Ford's after-sales?

AFTER-SALES AND SERVICE (Overview)

1. Have there been any significant <u>quantitative</u> difference in the number of after-sales outlets over the past 3 years? (if yes, what impact has been felt?)

2. Have there been any significant <u>qualitative</u> difference in after-sales outlets over the past 3 years? (e.g. customer satisfaction, number of complaints, etc)

3. How much of a threat are the new autocenters (e.g. CarLife), and the growth of those already present in the market, to Ford's network?

AFTER-SALES AND SERVICE (Ford)

1. Is Ford (after-sales and servicing) aiming at increasing their network (in terms of locations) in the near future?

2. Does Ford have a defined strategy to protect its after-sales and servicing market? What are those strategies (none confidencial)?

3. What have been the results of those strategies so far?

SUMMARY

1. Please highlight the most important objectives Ford (after-sales and servicing) is wishing to accomplish this year.

2. Please highlight the most important objectives Ford (after-sales and servicing) is wishing to accomplish in the next 3 years.

3. In the long run, what benefits, or downfalls, do you think the new legislation (BER) will bring to the following stakeholders:

A. Manufacturers
B. Dealerships
C. Independent Repairers
D. Customers