EU Block Exemption and the International Supply Chain implications for a group of Key Automotive Manufacturers

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ABSTRACT

This study explores the effects of EU policy on Block Exemption within the European Automotive industry. The approach taken was to gain exclusive access through industry insiders to four key car manufacturers with operations in the UK but European aspirations, namely, Honda, Audi, Toyota and the now defunct MG-Rover. The opinions gained from senior management within these companies combined with a study of the European policy and current Supply Chain business thinking presented some compelling findings.

Although there are differences between the four companies in their approach to this Block Exemption legislation, there are also some interesting although perhaps unsurprising protectionism views of the established position of these businesses. Certainly one of the key battle lines to be drawn going forward will be with the spare parts and after market where the competition for vital post-sales servicing revenues will intensify over the coming years, perhaps loosening what has been a domain controlled absolutely by the manufacturers. The long term implications and strategy adopted by the manufacturers may yet have the EU reaching for the rulebook again.

INTRODUCTION

As Europe nowadays enjoys a common market, threats as well as opportunities come along with it. Therefore one of the regulatory bodies of the European Union, the European Commission, needs to make sure competition is made fair and that it doesn't affect the market.

Decisions made by the European Commission affect all the industries within the EU and there can be the case that in particular situations exceptions to the law are made.

This was the case of the automobile industry. The automobile industry has been granted exemptions from some of the competition regulations present in the Treaty of Rome. As this is a unique industry, it shouldn't be compared to other manufacturing industries due to the complexity of the products it produces, so the European Commission decided that the exemptions made sense.

However, these privileges have given too much power to vehicle manufacturers, compromising the other sectors that cooperate with the industry, and the overall market as well. Due to this the European Commission has reformulated the competition laws for this industry, limiting the amount of control given to manufacturers, who are still enjoying block exemptions.

When hearing about these changes and how it would bring implications to the supply chain of vehicle manufacturers the author thought it would be very interesting to make a study of the effects of the changes within the regulations, by way of informed opinion from senior industry leaders.

So the purpose of this paper is mainly the one of drawing conclusions on whether the changes will be effective and how they will affect the major players of this industry within the market.

This area of research was not covered in the literature in depth. The authors are also aiming to contribute in the area of research with this up-to-date comprehensive paper.

One of the main difficulties encountered when performing the research was the fact that these changes in the EC competition rules have taken place quite recently so the academic literature available on the current situation within the industry is still quite limited.

However, this has been a much- discussed subject in the business and automotive media in the past couple of years; so updated information in newspapers and magazines is quite abundant.

1.2 RESEARCH METHODOLOGY

1.2.1 Secondary Research

The author has performed extensive reading on supply chain management and on the European Commission competition policies, in order to provide a good theoretical background on the subject being studied. This has included books, academic journals, Newspaper and magazine articles, and Internet sources.

Illustrations to support the theories can be found along the text of this paper.

A list of all the literature and sources of information used for the outcome of this work can be found in the reference section of this paper.

1.2.2 Primary Research

The main thrust of this paper revolves around four in-depth interviews conducted with senior figures at Toyota, Honda, Audi and MG-Rover, prior to the demise of the OEM.

2. SUPPLY CHAIN MANAGEMENT

As the European Union members have amalgamated and developed as a group, cross-border relationships have flourished. This has certainly been very apparent when looking at the infrastructure surrounding supply chains both in the automotive marketplace and elsewhere.

Although the principles and practices of the modern supply chain may be familiar to the reader, it may be appropriate to outline some of the key principles by way of a reminder and to serve as a framework for the later industry interview analysis.

A supply chain can be defined as a "network of organisations that are involved, through the upstream and downstream linkages, in the different processes and activities that produce value in the form of products and services in the hands of the ultimate consumer". All organisations that are part of the chain will depend on each other, although they will not be co-operating closely. This concept cannot be compared to the one of vertical integration as firms are now focusing on what they are specialised in and have a differential advantage, outsourcing everything else. An example of this can be automobile manufacturers that have once made their own components but now are only assembling the finished product. There can also be the case of firms subcontracting their manufacturing. (Christopher, 1998)

2.1 Structure of a Supply Chain

As already mentioned, a supply chain can be divided into upstream and downstream activities, being first the inward movement of materials (activities in front of the organisation) and second the outward movement of materials (activities after the organisation). While the upstream activities are divided into tiers of suppliers, the downstream activities are divided into tiers of customers.
(Waters, 2003, p.8)

A first tier supplier is the one who sends materials directly to the operations, the second tier supplier supplies the first tier and so on back until it reaches the original source of materials. With customers, there is also a similar division, where the first tier customer will be the one that gets the product directly from the organisation; a second tier customer will get the product from a first tier one etc. The following diagram shows the several activities in a supply chain.

As most companies get their materials from many different suppliers and sell to many different customers, it will either converge with raw materials moving in through the tiers of suppliers, or it will diverge with the moving out of products through the tiers of customers (Waters, 2003, p.8).

2.2 Value Chain

The competitive advantage of a firm cannot be understood if we look at the company as a whole, as it results from the various activities it performs in the design, production, marketing, delivery, and support of its product.

As the value chain developed by Michael Porter shows, a firm will gain competitive advantage if it performs the above mentioned strategic activities at a lower cost or better than the competition.

The basis for differentiation, analysing the value chain of a firm, will be the value chain of suppliers that create and deliver the purchased inputs to be used in the chain of a firm. Besides delivering, they can also influence the performance of a firm in many other ways. Many products will then pass through the channel value chains on the way to the buyer. They will also perform other activities that affect the buyer and also influence the activities of the firm. The final product will then become part of the buyer's value chain. Finally, a firm's differentiation will consist of its' role and its product's role in the buyer's value chain, determining the buyer's needs. "Gaining and sustaining competitive advantage depends on understanding not only a firm's value chain but how the firm fits in the overall value system." (Porter, 1998)

2.5 The use of supply chain and logistics management to achieve competitive advantage

It can be argued that logistics, and the effective management of a supply chain, is of great help in achieving Porter's value chain. The value chain, as mentioned before, consists of a firm achieving both cost advantage and value advantage over other competing firms within the same industry. So how can the management of supply chains and logistics help?

Logistics can further improve productivity or cost advantage, in the sense that it can create better capacity utilisation, reduce inventories and closely integrate suppliers. It can also contribute to a better customer service giving that way a value advantage to the firm, as that will be one of the bases for differentiation. So the aim of logistics management is to integrate the marketplace, the distribution network, and the process of manufacturing and procurement so that the level of customer service is high and of a low cost. Having achieved this, competitive advantage can then be gained against rival firms. (Christopher, 1998)

Previously it was common to see adversarial rather than co-operative relationships between suppliers and downstream customers. Today that still happens, in the sense that some companies will try to obtain cost reductions or increase profits through their supply chain partners. However, they are undermining the fact that this kind of relationship is not making them any more competitive, as in the end all the costs will be reflected in the price paid by the consumer. Companies that understand this situation will tend to make the whole supply chain more competitive by the value it can add to the whole process and the cost that can be reduced overall. Therefore, competitive advantage will not be achieved through company against company, but through supply chain against supply chain. (Christopher, 1998)

3. THE EUROPEAN UNION AND COMPETITION POLICY

The Treaty of Rome in 1957 established the European Economic Community with six members (France, Italy, Germany, Belgium, Netherlands and Luxembourg). This developed from the earlier European Coal and Steel Community (ECSC), which tied together the coal and steel industries of France and Germany. From that stage the Community went through five major processes of development until the most recent one, the May 2004 enlargement. (Dicken 2003, p.151).

The SEM has brought very positive effects to the business environment of Europe. There was a reduction of technical and regulatory barriers so that manufacturers could sell their products all over the European Union. Businesses were able to bid for contracts of the public sector outside their country and managed to operate more freely in the internal EU markets. Goods crossing the borders within the EU had no longer physical and administrative restrictions, and the free movement of capital has increased investments across-border. It has also allowed EU workers to move freely within the EU and have recognition of their higher education or professional qualifications in most cases. Consumers also enjoyed better prices as a result of the Single European Market, including a reduction in airfares and the average basket of groceries. (Mercado, 2001)

The main reason behind the creation of the Single European Market in 1992 was that the multiple internal barriers to trade and movement were adversely affecting the Community's competitiveness face to global markets. So individual countries were engaging in tactics that would prevent or delay the importation of certain products from other Member States. Therefore the argument brought up by the

Commission was that all these costs associated with the non-existence of a single market would lead to a potential loss in GDP and jobs, and weaken the Community's ability to compete with Japan and the United States. (Dicken 2003, p.152)

As the Member States of the European Union were finally enjoying a single market, there was the need for Competition law and Policy of the European Union to be created in order to guarantee the maintenance of liberal order and to ensure fair competition in the internal market of the Community. The articles and regulations on EU Competition Law only go as far as regulating practices that affect trade among Member States, therefore it is important to distinguish national from EC law. (Mercado 2001, p.166)

While the majority of competition and anti-trust legislation at a national level is only concerned with maintaining effective competition and fair trade as a mechanism for consumer protection, the EC competition law only seeks that same maintenance of competition and fair trade at a secondary level, being its main objective the promotion of Community integration (Maitland-Walker 1995, p.3). So the Commission has defined the objectives of competition policy as the prevention of "companies… re-establishing frontiers abolished 25 years ago through the less visible but equally effective means of market sharing agreements and export bans. Both consumers and traders benefit from this policy: consumers because they can enjoy the lowest prices available in any of the Member countries; traders because they have access to a market on a European scale;" and of "excessive concentrations of economic power from damaging the interests of consumer (or competitors…" (Maitland-Walker 1995, p.3). This led on to the EC developing and refining some specific laws and exemptions, where appropriate, that include the Automotive Industry with which this paper is primarily concerned.

3.1 Article 81(3) of the European Commission

In Article 81(3) there are two types of exemption: individual exemptions that are granted to a particular agreement, decision or concerted practice; and block exemption that is provided to categories of agreements, decisions or concerted practices. (Albors-Llorens 2002, p.47)

In the past, a broad view of Article 81(1) meant that many vertical agreements would fall under Article 81(3). The fact that the process of gaining an individual exemption was difficult has made block exemptions a very important matter, as an agreement that fell within its terms would benefit automatically from being exempt from the prohibition of Article 81(1). However, it hasn't always been easy to determine whether an agreement was infringing Article 81(1) or meeting Article 81(3)'s criteria. In practical terms, if a business has the concern that it might infringe Article 81(1), it might be advised to have its agreement fall within a block exemption. (Jones & Sufrin 2004, p.654)

The power of granting exemptions is attributed solely to the European Commission, although it may be subject to review by the European Court of Justice. Initially this aimed to ensure a coherent and uniform development when interpreting and applying Article 81(3) EC. However, a programme of reform has been outlined for the decentralisation of the application of Article 81(3) EC so that national courts and national authorities can apply it. (Albors-Llorens 2002, p.47)

3.2 Evolution of Block Exemption Regulations

Block Exemption is the term used for the Regulation of the European Commission that has been created with the original aim of exempting vehicle manufacturers from the provisions of the treaty of Rome that prohibit vertical restraints to trade. In practical terms, it would be illegal without this exemption for vehicle manufacturers to use Selective and Exclusive Distribution systems as it gave them complete control over the distribution networks, generating therefore anti-competitive behaviour.
(Europe Automotive Insight)

However, since the regulation has first been introduced in 1985 (123/1985) it has been subject to modifications, first ten years later in 1995 (1475/1995) and, most recently in October 2002 (1400/2002).

The following table below outlines the restrictions placed on dealers by the original block exemption and its 1995 revision

Restrictions Placed on Dealers by the Original Block Exemption and Subsequent Revision	
Original Agreement 1985	Revision 1995
Dealers were not allowed to sell competing brands.	Dealers were allowed to distribute multiple makes of cars but only through different showrooms and under different management teams.
Franchise agreements ran for four years.	Agreements extended to five years.
Franchise termination period is for one year.	Termination period extended to two years.
Spare parts to be supplied only by the OEM.	Dealers allowed to sell non-OEM parts provided they were of equivalent quality.
Sales targets set by the OEMs.	Sales targets now set by mutual agreement, with disagreements sent to arbitration.

Table 3: Restrictions Placed on Dealers by the Original Block Exemption and Subsequent Revision in 1995
Source:
www.worldmarketanalysis.com/InFocus2002/articles/westeurope_blockexempt.html

3.2.1 1400/2002

This new regulation applies specifically to agreements in the motor vehicle distribution and came to replace the previous 1475/1995 regulation. The application of the previous Block Exemption caused some controversy as it was considered to be too severe. Also, the Commission was worried that it was giving too much power to OEMs and limiting dealers' freedom; it hadn't achieved the integration of national markets; and the vehicle manufacturers hadn't properly implemented it.
(Jones & Sufrin 2004, p. 676, 677)

The European Commission published in November 2000 a review of the Block Exemption for motor vehicle distribution and found that the system was failing to meet the important objectives it had been set for, when established in 1995. A more thorough description of the problems encountered by the EC can be found in the table below.

Below is an outline of the several problems with the 1995 Block Exemption (1475/95) identified by the EC

1. "Large international price differentials, with obstacles to arbitrage
   a) Margins in new car sales are low, so dealers have little incentive to sell cars outside their territories, which they will not then go on to service.
   b) Dealers were found to impose longer delivery times and higher deposits for foreign buyers.
   c) Dealers cannot get hold of vehicles to sell to foreign buyers.
   d) Dealer's sales to foreign buyers may not count towards sales targets set by VMs.
   e) Intermediaries (firms which fulfil orders placed by buyers) are affected by these same problems and, in addition, can buy no more than 10% of a dealer's output nor access the same discounts as domestic buyers.
   f) Independent producers of spare parts unable to compete with VMs
   g) Economic abuses by VMs: VW, Opel and DC
   h) Lack of multi-brand retailing, which is regarded as efficient and pro-competitive

EC views problems resulting from this as:

a) Lack of achieved economies of scale
b) Lack of efficient cost structures
c) Excessive risk for dealers resulting from their dependence on a single manufacturer
   i) Insufficient competition between dealers

EC alleges competition is weakened by VMs:

a) Setting sales targets are reward schemes, which do not give dealers an incentive to maximise sales
   - There are insufficient volume discounts
   - Bonuses are "not transparent"
b) In some cases, enforcing resale price maintenance
c) Reserving the largest retail contracts (with fleet buyers) for themselves
   j) Inefficient new car distribution infrastructure
   k) Independents unable to compete with dealers in repair (too expensive)

Under the 1995 BER, the EC states that:

a) Independent repairers do not have access to original spare parts at same prices as dealers
b) Independent repairers do not have access to technical information or diagnostics on same terms as dealers
c) Hence independents are not properly able to compete with dealers on price
   l) Some limited allegations of poor after-sales service quality
   m) Some of these problems are made worse by dealers weakness relative to VMs"

Source: Adapted from Tim Ogier's Presentation Slides, The New BER: Intentions and Innovations, PriceWaterhouseCoopers, 30/09/2002

The new Block Exemption regulation came into force on 1 October 2002 (see Appendix 1 to see the actual publication of the regulations) aiming to address some of the difficulties that the old Block Exemption regulations faced, and taking into account the particularities of the automotive industry. More particularly, this new Regulation aimed to encourage competition between dealers, make it easier to purchase new vehicles abroad, and to create better price competition. This regulating reform aimed to promote competition at all the levels of car distribution, including the distribution of motor vehicles, the issues of repair and maintenance, and the supply of spare parts. (Jones & Sufrin 2004, p. 677)

OVERHAULING EUROPEAN AUTO DISTRIBUTION

Europe's car-retailing system was built decades ago, when dense and integrated sales and service networks were needed to satisfy demand in growing markets and to offer qualified repair service for cars whose quality and performance were generally worse and more varied than they are now.

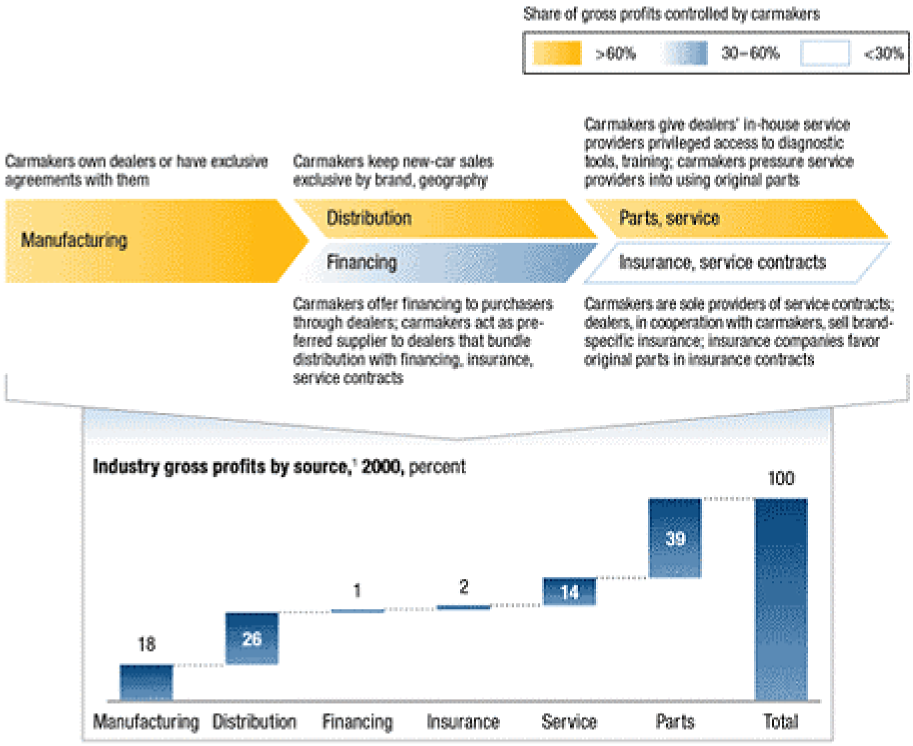
To stimulate the large investments that were necessary, regulators allowed the automakers to grant their franchised dealers sales areas in which nobody else could sell their cars—an arrangement known as the exclusivity rule.

Taken together, the rules created an integrated automotive value chain with limited competition for dealers and automakers alike

The result has been limited competition both among dealers and between dealers and other sales channels. In the after-sales market, manufacturers were allowed not only to support their own dealerships' service centers with original parts, full technical information, training, and the official stamp of authorization but also to exclude all others from such benefits. Taken together, these rules have created an integrated automotive value chain with limited competition for dealers and automakers alike (Exhibit 1). In fact, net profits from spare parts, service contracts, financing, and insurance subsidize sales of new cars.

EXHIBIT 1

For now, an aftermarket bonanza



[1]Disguised example.
Source: European Commission; interviews; McKinsey analysis

There has long been a need to consolidate overly dense European networks—Germany alone has more car sales points than does the entire United States—and to expand the range of retail channels to reduce distribution costs in a market suffering from overcapacity.

New rules of the game

All this is about to change as a result of new regulations, adopted in July 2002, that for the most part will be fully implemented by October 2003.

Under the new rules, manufacturers will have to choose between revised versions of the exclusivity and selectivity rules. If they opt for exclusivity, they can continue to grant and dictate exclusive sales territories for their distributors, thus limiting competition among dealers selling the same brand. In the new system, however, the dealer has the right to sell cars to nonauthorized resellers, which can in turn sell them anywhere in the European Union.

Using a reseller that isn't a direct competitor is a way for the dealership to sell additional cars with minimal effort: it makes a profit on the difference between the wholesale price it gives the manufacturer and whatever higher price the reseller is willing to pay.

Most manufacturers will probably choose selectivity, which allows them to ban unauthorized resellers.

So most manufacturers will probably choose selectivity, which allows them to ban nonauthorized resellers, such as supermarkets. The downside for the manufacturer is that dealers will then be allowed to market and sell cars directly to consumers anywhere in the European Union and also, from October 2005 onward, to open new outlets anywhere in it. The result, inevitably, will be more competition among dealers selling the same brand.

Regardless of whether a manufacturer opts for exclusivity or for selectivity, additional price pressures are bound to come from two other regulatory changes. This rule is intended to spur cross-border trade and thus to accelerate the harmonization of car prices, which now differ substantially across the European Union.

Even more important, the new rules threaten the share and margins of the car manufacturers in the after-sales market, in which they currently make most of their profits, by breaking down the car business value chain. Dealers will have the choice of providing service themselves, either at their sales points or elsewhere, or of outsourcing service altogether.

Consumers should benefit from all these changes in the form of lower prices. Spare-parts providers too are likely winners, since they will be able to sell original parts directly to service shops, without sharing their margins with car manufacturers.

Three strategic directions

Producers have a choice of three strategic directions, which have in common a need to improve the distribution system's performance

Manufacturers have a choice of three strategic directions, each emphasizing one or more of the industry's value drivers—selling more cars, finding ways to keep margins as high as possible, and protecting share and margins in the lucrative after-sales market—to maintain their profitability in Europe. What these three alternatives have in common is the need to improve the performance of the distribution system. Each manufacturer must assess its brand strategy, growth aspirations, starting position, and capabilities in its different markets and decide on the right strategy for each of them.

Product specialist

The first option for manufacturers is to become product specialists, concentrating on volume by making cars widely available at competitive prices while maintaining reasonable margins.

This arrangement is quite usual in most other industries where consumers can choose from a variety of distribution channels.

There have been isolated European initiatives to sell cars in supermarkets—Germany's Edeka has sold the Fiat Punto, and cars have been offered, in cooperation with one or more dealers, in the El Corte Inglés and Alcampo hypermarkets in Spain. But no manufacturer has made a concerted effort to develop sales through low-cost channels, despite latent demand: a McKinsey automotive-consumer survey showed that 41 percent of respondents in Germany could imagine buying a car from a supermarket, while 17 percent could imagine buying one directly from the manufacturer over the Internet, without a test drive.

Making the transition to the product specialist strategy is a bold move posing some likely difficulties. For one thing, manufacturers would have to give careful consideration to the possibility that using this approach in one market might damage their brands in another.

Downstream integrator

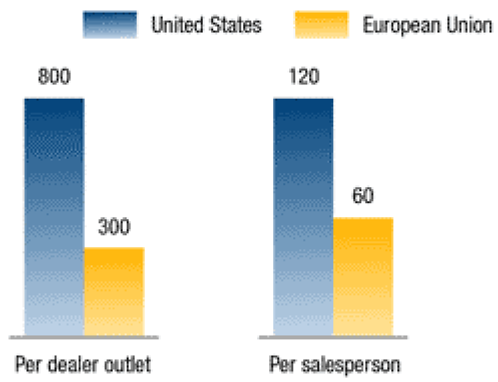
Another response to the new regulatory environment would be to become a downstream integrator. In this strategy, the manufacturer moves aggressively to acquire dealers, to take control of its retail network in selected markets, to maximize margins on its cars, and to protect its share of the service and spare-parts market.

Ownership of a distribution network secures a 100 percent share of its retail margins and a profitable service business, in which manufacturers can insist on the use of their own original spare parts. The potential gains are suggested by the sizable gap in the number of cars sold per outlet and per salesperson in Europe as compared with the United States (Exhibit 2), where dealerships tend to be larger.

EXHIBIT 2

Atlantic gap

Number of new cars sold in 2000



Source: Economist Intelligence Unit; *EMAP European Car Distribution Handbook, 2000*; McKinsey analysis

Nevertheless, ownership too entails major risks. Dealerships owned by manufacturers have difficulty matching the retail skills of independent operators, which evince much greater entrepreneurial drive.

This strategy will probably be most attractive to premium-brand manufacturers, which regard the brand experience as vital and tend to have higher retail margins for their products. To compensate for the investments and risks involved, this strategy will probably be used primarily in markets where a brand has both a strong position and high volumes and where margins ensure healthy returns. Franchising agreements will be more favored in less attractive markets.

World-class franchise partner

Finally, there is a less aggressive but equally challenging strategy, which is likely to be chosen in most markets by a majority of car manufacturers that have a brand price premium to defend but are unwilling or unable to buy and run their own dealer networks.Success will require a new attitude, including a greater overall focus on distribution and the adoption and management of new retail channels consistent with the brand image of the manufacturers.

Manufacturers choosing this strategy will still depend heavily on their franchised dealers, over which they will have less power. They must now act decisively to improve the way their cars are sold, by cooperating more closely with dealers.

4. ANALYSIS

The reforms in regulations that took place in October 2002, with regards to competition policy, and more particularly block exemptions, have caused a change of scenario for the automobile industry in Europe. It has affected the whole supply chain of the industry.

Previously, the findings served the main purpose of giving some background knowledge on competition policy of the European Union, focusing on block exemptions, and on the automobile industry and the major drivers within it. This final third of the paper focuses on some unique primary research with key decision makers in the European Automotive market.

The interviews that the author has been granted are from people that work for three leading car manufacturers – Honda, Audi , MG-Rover together with a fourth interview with one of Toyota's managers in the UK, performed by Vigneshwar C. Selvakumar for the purpose of his MSc. Thesis. Also academic journals, newspaper and magazine articles are being used as references in this paper, as this will be the literature with the most updated information.

One of the factors that has influenced the reforms in the EC block exemption regulations was the former European competition commissioner's (Mario Monti's), concern over the enormous differences in car prices before tax within Europe. The reforms that took place in October 2002 on how cars should be sold and serviced took the European automotive industry by storm, but Monti predicted the changes to be for the best, allowing for more competition which may very well increase with the recent EU enlargement (a. Karen Carstens, Economist, EIU, 10.02.2003).

Thanks to the previous block exemption regulations vehicle manufacturers were not bound by some of the provisions of the Treaty of Rome, more particularly the ones that concerned vertical restraints on trade. This way, car manufacturers were allowed to have at the same time Selective and Exclusive Distribution systems in order to control the distribution of vehicles and spare parts, and all this without performing illegally (The Economist, Survey: Driven to Distraction, Dec 2001). After the reforms in 2002 car manufacturers were forced to choose either one system or the other. This meant that they are now supposed to either assign one exclusive sales territory with the dealer (exclusive dealership); or chose a system where dealers have the choice of opening more delivery points and showrooms (selective dealership).

A one-year period was given to car manufacturers so that they could adapt to the reforms in the BE regulations, therefore the changes in the market and its effects are still quite recent. So from 30 September 2003 (exactly one year after the reforms), car manufacturers have had to give valid and detailed reasons to drop franchised dealers. What happened in that gap year was that a lot of re-franchising took place as manufacturers were trying to consolidate their networks of dealerships before the deadline was over. According to Alan Pulham, director of the UK National Franchise Dealers Association, manufacturers have performed questionable methods and actions, within that year. One of their tactics was to persuade their dealers into selling them large shareholdings in their businesses (b. Karen Carstens, Economist, EIU, 10.02.2003).

One example of the early effects of the end of the changes in block exemption rules was Daimler Chrysler that went ahead with the restructuring of its Mercedes-Benz sales network in the UK, when it anticipated the reforms in the BE regulations to come in 2002. The law at the time allowed them to restrict who would sell their vehicles and with the changes that soon would be coming through, they have started preparing for it by re-shaping their sales structures. DC reduced its 155 UK dealer network to only 35 independent dealers. It has created a network of 11, mostly owned by the company, 'experience centres', with the support of smaller vehicle centres. This resulted in the dealers filling for lawsuit, taking DC to court. (Datamonitor News, DaimlerChrysler: appeasing the soon-to-be ex-dealers, 04.07.2001)

Audi, Honda, MG-Rover and Toyota are among the leading car manufacturing companies in Europe that have been affected by the changes in block exemption regulations.

Manufacturer's View of the Principle of Block Exemptions

Mr. Kevin Brown, Corporate Sales Director at MG-Rover, believes the previous block exemption regulations were fair and had valid reasons to exist. In his view "vehicles are complex pieces of equipment and when serviced by the wrong hands with the wrong equipment could be dangerous", so there needs to be the ability to look properly after vehicles in the aftermarket. He doesn't agree that price differentials are related to BE, but to taxation rules instead.

Mr. Paul Hunter, Network Development Standards Manager at Honda, shares the same view. He stated that cars are complicated and special tools that need to be maintained and the reasons to why the previous BE regulations existed is that if they are not maintained properly there can be dangerous consequences to it and the EC recognised the special need to protect those businesses because if they were completely free anyone could look after the vehicles and probably not doing it effectively. With the new regulations, cars will still have to be maintained so therefore more training and investment equipment will have to be invested in.

Mr. Mark Roden from Toyota believes that the latest changes in the BE regulations were a way of the European Commission taking the control out of vehicle manufacturers' hands, and giving more responsibilities to dealers in the sense that the customer gets the best deal. However, the EC is forgetting that the dealer is in business to make profit; so benefiting dealers doesn't mean that the customer gets the best deal in the end.

Ms. Elaine Turner from Audi felt that the legislation meant that dealers focused more locally although it perhaps did not benefit customers as much as it may have done.

Aftermarket Profit Stream

"We need to be aware that there are basically two areas that most manufacturers can go down. One is quantity and the other one is quality, and basically the route that Audi decided to go down servicing was the quality route, so basically anyone can service our vehicles provided that they can meet our standards in terms of equipment, training and premises. So I think that, effectively, that allows us to sort of control the standards that people get at an authorised Audi repairer because, of course if your car is in the first three years of its warranty you can't take it anywhere other than an Audi authorised repairer anyway, and after that time, really, the way that we have very nice facilities, the actual Audi centre facilities are better than anything else that is available, so we like to think that people still use our services because of the experience and the customer service that they actually get from servicing their Audi vehicle there as opposed to an independent repairer". (Elaine Turner, Audi)

As Elaine Turner from Audi clearly illustrates above, the emphasis is very much on the dealership customer experience as a means of maintaining customer loyalty to the designated Audi dealerships. So, very much of a pull process into the dealerships preventing a leakage of customers to alternative servicing outlets.

Dealer and Franchise Partner Relationships

In the UK the total number of franchised dealers has fallen from 22,000 in 1970 to 6,000, and PricewaterhouseCoopers estimates that within a decade the number could fall to 4,000 due to the rapid change in the business landscape. The previous block exemption regulations have caused too many dealership networks to exist within Europe, and the number is almost twice as large per car sold in the US. Dealers sell very few cars to be able to survive on sales alone and service is what provides them with revenues. Before the block exemption reforms servicing and repair represented 60 % of a dealer's profit, however, they now have to face an increase in competition from repair specialists (b. Karen Carstens, Economist, EIU, 10.02.2003).

"I would say in a lot of ways it has improved. The relationship that we have now is more consultative, because you know, we don't have things like post code areas, but obviously in terms of the standards that we set and that we are audited against, we need to work and support our centres to make sure that having selected these people to represent and under the quantitative policy that we've got for sales in particular, we selected these people, these franchisees based on the fact that we want them to represent our branch so we do have to make sure that in terms of the standards that we set and that we are audited against that we do everything to make sure that they are fully compliant". (Elaine Turner, Audi)

Mr. Kevin Brown has stated that reforms in the BER have changed relationships with dealers at MG-Rover, in the sense that they have become more commercial and less contractual. Their fairly rigorous standards of the past have changed dramatically with the changes in regulations, which made car manufacturers lose some of their commercial power over dealers.

He also believes that the changes will not bring more competition to dealers and will probably benefit them better than customers. This is because dealers will be able to control better the way vehicles are marketed and obtain more profits due to scale efficiencies, as they will use their increased purchasing power and buy cars in bulk, not leaving much of a chance to smaller dealers, which ends up reducing consumer choice. He even compares it to the groceries market and the way supermarkets have eroded smaller shops. It didn't make them bring more consumer choice or made groceries cheaper; it just brought more profits to supermarkets and he believes that a similar situation will happen to cars.

Although MG-Rover still has to comply with the changes in the competition rules, the exceptions the manufacturer still enjoys are around the fact that it is still able to grant exclusivity of operation, keep the standards and give people exclusive rights in certain geographic areas. However, there are other competition rules that still have to be complied, like not fixing prices or constraining supplies. The only restrictions the changes have brought them were around making restrict supplies of car parts and being able to terminate franchises (Kevin Brown, MG-Rover).

Honda enjoys exemption from some of the regulations as the EC has understood that the company isn't changing, leading or shaping the market, which gives them some more freedom of action when compared with other leading manufacturers. Honda is in a position that it can appoint individual sales points, although they are not free to appoint in the service or after sales on the basis of geographical location. Here we can see that sales regulations differ from the service ones (Paul Hunter, Honda).

Elaine Turner suggested that Audi has some strict policies around dealers in terms of the location, facilities, servicing equipment and the labour force and its associated training. If a dealer can meet all of these requirements, then there is no reason why it cannot be an Audi dealership. However, although Audi operates its dealerships through a franchising network, it owns many of the sites currently in operation.

"The EC has agreed with manufacturers that the automobile industry is a mature industry that doesn't need a great deal of regulations to be managed, so it is giving the industry some guidelines, and at the end if the customer is not being treated fairly, further action will be taken. However, the EC leaves at the manufacturers' discretion how to do it" (Mark Roden, Toyota).

As for the price differentials mentioned by Mario Monti, Paul Hunter said that, although the retail price for cars isn't set, it would have to be set at an acceptable level after the consumer has paid tax, so that it fits in the market where the car is being sold. In the case of countries with very high taxation, manufacturers have no other choice than to sell cars at a loss, so that the consumer can still afford the after-tax price. That is the case of Denmark, Cyprus, Malta, Gibraltar, and Belgium. Therefore taxation, and not block exemption, is the prime cause of price differencials, being both top and bottom prices managed by the law that controls the tax rates.

After 2010

In 2010 the current regulations on block exemptions will go through a reform. There is speculation that the block exemption on the automotive industry will be removed completely. This would take away from vehicle manufacturers all the control they used to enjoy over the market, and make them face the fair game of competition.

When asked if the company was taking any measures to ensure direct control with regards to distribution, in case block exemptions are completely removed by 2010, Mr. Kevin Brown has replied that MG-Rover doesn't see the need for owned outlets. What would be done would be to give dealers strong economic reasons to stay with the manufacturer in the market, and with that achieved there wouldn't be the need to have manufacturer-owned sites. Mr. Paul Hunter said that Honda has 200 outlets in the UK and around 1500 across Europe so it would become a challenge for the manufacturer to own its outlets. He has said that in general manufacturer owned outlets don't perform financially as well as franchises as there is great difference in the retailing of cars and the retailing of other products.

"Basically our view point is that we are an importer and that we are not retailers, we've just built an 8 million pounds Audi experienced centre in Glasgow and basically Audi own that premises, we don't manage it and that's the route that we go down. So we do own a lot of the centres, and particularly the new experienced centres that we're buying and that we're setting up, but in actual terms of running them no, we will always go down the franchising route". (Elaine Turner, Audi)

However, Kevin Brown believes that even if BERs are removed, there will still be unique legislation due to the unique nature of the industry. He is of the opinion that if BERs were to fall or be renewed there would still be legislation applied specifically to the automobile industry. On the other hand Paul Hunter has a different view. He doesn’t believe it will be unlikely that the BERs will be removed as in his view the EU commissionaires are people that have never worked in the industries they are regulating and some of them are public sector professionals who have never worked in an industry at all. The automobile industry is definitely a very unique industry as cars, which are high capital goods, are being bought and sold in the retail market, which is something not many other industries are doing.

This is also at odds with Elaine Turner from Audi who does not see the Automotive industry as unique, “I don’t think it’s a unique industry, we sell a product at the end of the day, lots of other people sell a product and therefore I don’t think we’re unique. If someone can prove otherwise, then no, I don’t think they’ll ever be totally listed but my own personal viewpoint is no, that we’re not unique. We are a manufacturer who manufactures a product and have retail outlets to sell that product, and I don’t think that that makes us unique to other people, personally. Block exemptions only existed because we considered ourselves to be unique, I don’t think we are particularly unique and I think the only way that they could ever not be listed is if it could be proved that it was unique and they needed to be there”.

CONCLUSION

The study that has been performed throughout this paper has allowed the conclusion that although there is a great will on part of the European Commission of ensuring the best fairness possible within the European Union, a lot more will have to be done, although it is very critical to take drastic measures within the competition rules of this industry, as this is a very unique and mature industry. Changes could very well give with one hand and take away with the other.

Although dealers now have more freedom, in the sense that they don’t have to be exclusive to only one car manufacturer, smaller dealers will be facing unfair competition, as the stronger ones, with more purchasing power will be benefiting from scale efficiencies because they will have the resources to buy cars in bulk.

Also, independent garages that are now allowed to provide after-sales service or maintenance to cars still under the manufacturer’s warranty, in order to do so, will have to comply with the manufacturer’s standards and invest in equipment and further training. All this comes at a price, and the customer in the end will be the one paying for it.

For a supply chain to bring value to an organisation there needs to be a full integration of all intermediaries and activities within the chain. At the beginning of the paper the theories around this are exploited and adapted to the particular cases of the automotive industry. With the constant changes in the picture of the industry’s regulations in Europe, the value chain has to be in constant change and update so that it achieves value delivery and vehicle manufacturers can remain competitive in the market.

Supply Chain is a fairly new concept in the business world. However, it is considered importance nowadays one of the driving forces in achieving superior performance.

Companies more and more are starting to outsource some of the additional activities that they used to perform before and tend to concentrate on the actual thing they are specialised in producing or assembling.

The management of a supply chain consists is basically the integration of all the intermediaries that cooperate in the production the central organisation performs. So these will be suppliers, wholesaler, retailers and in the end, the consumer.

The effective management of the integration of these activities is very critical for the performance of the organisation as it will be the determinant of how the company will perform compared to its competitors, so Michael Porter's theory on value chain is very intimately linked with the management of a supply chain.

In this paper the theories of supply chain and value chain are applied to the automotive industry, where an outline is given on how this industry integrates the various intermediaries.

The focal centre of this study was the fact that the automotive industry in Europe enjoys some exceptions in regards to competition rules set out in the Treaty of Rome. Those exceptions were called block exemptions and gave total control to car manufacturers, allowing them to have a more powerful position than the other sectors of the industry, albeit, the aftermarket.

The European Commission decided at the time that this was causing unfairness within the market and benefiting only the manufacturing sector. So changes to the regulations have been made in October 2002 in an attempt to revert this situation.

Now, with the present regulations, car manufacturers have had to change their posture in regards to the aftermarket, i.e. dealers, independent part manufacturers and independent garages.

Before, manufacturers could appoint both selective and exclusive dealerships. Now they will have to either opt to one system or the other, and can't have both at the same time. They can no longer demand that their dealers sell original parts to customers, so they are allowed to sell compatible parts from independent manufacturers. Also the aftercare market isn't restricted to authorised dealers anymore. Independent garages, provided that they will comply with the manufacturers standards can provide the service now.

The intention of these changes has been to benefit all the players that take part in the activities performed by the automobile industry, i.e. dealers, independent part manufacturers, independent garages and, of course, customers.

However, there has been speculation that this is rather idealistic, as the unique nature of this industry might bring some setbacks to the recent changes.

It is believed that dealers will not benefit from this in general, as stronger dealers will take over the market for that sector. Consequently, customer might lose out as well as this may lower down the options for consumers, who won't be enjoying competitive prices.

Also the idea that customers will benefit from independent garages also performing after-sales service to new cars is a very optimistic one, as this will cause a lot of costs so that they can comply with the manufacturers' standards. In the end it might all come out of the customer's pocket.

Quoting Mr. Kevin Brown, maybe there was a valid reason, after all, for the existence of the previous block exemptions. The fact that this is a unique and mature industry makes it sensitive to changes, and things might just get worse off than they were before for the customer.

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