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Gentlemen's dispute or bar room brawl?

Part four:

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

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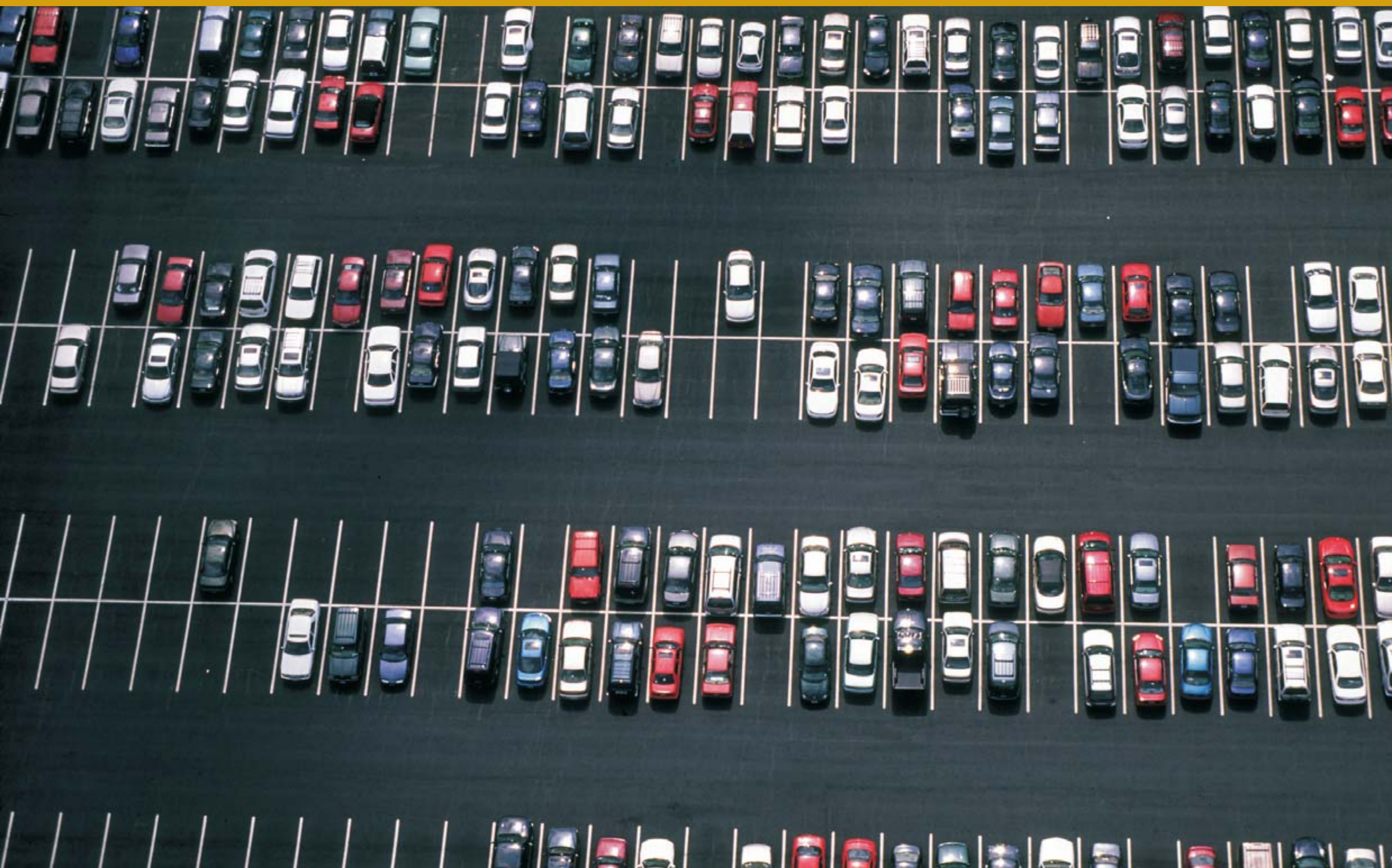
The new block exemption regulation (BER) governing automotive sales and after-sales took effect on 1 October 2003. It encompasses the way in which carmakers distribute their vehicles in Europe, how those vehicles are serviced, and how spare parts are sourced. It has huge consequences for everyone in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

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 Lichtenstein, as well as all the member states of the EU.



But no political body can manage markets or legislate for buying patterns and preferences, so consumers will play a huge role in determining whether or not the new BER works. Moreover, cars are not just commodities; they are status symbols that sometimes evoke considerable passion, although this tendency is not as pronounced as it once was.

The success of the new regulation depends on several other factors, too. It rests, for example, on the degree to which the various participants in the automotive retailing and servicing chain seek new opportunities to grow, rather than trying to minimise the risk to their entrenched interests; and the vigorousness with which the European Commission monitors the industry.

A mixed bag for consumers

It is also clear that any alterations in the way consumers behave will take some time to emerge, because the frequency of contact between consumer and retailer is critical in determining the speed of change. Consumers typically shop at a supermarket once a week, for example, which is why the switch from cash to plastic occurred quite rapidly. But the average family purchases between 18 and 20 cars in its lifetime, at average intervals of between 3½ and 4 years, so the speed of change will be correspondingly slower. Lastly, the impact of the regulation will vary from one country to another, and one consumer to another.

Greater competition

If the European Commission has its way, the price of new cars will come down – and that will in turn reduce the price of used cars, since the residual value of used cars reflects their original purchase price and condition. In theory, at least, three factors should help to lower prices: greater competition between dealers selling multiple brands from multiple carmakers; the emergence of new retailing formats; and the removal of the price differentials between the various member states. In practice, however, the situation is very complicated, and it will take some years to establish whether the Commission's aims are achieved.

Under the old regime, dealers could not actively sell to consumers outside the territory allocated to them by the carmaker whose brands they represented. But selective dealers (and most carmakers have chosen this route) are now free to sell actively to consumers throughout the region covered by the new BER. They will also be able to open secondary outlets anywhere in the EU after 1 October 2005. This should increase the competition between dealers and allow the more entrepreneurial dealers to expand. The powerful multi-franchise dealerships that emerge will then be able to negotiate bigger discounts from the carmakers – which should, in turn, reduce retail prices.

But though some consumers could see prices fall, others could experience more difficulty because they have to travel long distances or buy from a retailer with a virtual monopoly on the local market. The change in the rules will concentrate ownership of the dealer network and ultimately, perhaps, reduce the number of sites at which new cars are sold. Of course rival dealers could enter the market, but they will naturally focus on those areas that show the greatest potential. In affluent urban areas there is likely to be plenty of competition, but in rural regions there may well be far less. Consumers living in the countryside could therefore end up having to pay more for their new cars.

The concentration of power in the hands of a small number of retailers does not always signify higher prices; the UK supermarkets have, for example, been very successful in negotiating massive cuts in suppliers' margins and reducing prices for consumers. Nevertheless, most branches of the big supermarket chains face intense local competition, whereas dealers operating in rural areas would not necessarily be subject to the same market pressures.

Two other factors will have a bearing on the prices consumers pay, regardless of where they live. First, some carmakers are setting standards that, in the eyes of their dealers and repairers, are too high – and the European Commission is currently investigating a number of complaints on this score. In fact, there are good reasons why carmakers should set high standards, since anyone who meets those standards can become an authorised repairer and anyone appointed as a retailer will soon be able to set up shop in any location. The criteria the carmakers impose are thus their sole means of ensuring the quality of their networks, but it is ultimately consumers who will have to pick up the costs of compliance.

Second, the traditional automotive retailing model provides higher margins for servicing cars than for selling them – and the new regulation will change this model dramatically. The repair market, like the retail market, will be subject to much greater competition. But those dealers that lose revenues from their repair operations will be unable to subsidise the sale of new cars, as they have done in the past. So they will need to raise their prices and reduce their costs, although they will be restricted in the extent to which they can increase prices because they will have to remain competitive.

In short, the evidence that greater competition will reduce prices for consumers is mixed. The prices of new cars will probably fall in urban locations where there is intense competition between powerful groups of dealers, but they could stay much the same or even rise in rural locations where consolidation has created virtual monopolies. Higher standards and the removal of cross-subsidies could also counteract some of the advantages of increased competition, although it is likely that the European Commission will monitor the situation carefully.

New ways in which consumers can buy cars

Apart from promoting greater competition, the new regulation aims to give consumers more freedom in the way they buy new cars. Formerly, dealers could not sell brands from different carmakers unless they set up separate showrooms with separate back-office processes, accounting systems and so forth. But they can now sell multiple brands in the same showroom (as long as they adhere to certain restrictions).

Multi-branding will make it much easier for consumers to compare the prices of similar models without having to visit numerous outlets. It should also help to improve the quality of the brands they can buy. Experience in the white goods industry shows that consumers readily pay more for washing machines, refrigerators and freezers with top-quality brands – even when they are sold next to products that are half the price. Conversely, poor brands that are overpriced lose market share and ultimately disappear. However, the potential for abuse is correspondingly greater. One key concern, for example, is whether sales staff will push consumers in a particular direction because they get bigger bonuses for selling certain brands.

The rules on intermediaries have also been relaxed. Exclusive dealers can sell new cars to independent resellers and intermediaries (mandated by the carmakers), paving the way for totally new retailers and retailing formats. Several new entrants with expertise in selling to consumers in other sectors have already entered the market. Virgin Cars recently opened a vehicle department store in Salford, UK, while Quelle, the German mail-order giant, has just started selling Volkswagen's new Golf V model at a 10% discount on its Internet site. Quelle hopes to sell between 3,000 and 4,000 cars a months within two years' time. Some financial institutions could likewise decide to set up car-retailing operations, as the popularity of renting, leasing and other forms of ownership increases.

But the big question is how intermediaries will source the cars they sell. Volkswagen has already said that it will not supply Quelle because that would violate the carmaker's agreements with its dealers, although Quelle argues that it is acting quite legally as a middleman and only facilitating the sale of new cars between consumers and the 12 authorised dealers with which it has a relationship. Most carmakers have also taken the selective route precisely because they do not want their dealers to act as wholesalers.

Indeed, with the termination of the traditional contracts that gave dealers exclusive selling rights in a designated territory, some carmakers may well seize the opportunity to become retailers themselves. Mercedes, BMW and Volkswagen have already established their own retail networks – and in areas where real estate is very expensive, carmakers may have no alternative.

Many carmakers also offer special services for diplomats, military personnel and expatriates. Customers can order the model they want, configured to the standards of their country of destination, and collect their cars at the factory gate or have them delivered to selected major cities. Orders must normally be placed through a dealer, but it is conceivable that some vehicle manufacturers could eventually sell directly to such customers.

The "noise" in the marketplace will thus become much louder – and probably much more confusing for consumers. Instead of selecting a model and comparing the prices offered by several local dealers, they will be bombarded with a bewildering array of retailers, advertising messages and retailing styles.

Some consumers may prefer to stick to what they know; research conducted by the European Commission suggests that many customers are happy with the traditional format. This would initially favour conventional dealers offering a one-stop shop for the purchase of new and used cars, provision of repairs and supply of parts. Such dealers also currently have an advantage over new retailers because they possess information systems that enable them to communicate directly with the carmakers whose brands they sell, so determining whether a car is still under warranty, for example, is relatively simple. But in the longer term, it is likely that new retailing formats and players will change the shape of the market – and savvy consumers who are capable of making their way through the maze should see prices fall.

Carmakers typically adjust prices to reflect variations in the tax regimes of the member states. If all identical cars were sold at the same average pre-tax price, consumers living in countries with low vehicle taxes would see prices fall while those living in countries with high vehicle taxes would have to pay very much more

Price harmonisation

One last feature could affect pricing: namely, the European Commission's aim of harmonising prices across the EU, by making it very much easier to buy and sell cars across borders. Selective dealers will soon be allowed to set up satellite operations in any member state, although how many choose to do so (or prove competent to run an international business) is another matter. The growing popularity of the Internet could also encourage consumers to become more mobile. But it is a moot point whether these changes will cause prices to converge across the EU – and, even if they did, some consumers would benefit at the expense of others.

In fact, there is currently no obvious consumer appetite for cross-border buying because of the time, distance and difficulties involved – difficulties such as variations in specification and getting a car that has been purchased elsewhere serviced. Data from eurocarprice.com, which tracks the prices of new and used cars across Europe, shows that, between January and September 2003, there was no convergence in the pre-tax and post-tax prices of new cars sold across the euro zone, even though consumers living in these countries can shop across borders quite easily because they are not exposed to currency fluctuations. Had there been much cross-border trading, those prices would have started to converge.

Analysis of the prices of a pool of new cars across the 18 states affected by the new regulation also shows that, in September 2003, the pre-tax price difference between the cheapest and most expensive territories was just 24%. Conversely, the post-tax price difference was 103%. In other words, the biggest reason for the discrepancy in prices is variations in the tax regimes of the respective member states.

Carmakers typically try to manage these differences by reducing their pre-tax prices in countries where vehicle taxes are high and offsetting the cost of the reductions with higher prices in countries where vehicle taxes are low. So, if all identical cars were sold at the same average pre-tax price, consumers living in countries with low taxes would see prices fall while those living in countries with high taxes would have to pay substantially more. That, in turn, would reduce the sales volumes, economies of scale and profits enjoyed by the carmakers. It might even, perhaps, result in the consolidation of the sector and ultimately increase prices for consumers, in the same way that the deregulation of the US airline industry ended in the demise of several major carriers and more expensive flights.

Thus the situation as regards car prices is extremely complex. Consumers living in urban locations in countries with low vehicle taxes could well see considerable savings. But those living in rural locations or in countries with high vehicle taxes could end up having to pay more – although the development of multiple retailing channels, the emergence of new entrants and greater competition between traditional dealers will counterbalance some of these pricing pressures, since any retailer that is not competitive within its local market will ultimately lose its customer base.

Consumer access to the after-sales market

The new-car market will take some time to change, but the after-sales market is likely to alter more rapidly – not least because consumers get their cars serviced and repaired far more frequently than they buy new models. The lifespan of most vehicles has also increased; the average car now has four owners, compared with three just a decade ago. So vehicle repairs account for a growing percentage of the money consumers spend on cars.

The quality of the after-sales service dealers provide has generally been quite uneven, and carmakers are keen to engineer vehicles that require less frequent servicing. But the new regulation will give them an even greater incentive. Carmakers currently manage the supply and distribution of spare parts, and charge a substantial premium for doing so; however, the new BER allows authorised and independent repairers to buy spare parts directly from a wide range of suppliers, including third-party producers making “matching quality” spare parts.

This should ultimately benefit consumers by reducing the price of spare parts but, again, the situation is far from straightforward. One recent study shows that spare parts account for much the biggest share of the automotive industry’s gross profits – at 39% – and experience in other industries suggests that new entrants target the most profitable areas first. Most of the direct insurers that have sprung up in the past 20 years have, for example, focused on automotive and home insurance rather than life insurance. Similarly, no-frills airlines like Ryanair and EasyJet have targeted the most popular consumer routes. So it seems reasonable to assume that the spare parts market will also attract great interest.

But some carmakers may try to retain market share by wrapping up the sale of new cars with lengthy servicing packages, although the European Commission has indicated that it will put a stop to any measures clearly intended to subvert the new regulation. Consumers with cars that are out of warranty may also be wary about allowing repairers to fit matching quality spare parts because they suspect the quality of those parts is inferior. Widespread use of alternative sources for spare parts is therefore likely to take some years – and to start at the lower end of the market, with older vehicles and mass brands.

The liberalisation of the spare parts business is by no means the only change that will affect consumers. The mandatory link between sales and servicing has been removed, so that retailers can sell new cars without servicing them (although they then have to supply their customers with the name and address of an authorised repairer operating in the area). Alternatively, they can service new cars without selling them, or perform both activities as before. This move is intended to encourage new entrants, but it poses one serious danger: it fragments responsibility for the customer.

The key consequences of the new regulation for consumers

- Consumers living in rural areas could end up having to travel long distances or buy from a retailer with a local monopoly because the new regulation will reduce the number of existing dealership outlets operating in the EU to as little as half the current level by 2010.
- Consumers living in affluent urban areas will enjoy more choice and lower prices because the consolidation of the traditional dealer network will promote the development of large multi-franchise dealers capable of negotiating bigger discounts from carmakers and passing on some of those savings to the public.
- The outlets through which consumers can buy new cars will become much more diverse, as new retailers enter the market - and gradually change distribution from a dealer-based system to a retailer-based system that includes bricks, clicks and multi-channel retailers, using classic retailing techniques with "customer-driven" after-sales services.
- Consumers will enjoy better service. Carmakers will demand higher standards of performance from their retailers, giving consumers a better and more consistent level of service (although they will have to pay for these improvements).
- Consumers will need to spend less time and money maintaining their cars because the new regulation will encourage competing carmakers to engineer vehicles that need less frequent servicing, and are therefore less subject to variations in the quality of the after-sales service.
- Consumers will enjoy more clout as the new regulation rebalances the relationship between the various parties in the automotive value chain. 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.
- The buying experience will be transformed, since greater competition will ultimately ensure that carmakers and dealers pass on some of the savings they accrue from the development of more efficient sales and service processes - in the form of lower prices and better products and services.

The repair market has likewise been opened up, so the pool of competent repairers on which consumers can call should expand. Suitably qualified independent repairers can now become authorised repairers, although they will have to invest in new tools and equipment – and this is a cost consumers will ultimately bear. Independent repairers that stay independent should also be able to keep abreast of technical innovations more easily and, as cars become more sophisticated, access to technical support is increasingly important.

Nevertheless, many consumers may be cautious about using independent repairers. Typically, independent repairers carry fewer spare parts – and, in the short term at least, as spare parts producers assume responsibility for distributing their own parts, there could be more problems obtaining stock. So consumers using independent repairers could experience greater difficulty getting their warranties honoured and have to wait longer for repairs to be done.

Consumer demand for better products and services

The new regime is something of a mixed bag for consumers, then, but it could have another long-term effect that is not in the legislation itself. It could act as a stimulus for the provision of better products and services, as carmakers and dealers alike face greater competition for a share of consumers' wallets.

Research by J.D. Powers, the global marketing information services company, shows, for example, that consumers place more emphasis on safety than on anything else, when they are choosing new cars. In a study of 25 optional automotive features, respondents expressed most interest in the nine features that were designed to enhance their safety – such as low tyre pressure monitors, anti-whiplash seats, night vision systems, run-flat tyres and external surround sensing. Predictably, women also favour intruder alarm systems, while people with children prefer reconfigurable seating and young men prefer high-tech audio systems.

The quality of the service consumers receive is likewise very important in shaping their purchasing decisions. And, again, research by J.D. Powers shows that a positive experience with the dealer that has sold the car weighs heavily when consumers choose where to take their cars for servicing, as does the ability to "fix it right first time".

Customer relationship management is also likely to become much more important, and here the automotive industry has traditionally proved rather poor. Carmakers and dealers collect relatively little information about their customers – and much of the data they collect they do not share, despite the fact that they have specialised communication systems to facilitate their retail and repair activities. But as new retailers with a much greater focus on consumers enter the scene, those retailers will demand totally different communication systems (a topic we covered in our previous paper). They will also use their skills to manage relations with their customers quite differently

If the carmakers and traditional dealers want to keep up, they will therefore have to develop a shared information infrastructure that enables them to track customers and offer them value-added services. Of course any such infrastructure must be handled very carefully. The laws on privacy are steadily becoming more stringent and dealers in the US have already run into difficulties with the new Data Protection Act. But the advantages for consumers could be considerable. They might, for example, include the provision of an "authorised service history" when owners decide to sell their cars. At present, the value of a used car is largely subjective – what a dealer thinks it is worth, given the model, age and condition. But a record of each car's history would ensure that its full value was recognised and reduce the danger of buying a used car that has been badly damaged and badly repaired or, worse still, welded together from several different vehicles.

Conclusions

In short, the success of the new BER is contingent upon the way consumers react – but that reaction will probably vary in keeping with the variation in the extent to which consumers benefit. Those living in markets with attractive economics will enjoy the full advantages of greater choice and lower prices. Those living in more rural areas could find it much harder to purchase new cars, either from traditional dealers or new-style retailers.

Nevertheless, all consumers should be able to compare models and prices more easily, in person or via the Internet. They should also benefit from the standards carmakers are setting for their dealers and from a gradual reduction in the cost of maintaining their cars. Lastly, they may benefit indirectly from the cultural changes the regulation aims to encourage. The European Commission has made it clear to the automotive industry that it wants consumers in the driving seat – and much as some of the participants may dislike the message, they would be ill-advised to ignore it.

For further information please contact the Office of Block Exemption:

Charles L Seguin

+1 905 897 4547
charles.l.seguin@ca.pwc.com

Guy A Sitbon

+33 1 5657 8204
guy.a.sitbon@fr.pwc.com

Sergio Duca

+390 2 7785 350
sergio.duca@it.pwc.com

Tim Ogier

+44 20 7804 5207
tim.ogier@uk.pwc.com

Luis Comas

+34 93 253 2741
luis.comas@es.pwc.com

J Ferron

+1 313 394 6689
j.ferron@us.pwc.com

Gerald Heine

+49 511 5357 5276
gerald.heine@de.pwc.com

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