

Gentlemen's dispute or bar room brawl?

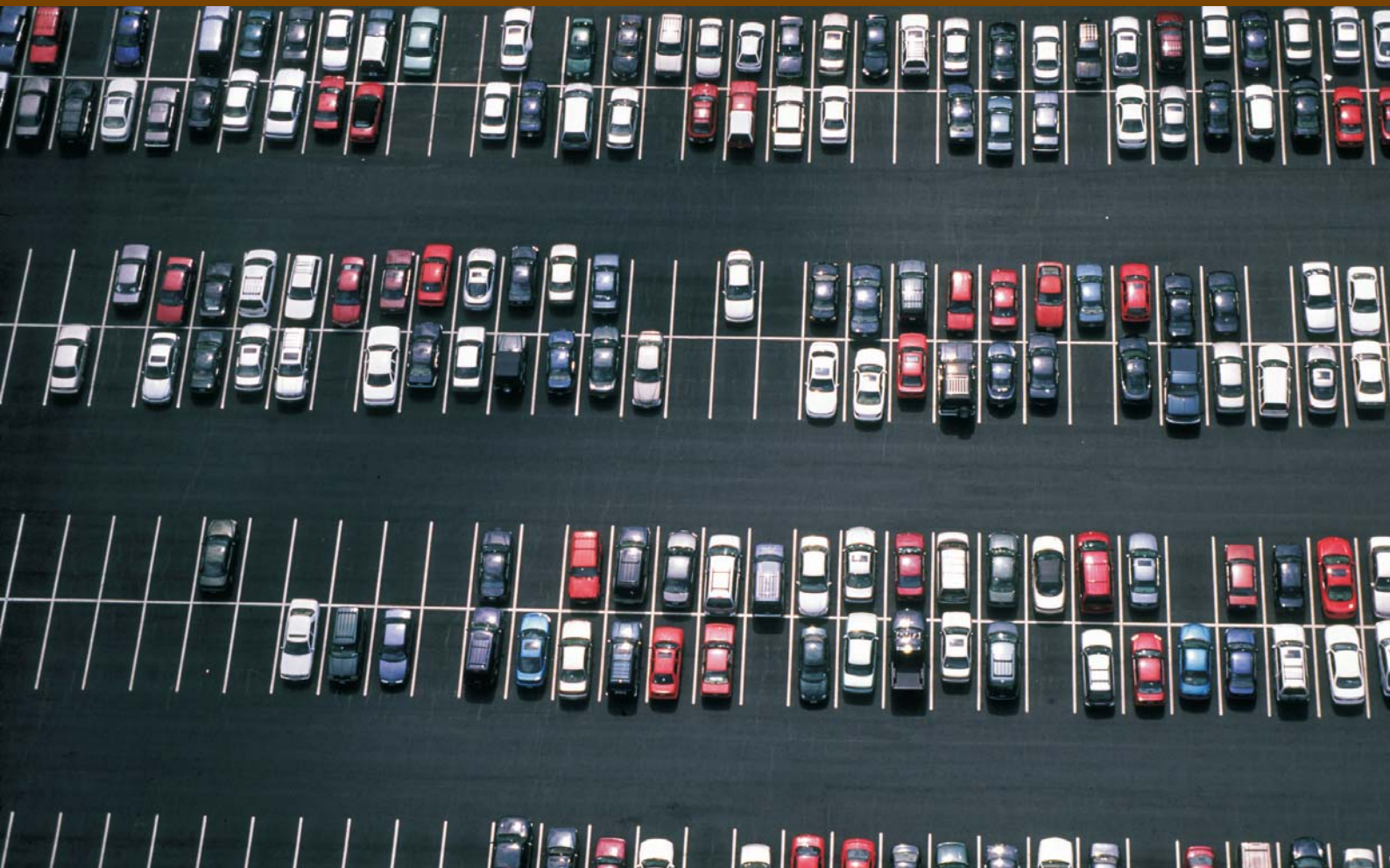
Part six:

*The impact of the new block exemption regulation on repairers**

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The new block exemption regulation (BER) governing automotive sales and after-sales took effect on 1 October 2003. It encompasses the way in which carmakers distribute their vehicles in Europe, how those vehicles are serviced, and how spare parts are sourced. It has huge consequences for everyone in the automotive industry (see box on p5). We have already discussed the impact of the changes on carmakers, dealers, technology providers, consumers and spare parts producers. In this article, we shall explore the implications for repairers.

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. The new regulation has accordingly been designed to accomplish several objectives: to promote intra-brand competition and the harmonisation of prices across the European Union (EU); to give dealers more independence from vehicle manufacturers; and 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 Norway, Iceland and Liechtenstein, as well as all the member states of the EU.



Of all the changes made by the regulation, the introduction of greater competition in service and repairs is likely to be the most bitterly contested because after-sales servicing is by far the most profitable part of the automotive value chain. It is also the single most consistent point of contact between consumers and the industry itself.

The opening up of the relationship with the customer

Under the old regime, dealers were obliged by the terms of their franchises to provide service and repair facilities as well as showrooms. In return, they got exclusive access to technical information, service bulletins, diagnostic equipment and special tools from the carmakers whose brands they represented, together with the right to perform warranty repairs and be reimbursed. They also got the endorsement of those carmakers, which gave them a major marketing lead over the other key players in the after-sales servicing arena.

Collectively, these advantages locked out most of the competition. Any consumers who took their cars to be serviced or repaired outside the official dealer network made a conscious decision to do so – usually on grounds of proximity, quality or price (in that order) – and the newer or more expensive their cars, the less likely they were to take the risk. Hence the fact that dealers currently perform some 80% of all repairs on vehicles that are less than four years old.

But the new regulation has opened up the relationship with the customer to the other parties in the sector. It has severed the once mandatory link between sales and servicing: dealers can now sell new cars without servicing them, service new cars without selling them or perform both activities as before. To this end, it has created a new category of repairers – those that are approved by a particular carmaker and can call themselves “authorised” repairers.

The regulation also specifies that every carmaker must provide equal access to technical information (including training, software, tools and equipment) for all operators involved in repair, training and technical assistance, regardless of whether they are authorised or independent. Furthermore, any independent repairer that wants to become an authorised repairer and fulfils a carmaker’s qualitative criteria is free to do so. Thus repairers that are not dealers can now get much closer to the customer and, theoretically at least, can do so on much more equitable terms.

The implications of being an authorised repairer

Indeed, financially, repairers now enjoy an active advantage over dealers. Building a showroom in a prominent location and maintaining a stock of new cars costs a substantial amount of money – and traditional dealers have made the investment on the understanding that exclusive representation of a particular carmaker in a designated territory would help them get a good return on their investment. But repairers do not need to purchase premises in the centre of town or invest in expensive showrooms.

Not only are the entry costs much lower, the gross margins on revenues earned from servicing vehicles are also much higher than those from selling new 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 earnings before interest and taxes (EBIT); conversely, service labour and spare parts account for only 20% of sales but 50% of EBIT.

Many dealers that lose their franchises may therefore apply to become authorised repairers – and, as the carmakers consolidate their distribution networks in the wake of the new regulation, the number of dealers operating in Europe will fall quite dramatically. Some ex-dealers may also join the multi-marque repair networks certain carmakers have set up in an effort to maintain their share of the spare parts market. Both Renault and Citroen, for example, have launched new garage networks – called Motrio and Europepar respectively – which service all makes of car, primarily for ex-dealers with which they still want to do business.

A number of independent repairers may also choose to become authorised repairers, provided that they can meet the standards laid down by the carmakers. Unlike traditional dealers, independent repairers typically service and repair a wide variety of brands. But cars are becoming steadily more complex, a trend that makes it increasingly difficult to service and repair numerous different marques. The advantage for

independent repairers of choosing to become authorised repairers, then, is that they can specialise in one or two brands and enhance their status by securing the carmaker's stamp of approval.

The implications of being an independent repairer

In practice, however, the majority of independent repairers will probably want to remain independent, particularly if the privileges dealers and authorised repairers enjoy regarding warranty work are removed. In December 2003, the UK Office of Fair Trading (OFT) argued that the restriction which some carmakers impose, requiring customers to have their cars serviced by a dealer or authorised repairer while under warranty (whether this be the manufacturer's warranty or a "dealer-based extended warranty") is contrary to the spirit of the new regulation.

The OFT has accordingly called on carmakers and dealers to remove any such constraints, and to give consumers clearer information about the terms and conditions of their warranties. In addition, it has announced that it will take various measures to ensure consumers are better informed – and has explicitly reminded the industry that, from 1 May 2004, it will have the power to withdraw the benefits of the block exemption in the UK if such servicing restrictions remain.

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. Thus, if the competition authorities in other member states take the same stance, independent repairers will be able to compete far more effectively for all routine servicing work from the moment a car is sold.

But many independent repairers may prefer to stay independent regardless of such developments. They may, for example, fear losing their autonomy. Most small garages succeed by maintaining personal relationships with their customers, while the larger repair chains are often run by entrepreneurs. For both such groups, the freedom to manage their businesses as they see fit could well outweigh the advantages of becoming authorised.

The standards the carmakers have laid down are likely to prove an even bigger obstacle. The European Commission is currently investigating complaints that some vehicle manufacturers have deliberately set very high standards in an effort to keep independent repairers from joining their

networks and stealing a very profitable line of business. But irrespective of the truth or otherwise of such allegations, many independent repairers – particularly sole traders – simply cannot afford to meet the costs of conforming to the carmakers' standards.

One possible response to this dilemma is the development of associations that would enable independent repairers to get information, equipment and expertise on a cost-effective basis. The formation of local networks would allow small repair businesses in the same geographic area to share sophisticated diagnostic tools and expensive new equipment – something they will certainly need as the growing use of electronics makes even common repairs such as changing a tyre increasingly high-tech.

It might likewise enable them to "borrow" from other brands, if they teamed up with some of the other big participants in the automotive market. In the UK, for example, several independent national networks are already starting to emerge, including the Good Garage Scheme (which is backed by the Department of Trade and Industry and the Retail Motor Industry Federation); and the Shell Helix Service Centre (which was launched by Royal Dutch/Shell and has over 580 members).

Recruitment and training

The new regulation has other ramifications in terms of recruitment and training. Carmakers and dealers already invest a considerable amount of time and money in technical training, but any independent repairer that wants to be authorised will now have to invest heavily in training as well. In the longer term, this could improve the quality of the service offered by *all* repairers, including fast-fit chains, autocentres and independent garages.

It could also help to alleviate the shortage of competent car mechanics. The majority of skilled mechanics are middle-aged, mainly because other areas of employment have proved more appealing to the next generation. But the automotive industry has worked hard to elevate the status of repairers, with the development of vocational courses and apprenticeships. Meanwhile, the increasing complexity of cars – including the explosive growth in electrical and electronic sensors, diesel fuel systems and air conditioning – has made the job more attractive to teenagers (and less attractive to older people unaccustomed to using computers), as has the fact that a good mechanic can now earn a very respectable income.

The advent of new entrants

If a career as a car mechanic has increasing appeal for school-leavers, the liberalisation of the market is likely to elicit increasing corporate interest – especially from organisations eager to break into servicing and repairs for the first time. This has already happened in France, where leading components suppliers Autodistribution France, Delphi, Bosch and Valeo recently announced plans to collaborate and set up 100 automotive servicing centres by 2005. But there are other potential candidates, including the big general retailers and finance houses.

Research by the OFT suggests that, in the UK, servicing at franchised dealerships generally costs more than servicing at independent garages, averaging £199 and £116 respectively – although the pricing structure in the aftermarket is quite complicated and other sources show that dealers tend to charge more for routine maintenance, while independent repairers charge more for infrequent repairs

Carrefour, the French hypermarket chain, has already dipped a toe in the sector, although it recently sold its 55 autocentres to Feu Vert (in which the supermarket group Casino has a stake). Similarly, several British banks, including Lloyds TSB, have moved into fleet management, while Direct Line, the online motor insurer, operates a roadside breakdown service. Some of these financial institutions may see a move into maintenance and repairs as an opportunity to tighten their grip on their target markets or expand their role.

Resistance from dealers

However, it is equally obvious that, whether they are new or existing players, all repairers will face a tough battle for market share. Dealers will fight tooth and nail to keep their slice of the aftermarket business, precisely because it is so profitable. Although better components and engineering have reduced revenues per car per annum, overall revenues are rising with the increase in the lifespan of the average vehicle and the greater complexity of onboard electronics.

Moreover, dealers could ultimately be in a very strong position to compete. Research by the OFT suggests that, in the UK, servicing at franchised dealerships generally costs more than servicing at independent garages, averaging £199 and £116 respectively – although the pricing structure in the aftermarket is quite complicated and other sources show that dealers tend to charge more for routine maintenance, while independent repairers charge more for infrequent repairs. This price differential is growing, primarily because selling new cars is much less profitable than servicing them (especially in the UK, where there is a large fleet market).

But in a competitive environment it is impossible to subsidise one activity at the expense of another – and unbundling service labour revenues shows that more than 40% of the average hourly rate British dealers charge goes on cross-subsidies. So, if dealers stopped subsidising their sales activities, and revised their operating processes and merchandising schemes, they could charge the same labour rates for servicing and repairs as independent repairers, without reducing their retained gross margins or expenditure on training. Multi-brand dealers and authorised repairers could then seize a much larger share of the market, leaving independent repairers out in the cold.

The market itself may also evolve to reflect the nature of the repairs being performed, and the age and value of the vehicles being serviced. Carmakers in countries such as France and Germany, for example, currently enjoy a monopoly on the supply of crash parts – body panels, lights and glass parts. The European Commission wants to end that monopoly, so some member states may impose restrictions on which repairers can perform repairs involving essential car parts, both to protect domestic manufacturers and on grounds of security.

Similarly, in countries where it remains acceptable for carmakers and dealers to issue warranties with servicing restrictions, a three-tier structure might emerge in which new cars under warranty are serviced by a franchised dealer. Relatively new or expensive cars on which the warranty has expired would be serviced by an authorised repairer because

consumers might still have some sort of comeback with the manufacturer, if anything went wrong. And old cars would be serviced by an independent repairer because this would be the cheapest option.

But whatever happens, it is clear that consumers will ultimately determine the way in which the market evolves, through the distance they are prepared to travel and the amount they are willing to pay for servicing and repairing their cars. Inconsistencies in performance are also likely to increase, in the short term at least, as the market sorts itself out.

A plethora of mergers and acquisitions

Mergers and acquisitions will almost certainly form a major part of this process. The independent repair market is currently very fragmented because it includes thousands of sole traders and small chains. But some of the fast-fit operations and large repair chains could attract considerable interest.

Fast-fit and national auto chains already control more than 50% of the European market for fitting tyres, exhausts, brake pads and oil filters (largely because they trade in convenient locations). Further consolidation seems inevitable – especially given experience in the US, where a number of fast-fit companies have won market share from dealers by expanding the menu of services they offer and providing those services on a drive-up basis.

Private equity firms, most of which invest for a maximum of five years, also own a number of fast-fit operations and autocentres. They include Nationwide Automotive Centres, which is owned by NBSG; ATU, which is owned by Doughty Hanson; and Kwik-Fit, which was recently bought from Ford by CVC Capital Partners. Such companies could be attractive to

The key consequences of the new regulation for repairers

- Many of the dealers that lose their franchises, as the carmakers consolidate their distribution networks, will become authorised repairers.
- Any independent repairer that wants to become authorised and can meet a particular carmaker's standards will be free to do so.
- All repairers, whether they are authorised or independent, can set up shop wherever they want because the location clause does not apply to repairers. In the long term, some carmakers may therefore have to revise their global repair network strategies to ensure they can offer full coverage.
- All repairers, whether they are authorised or independent, will be entitled to equal access to all technical information and equipment. Access to technical information and training will also become increasingly important, as cars become more complex.
- All repairers will need to develop a closer relationship with spare parts suppliers, particularly those that make highly specialised parts such as airbags and air conditioning equipment.
- Some repairers will lack the technical equipment and know-how to perform certain common repairs. It will soon be impossible to change a tyre on some models, for example, without resetting the tyre-pressure sensors.
- Service and repair spend per car per annum will continue to fall, as carmakers engineer vehicles that need less frequent servicing and use more durable components. But the increase in the lifespan of the average vehicle and the growing complexity of onboard electronics will more than compensate for this trend.
- New players will enter the aftermarket arena, including general retailers, carmakers and financial institutions.
- The number of jobs in traditional dealer networks will fall, while the number of jobs in service and repair shops will increase.
- Franchised dealers will fight hard to retain their share of the aftermarket business. They will no longer be able to use the revenues from servicing and repairs to subsidise their retail activities. So they will have to reduce their prices, and revise their operating processes and merchandising schemes. That will put greater pressure on independent repairers.
- The relationship between the various participants in the automotive value chain will be rebalanced. Vehicle manufacturers have traditionally enjoyed the "whip hand", but the emergence of new-style retail outlets and the wider range of choices likely to be available to consumers will slowly alter the balance of power.

Japanese trading houses involved in the manufacturing of automotive components (such as Mitsubishi) or any vehicle manufacturer eager to secure a foothold in the European servicing and repairs market.

Most carmakers want to track their cars and customers, so that they can improve their products and market to former customers more effectively. At present, this is very difficult, because only the dealer that services a customer's car keeps any information on the customer and the car after the point of sale or completion of the financing contract. And dealers generally do not share such information either with the carmakers they represent or with other dealers in the same network.

Thus some carmakers might decide to set up their own authorised repair chains – much as BMW and Mercedes-Benz have set up their own retail outlets – as a means of protecting their relations with their customers *and* their share of the lucrative spare parts market. This is already true in mature markets such as France, where Renault, Citroen, Peugeot and Fiat all have various fast-fit or autocentre operations; and in North America, where carmakers such as General Motors, Ford and Honda have set up authorised repair outlets under related brand names like GM Goodwrench.

However, some of the larger dealers could also seize the opportunity to extend their remit by acquiring small groups of franchised dealers or independent repair chains. They could then split their retail and repair operations in order to compete more effectively with authorised and independent repairers unburdened by the expenses of running a costly showroom. Alternatively, they could operate a full-service business that includes retail sites and satellite repair shops – both authorised and independent.

This would be one way of trying to capture the entire market, much as airlines offer first-, business- and economy-class seating for passengers with different budgets. It would also increase their customer retention rates; industry data shows that consumers are much more likely to purchase another car from the dealer that services their existing vehicles than from a dealer they do not know.

Conclusions

In short, there will probably be ferocious competition in the servicing and repair market for some time to come. Many of the dealers that lose their franchises, as the carmakers consolidate their distribution networks, will become authorised repairers – and those that retain their franchises are currently at a definite disadvantage, weighed down as they are by the costs associated with selling new cars.

But though authorised and independent repairers could thrive in the short term, dealers will certainly fight back. They will stop using the revenues from their servicing and repair operations to subsidise their retail operations, so that they can compete more effectively. They will also actively expand the services they offer, and improve access to those services, by setting up satellite sites. Prices will then fall, putting further pressure on authorised and independent repairers. Meanwhile, the lucrative nature of the aftermarket will attract new entrants, including general retailers, carmakers and financial institutions already involved in vehicle financing.



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