ESMT Competition Analysis

ESMT CA

FINAL

REPORT

Do we need a Motor Vehicle Block Exemption?

An economic perspective with a focus on the interaction between non-compete clauses, restrictive contractual arrangements and entry in the European car market

12 June 2009

Editorial note:
ESMT Competition Analysis has been renamed to E.CA Economics

"This Report was commissioned by Daimler with the intention to obtain and present for public debate an objective analysis of a series of economic issues of relevance for the play of competition in the organisation of motor vehicle distribution, repair and servicing. The conclusions are the results of ESMT Competition Analysis' ("ESMT CA") best professional judgment. ESMT CA accepts no duty of care or liability for damages suffered by Daimler or any third party as a result of decisions made or actions taken based on this document."

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1. Executive summary

The current motor vehicle block exemption regulation (MVBER) is due to expire in May 2010. In May 2008, the Directorate General Competition has issued an evaluation report on the operation of the MVBER. The report suggests that a specific regulation in the automotive sector might no longer be appropriate and that a "*more effects-based and flexible approach would deliver better results for consumers*".[1] While car manufacturers generally support the European Commission's findings and views, there are several market participants who have been contesting its view. They argue that the MVBER has met most of its objectives and improved competition concluding that it should stay in place.

This study concentrates on the issues of competition in the passenger car sector. It analyses the potential economic effects of moving from the MVBER to the vertical block exemption regulation (VBER) with a focus on the interaction between non-compete clauses, restrictive contractual arrangements and entry in the European car market. One element of particular importance in this context is that such a move shifts the choice on multi-branding of competing brands in the same showroom from the dealer to the manufacturer. Focusing on those cases where interests between dealers and manufacturers may conflict, this report attempts to contribute to the current debate on the MVBER by analysing the following issues: (1) Is the observed increase in competition due to MVBER-measures or other reasons? In particular, to what extent have the multi-branding provisions fostered entry and thereby increased consumer welfare? and (2) What are the costs of such multi-branding provisions to consumers?

Overall, we find that the MVBER is unlikely to have played a significant role in fostering competition. There is good evidence that many of the market developments which have enhanced competition in the past years are independent of the MVBER. Furthermore, with regards to multi-branding in particular, we estimate an upper bound on the potential entry enhancing effects that the regulation could have had in the past by identifying the countries where specific brands may have significantly expanded market shares due to multi-branding. We estimate an upper bound of cars sold due to the MVBER at 1% of the total volume of cars sold in the EU in 2008. Even when taking this upper bound at face value, the effects on the relevant concentration ratios in the affected countries are small and concentration is generally low. Moreover, the true number may well have been close to zero as entrants could have entered without using multi-branding - an option chosen frequently. Thus, we conclude that the entry enhancing effect has had at most a negligible positive impact on competition.

At the same time, we identify several costs inherent to multi-branding. These costs can take a number of forms, among others, costs through brand dilution, higher *brand specific* investment of manufacturer, higher *brand-specific* investments of dealers at the point of sale, reduction in the geographic representation of brands and lower *non-brand specific* investment of the manufacturer. Some of these costs arise as the manufacturers strategically adjust the organisation of their retail networks to avoid brand dilution and free-riding of rivals. While there

[1] Commission Evaluation Report on the Operation of Regulation (EC) No. 1400/2002 concerning motor vehicle distribution and servicing, page 12.

is no sufficient data to precisely estimate the magnitude of these costs, the available evidence indicates that all of these costs are present and significant in comparison to potential benefits.

Based on this evidence, this report finds that multi-branding provisions of the MVBER inadvertently and unnecessarily limit manufacturers' flexibility to enter into efficient relationships with their dealers. Thus, multi-branding provisions should not serve as an argument to maintain the MVBER in its current form.

The report also discusses other provisions of the MVBER that have featured in the current political debate. It appears that in many instances dropping the MVBER and moving to the VBER will not induce a major change. In other cases, regulation seems required, but there is an ongoing legal debate as to the appropriate form. Relying on the European Commission's assessment that these matters can be appropriately addressed by other means, we find that there is no need for the MVBER in its current restrictive form.

The remainder of the executive summary explains the approach and the main findings in more detail.

The counterfactual without the MVBER

Should the sector specific regulation be abolished, the more flexible VBER would take its place. Although the VBER is going to expire at the same time as the MVBER and the evaluation process on the future definition of the VBER is ongoing, we understand that the general consensus is that the VBER is likely to be extended without major changes. Therefore, in order to assess the case for a removal of the sector specific regulation a comparison between the current MVBER and the current VBER appears reasonable. Comparing the MVBER with the current VBER, we identify a number of provisions that differ within the two legal frameworks. A key aspect that is both of interest in the current debate on the future of the MVBER and relevant for economic analyses is the effect of changes relating to multi-branding and exclusive dealing.

With regard to multi-branding and exclusive dealing, the move from the current MVBER to the VBER can be thought of as shifting certain decision rights over multi-branding from dealers to manufacturers. Due to the 30% maximum obligation threshold, under the MVBER each dealer has an option to source his supplies from at least three different suppliers, hence the decision whether to multi-brand resides with the dealer. In contrast, under the VBER the manufacturers are able to negotiate a binding contract with a high 80% minimum obligation requirement with their dealers, assuming that this is accepted by the dealer. For simplicity, we will abstract from the negotiation process and assume that under the VBER the decision whether to allow multi-branding or not resides with the manufacturers.

Our task

This report attempts to complement and deepen the analysis regarding the arguments for and against the MVBER. In particular, this study covers the effects of a move to the VBER in relation to the following provisions:

- **Exclusive dealing and multi-branding in relation to new car distribution:** The competitive effects of less restrictive rules on multi-branding are the focus of this report. A detailed assessment is provided in Sections 4, 5, 6 and 7.

- **Provisions strengthening dealers:** Potential effects resulting from the removal of particular clauses strengthening the bargaining power of dealers are briefly discussed in Section 8.1, but not analysed in detail.

- **Separation of sales and services:** Potential effects resulting from the ability to combine sales and service contracts are briefly discussed in Section 8.2, but not analysed in detail.

In contrast, this study does not cover the effects of a move to the VBER in relation to the following provisions:

- **Safe harbours**: Market share thresholds for quantitative selective distribution are lower in the VBER than in the MVBER. This may induce changes in how dealer and service networks are organised. It is not a focus in this report as there are indications that expected changes are likely to be minor.

- **Provisions affecting parallel trade:** For most of the specific clauses no change with a move to the VBER is expected. Only the location clause does not seem to have a counterpart within the relevant counterfactual. However, for various reasons dealers did not find the option to open secondary outlets economically attractive and as a result very few of them took advantage of the opportunities afforded in the location clause.

- **Provisions promoting competition between authorised and independent repairers:** For most of the specific clauses no change with a move to the VBER/relevant counterfactual is expected.

- **Spare parts:** The changes with respect to the relevant counterfactual in relation to provisions on spare pars appear to be relatively minor and mainly of a legal nature.

When does dealers' choice differ from manufacturers' choice

Although generally dealers are likely to implement multi-branding more frequently than manufacturers, there are a number of circumstances in which both dealers and manufacturers consider multi-branding as their optimal choice. So, other things equal, we expect an overall decrease in multi-branding, but not its complete elimination, when shifting certain decision rights over multi-branding from the dealer to the manufacturer.

In particular, the likelihood of identical decisions between manufacturers varies with the extent of capacity utilisation in the short run: with low levels of spare capacity, both manufacturer and dealer are likely to abstain from multi-branding; while with very high levels of spare capacity both would choose to introduce multi-branding in order to increase overall profitability of the dealer. It is the intermediate range of capacity utilisation where a conflict of interest appears most likely. Theoretically, the ability of dealers to multi-brand might foster capacity expansion in the longer run. So far however, we have not seen any clear evidence that capacity expansion is driven by the ability to engage in multi-branding. This lack of evidence itself could be an indication that the ability to multi-brand is not the ultimate driver for capacity expansion.

There are several types of multi-branding: multi-branding from the same showroom, multi-branding from different showrooms within the same location and multi-branding in different

locations. The MVBER in comparison to the preceding sector regulation stipulates same showroom multi-branding (of brands from different manufacturers). Thus, when assessing the changes that the current MVBER introduced, we concentrate on the changes in same showroom multi-branding. The hypothesis that there is a subset of situations where the multi-branding decision of the manufacturer and the dealer coincide is supported by evidence prior to the MVBER: same showroom multi-branding is likely to have existed to a significant extent prior to the MVBER. Therefore, we expect limited changes from a move of the current MVBER to the VBER.

Even if the change in observed multi-branding (in the same showroom as well as in different showrooms) is likely to be limited – what are the welfare implications of this change? This issue is picked up in the following sections which report our findings on the benefits and costs of multi-branding provisions.

Benefits linked to multi-branding provisions

Among the potential benefits of the multi-branding provisions in the MVBER we have identified a reduced risk of foreclosure, a reduction in consumers' search costs and a reduction in dealers' operating costs due to economies of scope. The report focuses on the effects of the multi-branding provisions on foreclosure. It appears that both the reduction in consumers' search costs and in dealers' operating costs are negligible.

In relation to foreclosure, the first set of questions is whether manufacturers' have the ability and incentive to foreclose. The report finds:

- **Limited ability:** on a national level no market participant has a market share large enough to be able to foreclose unilaterally. Foreclosure can only potentially be achieved through cumulative action of multiple participants.

- **Limited incentive:** inter-brand competition in the automotive industry is high, which implies that manufacturers have rather limited incentives to foreclose.

These conclusions are based on a number of indicators on the current level of inter-brand competition:

- Overall, the industry concentration as measured by the concentration ratio HHI is moderate. The HHI is a concentration measure of the industry that takes into account the relative size of the individual market participants. The weighted average over the HHIs in 27 countries amounted to 1,398 in 2008, representing a slight drop since 2002 when the same index stood at about 1,451. This compares to a weighted average HHI at the level of national car segments in 2008 of 1,849. Computations on pan-European levels decrease the level of concentration only slightly.

- The industry is characterised by a fairly high volatility of market shares: national industry market shares on average differ by about 13% from their long run mean. In comparison, the weighted average coefficient on the level of national segments is equal to 25%. Coefficients are reduced when the geographic scope of the market is broadened to the European level.

- There is no evidence of long-run excess profits. Instead, we observe relatively stable dealership profitability at a relatively low level (~1%) and a higher volatility of manufacturers' margins at a slightly higher level.

- There exist significant levels of excess capacity within the industry.

These arguments suggest that foreclosure in the absence of the MVBER is unlikely. However, the assessment can be informed by identifying an upper bound on the potential negative effect on consumers. In order to do so, we identified events in which a brand entered or expanded significantly on a national market and where multi-branding could have played some positive role. We then computed the share of those events on total volume sales in Europe. We find that the **upper bound on the volume** directly affected by multi-branding is therefore **slightly above 1%** of total volume sales throughout Europe in 2008.

Furthermore, the low end segments of the market are likely to be more affected than the high end segments since most brands that have potentially expanded through multi-branding are concentrated in those segments: Kia is the brand that has likely benefited most from multi-branding. This brand operates mostly in the low end car segments (A, B and C) and MPV and SUV segments. This implies that the upper bound in terms of value directly affects by multi-branding is likely lower than 1%.

To further quantify the potential impact of multi-branding on competition, we performed additional calculations of concentration indices. Specifically, for each country we have calculated the hypothetical change in HHI at the brand level that would take place absent multi-branding. This hypothetical change can be thought of as a proxy for the upper bound of the impact that exclusivity might have had on foreclosure. Not surprisingly, the hypothetical impact on the concentration index is the largest in those countries for which most entry/expansion events were identified (Latvia, Estonia, Lithuania, Slovakia). In order to take into account the relative importance of different sales volumes, we have calculated the overall impact of multi-branding by weighting the average of the hypothetical HHI changes using sales volumes. The overall impact of multi-branding measured this way is **equivalent to lowering the average HHI concentration measure by 19 points or 1.3%**. In addition, we approximate the hypothetical change in HHI on a segment basis also showing a limited effect on consumers (average decrease in the HHI of 38 points or 2%).

Furthermore, we find that the MVBER multi-branding provisions are unlikely to have had any significant effect on facilitating entry or expansion in any of the **largest and most mature markets** in the European Union, such as Germany, France, Italy or the UK. Therefore, removing the non-compete obligations from the regulation will most likely only have a minimal impact on foreclosure in these markets. In relation to **smaller markets**, positive effects of the multi-branding provisions are likely to be further limited due to the following factors:

- **Multi-branding may prevail:** the identified smaller markets could be exactly those regions where a higher level of multi-branding would have arisen regardless of the regulation as both dealers and manufacturers prefer multi-branding to single-branding in those regions. Some of the demographics of these markets seem to suggest this.

- **Entrants have other options:** many recent entrants have successfully expanded using their own existing network (other brands in the same group) or by setting up single-brand network. Multi-branding is just one of several options to expand. Therefore, even if

multi-branding could have been prevented by manufacturers, recent entrants are likely to have expanded with their own dealer networks – as this was the choice of many manufacturers for many brands in many countries.

Furthermore, potential entrants and expansion candidates do not uniformly express the opinion that the ability to multi-brand is essential to their entry and expansion plans. For example, the Spanish brand Seat which is strong on the home market, but not in other European countries, prefers exclusive dealerships for its expansion plans. As another example, Korean automobile manufacturers have put forward contradicting statements: on the one hand, the industry association voices the opinion that the possibility of dealers to sell brands of competing manufacturers within the same showroom is a vital element for foreign manufacturers. On the other hand, Hyundai stated that it prefers to work with dealers that sell only the Hyundai brand, but that multi-brand dealers offer the manufacturer a chance to be represented in countries with lower local potential, such as Switzerland and Scandinavia.

All these findings suggest that from a competition policy perspective the specific and general regulation of multi-branding in the MVBER is not required. This conclusion is reinforced when considering the costs linked to the multi-branding provisions.

Costs linked to the multi-branding provisions

The multi-branding provisions of the MVBER also come with costs: vertical restraints can often have positive effects. Appropriately structured vertical contracts can enable suppliers to increase their efficiency by optimising their manufacturing or distribution processes. The potential scope of the benefits of such optimisation in the automotive industry is significant, because distribution costs account for about 30% of the total cost of a new car. As recently summarised by Commissioner Kroes:

> *[T]here were certain overly restrictive sector-specific provisions regarding the sale of new cars, which, while not necessary for safeguarding competition, could in fact be hampering the flexible and efficient adjustment of car manufacturers' networks to changing market conditions. This may be having a significant impact on the competitiveness of the European car industry, particularly in the current economic climate. The resulting inefficiencies would add to the industry's distribution costs, which would imply higher prices for consumers.*[2]

Costs inherent to multi-branding are difficult to measure precisely. Some arise as manufacturers strategically adjust the organisation of their retail networks to the constrained "second best". Others may reflect negative effects on manufacturers that are not fully internalised by dealers. In other words, the efficiency of manufacturers' networks with forced multi-branding is lower than if they did not face this constraint. These efficiency costs can take a number of forms, among others:

- **Brand dilution:** the strength of a brand might be weakened through the joint display with another brand. This is likely to reduce demand for cars overall. Strategies of multi-brand manufacturers who often avoid mixing their own brands in a single showroom underpin the importance of this factor and indicate that factors such as creating and

[2] Answer to question P-1363/09, 1 April 2009.

maintaining strong brand image -and not foreclosure- are primarily responsible for exclusivity policies.

- **Higher brand specific investment of manufacturer (overinvestment):** in order to avoid brand dilution, manufacturers invest more in their brands than without multi-branding (e.g. advertisement). This type of cost is not restricted to certain geographic areas or consumer types.

- **Higher brand-specific investments of dealers at the point of sale:** in order to avoid brand dilution, manufacturers ask for higher brand specific investment of the dealers in order to differentiate brands more clearly. These costs are quite universal. The establishment or increase in the minimum number of models requested on display per outlet is a special form of higher brand-specific investments which is more likely to affect smaller dealers.

- **Lower non-brand specific investment of the manufacturer (underinvestment):** due to free-riding effects of another manufacturer's brands also displayed within a single dealership, the manufacturer is less inclined to engage in non-brand specific investment (e.g. events at a certain dealership). These costs are likely to apply only to areas where dealers engage in multi-branding.

While there is no sufficient data to precisely estimate the magnitude of these costs, the available information indicates that all of these costs are to some extent empirically present. In particular, vertical integration has increased and so has manufacturers' brand specific investment requirements.

Balancing of costs and benefits

Overall, we identified only very limited positive effects of the multi-branding provisions of the MVBER. In particular, those effects are restricted to certain regions and certain segments. In contrast, many costs associated with the provisions apply quite generally and the provisions appear to have had appreciable negative effects. We conclude that the multi-branding provisions unduly restrict manufacturers' flexibility to enter into efficient relationships with their dealers.

Shift of bargaining power

As pointed out above, moving from the MVBER to the VBER gives manufacturers more leeway in preventing multi-branding of any type resulting in a general shift of bargaining power to manufacturers. This and other provisions in the MVBER, like the right to sell their franchise (and contract with the manufacturer) without consent of the manufacturer, may shift the bargaining power from dealers to manufacturers. A shift in bargaining power implies foremost a change in the distribution of rents between manufacturers and dealers. From an efficiency and consumer perspective, changes in bargaining power only matter if it impacts the efficiency of the vertical relationship.

In relation to pro-competitive effects of strengthening dealers' bargaining power we find that in some industries a shift in bargaining power to retailers or other downstream units may be desirable in order to lower the margins upstream and, hence, unit costs (and ultimately prices). However, there appears little evidence of a lack of competition. Hence, excessive margins at the

manufacturer level seem unlikely. Furthermore, specific contractual rights for the dealer might be justified by the fear that manufacturers may use the right to terminate a contract in order to appropriate the investments of dealers. However, there is empirical evidence that reputation effects are sufficient to keep the contract termination rights of the manufacturer in check. Furthermore, there is evidence that, to the contrary, manufacturers might use the contract termination rights efficiently as an instrument of screening bad dealers out of the network.

At the same time, shifting bargaining power to dealers may also result in consumer harm since it might lead to dealer concentration in relevant anti-trust markets. Additionally, such a shift may also prevent the optimisation of dealer networks as it becomes more difficult to rationalise the network. The optimisation of dealer networks is further hindered by forbidding location clauses in dealer agreements undermining quantitative selection.

Competition policy arguments can therefore not serve as a *general* justification for "protecting" dealers' bargaining power, even if this may be desirable under specific circumstances.

Unbundling sales and services

This report does not focus in much detail on the potential effects of a transition from the MVBER to the VBER in relation to the provisions on unbundling of sales and services. This is due to the fact that strong effects appear unlikely:

- **Agreements rendering sales conditional on services**: Article 4(1)(g) of the MVBER prevents manufacturers from offering sales contracts conditional on the provision of services. Although this provision has no counterpart within the VBER, the removal of this provision is unlikely to have any negative effects for the following reasons. First, not many dealers have taken up the opportunity to become stand-alone dealers. Since dealers profits are mainly generated within the repair section, this is not a surprising result. Second, it appears that the provision is ineffective in stipulating multi-branding, which it was supposed to do by freeing-up capacity within the dealership.

- **Agreements rendering services conditional on sales**: Article 4(1)(h) of the MVBER prevents manufacturers from offering services contracts conditional on the sale of new cars. Since most repair networks are organised, and have possibly (depending on the definition of the relevant market) to be organised under the qualitative selective system, Article 4(1)(h) is effectively redundant. A requirement to sell new cars does not qualify as a qualitative criterion for the selective system. Thus, service contracts conditional on the sales of new cars are also not exempted under the VBER. Moreover, obliging repairers to also sell cars has never been a practical issue.

While there appear to be no or minimal negative effects, there exist positive effects of a transition from the MVBER to the VBER due to increases in contractual flexibility. In the presence of a positive impact of high service levels on overall brand perception, there exist business rationales for linking sales contracts to services contracts: bad service can negatively affect the overall sales of a manufacturer. Linking sales contracts to service contracts enables the manufacturer to incentivise dealers in their services such that they take into account the negative reputation effect of bad services on the brand image. By doing so, overall welfare can be increased. Since most dealer outlets are currently combined sales and service outlets, it is likely that significant efficiencies are foregone due to the fact that no linkage is possible.

Conclusion

From a competition policy perspective, the following factors suggest that a move from the MVBER to the VBER will benefit rather than harm consumers:

(1) The potential entry enhancing effect of the multi-branding provisions is limited to specific countries and brands.

(2) The potential beneficial effect on enhanced competition in such countries appears very small.

(3) The multi-branding provisions induce costs, most of which will impact all brands and all countries.

(4) Overall, shifting bargaining power to dealers and reducing the contractual flexibility of manufacturers by not allowing sales contracts which are conditional on servicing may entail on balance negative effects for consumers.

These findings suggest that a specific regulation in the automotive sector might no longer be appropriate and reinforce the European Commission's statement that a "*more effects-based and flexible approach would deliver better results for consumers*".[3]

[3] Commission Evaluation Report on the Operation of Regulation (EC) No. 1400/2002 concerning motor vehicle distribution and servicing, page 12.

2. Background, objective and approach of the study

2.1 Background

The current motor vehicle block exemption regulation (MVBER) is due to expire in May 2010. In May 2008, the DG Competition issued an evaluation report on the operation of the MVBER. The report suggests that a specific regulation in the automotive sector might no longer be appropriate and that a "*more effects-based and flexible approach would deliver better results for consumers*".[4]

Whereas generally car manufacturers support the European Commission's findings and views, there are several market participants who have been contesting its view. Broadly speaking there are two opposing views:

- **Pro VBER:** The level of competition has changed relative to the situation that prevailed when the MVBER was introduced. Given that currently competition between car manufacturers is intense, there is no need to maintain the current MVBER. This argument is often used in favour of abolishing the MVBER. Moreover, the MVBER is perceived to have triggered unintended side-effects which negatively affect consumers.

- **Pro MVBER:** Although there is agreement that current market outcomes do not fulfil the expectations that prevailed at the time of the introduction of the MVBER, the MVBER still had some beneficial effects and more beneficial effects are to be expected in the future. This is a view often supported by some automotive dealers, authorised and independent repairers as well as aftermarket distributors and spare parts suppliers.

In addition, the ongoing discussion on the need of the MVBER includes a legal discussion on how and where to best regulate certain issues such as certain protection rules for dealers, access to spare parts and access to technical information. We do not focus on these issues in this report, which takes an economic perspective.

During the ongoing consultation process interested parties have raised a number of more detailed reasons, both in favour and against maintaining the current regulation. The following is a brief summary of arguments made by associations of individual dealers, vehicle manufacturers, spare parts producers, leasing companies and other parties to the ongoing debate.

Essentially all parties to the consultation process agree that **competitiveness of the automotive industry increased** since MVBER went into effect. There is however substantial disagreement about the sources of the increased competition. The Commission and carmakers are generally of the opinion that the positive developments can to a large extent be attributed to external market forces, which are not directly attributable to the MVBER. They point out that dealers

[4] Commission Evaluation Report on the Operation of Regulation (EC) No. 1400/2002 concerning motor vehicle distribution and servicing, page 12.

have often not taken up opportunities afforded to them by MVBER provisions and hence their impact must have been limited. In contrast, dealers and their interest groups interpret the situation differently and claim that MVBER provisions were instrumental in increasing competition in the industry.

Another general difference of opinions expressed in submissions regards the **uniqueness of the automotive sector** in comparison to other industries. Parties arguing for maintaining a version of the MVBER typically argue that the automotive industry is exceptional in its competitive structure and hence requires a dedicated set of legal rules. Other parties asserting that the MVBER should be allowed to expire in 2010 indicate that the car industry - while definitely large and important to the economy overall - is not substantially different from other industries that do not have their own block exemption regulations.

One aspect of this uniqueness that is frequently emphasised is the **asymmetry in relation between manufacturers and dealers** which is generally skewed in favour of the suppliers. While the emergence of large dealer groups and current MVBER regulations seem to have shifted the balance a bit in favour of the dealers, this asymmetry is generally acknowledged by all parties. There is a difference in opinion on whether the issue of asymmetry needs to be addressed in a regulation. Not surprisingly, dealers and their associations argue for maintaining provisions strengthening their bargaining power vis-à-vis manufacturers. Carmakers take the opposing view, although they also offer to make some concessions, proposing a self-binding commitment in a code of good conduct that would protect some of the dealer rights. The Commission's position on the issue seems to be somewhere in between. On the one hand, it recognises that the goal of antitrust policy is not independence of dealers from their suppliers per se but rather protection of competition.[5] On the other hand, obviously the Commission recognises the policy objective of supporting small and medium-sized enterprises (SMEs) and potential benefits of creating some countervailing force against the suppliers.[6]

Another important general argument raised usually by dealers and their associations in favour of maintaining the MVBER is that there was **not enough time for the dealers to fully take advantage of the opportunities** offered by the MVBER as well as for the Commission to thoroughly evaluate all the positive effects of the regulation. More specifically, the dealers claim that to institute changes afforded by the regulation requires significant planning, financing, capital investments that may need additional time to develop. They imply that the Commission's evaluation (undertaken in 2007) as well as the London Economics report (published in 2006) might not have been able to take into account the more recent and certainly not future developments.

There are also some stark differences in opinion between carmakers and dealers regarding some more specific issues such as **multi-branding**. The dealers, who to a large extent favour multi-branding, claim that it prevents foreclosure of competing carmakers, lowers consumers' search costs, promotes economies of scope by allowing overhead costs to be spread across multiple brands and reduces dependence of dealers on suppliers. The Korean vehicle manufacturers associated in KAMA also issued a statement in support of the foreclosure argument.

[5] Commission's report, page 10.

[6] "*Paolo Cesarini, who is in charge of regulating competition in the auto industry at the EU Commission, said that "some degree of consolidation" could actually make dealers more powerful, which would boost competition.*" Rise of big multi-brand dealers curbs competition, Automotive News, June 27, 2005.

In contrast, most of the other manufacturers, through their associations (ACEA and JAMA) argue that same showroom multi-branding has not increased as much as expected. They attribute it to the fact that the regulation was too prescriptive – it advocates a particular type of multi-branding, same showroom multi-branding. Manufacturers also argue that the case for efficiencies of selling competing brands in the same showroom is weak while the costs are high. Finally, they suggest that the decision to offer multiple brands should be driven by market circumstances and not by regulation.

There are also numerous **legal arguments** both for and against the MVBER that are presented in the debate. In this report we do not consider in any depth various legal arguments but focus on those issues where economic analysis appears useful.

The proponents of maintaining the MVBER argue that if it were allowed to expire, the automotive sector would have to rely on many scattered legal instruments. They further argue that it would create a legal patchwork and seriously increased complexity, legal uncertainty and compliance costs. The opponents counter that the current MVBER overlaps with many other regulations that went into effect since 2002 and that it is this overlap in regulation that increases uncertainty and compliance costs. Dealers and their associations are also of the opinion that a self imposed industry code of good practice is a poor substitute for legally binding requirements of the block exemption regulation.

2.2 Objective and approach

Against this background this study investigates the competitive effects of the current MVBER relative to a VBER regime. The focus is on the interaction between non-compete clauses and entry in the European passenger car market. This study does not analyse the effects of a shift from the MVBER to the VBER on the commercial vehicle sector, among other reasons, because the commercial vehicle market does not involve "consumers", but is a Business-to-Business market.

The MVBER regulates behaviour in three different aspects of the automotive industry:

(1) car distribution,

(2) spare parts distribution; and

(3) repair and maintenance.

Should the sector specific regulation be abolished, the VBER would take its place. Although the VBER is going to expire at the same time as the MVBER and the evaluation process is ongoing on the future definition of the VBER, we understand that the general consensus is that the VBER is likely to be extended without major changes that could affect the automotive industry. Therefore, in order to assess the case for a removal of the sector specific regulation a comparison between the current MVBER and the current VBER appears reasonable.

In this report we attempt to complement and deepen the analysis regarding the arguments for and against the MVBER. In particular, this study covers the effects of a move to the VBER in relation to the following provisions:

- **Exclusive dealing and multi-branding:** The competitive effects of less restrictive rules on multi-branding are the focus of this report. A detailed assessment is provided in Sections 4, 5, 6 and 7.

- **Provisions strengthening dealers:** Potential effects resulting from the removal of particular clauses strengthening the bargaining power of dealers are briefly discussed, but not analysed in detail, in Section 8.1.

- **Separation of sales and services:** Potential effects resulting from the ability to combine sales and service contracts are briefly discussed, but not analysed in detail, in Section 8.2.

Given the more restrictive and prescriptive nature of the MVBER, the shift from the MVBER towards the VBER can be interpreted to an extent as a shift from more *per se* regulation to more case-by-case, effects-based regime. We do not address this issue in detail because our methodology is to analyse the effects of the change in regime relative to the defined counterfactual. In general, however, vertical restraints can be associated with both pro- and anti-competitive effects, which often warrant a more detailed case-by-case analysis.

In **Section 3** we describe the vertical distribution arrangements that have been exempted in the MVBER and their counterparts in the VBER in order to identify the key **differences between the MVBER and the current VBER**. This section defines the relevant counterfactual scenario that forms the basis of our further analysis.

In **Section 4** we discuss different **definitions of multi-branding** and analyse theoretical **incentives of dealers and manufacturers** to engage in multi-branding.

Section 5 analyses in more detail the **pro-competitive effects of multi-branding**. We provide empirical data on the intensity of inter-brand competition and quantify the potential effect multi-branding might have had on preventing foreclosure. We also discuss the reduction in consumers' search costs as well as a potential reduction in dealers' operating costs due to economies of scope.

In **Section 6** we turn our attention to a**nti-competitive effects of multi-branding**. Vertical restraints can often have positive effects, for instance by improving quality of services through non-price competition. Without sufficient flexibility in contracting suppliers may be constrained in optimising their distribution processes. With that in mind, we analyse issues such as brand dilution; overinvestment in *brand specific* investments, underinvestment in *non-brand specific* investment and other strategic responses of manufacturers.

In **Section 7** we briefly compare the pro- and anti-competitive effects to asses a possible overall impact of multi-branding on **consumer welfare**.

The study is then complemented in **Section 8** by a brief appraisal of issues unrelated directly to multi-branding, but which would be changed under the VBER regime and that may lead to economic consequences. We discuss there issues related to **changes in bargaining power**

between dealers and manufacturers on consumers' welfare and potential effects of **bundling sales and service** contracts together by the manufacturer.

3. The regulatory setting absent the MVBER – the relevant counterfactual

3.1 Objectives and key measures of the MVBER

Block exemption regulations are specific applications of Article 81(3), which allows exempting agreements that confer sufficient benefits to outweigh the anti-competitive effects from prohibition expressed in Article 81(1). One such exemption - Regulation 2790/1999 (VBER) - applies to vertical agreements and concerted practices. However, the VBER does not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation.[7] The distribution agreements in the motor vehicle industry are therefore exempted by a separate, sector-specific block exemption Regulation 1400/2002 (MVBER) rather than the VBER.

The MVBER and VBER describe sets of practices and vertical agreements which are presumed legal. The MVBER, applicable solely to the automotive sector, is more restrictive than the VBER, in the sense that the safe harbour it creates is in general smaller.[8] Vertical agreements falling outside a block exemption regulation are not presumed to be illegal but may need individual examination.[9] This fulfils one of the general objectives of block exemption regulations, which is to provide legal clarity and lower the compliance costs of anti-trust regulation for market participants. At the same time, however, the Commission indicated that failure to comply with the conditions stipulated in MVBER will be met with vigorous enforcement action.[10]

Parties attach significant value to the legal certainty resulting from safe harbour provisions of the MVBER and in general structure their contracts so that they are covered by the block exemption. For the MVBER this is evidenced for example by the fact that in countries in which manufacturers exceed the 40% safe harbour threshold for new car distribution in the quantitative distribution system they opted for a qualitative selective distribution, which is exempted regardless of the market share. This was the choice of for example Volkswagen in the Czech Republic.[11] Similarly, it is assumed by the European Commission that the provision of after-sales services for each vehicle brand constitutes a relevant anti-trust market and market shares of the respective authorised networks normally exceed 30% in these markets. In consequence, practically all vehicle manufacturers have organised their authorised service networks according to the qualitative selective distribution model, to meet the safe harbour provisions of the

[7] Article 2(5) of the VBER.

[8] See e.g. Recital 2 of the MVBER.

[9] Guidelines on Vertical Restraints, Paragraph 62.

[10] See e.g. Speech by Mr. Mario MONTI European Commissioner for Competition Policy: *The new legal framework for car distribution*, Ninth Annual European Automotive Conference: *Car retailing at a crossroads*, Hilton Hotel Brussels, February 6th 2003: "*Put bluntly, where we detect problems, we can and will act vigorously to enforce the rules. In the past, we have done so in areas such as price fixing and export bans. We will be equally tough when it comes to the new freedoms offered by the block exemption, and will react decisively if there is any attempt to prevent their proper implementation.*"

[11] Staff working document No 4, page 10.

MVBER.[12] So even though the MVBER does not apply automatically, carmakers treat it as de facto binding. This indicates that the benefits the safe harbour of the block-exemption regulation provides are significant.

According to the Commission (see Staff working document No 1, pages 8-10), the specific stated objectives of the MVBER are:

1. To prevent **foreclosure** of competing vehicle manufacturers and to safeguard access to the vehicle retailing and repair markets.

2. To reinforce intra-brand and inter-brand competition through an increased **diversity of distribution systems** across the market.

3. To facilitate **parallel trade** in motor vehicles between EU countries.

4. To protect competition between **independent and authorised repairers**.

5. To ensure effective competition within the manufacturers' **networks of authorised repairers**.

6. To promote **spare parts** manufacturers' access to the automotive aftermarkets.

7. To ensure that **dealers felt sufficiently independent** from their suppliers.

The objectives were to be achieved by a number of key measures introduced, among them:

- Different market thresholds for different methods of distribution described in Article 3(1) and 3(2).

- Measures intended to strengthen the position of dealers vis-à-vis manufacturers described in Articles 3(3) through 3(6).

- Specific hardcore restrictions described in Article 4.

- Additional specific conditions described in Article 5.

The difference between the hardcore restrictions and specific conditions is their severability. That is, inclusion of a hardcore restriction into an agreement between a carmaker and a retailer or wholesaler renders the MVBER exemption inapplicable to the agreement as a whole. Furthermore, these restrictions are unlikely to benefit from individual exemptions. On the other hand, specific conditions listed in Article 5 are exempted *separately* from the whole agreement, i.e. the MVBER exemption continues to apply to the rest of the vertical agreement.[13]

As discussed in the previous chapter, for the purposes of our analysis, we assume that should the MVBER not be renewed in 2010, the vertical agreements in the automotive industry will fall under the scope of the VBER in its current form. The following subsections analyse in detail the relevant differences between the status quo and the hypothetical VBER regime.

[12] Staff working document No 4, page 25.

[13] Explanatory brochure for Commission Regulation (EC) No 1400/2002, Section 3.1.

3.2 Relevant counterfactual: distribution systems for new cars

Regarding the distribution of new cars, the key differences between the MVBER and the VBER in their current state relate to the maximum market share thresholds necessary for exemption for different distribution systems (or for authorised after-sales service networks), treatment of exclusive dealing and multi-branding, provisions promoting parallel trade (incl. the so-called location clause) and clauses related to strengthening dealers' negotiating position vis-à-vis manufacturers.

3.2.1 Differences in market share thresholds for different distribution systems

One of the key measures introduced in the MVBER are different market share thresholds for different distribution systems. Under **exclusive distribution** the manufacturer can appoint a single dealer in a designated territory which can be prohibited from active sales outside its territory, including the opening of secondary outlets, not however from passive outside territory sales.[14] This distribution format therefore allows (passive) sales to any other dealer or end consumer. For the agreements containing exclusive supply obligations to be covered by the MVBER exemption, the market share of the buyer in the relevant anti-trust market must not exceed 30%.[15] The same threshold is specified in the VBER.[16] So the move from the MVBER to the VBER will not affect the few manufacturers which have chosen to distribute their new cars under an exclusive distribution system, such as for example Suzuki.[17]

Another option to organise the retail network to take advantage of the MVBER exemption is the **selective distribution** method, either qualitative and/ or quantitative.[18] Within this distribution format dealers can sell to end consumers and authorised dealers within the distribution network, but not to other unauthorised dealers outside the network. In qualitative selective distribution, dealers are admitted to the network only on the basis of objective criteria required by the nature of the product, such as training of sales personnel, the service provided at the point of sale, a certain range of the products being sold, etc. Quantitative selective distribution allows manufacturers to use additional selection criteria which are quantitative in nature and which can directly limit the potential number of dealers in the network, for example by fixing the number of dealers or requiring minimum or maximum sales.[19]

Most manufacturers have chosen the quantitative selective distribution system as the optimal way of distributing new cars under the MVBER. The regulation specifies a supplier market share

[14] Guidelines on Vertical Restraints define active and passive sales in Paragraph 50. Active sales mean actively approaching individual customers inside another distributor's exclusive territory or exclusive customer group by for instance direct mail or visits; or actively approaching a specific customer group or customers in a specific territory allocated exclusively to another distributor through advertisement in media or other promotions specifically targeted at that customer group or targeted at customers in that territory; or establishing a warehouse or distribution outlet in another distributor's exclusive territory. Passive sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion in media or on the Internet that reaches customers in other distributors' exclusive territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in non-exclusive territories or in one's own territory, are passive sales.

[15] MVBER, Article 3(2).

[16] VBER, Article 3(2).

[17] Staff working document No 2, page 15.

[18] It should be noted that similar safe harbour provisions apply to the organisation of authorised after-sales service networks. The main difference is that in relation to the authorised after-sales networks, the respective market share threshold for quantitative selective distribution is 30%.

[19] Guidelines on Vertical Restraints , Paragraph 185.

threshold of 40% for the quantitative selective distribution system and exempts all purely qualitative selective distribution systems.[20] In contrast, the VBER does not distinguish between different qualitative selective distribution systems[21] and applies the same 30% supplier market share threshold for both qualitative and quantitative selective distribution.[22]

Under the current MVBER the manufacturers which exceed the 40% safe harbour threshold for new car distribution in the quantitative distribution system can choose qualitative selective distribution and remain exempted. This will no longer be the case under the VBER. Carmakers whose market shares exceed 30% will no longer be eligible to take advantage of the benefits offered by the exemption and these cases will need to be analysed individually under the general Article 81 Guidelines.

3.2.2 Differences in exclusive dealing and multi-branding rules

Another set of significant differences between the MVBER and the VBER concerns their treatment of exclusive dealing and multi-branding. One of the goals of the current MVBER was the promotion of multi-branding, and more specifically multi-branding from the same showroom. To that effect Article 5(1)(a) of the MVBER excludes from the exemption any direct or indirect non-compete obligations. This means that obligations forbidding the purchase of cars from a competing supplier or obligations to purchase more than 30% of the buyer's total purchases from the contracting supplier are illegal.[23] The purpose of the 30% threshold was to enable the dealers to source the cars they sell from at least two additional suppliers.

In contrast, the VBER is much more liberal regarding the exclusivity requirements. It allows contract obligations that require dealers not to purchase cars from a competing supplier for a duration not exceeding five years, as well as obligations that require dealers to purchase up to 80% of the buyer's total purchases from the contracting supplier (even for a duration exceeding five years).[24]

Also, the VBER regulation does not distinguish between different types of multi-branding. So in principle a manufacturer is going to be able to require a dealer not to sell cars of different manufacturers even in separate showrooms.

3.2.3 Provisions promoting parallel trade

Another difference between the MVBER and the VBER that applies to new car distribution systems are provisions intended to promote parallel trade. Among them are a location clause, an availability clause and a cross-supply clause. The **location clause** contained in Article 5(2)(b) of the MVBER is a specific condition which withdraws the benefit of exemption from any direct or indirect obligation on any distributor within a selective distribution system, which limits the dealer's ability to establish additional sales or delivery outlets at other locations within the common market where selective distribution is applied. Unlike the rest of the MVBER regulation which went into effect on 1 October 2002, this provision went into effect on 1 October 2005

[20] MVBER, Article 3(1).
[21] VBER, Article 1(d).
[22] VBER, Article 3(1).
[23] MVBER, Article 1(1)(b).
[24] VBER, Article 5(a).

after a three year transition period.[25] There is no clause equivalent to the location clause in the VBER. Hence, under the VBER an agreement within selective distribution system which prohibits dealers from opening secondary outlets would benefit from the exemption.

The **availability clause** is a hardcore restriction contained in Article 4(1)(f) of the MVBER that excludes the benefit of the exemption from agreements that restrict the dealers' ability to obtain vehicles with specifications current in other Member States. This restriction was intended to allow dealers to fulfil orders from foreign final consumers, e.g. provide left-hand-drive cars in continental Europe for customers from the UK. The VBER does not contain such an explicit restriction. However, according to the Commission's report this provision is redundant, as it is implicitly contained in Article 4(1)(b) discussed next.

The hardcore restriction relating to **active and passive sales** contained in Article 4(1)(b) of the MVBER exempts only the selective distribution agreements for which both passive and active sales are not restricted, either directly or indirectly. This provision is however, equivalent to Article 4(b) of the VBER, so the change between the two regimes will have no practical impact on the clause.

Finally, the **cross supply clause** is another hardcore restriction contained in Article 4(1)(c) of the MVBER. Its purpose is to prevent manufacturers from restricting cross-supplies between dealers belonging to the same selective distribution system. Its purpose was to promote arbitrage by allowing dealers to purchase vehicles in EU Member countries where they were the cheapest. This provision is equivalent to article 4(d) of the VBER.

3.2.4 Provisions strengthening dealers vis-à-vis manufacturers

Another set of clauses that potentially affect the distribution system are measures intended to strengthen the position of dealers vis-à-vis manufacturers described in Articles 3(3) through 3(6). These dealer protection clauses have their roots in part already in the first MVBER of 1985 and have continuously expanded over time. In 2002, the Commission had noted a weak bargaining power on the part of the dealers and that protecting the dealers could encourage them to act more pro-competitively. The initial objective was to make dealers economically more independent from manufacturers than before. To that effect the MVBER contains a number of flanking measures addressing:

- The right of a dealer to sell his franchise to another dealer already holding a contract with the same manufacturer (Article 3(3)).
- The requirement to give a written cause for termination of an agreement (Article 3(4)).
- Minimum notice periods for contractual termination (Article 3(5)).[26]
- Mandatory contractual arbitration mechanisms for dispute resolution on a number of issues ranging from the setting of sales targets to reasons for contract termination (Article 3(6)).

[25] MVBER, Article 12(2).

[26] For indefinite contracts: 2 year notice period with detailed reasons; for fixed term contracts (minimum 5 years): 6 months notice period.

In contrast, the VBER has no provisions addressing imbalances in bargaining power by protecting dealers' investments. However, manufacturer associations suggest dealing with at least the last two provisions within a self-binding commitment by the industry.[27]

Another potential difference between the MVBER and the VBER that can affect the bargaining position of the parties in the significant leasing segment of the market is the definition of end-user status. Article 1(1)(w) of the MVBER explicitly stipulates that leasing companies are to be considered end-users. The difference in the definition can be important for leasing companies, because end users can source their cars from any dealer, while non-authorised independent resellers cannot. The VBER does not contain a definition equivalent to Article 1(1)(w) of the MVBER. However, according to the Guidelines on Vertical Restraints, under the VBER the leasing companies could still be considered "professional end users".[28] While the change in the definition may have some economic implications for the leasing sector, it is legal in nature and therefore beyond the scope of our analysis.

3.3 Relevant counterfactual: after-sales services and spare parts

The MVBER also contains a number of provisions that regulate the organisation of authorised after-sales service networks and the functioning of the market for spare parts. Beside the MVBER these markets are also covered by various other regulations and directives.

The provisions discussed below are additional to the provisions on market share thresholds as well as exclusivity requirements already discussed under the section on distribution for new cars.

3.3.1 Separation of sales from services

Additional MVBER rules were created to promote intra-brand competition within the authorised networks. Specifically, Articles 4(1)(g) and 4(1)(h) are hardcore restrictions that withdraw the benefit of the exemption from any agreements that make access to the authorised service network conditional on an obligation to also sell new cars or vice versa. In other words, under the current MVBER manufacturers must offer separate sales and service contracts to their dealers. The VBER does not contain an equivalent provision.

3.3.2 Provisions promoting competition between authorised and independent repairers

The MVBER contains a number of provisions that intend to promote competition between authorised and independent repairers. First, a hardcore restriction relating to the **sale of spare parts in Article 4(1)(i)** excludes the benefit of the block exemption from agreements that restrict members of the authorised network from selling spare parts to independent repairers. According to the Commission's interpretation of that provision, it is redundant in the sense that it applies a principle of Article 4(1)(b) discussed earlier. Specifically, it is also equivalent to Article 4(b) of the VBER which exempts only these selective distribution agreements for which

[27] See ACEA response to evaluation report, attachment 2 (ACEA members are BMW, DAF Trucks, Daimler, FIAT, Ford of Europe, General Motors, Europe, Jaguar Land Rover, MAN, Porsche, PSA Peugeot Citroën, Renault, Scania, Toyota Motor Europe, Volkswagen and Volvo) or JAMA response to evaluation report, Annex 2.

[28] Guidelines on Vertical Restraints, Paragraph 53.

both passive and active sales are not restricted, so the change between the two regimes will have no significant impact on the clause.

Similarly, a hardcore restriction relating to the **sale of spare parts in Article 4(1)(j)** of MVBER states that the block exemption does not cover agreements between a manufacturer and an original equipment supplier (OES) which prevents the latter from selling spare parts directly to the aftermarket. Again, according to the Commission, this provision is equivalent to Article 4(e) of the VBER, so the move from MVBER to VBER will have no effect on the clause.

Finally, the hardcore restriction contained in Article 4(2) of the MVBER ensures that independent repairers have **access to technical information**, equipment and tools required for repair and maintenance of motor vehicles. Agreements which restrict such access are not exempted by the MVBER. While the VBER does not regulate these issues, according to the Commission they will be covered by Regulation 715/2007, which enters into effect in 2009.

3.3.3 Provisions promoting spare parts producers' access to the aftermarket

Finally, the MVBER contains a number of provisions that intend to promote spare parts producers' access to the aftermarket. These provisions relate to access to the aftermarket, dual-branding and definitions of original and matching quality spare parts. Hardcore restrictions in Articles 4(1)(j) and 4(1)(k) of the MVBER provide **access of the OES and third parties to the after-sales market**. Specifically, Article 4(1)(j) does not grant block exemption for agreements that restrict the OES' ability to supply its spare parts directly to the aftermarket. Article 4(1)(k) withdraws the benefit of the block exemption of agreements which prevent authorised repairers or distributors from sourcing matching quality parts or other brands of original parts from other suppliers, with the exception of original spare parts supplied by the manufacturer for repairs carried out under warranty, free servicing and vehicle recall work. According to the Commission's analysis, the requirements set forth in Article 4(e) of the VBER would have a similar effect.

The hardcore restriction expressed in Article 4(1)(l) excludes from the benefit of the block exemptions any agreement that restricts **dual-branding**, i.e. the ability of the OES to place its own trademark or logo on components and spare parts supplied to a vehicle manufacturer for the purpose of the first assembly into a motor vehicle. As was the case for access to technical information, the issue of dual branding is not addressed in the VBER, but is instead addressed in Regulation 715/2007.

Finally, **Article 1(t)** defines original spare parts as self-certified spare parts which are of the same quality as the components used for the assembly of a motor vehicle and which are manufactured according to the specifications and production standards provided by the vehicle manufacturer. Similarly, **Article 1(u)** defines spare parts of matching quality as spare parts which can be certified at any moment by its manufacturer to match the quality of the components which are or were used for the assembly of a motor vehicle. These definitions were intended to increase marketing opportunities of OES and third parties and prevent carmakers from invoking differences in quality as a justification to prevent authorised repairers to use parts from competing suppliers. Following the Commission's analysis of the issue, the same definition of original spare parts went into effect in October 2007 as Directive 2007/46/EC.

3.4 Summary on regulatory changes and outlook on economic effects

This section summarises the results on the assumed counterfactual and gives an overview regarding the expected behavioural changes. Moreover, it is indicated in which areas an economic analysis of potential competitive effects is likely to be most fruitful. To start, Table 1 summarises the differences between the MVBER and the assumed counterfactual, the current VBER (which is used as a proxy for the new VBER which is at the time of drafting of this report being prepared by the European Commission). This table briefly states the relevant provisions in the current MVBER and whether or not there are equivalent provisions to be expected within the VBER. The last column indicates whether a significant change to the VBER is perceived as likely and, if so, why we examine the effects of a change with regard to the respective provision. The table is followed by a detailed commentary on the expected behavioural changes and it should be read in conjunction with this text.

Table 1: Summary of key differences between the MVBER and the assumed counterfactual*

	MVBER	VBER/counterfactual	Comment
Safe harbours	40% for quantitative selective distribution No thresholds for qualitative selective distribution	30% for quantitative selective distribution 30% for qualitative selective distribution	Market share thresholds for quantitative selective distribution are lower in the VBER than in the MVBER. This may induce changes in how dealer and service networks are organised. It is not a focus of this report as there are indications that expected changes are likely to be minor.
Exclusive dealing/ Multi-branding	Maximum of 30% minimal procurement from a dealer.	Up to 80% minimal procurement for an indefinite period; more than 80% if obligation does not exceed 5 years.	The competitive effects of this change in relation to new car distribution are the focus of this report. Detailed assessment in Sections 4, 5, 6 and 7. In relation to spare parts many legal questions have to be answered.
Provisions affecting parallel trade	Location clause	No equivalent provision	There are indications that the expected impact of this change is minimal: for various reasons dealers did not find the option to open secondary outlets economically attractive and as result very few of them took advantage of the opportunities afforded in the location clause (acquisition more attractive). Thus, we do not focus on this effect.
	Availability clause	No equivalent provision	This clause is redundant as the provisions are implicitly contained in Art 4(1)(b)). No or limited change is assumed.
	Active and passive sales (Art 4(1)(b))	Equivalent provision	No or limited change is assumed.
	Cross supply clause	Equivalent provision	No or limited change is assumed.
Provisions strengthening dealers	Rights to sell franchise to another dealer	No such right	A brief description of potential effects is provided in Section 8.1.: a prominent aspect of the distribution of bargaining power is rent allocation, rather than effects on consumers. Aspects at stake do not seem to be specific to the automotive sector. Legal issues may be more relevant here than economic ones.
	Written cause for termination	No such requirement	
	Minimum notice periods for termination	Potential self-binding commitment by industry	
	Arbitration mechanism	Potential self-binding commitment by industry	
Separation of sales and services	Service contracts cannot be made conditional on selling new cars or vice versa	No equivalent provision	A description of potential effects is provided in Section 8.2.
Provisions promoting competition between authorised and independent repairers	Authorised dealer sale of spare parts	Equivalent provision	No or limited change is assumed
	OES sale of spare parts	Equivalent provision	No or limited change is assumed
	Access to technical information	While the VBER does not regulate these issues, according to the Commission they will be covered by Regulation 715/2007, which enters into effect in 2009	While access to technical information is likely helpful or even necessary for fostering competition, we understand that the focus of the disagreement is on how it is best achieved. We therefore perceive this as a predominantly legal question. No or limited change is assumed.
Provisions promoting spare parts producers' access to the aftermarket	Access of the OES and third parties to the after-sales market (Art 4(1)(j) and 4(1)(k))	Equivalent provision	No or limited change is assumed.
	Dual branding	While the VBER does not regulate these issues, according to the Commission they will be covered by Regulation 715/2007, which enters into effect in 2009	No or limited change is assumed. If there are gap cases outside the MVBER or the VBER, addressing them appropriately is perceived as a legal question.
	Definitions of original spare parts (Article 1(t)) and spare parts of matching quality	Same definition of original spare parts went into effect in October 2007 as	No or limited change is assumed in relation to original spare parts. Analysis of access of competing parts manufacturer under Art 81

	MVBER	VBER/counterfactual	Comment
	(Article 1(u))	Directive 2007/46/EC No equivalent for spare parts of matching quality.	

Note: * The table provides a simplified representation of our assumptions and should be read in conjunction with the text that follows.

Source: ESMT CA.

Market share thresholds in relation to distribution systems

Market share thresholds affect which distribution systems manufacturers choose (e.g. selective vs. exclusive). Potential competitive effects due to the choice of the distribution system only arise if there is a change in the choice of the distribution system; consequently, there is no effect if manufacturers choose the same system under the VBER as under the MVBER.

Manufacturers whose market share is between 30% and 40% will lose the benefit of the exemption and their legal uncertainty will increase. A possible result of moving from the current MVBER to the VBER is that those manufacturers who have chosen quantitative selective distribution under the MVBER and have market shares between 30% and 40% will instead choose the qualitative selective distribution under the VBER. This is due to the fact that according to Guidelines on Vertical Restraints (GVR):

> *"[P]urely qualitative selective distribution is in general considered to fall outside Article 81(1) for lack of anti-competitive effects".*[29]

On the other hand, should they choose quantitative selective distribution, the situation is less clear. Specifically, again according to the GVR guidelines:

> *"[W]here both the CR5 and the share of the market covered by selective distribution exceed 50 %, the assessment may vary depending on whether or not all five largest suppliers apply selective distribution. […] If all five largest suppliers apply selective distribution, competition concerns may in particular arise with respect to those agreements that apply quantitative selection criteria by directly limiting the number of authorised dealers."*[30]

Given the current approach to market definition by the European Commission there will be few cases where the market share of a manufacturer exceeds 30%. Thus, only a minority of manufacturers is affected and might change from quantitative selective to qualitative selective distribution. Therefore, this study does not look in further detail into the expected changes in relation to the safe harbour adjustments with a move to the VBER.

Market share thresholds in relation to authorised service networks

Market share thresholds affect which authorised service networks manufacturers choose (e.g. quantitative or qualitative selection). Potential competitive effects only arise if there is a change in the choice of the network; consequently, there is no effect if manufacturers choose the same system under VBER as under the MVBER.

The view presented by the Commission is that a brand-specific repair market constitutes a relevant anti-trust market. Because the network of authorised repairers and parts distributors of a given brand normally has a market share above 30% in that market to benefit from the exemption, most (if not all) manufacturers had to organise their networks according to qualitative selective distribution criteria.[31] However, the VBER does not make a distinction

[29] Guidelines on Vertical Restraints, Paragraph 185.

[30] Guidelines on Vertical Restraints, Paragraph 189. The concentration ratio CR5 gives the joint market share of the five biggest players on the market. It is thus an absolute measure of concentration which does not take the relative size of the market participants into account.

[31] See for example Staff working document #4, page 22 and page 25. "*As the network of authorised repairers and parts distributors of a given brand is normally considered to have market share above 30% of that brand-specific repair*

between qualitative and quantitative selective distribution[32] and exempts only suppliers with market shares below 30%[33]. Therefore, under the VBER, manufacturers whose authorised after-sales network exceeds a market share of 30% will not be able to organise the after-sales network to benefit from the exemption and the vertical restraints will need to be analysed on a case-by-case basis.

We do not believe that this change will have a significant effect: currently most, if not all, suppliers have chosen qualitative selective distribution and suppliers are likely to stick to this choice. The reason for this is that qualitative selective distribution in general is considered to fall outside the scope of Article 81(1) for lack of anti-competitive effects.[34] Contrary, quantitative selective distribution is more problematic since the GVR guidelines argue that competition concerns may arise with respect to agreements that apply quantitative selective distribution if both the CR5 and the share of the market covered by selective distribution exceed 50 %, which would likely be the case.[35]

Multi-branding and exclusive dealing

In a very simplified way, the move from the current MVBER to the VBER can be thought of as shifting some of the decision rights over multi-branding from dealers to manufacturers. Because of the 30% maximum obligation threshold, under the MVBER each dealer has an option to source his supplies from at least 3 different suppliers. Hence, the decision whether to multi-brand resides with the dealer. In contrast, under the VBER the suppliers are able to negotiate 80% minimum obligation requirements. However, a manufacturer may not be able to prevent multi-branding as the dealer may still reject the contract altogether.

Generally, there are three different types of multi-branding:[36] (1) different brands in different locations, (2) different brands in different showrooms on the same site and (3) different brands from the same site and within a single showroom. The VBER regulation does not distinguish between different types of multi-branding. Therefore, in principle a manufacturer is going to be able to require a dealer not to sell cars of different manufacturers even in separate showrooms.

However, there are a number of reasons why the expected changes resulting from a transition to the VBER for multi-branding in different showrooms are limited in comparison to multi-branding in the same showroom:

- Under the VBER dealers will still be able to setup separate legal entities to sell cars of different brands in different showrooms on the same site or in different sites. It is considered unlikely that the VBER exemption is applicable for contracts that require minimum purchase requirements above 80% jointly for the separate legal entities.[37] With this outside option for retailers, the prevention of multi-branding from different showrooms will remain difficult for the manufacturer.

market, vehicle manufacturers that wish their networks to benefit from the block exemption are induced to apply qualitative selective distribution."

[32] VBER, Article 1(d).

[33] VBER, Article 3(1).

[34] Guidelines on Vertical Restraints, Paragraph 185.

[35] Guidelines on Vertical Restraints. Paragraph 189.

[36] Staff Working Document No. 4, page 1.

[37] It should however be noted that from a legal point of view it is unclear whether two entities selling from the same site can be declared as entirely legally distinct.

- The incentives of dealers and manufacturers regarding sales of different brands from different showrooms on the same site or from different sites are closer aligned than incentives to sell cars from the same showroom: selling cars from separate showrooms allows manufacturers to better prevent their brand identity. Because the most immediate and direct cost of multi-branding is gone, the manufacturer has less incentives to prevent the practice.

Overall, the impact of a transition from the MVBER to the VBER on multi-branding will largely be constrained to same showroom multi-branding. The analysis therefore focuses on same showroom multi-branding:

- Section 4 discusses the expected changes in the extent of multi-branding associated with the move to the VBER.

- Sections 5 and 6 then discuss the pro- and anti-competitive effects of multi-branding.

- Section 7 summarises the results and examines whether, with a potential decrease of multi-branding, we would expect a decrease or an increase in consumer welfare overall.

Furthermore, as described above, the changes in the provisions regarding multi-branding are similar to a shift in bargaining power. In this sense the effect of moving from MVBER to VBER on multi-branding provisions is similar to the dealer power provisions in Articles 3(3) through 3(6). Effects of the shift in bargaining power are further examined in Section 8.1.

Location clause

The location clause gives authorised dealers in a selective distribution network unhindered opportunity to establish additional sales or delivery outlets at other locations within the common market. The intent of the clause was to enhance intra-brand competition and parallel trade by allowing dealers to take advantage of price differentials across different localisation, also internationally. There is no equivalent provision in the VBER.

Despite the opportunity few dealers have opened additional sales outlets of any kind in foreign countries.[38] This could be potentially explained by the extended transition period of the provision, but according to the Commission no change in the trend is apparent even after 2005. Dealers looking to expand often find an acquisition of another dealership enabled by the Article 3(3) to be a more attractive option than opening a secondary outlet.[39] Furthermore, the following factors could contribute to the explanation why dealers have not been taking up the opportunities presented under the location clause:

- Price differentials across European Union countries have decreased significantly, reducing profitability of any arbitrage opportunities that remain.

- Small dealers lack expertise and financial clout required to set up international operations and hence few give the option consideration.

[38] "Block exemption regulation. The bar room brawl series" PricewaterhouseCoopers, page 50 gives an example of Polish Volkswagen dealer selling cars in Germany.

[39] Staff working document No 4, page 11.

- Language barriers, local bureaucratic rules and regulations as well as lack of detailed knowledge of local markets can be additional factors increasing dealer's risk of opening foreign operations.

These observations indicate that the likely effect of the change would be minimal. In this report we do not analyse the full impact of abandoning the location clause. However, it should be noted that it is likely that the non-exemption of location clauses shifts bargaining rights to dealers. Therefore, the effects are partly also covered in the discussion in Section 8.1.

Further provisions affecting parallel trade

We understand that all three further provisions affecting parallel trade (availability clause, active and passive sales (Art 4(1)(b)) and cross supply clause) are either redundant or have an equivalent provision within the VBER. Therefore, with respect to those provisions we assume no changes with a transition to the VBER.

Provisions strengthening dealers bargaining power

As indicated in Table 1, there are some provisions within the MVBER which are not found in the assumed counterfactual situation. Therefore, the move from the MVBER to the VBER would likely have some impact on dealers. This impact is briefly covered in this report (see Section 8.1). However, we do not address this issue in much detail for two main reasons:

- First, the distribution of negotiation strength is likely to have foremost effects on the allocation of rents within a bilateral bargaining situation and it does not directly impact efficiency considerations. In Europe, protecting retailers is not a generally accepted way to enhance competition, as evidenced by the absence of any such measures in the VBER covering all but the automotive sector. This point is succinctly summarised in the principle that the antitrust laws are enacted for the protection of competition, not competitors.[40] Thus, correcting imbalances between parties in this case may be more a contract law issue than a competitive issue.

- Second, we understand that a number of the factors affecting the balancing of bargaining power between the parties can be resolved elsewhere, e.g. in a code of good practice that would be binding for the participants and that has been proposed for example by the Association des Constructeurs Européens d'Automobiles (ACEA). While one could argue that providing reassurances for the dealers by means of an industry code of conduct has lower value than through block exemption regulation, the exact means of providing and enforcing such assurances are a legal and not an economic issue. They are therefore not covered in this report.

In spite of its pro-competitive rationale some of the dealer strengthening provisions may have led to undesirable long-term side-effects. Section 8.1 discusses some indications that provisions of Article 3(3) might have induced consolidation in retail markets and hence contributed to additional deterioration of the small dealers' position in the market. Another potential side-

[40] See e.g. Neelie Kroes' Speech at the Fordham Corporate Law Institute on 23 September 2005: "*My own philosophy on this is fairly simple. First, it is competition, and not competitors, that is to be protected. Second, ultimately the aim is to avoid consumers harm*." (page 3).

effect of the provisions is that they make it more difficult for the manufacturers to terminate underperforming dealers and hence timely optimise their networks.

Separation of sales and services

There are indications that the effect of moving to the VBER in terms of the actual change in the market structure with respect to sales or service outlets may be limited. While the effect on market structure may be limited, there may well be benefits from adopting a less restrictive approach as there might be economic benefits of linking sales and services. For example, by linking sales with service contracts dealers might be incentivised to provide higher service levels. A more detailed analysis of the separation of sales and services follows in Section 8.2.

Provisions promoting competition between authorised and independent repairers: Sale of spare parts

We understand that both provisions with regard to the sale of spare parts (Article 4(1)(i) and Article 4(1)(j)) between authorised and independent repairers have their equivalents in the assumed counterfactual. Therefore, no change is assumed and the study does not focus on this part.

Technical information

There are good economic arguments why ensuring continued access to technical information, tools and equipment is helpful or even necessary for fostering competition in the aftermarket. Nevertheless, this study does not analyse the impact of the expiration of MVBER on the access to technical information, equipment and tools for two reasons:

- First, while the VBER does not regulate these issues, according to the Commission they will be covered by Regulation 715/2007, which enters into effect in 2009.

- Second, while this regulation only applies to newly launched models, the question of finding the solution bridging the current MVBER regime with the future regime under Regulation 715/2007 is ultimately a legal issue.

Access of the OES and third parties to the after-sales market

We understand that both provisions with regard to the access of OES and third parties to the after-sales market have their equivalents in the assumed counterfactual. Therefore, no change is assumed and the study does not focus on this part.

Dual Branding

While the VBER does not regulate these issues, according to the Commission they will be covered by Regulation 715/2007, which enters into effect in 2009.[41]

[41] As such, we are of the opinion that the question of finding the solution bridging the current MVBER regime with the future regime under Regulation 715/2007 is ultimately a legal issue.

Definitions of original spare parts and spare parts of matching quality

In relation to original spare parts an identical definition went into effect in October 2007 as Directive 2007/46/EC.[42]

Under the VBER, there is no exact definition of spare parts of matching quality. Therefore, absent such a definition, there might be a higher degree of legal uncertainty under the VBER. Potentially, an assessment of an agreement restricting the OES' ability to supply its spare parts of matching quality directly to the aftermarket might need to be performed based on an effects based cost-benefit analysis as prescribed by Article 81.

Summary

This study analyses the effects of a transition from the MVBER to the VBER from a competition economics point of view. Since many of the provisions currently in place under the MVBER will be essentially unchanged in the relevant counterfactual, the focus of this study is on the expected changes and effects of multi-branding. This appears from an economics point of view the most interesting issue. In particular, the study does not touch on predominantly legal issues such as the legal implications of governing specific clauses within the framework of a block exemption versus an industry code of conduct. Following the above exposition, this study covers the effects of a move to the VBER in relation to the following provisions:

- **Exclusive dealing and multi-branding in relation to new car distribution:** The competitive effects of less restrictive rules on multi-branding in the same showroom are the focus of this report. A detailed assessment is provided in Sections 4, 5, 6 and 7.

- **Provisions strengthening dealers:** Potential effects resulting from the removal of particular clauses strengthening the bargaining power of dealers are briefly discussed, but not analysed in detail, in Section 8.1.

- **Separation of sales and services:** Potential effects resulting from the ability to combine sales and service contracts are briefly discussed, but not analysed in detail, in Section 8.2.

In contrast, this study does not cover the effects of a move to the VBER in relation to the following provisions:

- **Safe harbours**: Market share thresholds for quantitative selective distribution are lower in the VBER than in the MVBER. This may induce changes in how dealer and service networks are organised. It is not a focus in this report as there are indications that expected changes are likely to be minor.

- **Provisions affecting parallel trade:** For most of the specific clauses no change with a move to the VBER is expected. Only the location clause does not seem to have a counterpart within the relevant counterfactual. However, for various reasons dealers did not find the option to open secondary outlets economically attractive and as result very few of them took advantage of the opportunities afforded in the location clause.

[42] The discussion whether the protection through a block exemption regulation or a directive is equally effective is a legal and not an economic issue.

Consequently, this study does not look into effects resulting from provisions affecting parallel trade in any detail.

- **Provisions promoting competition between authorised and independent repairers:** For most of the specific clauses no change with a move to the VBER/relevant counterfactual is expected. Consequently, this study does not look into effects resulting from these provisions in any detail.

- **Spare parts:** The changes with respect to the relevant counterfactual in relation to provisions on spare pars appear to be relatively minor and mainly of a legal nature

4. Multi-branding: alignment of dealers' and manufacturers' incentives

As discussed in Section 3.2, the move from the current MVBER to the VBER will shift some decision rights over multi-branding from dealers to manufacturers. In order to assess the welfare impact resulting from such a shift, two questions need to be answered:

- **Expected change in multi-branding:** Will this shift in decision rights affect the extent to which multi-branding is taking place? More specifically, in which situations will manufacturers choose not to allow multi-branding, where a dealer would wish to accept another brand? It is only in these situations where adopting the VBER will have consequences with respect to multi-branding.

- **Welfare assessment of that change:** In those situations where one would expect multi-branding to decrease if decision rights are in the hands of the manufacturers, does this decrease, on balance, have a positive or a negative effect on consumer welfare.

In this section we address the first question, Sections 5, 6 and 7 analyse the second question. This section first clarifies the different notions of multi-branding. It establishes that the focus of the evaluation of the MVBER with respect to multi-branding resides with multi-branding within the same showrooms: for this type of multi-branding the MVBER shifted decision rights to the dealer in comparison to the previous sector regulation. In order to identify the situations where the incentives for dealers and manufacturers in relation to multi-branding are not aligned, the second part of this section analyses the economic factors that drive the decision of the dealer in comparison to those that drive the decision of the manufacturer. The last section examines the evolution of multi-branding and draws some comparison between the period before the introduction of the MVBER and thereafter. This comparison might inform about the extent of changes expected when moving to the VBER.

4.1 Definitions of multi-branding

The term "multi-branding" as used by the industry participants can have a number of different meanings. For example, it is often used to describe a situation in which a dealer sells two or more brands from the same manufacturer. Another term used to describe this situation is "intra-branding". The so called intra-branding is not considered multi-branding within the MVBER; the regulation excludes from the benefit of the block exemption contractual arrangements which prevent the dealers from selling vehicle of competing manufacturers not belonging to a single group of undertakings.[43] Therefore, the decision to display several brands of the same manufacturer lies with the manufacturer.

[43] MVBER, Articles 1 (1)(b) and 5(1)(a).

The issue is further complicated by the fact that even if brands belong to competing manufacturers there is no single definition of multi-branding and different surveys and reports treat the issue differently. In particular, multi-branding in new car retailing can refer to at least three different business models:[44]

- Selling different brands in **different locations** by the same dealer.
- Selling different brands in **different showrooms** on the same site.
- Selling different brands from the same site and within a **single showroom**.

The MVBER is particularly concerned with same showroom multi-branding and tries to promote specifically this type. In Article 1(1)(b) of MVBER, it is stated that a non-compete obligation is a direct or indirect provision which obliges the buyer to purchase more than 30% of its total purchases from the supplier. Since there is no distinction made between single and multiple showroom dealers, this implies that a manufacturer is not able to impose single-branding on single showroom dealers. Only the following obligation in relation to same showroom multi-branding is explicitly exempted from being a non-compete clause:

> *An obligation that the distributor sells motor vehicles from other suppliers in separate areas of the showroom in order to avoid confusion between the makes does not constitute a non-compete obligation for the purposes of this Regulation.*[45]

Already, an obligation to have brand-specific sales personnel is not allowed:

> *An obligation that the distributor have brand-specific sales personnel for different brands of motor vehicles constitutes a non-compete obligation for the purposes of this Regulation, unless the distributor decides to have brand-specific sales personnel and the supplier pays all the additional costs involved.*[46]

These provisions constitute a change in comparison to the former sector block exemption, Regulation 1475/1995. In this regulation also general non-compete obligation were exempted as long as they were restricted to the same showroom:

> *Article 3: The exemption shall also apply where the obligation referred to in Article 1 is combined with an obligation on the dealer: …*
>
> *(3) not to sell new motor vehicles offered by persons other than the manufacturer except on separate sales premises, under separate management, in the form of a distinct legal entity and in a manner which avoids confusion between makes;*[47]

Therefore, the introduction of the MVBER constituted a move to more detailed rules in relation to same showroom multi-branding. Thus, in the empirical analysis which examines the effects of the introduction of the MVBER in 2002, we naturally focus on same showroom multi-branding. However, under the VBER manufacturers are allowed to offer exclusive dealing contracts for less

[44] Staff Working Document No. 4, page 1.
[45] MVBER, Article 1(1)(b), 2nd phrase.
[46] MVBER, Article 1(1)(b), 3rd phrase.
[47] Regulation 1475/1995, Article 3 (3).

than 5 years (or minimum purchase requirements of 80% for a longer period of time). Manufacturers are consequently able to negotiate a contract that prevents their dealers from multi-branding of any type. However, as pointed out in Section 3.4, it is expected that in practice the main changes are likely to be found in the extent of same showroom multi-branding. Thus, in the following, if not stated otherwise, the term multi-branding will refer to its narrowest interpretation: the selling of brands from competing manufacturers from the same showroom.

4.2 Dealers' and manufacturers' inclination to multi-branding

This section investigates in detail the aspects which drive the decision to single- or multi-brand of the dealer and the manufacturer respectively. It thus tries to shed some light on the question whether we should expect a change in the extent of multi-branding following an adoption of the VBER from a theoretical point of view and in which circumstance we should expect such a change. In doing so, we should keep in mind that while the allocation of certain decision rights may affect the distribution of bargaining power within the bilateral negotiations between dealer and manufacturer, this fact alone does not necessarily imply that the extent of multi-branding is going to change following a change in the allocation of decision rights. However, it is likely that following a change in bargaining power, the distribution of rents from a bilateral relationship is going to shift in favour of the party with increased bargaining power.

Generally speaking there are a number of factors which are likely to affect the decision to multi-brand and which are common between the manufacturer and the dealer. However, some factors are decidedly distinct, in particular:

1. The decision of the manufacturer is to a large extent driven by negative externalities of multi-branding on the manufacturer's own brand (e.g. brand dilution, cannibalisation) whereas those negative externalities are not incorporated to the full extent in the decision of the dealer.

2. The decision of the dealer takes any potential economies of scope through multi-branding into account whereas the manufacturer does this only to a limited extent.

These two factors would suggest that the decision of the manufacturer is almost always different to the decision of the dealer. In situations where a continuous decision has to be taken, such as how many cars to display in a dealership or how to divide the space between brand x and brand y, this is certainly true. However, the relevant decision environment from the perspective of the MVBER is binary: whether to multi-brand or not. In a binary decision situation, there is no room for marginal disagreement. In a binary setting the decisions of both players are either completely aligned or completely opposite. Thus, in certain circumstances the decisions of both are going to be identical.

In the following, we discuss the general decision problem of an integrated entity together with the potential externalities on the manufacturer and the dealer resulting from multi-branding in the short run. We then relate those costs and externalities to the extent of spare capacity of a dealer. In the second part, we briefly discuss how the decision to multi-brand might affect the capacity extension decision of a dealer.

4.2.1 Factors driving multi-branding in the short run

An integrated entity would take a decision on multi-branding as to maximise the joint profits of the manufacturer and the dealer taking all costs and externalities on different phases of the supply chain into account. In contrast, in a separated environment dealers and manufacturers maximise their profits separately. Therefore, certain costs and externalities on the other party are not taken into account when deciding on multi-branding. In the following, we discuss those costs and externalities. For the moment, we assume a short run perspective where showroom capacity is given. We therefore naturally focus on same showroom multi-branding in this subsection.[48] Of course the decision to multi-brand could also go alongside the decision to expand current showroom capacity. We come to this point in subsection 4.2.2.

The **risk of cannibalisation**[49] is an important factor in both the decision of the dealer as well as the manufacturer. Often the introduction of a second brand does not simply increase volumes overall, but has negative effects on sales of the first brand. This is obviously a negative effect for the manufacturer. Therefore the manufacturer is going to be more reluctant to implement multi-branding the higher the risk of cannibalisation. The dealer on the other hand, is going to profit from higher sales on the second brand. For the dealer the relationship between the losses on the first brand weighted by the margin on the first brand and the gains on the second brand weighted by its margins is essential in its decision. In consequence, whether an increase in the risk of cannibalisation decreases the likelihood of multi-branding is ambiguous. However, since it is likely that the first brand has the better margins for the dealer, typically, the increase in the risk of cannibalisation is going to lead to a decrease in the likelihood of multi-branding.

Manufacturers are mainly concerned with **brand dilution**[50] through multi-branding. Any factor which weakens the brand strength can have significant impact on the price premium that customers are willing to pay. Such factors are therefore carefully avoided by manufacturers. The positioning of the brand next to another brand within the same showroom of a car dealer is considered to be a factor that adversely affects brand strength and therewith brand value. It is thus not surprising that manufacturers of cars are critical with respect to multi-branding. In comparison, dealers do not immediately care for the effects of multi-branding on the strength of the brand as they do not necessarily participate in the losses to the brand strength and if only to a limited extent. Dealers might not participate directly in the losses in brand strength as margins might in the short run not be determined by the car's selling price, however in the longer term also dealers might be affected by brand dilution. Intuitively, the stronger the brand is in the first place, the higher is the damage of brand dilution for the manufacturer and potentially also the dealer.

The **volatility of demand** (reflected in the volatility of turnover) of the incumbent brand can also be a factor in the dealer's decision to multi-brand. In a situation with high volatility of demand, the dealer might want to hedge its risks by introducing a second brand for which demand is less volatile or has different dynamics than the first brand. The higher the volatility of

[48] For dealers owning solely a single showroom, we therefore naturally focus on same showroom multi-branding in this subsection. In contrast dealers with several showrooms could also within this short run perspective engage in different showroom multi-branding. In this latter case, some decision factors are going to be more aligned between manufacturer and dealer: brand dilution in different showrooms is less of a concern for the manufacturer and economies of scope are less a concern for the dealer.

[49] See for example Competition Policy Newsletter Nr. 2 Summer 2006: Multi-brand distribution and access to repairer networks under MVBER 1400/2002: the experience of the BMW and General Motors cases" (page 35).

[50] For a detailed discussion on brand dilution, see Section 6.1.

demand, the more attractive the introduction of a second brand might be for the dealer. Again, a manufacturer would not take this consideration into account when deciding on multi-branding as it only affects the profitability of the dealer.

Potential **economies of scope**[51] through multi-branding increase the profitability of distribution. Increases in distribution profitability directly benefit the dealer. Therefore, a dealer is going to fully internalise the benefits of scope when taking its decision to multi-brand. In contrast, the manufacturer does not care directly for increased profitability of the dealer.[52] It would thus not incorporate those benefits in its decision to multi-brand. However, there are a couple of exceptions:

- Increases in profitability might be re-invested into the business: additional rents that the dealer can appropriate due to reduced unit costs might be used in order to invest in the quality of services at the outlet, e.g. more attractive reception area, more personnel, additional sales training for personnel etc. This increases the quality level of the outlet, which benefits the manufacturer of the incumbent brand as well as the manufacturer of the new brand. Thus, increases in profitability may also impact the manufacturer indirectly. Therefore, the manufacturer might take economies of scope into account, albeit to a lesser extent.

- In case a dealer is making losses and the exit of the dealer leads to a reduction in network density below the desired level of the manufacturer, the manufacturer might prefer to establish multi-branding in order to sustain the dealer in the market.

The above indicates that dealers and manufacturers respond differently to the existence of economies of scope: whereas dealers fully incorporate them in their decision, manufacturers do so to a lesser extent. That is unless dealers' profitability is sufficiently low that economies of scope are essential to keep them in the market, in which case also manufacturers are likely to fully incorporate the benefits of scope within their decision. However, there is evidence that economies of scope are rather limited, see Section 5.3.[53] This indicates that they might not play a major role in the decision to multi-brand for the dealer or the manufacturer.

Investment costs for a new brand generally decrease the profitability of introducing multi-branding. Thus, dealers' willingness to multi-brand is going to decrease with an increase in investment costs. However, investment costs in particular for some Asian brands can be relatively small.

Since manufacturers do not bear the investment costs, they do not take them into account when taking a decision on multi-branding. To the contrary, manufacturers might be concerned that additional investment in new brands might have negative externalities on recurring investments on behalf of the incumbent brand.

[51] Economies of scale are related to higher volumes of the same product whereas economics of scope capture economies which originate when the production of another product is taken up. Therefore multi-branding of a dealer can be considered an economy of scope rather than scale.

[52] Increases in profitability might also imply that the manufacturer would renegotiate the contract with the dealer to extract some of the increases in profitability from the dealer. To the extent that the manufacturer has bargaining power, it is eventually going to take increases in profitability into account. However, it is likely that such adjustment from the side of the manufacturer would only come with some time lack. Therefore, it is likely that the manufacturer would take increases in profitability into account only to a lesser extent than the dealer itself.

[53] In Section 5.3 we firstly summarise the types of potential economies of scope resulting from multi-branding and secondly display the empirical evidence.

Typically the introduction of a second brand of the same manufacturer (intra-branding instead of multi-branding) could be relatively more attractive to the dealer -from the point of view of investment costs- since the introduction of a brand of the same manufacturer typically involves lower levels of investment, in particular as brands of the same manufacturer are generally more compatible with each other.[54] However, even though a manufacturer would suffer less from cannibalisation when intra-branding as compared to multi-branding, evidence suggests that at least some manufacturers prefer multi-branding to intra-branding.[55] This is related to the negative impact of brand dilution on the manufacturer. In this context, it should be noted that manufacturers have the right to prohibit intra-branding within the MVBER.

Table 2 gives a summary on the impact of various factors on the dealer's and manufacturer's inclination to multi-branding.

Table 2: Inclination to multi-branding in the short run (showroom capacity fixed)

	Dealer's perspective	Manufacturer's perspective
Cannibalisation	The higher the risk of cannibalisation, the less attractive is multi-branding for the dealer due to high losses on the incumbent brand.	The higher the risk of cannibalisation, the higher the loss in sales due to multi-branding.
Brand dilution	Dealers care less about brand dilution as the benefits of the strength of a brand do not necessarily affect them to the same extent as it affects manufacturer.	The higher the risk of brand dilution, the higher is the loss in brand strength through multi-branding. Thus, the higher the risk of brand dilution, the less likely is multi-branding.
Volatility of demand	The higher the volatility of demand of the incumbent brand, the more willing the dealer will be to hedge its risks with a second brand.	The manufacturer is generally not concerned with the volatility of demand at the outlet level.
Economies of scope	The higher the economies of scope, the higher the profitability of a dealer through multi-branding. Economies of scope thus increase the likelihood to multi-brand.	Manufacturers are not concerned with the profitability of the dealer unless (1) it is so low that the dealer might exit the market (2) it affects the dealer's willingness to re-invest into higher quality.
Investment costs	The higher the investment costs in new brands, the lower the profitability of multi-branding and the less likely it becomes.	Generally, the manufacturer is not concerned with the investment costs. However, the higher the investment costs in new brands the more a manufacturer might be concerned with negative externalities on new investments for the existing brand.

Source: ESMT CA.

The above considerations can be summarised by examining the role of capacity utilisation. In the shorter run, demand determines the **capacity utilisation rate** of a dealer, an aspect which has significant impact on the decision to multi-brand: a single brand dealer with no spare capacity is less likely to engage in multi-branding than a single brand dealer with spare capacity. Contrary, the manufacturer generally does not care for the utilisation rate of the dealer unless profitability of the dealer becomes so low that network density is endangered. In the following, we show however that in many capacity utilisation settings both the decision of the manufacturer and the dealer are likely to be identical. Table 3 summarises the arguments.

[54] Information according to interview with representative of VW on 2nd of February 2009.

[55] For more detail, see Section 5.1.

Table 3: Role of capacity utilisation in the short run

	Comment	Dealer/manufacturer decision
No spare capacity	No economies of scope, additional investment for multi-branding	Likely same decisions: single –branding
Low levels of spare capacity	Risk of cannibalisation	Likely same decisions: single –branding
Medium levels of spare capacity	Increasing importance of cost considerations	Likely different decisions: dealer multi-branding, manufacturer single-branding
High levels of spare capacity	dealer existence endangered by low profitability	Likely same decisions: multi-branding

Source: ESMT CA.

In a situation with **no spare capacity**, it is likely that the single brand concept is more attractive to the dealer given that new brands require investment by the dealer and that with full capacity operation no economies of scope at the outlet level can be achieved. Thus, in this situation the dealer is likely to keep the single brand concept just as the manufacturer would.

In the presence of **spare capacity**, cost considerations suggest that an increase in the capacity utilisation is desirable for the dealer. The question is, first, whether a dealer wants to achieve a higher utilisation rate and, second, how it can achieve this goal.[56]

- **Low levels** of spare capacity: since there is the risk of cannibalisation if another brand is introduced, there might be degrees of underutilisation where refraining from multi-branding is optimal from the point of view of the dealer even if new brand investment costs are relatively low. In this situation again, the decision of the dealer would be the same as the decision of the manufacturer.

- **Medium levels** of spare capacity: with increasing degrees of underutilisation of capacity the dealer it more likely to prefer the introduction of another brand in order to increase volumes overall. Since the manufacturer does not care directly for the profitability of the dealer, it is likely that in these situations the decision of the manufacturer and the dealer would not coincide.

- **High levels** of spare capacity: with high levels of spare capacity the overall profitability of a dealer might be endangered. In this case the manufacturer might prefer a healthy dealer with a brand of a different manufacturer than no dealer at all. Thus, if it is necessary to introduce a second brand in order to sustain the dealership, then also the manufacturer might prefer a multi-branding dealership.

The above shows that there is a subset of situations in which the dealer and the manufacturer would take the same decisions on multi-branding. This is also supported by the statement of JAMA that their authorised dealers generally prefer single-branding to multi-branding.[57]

[56] We assume the marketing efforts and model mix of the single brand are optimal and that higher utilisation cannot be achieved with a single brand only.

[57] JAMA comments on MVBER, page 2.

These situations depend in particular on local demand. Demand in a given area can usually be characterised by factors such as **population density**, **economic wealth** and **strength of brand**. Thus, a dealer in a wealthy urban area that is distributing a strong brand is likely to have a high capacity utilisation rate and is going to have relatively little incentives to adopt a new brand of another or the same manufacturer. Thus, such a situation is likely to belong to the set of circumstances where dealer and manufacturer take the same decision. Also, a dealer in a relatively poor rural area with a weak brand is likely to need another brand in order to survive. Also, this situation is likely to belong to the set of situations where both dealer and manufacturer decide in the same way. This is supported by the fact that before and after the introduction of the MVBER, there existed multi-branding in particular in rural areas.[58] Furthermore, these arguments can also shed some light on why same showroom multi-branding has not increased as expected since the introduction of the MVBER.

4.2.2 Factors driving multi-branding in the long run

The multi-branding decision of a dealer might be connected to the question of capacity expansion, making multi-branding feasible or more attractive in the first place. Therefore, we briefly examine the feedback effects between the decision to expand capacity and to introduce multi-branding in this section. This is of particular importance to the evaluation of multi-branding since capacity expansion is a time consuming process.[59] Therefore, evaluating the changes since the introduction of the MVBER in 2002 until 2004 as in the LE report (2006) might turn out to be too short sighted. The following questions might be of importance:

1. Does the ability to multi-brand influence the decision to expand capacity?[60]

2. If the ability to multi-brand fosters capacity expansion, how does this affect future entry of dealers?

3. If the dealer chooses to expand capacity (partly) based on its ability to multi-brand, is this going to lead to significant higher levels of same showroom multi-branding?

With increasing demand and an increasing number of available models per brand, the dealer is faced with the decision to expand its capacity. The decision to expand capacity or enter a new region depends on many factors of the business environment and a detailed analysis of the expansion decision would be beyond the scope of this study. With respect to the **first question**, capacity expansion might in some cases only be feasible for the dealer if it is able to engage in multi-branding. Again, whether multi-branding facilitates expansion depends on the same characteristics as the decision to multi-brand with given capacity: brand dilution cannibalisation, the volatility of demand, economies of scope and investment costs. Thus, similar to the short run perspective, also in the long run a subset of decision situations will induce the same binary outcome irrespective of the allocation of decision rights.

[58] Information according to interview with representative of VW on 2 February 2009.

[59] See e.g. CECRA response, page 11: *"In such a complex and capital industry multibranding development takes time."*

[60] How the decision to invest in capacity expansion is influenced by the ability to multi-brand is similar in nature to the question how the decision to enter the market as a new dealer depends on the ability to multi-brand. However, the decision to enter is in particular influenced by the network density which in turn might be affected by the ability to multi-brand.

However, the capacity decision is in its nature different from the decision to multi-brand as it is not binary. Therefore, it is likely that the allocation of decision rights impacts the amount of capacity expansion envisaged by either the dealer or the manufacturer. However, since the capacity expansion decision is likely to be influenced by the contract for the incumbent brand which would be available to the dealer after the capacity expansion, it is likely that the extent of capacity extension is significantly influenced by the joint interest between dealer and manufacturer. However, the ability of the dealer to engage also in temporary multi-branding for a couple of years in order to "finance" still open capacities might influence the dealer to invest in a larger capacity expansion than if it did not have this right. Also the manufacturers would optimally require their dealers to invest into some extra capacity to account for an increasing portfolio of models. I.e. if Porsche expects to enter in the middle class segment in 3-5 years, it will likely require the dealers to build a larger showroom. However, if the dealer uses this spare capacity for multi-branding this undermines the manufacturer's optimal long-term strategy.

Furthermore, it should be noted that it is likely that the manufacturer can influence the capacity expansion plans depending on the cost of investment: the higher the costs of capacity expansion the more difficult it is for dealers to finance the investment and the more likely it is that they rely on financial support of manufacturers. This is for example supported by the fact that manufacturer owned outlets are more common in urban areas where capacity costs are high and therefore potentially too high for individual dealers. Therefore, everything else equal, the higher the cost of capacity expansion, the lower is the expected difference between the extent of multi-branding after the capacity expansion decision depending on whether the right to multi-brand lies with the dealer or not.

In order to examine the **second question** regarding the effects on network density and future entry of dealers, suppose that the ability of dealers to multi-brand does positively affect their decision to expand existing capacity. This implies that the average size of outlets is larger in a world where dealers are able to unilaterally decide on multi-branding than in a world where manufacturers have more power over the multi-branding decision. If the average size of outlets is large, then the number of outlets is going to be smaller. As an example take a given region with demand of four different brands for a 100 cars each. Multi-branding dealerships might bundle two brands each and sell a 100 cars of the respective brand. Therefore, there would be only room for two dealerships in total. In contrast exclusive dealerships would each sell hundred cars of a particular brand and there would be four dealerships in total. This example illustrates that network density overall might decrease due to the existence of multi-branding dealerships.

In contrast, multi-branding might increase network density per brand. Take the same example of demand for four brands of a 100 cars each. In a multi-branding world, each dealer might carry two brands and sell 50 cars of each. There would be four dealerships in total. Again in a single branding world, four dealers would sell 100 cars of one brand each. Thus, in this world multi-branding increases network density per brand leaving overall network density constant.

However, this world does not capture the long run as the average size of outlets is the same in both situations. If multi-branding does increase the average size of an outlet through a increasing the incentives to expand capacity, then network density is going to decrease. In our example world this effect would be captured as follows: with multi-branding dealerships there could be two dealerships selling the four brands at 50 cars each. Therefore, the size of a dealership would be 200 cars. In comparison to the situation with exclusive dealing where each of four dealers sells a single brand, the size of the dealership increased from 100 cars to 200 cars. At the same time, network density per brand increased as two dealers are carrying each brand in comparison

to just one. However, network density overall decreased from four dealerships to two dealerships.

As the above example illustrates, although multi-branding outlets might increase network density per brand, larger outlets are likely to reduce overall network density (in a steady state). Therefore, we would expect relatively low market entry in a world with high numbers of relatively large multi-branding dealerships.

Concerning the **third question** on the type of multi-branding in the long run: essentially, the dealer might choose between two types of capacity expansion: (1) it might expand a single showroom into a newer and bigger showroom (demolishing the older showroom) or (2) it might build a second showroom. When building a second showroom, it is likely that the dealer is going to separate brands by showroom: brand dilution might also have short and long term effects on the dealer albeit presumably to a lesser extent than on manufacturers. Still in the presence of brand dilution effects on the dealer, it is likely to separate brand according to showroom. For example, a BMW dealer might decide to build a new showroom for an enriched portfolio of BMW models. But instead of demolishing the old showroom, it might decide take another brand of another manufacturer into this showroom.

Ultimately, whether capacity expansion is going to be fostered by the ability to multi-brand and whether this is then going to lead to higher levels of same showroom multi-branding within a single enlarged showroom or higher levels of multi-branding from different showrooms is an empirical question which can only be answered with time and the appropriate data. However, we have so far not seen any clear evidence that capacity expansion is driven by the ability to engage in multi-branding. In particular, none of the affected parties has produced evidence that after the introduction of the previous sector regulation in 1995 capacity expansion accelerated due to the ability of dealers to engage in multi-branding in different showrooms.[61] Furthermore, no evidence has been produced so far that the fostering multi-branding at the showroom level since 2002 has lead to significant capacity increases. Of the affected parties only CECRA mentioned en-passant that the development of multi-branding needs time, hinting at the potential connection between capacity expansion and multi-branding.[62] This lack of evidence itself could be an indication that the ability to multi-brand is not the ultimate driver for capacity expansion.

4.3 Likely impact of MVBER on the evolution of multi-branding since 1997

In the following, we examine the evolution of multi-branding since 1997. Due to data limitation, a detailed assessment of the different types of multi-branding is impossible. However, it appears that even pre MVBER there have been non-negligible levels of multi-branding, both on the overall level as well as the same showroom level. This is consistent with the hypothesis that also manufacturers have an incentive to implement multi-branding in different circumstances. Furthermore, the evolution of multi-branding seems to a large extent be driven by factors external to the MVBER such as consolidation on the dealer level.

[61] The sector regulation in 1995 introduced the right for dealers to sell different brands in different showrooms (by a distinct legal entity and under separate management), see Commission Evaluation Report 2000, para. (272) and (273).

[62] See Cecra response to Commission Evaluation Report, page 11.

4.3.1 Evolution of multi-branding

As indicated in the introduction to this Section, the term "multi-branding" as used by the industry participants can have a number of different meanings. While in this study a focus is on the selling of brands from competing manufacturers in the same showroom, the available data on multi-branding is of rather poor quality and often does not explicitly state which types of multi-branding (different sites, same site different showrooms, different showroom) are being described and whether the multiple brands sold by a single dealer belong to the same manufacturer or not. Based on our interviews with selected manufacturers, it appears that many manufacturers do not systematically track the multi-branding status of their dealers. In particular, there appears to be no systematic information on the market as to which brands of different manufacturers are actually displayed together by a dealer.

Also data are limited as to the time frame for which data are available. The most comprehensive source of time trends on multi-branding can be found in the LE report (2006); here data are recorded since 1997 until 2004. Therefore, this data source only spans about two years after the introduction of the MVBER in 2002. This hampers the comparison of trends before the introduction in 2002 with trends thereafter significantly. Thus, any comparison between the pre MVBER period of 1997 to 2002 and the post MVBER period of 2003 to 2004 should only be interpreted with care and can merely serve as an indication. Furthermore, the European Car Distribution Handbook of HWB International Ltd. collects information on the ratio of exclusive outlets by brand and country. However, this statistic is only published for 2006 and 2007. Even a comparison between these two years would only lead to inconclusive results as the exclusivity data in 2007 is incomplete or missing for 10 out of 35 brands (BMW, Chrysler/Jeep, Dacia, Lancia, Mercedes Benz, Mini, Mitsubishi, Peugeot, Renault and Smart). We therefore abstracted from this exercise.

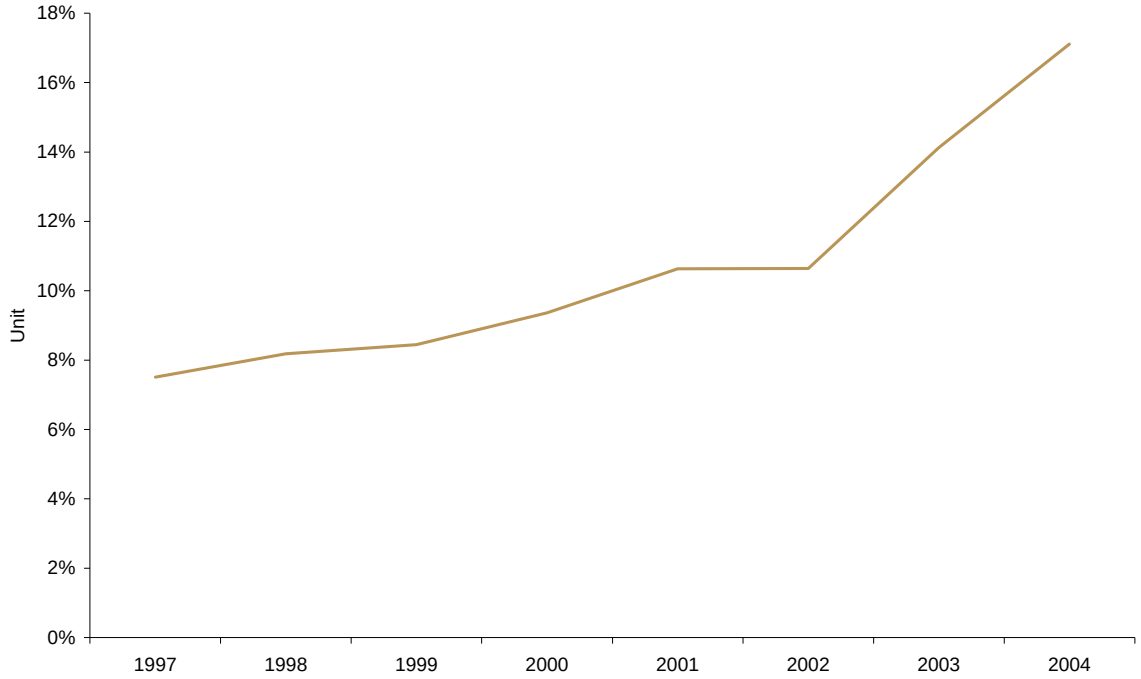
Despite the limited detail that available data provides, it appears that the following general statements on the evolution of multi-branding over the last years can be supported:

1. Multi-branding in its widest interpretation (i.e. including dealers that offer the competing brands at different sites) has increased since 1997. The increasing trend in this widely defined multi-branding started well before the coming into force of the MVBER. However, it appears that the growth of multi-branding has gathered some speed since the introduction of the MVBER in 2002.

2. When focusing on multi-branding (including intra-branding) within the same showroom there is a decreasing trend since 1997. This trend is not broken by the introduction of the MVBER in 2002.

Essentially all sources report that multi-branding overall (including all three types of multi-branding) has increased in recent years. The LE report (2006) shows the evolution of multi-branding for 12 European countries and 14 brands. They find that the proportion of overall multi-branding has increased from 7% in 1997 to 17% in 2004. Figure 1 depicts the trend of overall multi-branding as found in the LE report. In order to replicate the proportion of multi-branding dealerships, we have taken the (simple) average of the proportion of multi-brand dealerships by manufacturer as displayed in Figure 45 of LE report (2006).

Figure 1: Proportion of multi-branding dealerships (incl. all three types, 1997-2004)



Source: LE report (2006), simple average of Figure 45 based on manufacturer survey.

On the basis of a simple average over all 14 brands, we find that from 1997 to 2002 the proportion of multi-brand dealerships to single-brand dealerships increased from 7.5% to 10.6%. This implies an average annual growth rate of 7.2%. In comparison, from 2002 to 2004 the proportion of multi-brand to single-brand dealerships increased from 10.6% to 17.1%, equalling an average annual growth rate of 26.8%. Thus, there is evidence that after 2002 the growth of the proportion of multi-brand to single-brand dealerships accelerated. The commission concedes that the findings of LE are in line with their own inquiry.[63]

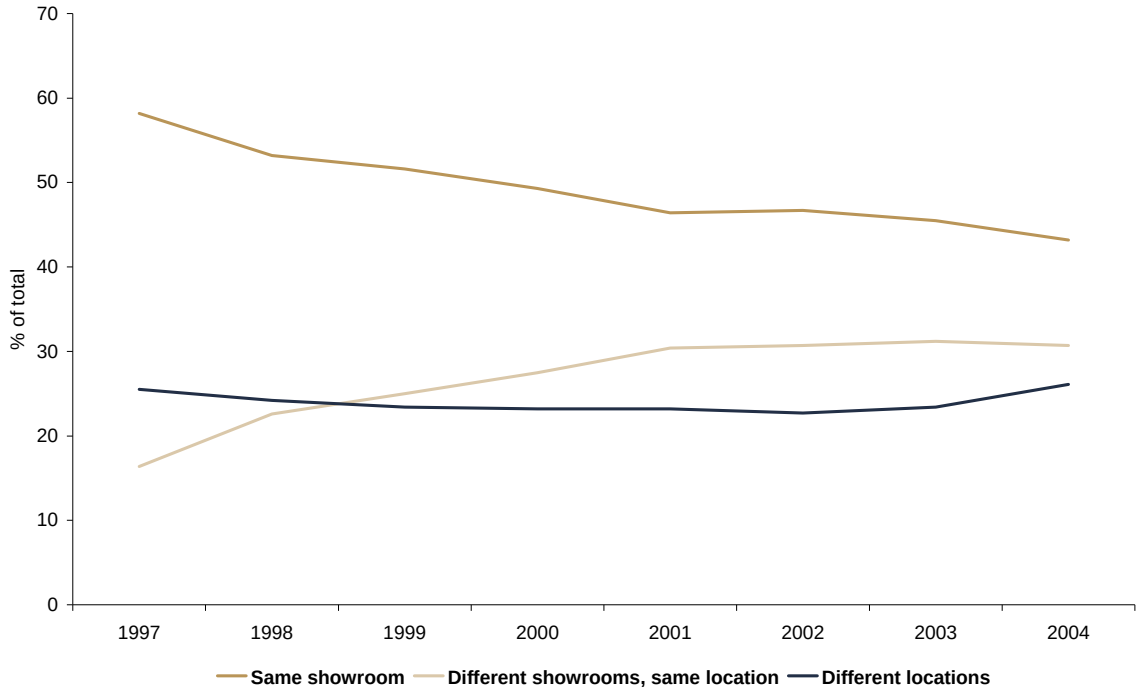
The above shows that the fraction of multi-brand dealerships has increased. However, at the same time it appears that the number of outlets as well as the number of dealerships decreased in absolute terms, reflecting among other things a rationalisation process at the outlet level and a concentration trend among dealers. Unfortunately, there appears to be no reliable information on the evolution of dealerships. Therefore, we explored the evolution of the number of outlets over time in order to shed some further light on the evolution of the absolute number of multi-branding dealerships. To this aim, we multiplied the proportion of multi-branding dealerships according to the LE manufacturer survey with the total number of outlets within the 27 European markets according to the European Car Distribution Handbook of HWB International Ltd. from 1998 to 2004. This indicates that there is also an increase in the total number of outlets which are generally multi-branding. However, the increase measured in terms of absolute number is significantly smaller than the increase measured in terms of the proportion of dealerships: from 1998 to 2002, the average annual increase in the absolute number of multi-branding outlets is 2.6%; this compares to a 6.8% average annual increase in the proportion of multi-branding dealerships. This growth accelerated from 2002 onwards: from 2002 to 2004, the average annual

[63] Staff working document No. 4, page 3.

increase in the absolute number of multi-branding outlets is 14%; this corresponds to a 26.8% average annual increase in the proportion of multi-branding dealerships.

While multi-branding overall seems to be on the rise, the LE report (2006) notices a decreasing trend of the same-showroom multi-branding (including intra-branding) relative to other types of multi-branding (including intra-branding), see Figure 2.[64]

Figure 2: Development of different types of multi-branding (incl. intra-branding, 1997-2004)



Note: includes intra-branding (i.e. selling different brands of the same manufacturer).

Source: LE report (2006), Figure 48 based on dealer survey.

The fraction of multi-brand dealerships selling different brands in the same showroom declined from 1997 to 2002 from 58.2% to 46.7%. This implies an average annual decrease of 4.3%. The introduction of MVBER did not reverse this trend. Under MVBER, from 2002 to 2004 the fraction further declined from 46.7% to 43.2%, which equals an average annual decrease of 3.8%. Thus, this indicates that the MVBER has not significantly impacted the decreasing trend of same showroom arrangements.

It has to be noted that due to the voluntary survey methodology it is likely that there is a bias towards larger dealerships within the sample.[65] This might impact on the proportion of the different types of multi-branding arrangements. However, as long as it does not impact the

[64] London Economics, 2006 report, Figure 48.

[65] It should be noted that within the dealer survey the reported overall figure for multi-branding dealerships is very high with 23%, see Figure 47 LE report (2006). This compares to a maximal multi-branding proportion of 17% within the manufacturer survey, see Figure 46 LE report (2006). The dealer survey figure is likely to be an overestimate of the actual number of multi-branding dealerships due to a selection bias resulting from the voluntary survey methodology: If there is a positive correlation between the size of a dealership and the probability of response to the survey, then large dealerships will be overrepresented in the sample. It can also be expected that larger dealer operations will be more likely to carry multiple brands (be it in different site, different showrooms or the same showroom). This can significantly skew the survey results in favour of multi-branding.

proportions differently in the different years, there is no reason to believe that the trend is influenced by the selection bias.[66]

On same showroom multi-branding, the European Car Distribution Handbook 2008 of HWB International comments that according to their observation this type of multi-branding is not increasing. However, due to poor data availability they do not publish statistics on those trends:

> *We do not attempt to record the trends in the number of Corporate Exclusive dealers (which would include Renault/Dacia or Fiat/Alfa Romeo etc dealers) that do not share showrooms with brands of competition corporations. We do not publish these results because the data are too often omitted from the returns from manufacturers – whether from ignorance or by policy. Similarly, most makes are unable to inform us of whether they operate branded used car programmes or fast-fits schemes. True multi-franchising (among competing corporations) does not appear to be rising, manufacturers preferring to shrink sales networks to make exclusivity affordable to dealers.*

4.3.2 Multi-branding decisions of manufacturers pre MVBER

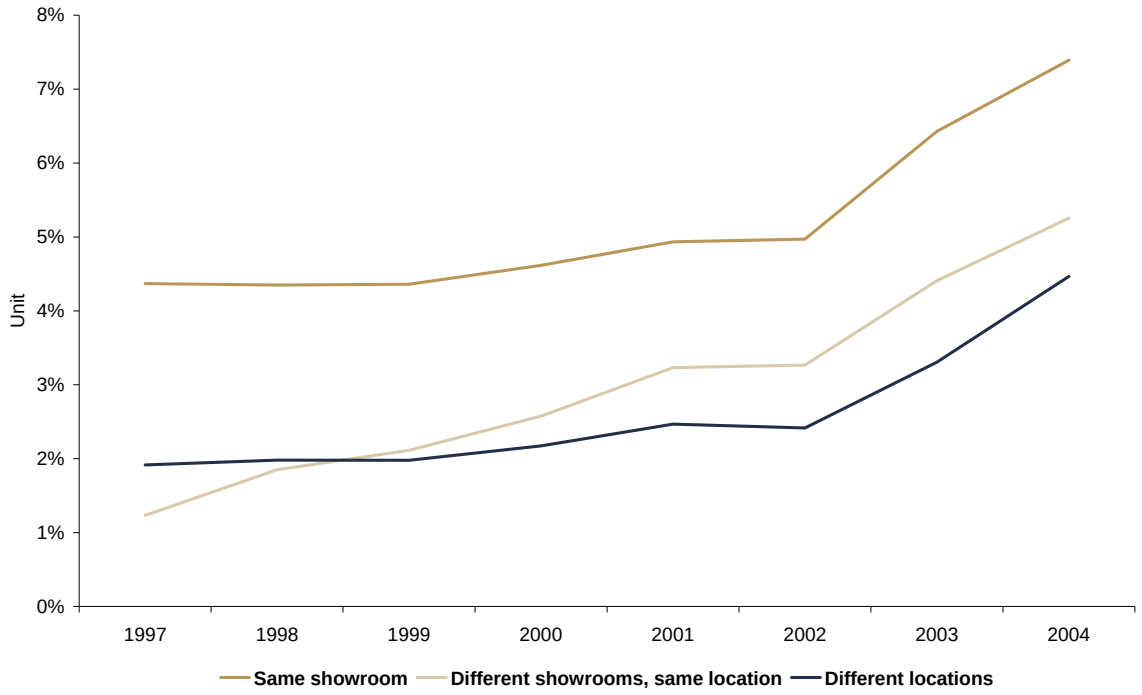
Figure 1 shows that between 1997 and 2002 the proportion of dealerships using multi-branding (including all three types) amounted to 7% - 11%. This indicates that in general multi-branding existed to a considerable amount even before the introduction of the MVBER in 2002. However, it has to be noted that the previous sector regulation exempted non-compete clauses on the level of the same showroom; however not on the level of different showrooms. Therefore a dealer could not be prevented by the manufacturer to engage in multi-branding at different sites or at the same site in different showrooms. Thus, Figure 1 can only serve as an indication, but not as evidence, for the existence of same showroom multi-branding.

The combination of Figure 1 and Figure 2 points to non-negligible levels of multi-branding within the same showroom well before the introduction of the MVBER in 2002. However, this cannot be said with confidence as the information on multi-branding on the same showroom as presented by London Economics might ultimately only represent intra-branding (i.e. multi-branding of brands from the same manufacturer). In order to shed some lights on the level of multi-branding in the same showroom, we multiplied the proportion of dealerships that multi-brand according to the LE manufacturer survey (as computed for Figure 1) with the proportion of same showroom multi-branding (including intra-branding) according to the LE dealer survey (Figure 2). This computation is flawed in particular since the manufacturer survey reports multi-branding excluding intra-branding, while the dealer survey includes multi-branding only.[67] Figure 3 shows the percentage of multi-branding dealerships computed in this way according to type.

[66] Of course these trends could also be driven by trends in intra-branding: a decrease in the extent of intra-branding at the same showroom could potentially hide a potential increase in the extent of multi-branding at the same showroom level.

[67] The computation essentially assumes that the distribution of multi-branding arrangements equals the distribution of intra-branding arrangements.

Figure 3: Approximated proportion of multi-branding dealerships by type (1997-2004)



Note: simple average of Figure 45 based on manufacturer survey multiplied by percentage of different types of multi-branding (including intra-branding) according to dealer survey.
Source: LE report (2006), ESMT CA.

This computation shows that between 1997 and 2002 the proportion of same showroom dealerships amounted to approximately 4-5% of total dealerships, or about half of multi-branding dealers were implementing the multi-branding within the same showroom. However, this can only be interpreted as approximation, since it might include intra-branding to some extent.

4.3.3 External factors driving the evolution of multi-branding

The Commission Evaluation Report states that dealers have not taken up the new opportunities regarding multi-branding within the same showroom and finds that:

> *[T]he sector-specific rules on multi-branding have not been fully effective.*[68]

Furthermore, the report concedes that the main drivers behind the evolution of multi-branding (including all three types) are found beyond the sector specific regulation:

> *[I]t is clear that the main driver behind multi-brand sales has been external market developments.*

Figure 3 shows an approximation of the proportion of dealerships which engage in the three different types of multi-branding. The figure displays slight increases in multi-branding of all three types from 1997 to 2002; same showroom and different locations multi-branding display a relatively similar trend whereas in increase in different showroom same location multi-branding

[68] Commision Evaluation Report, Section IIIA.

was slightly more pronounced than the increase of the other two types. The graph indicated that from 2002 onwards all three types of multi-branding experienced a similar kind of increase, slightly steeper than in the period preceding the introduction of the MVBER. Since the MVBER shifted decision rights to the manufacturer only for same showroom multi-branding (whereas for the other two types the decision rights were already with the dealer since the previous sector regulation), this can serve as a first indication that external factors might have driven the evolution of multi-branding.

In particular, two factors might have contributed to a significant extent to the increase of multi-branding of all three types: first, there has been a trend to decrease network density accompanied by an increase in the size of outlets, and second, there has been considerable consolidation activity on the dealer level.

The LE report (2006) finds that in almost all analysed countries the average **network density** -as measured by average number of outlets per 1,000 inhabitants- decreased between the period of 1997 to 2002 and the period from 2003 to 2004.[69] As already indicated this trend is accompanied by an **increase in the average size of dealers**. The LE report (2006) finds that on average the unit sales per outlet increased by about 59% from 1997 to 2004.[70] Furthermore, the report finds that the decrease in the number of outlets is more than compensated by the increase in turnover on outlet level. Therefore, the contracting of the network density is not induced by decreases in demand. This indicates that the movement to fewer bigger dealers is a deliberate movement initiated by manufacturers and/or dealers.

It is also stated that in most countries the total number of franchised outlets remained more or less the same between 1997 and 2000. From 2001 onwards, the total number of outlets started to decrease significantly.[71] This is an indication that a rationalisation process which reduced the number of total outlets but increased the average throughput was initialised about two years before the MVBER came into force. It might be argued that manufacturers anticipated the MVBER and realised that termination of contracts under the MVBER would become significantly more difficult; in consequence they terminated the contracts well before. This would explain why we observe a decrease in the number of dealers across countries in particular in the years preceding the MVBER. However, it would not imply that there is a causal connection of the reason for the rationalisation and the provisions of the MVBER. Instead, the LE report (2006) points out that this rationalisation process started at different times in different countries. For example, in the UK the rationalisation process started in the 1980s. Thus, there is no significant reduction observed in the period from 1997 to 2004. In other countries such as Austria, Greece, Portugal or Spain the process started only about 2003/2004. This heterogeneity in the individual developments in different countries indicates that this process is likely unrelated to the MVBER.

With respect to multi-branding, it is likely that in order to profitably operate a larger dealer outlet, it is necessary that the dealer implements multi-branding even at the same showroom level. This evolution may therefore explain part of the increase in same showroom multi-branding.

In particular multi-branding at different sites, but certainly also to some extent multi-branding at different showrooms at the same site, is likely to be driven by **mergers or takeover activity**

[69] LE report (2006), Figure 21, the exception forms Estonia.

[70] LE report (2006), Figure 25.

[71] LE report (2006), Figure 22.

at the dealer level. The consolidation at the dealer level and the emergence of dealer groups owning multiple sales outlets selling multiple brands is well documented.[72] On the one hand, concentration could bring efficiencies in the form of synergies and cost savings. However, as shown in Section 5.3 evidence on actual efficiencies of scale does not support the existence of significant efficiencies. On the other hand, this concentration process could potentially lead to increasing dealer's market power at a local level with potential adverse effects on competition and consumers in the form of higher prices.

4.4 Summary on the expected change in multi-branding

The previous analysis shows that there is a subset of situations where theoretically dealers and manufacturers are taking the same decision with regard to multi-branding in the short run. The likelihood of identical decisions between manufacturers varies with the extent of capacity utilisation:

- With no spare capacity as well as low levels of spare capacity, both manufacturer and dealer are likely to abstain from multi-branding.

- With increasing degrees of underutilisation of capacity the dealer is more likely to prefer the introduction of another brand whereas the manufacturer is not; it is likely that in these situations the decision of the manufacturer and the dealer would not coincide.

- Finally, with very high levels of spare capacity dealer and manufacturer would choose to introduce multi-branding in order to increase overall profitability of the dealer.

In the longer run, there are indications that the decision of capacity expansion by the dealer is among other factors influenced by the manufacturer. Therefore, to a large extent the decision to enlarge capacity might be independent of the ability of the dealer to multi-brand. However, to what extent the capacity expansion decision might be fostered by the ability to multi-brand is an empirical question which can only be answered with time and the appropriate data. However, we have so far not seen any clear evidence that capacity expansion is driven by the ability to engage in multi-branding. This lack of evidence itself could be an indication that the ability to multi-brand is not the ultimate driver for capacity expansion.

There are several types of multi-branding. The MVBER in comparison to the preceding sector regulation stipulated same showroom multi-branding (of brands from different manufacturers). Its predecessor allowed for restrictions on same showroom multi-branding, but not on different showroom multi-branding. The hypothesis that there is a subset of situation where the multi-branding decision of the manufacturer and the dealer coincide is supported by evidence prior and post MVBER:

- Same showroom multi-branding is likely to have existed to a significant extent prior to the MVBER.

[72] See e.g. LE report (2006), Section 2.3.3.

- There are indications that the relative importance of same showroom multi-branding in relation to all types of multi-branding decreased since 1997.

- The proportion of same showroom multi-branding dealers on all dealers increased since 2002. However, the increase is similar to increases of different showroom multi-branding.

The evidence thus suggests that the extent of multi-branding is partly independent of the allocation of certain decision rights over multi-branding. Therefore, the change expected with a move to the VBER from the MVBER in relation to multi-branding is considered limited.

5. Pro-competitive effects of multi-branding

In the previous section we have described in detail possible definitions and various types of multi-branding, have analysed incentives of both manufacturers and dealers to engage in multi-branding and described situations in which incentives of the two parties coincide with each other or diverge. Finally, we have characterised the likely impact of MVBER on the evolution of multi-branding since 1997.

Having assessed the impact of MVBER on multi-branding, in this and the two following sections we will take the analysis one step further and will analyse the welfare implications of multi-branding. In this section we focus on the potential pro-competitive benefits of multi-branding. We describe them theoretically and provide supporting evidence to empirically evaluate their magnitude. The next section focuses on possible anti-competitive effects of multi-branding and then the following section attempts to balance both the pro-competitive and anti-competitive effects to asses the overall impact of multi-branding on consumer welfare.

The three main efficiency justifications of multi-branding listed in the literature are:

- Preventing foreclosure.
- Lowering search costs of the consumers.
- Achieving economies of scope by sharing overhead costs among multiple brands.

Foreclosure appears to be the most important one. It is also the only of the three listed explicitly in the MVBER regulation.[73] So while we address all three factors, our analysis primarily focuses on foreclosure.

5.1 Preventing foreclosure

Market foreclosure refers to practices of a dominant player which prevent entry or expansion into the relevant market. In the following, we are going to present arguments in relation to the foreclosure effect of exclusive dealing in the automotive industry. However, this chapter does not intend to identify the relevant antitrust markets across Europe. Such an exercise is well beyond the scope of the study. It is likely that such markets differ in many respects and cannot simply be summarised on national and or segment level. This has been confirmed in an empirical study by Verboven dedicated to the topic of defining relevant anti-trust markets:

[73] Recital 29 of MVBER: "*In addition, specific conditions are required to exclude certain restrictions, sometimes imposed in the context of a selective distribution system, from the scope of the exemption. This applies in particular to obligations which have the effect of preventing the members of a selective distribution system from selling the brands of particular competing suppliers, which could easily lead to foreclosure of certain brands.*"

> *[A] meaningful competitive assessment of the passenger car sector cannot rely on the assumption that there is a sole relevant market in which all cars compete throughout the EU on equal basis.*[74]

In the following, we are going to present most results based on the practice of the Commission assuming an overall national market for passenger cars which is not segmented according to different types of car. However, we are going to complement this exercise by a more conservative approach using indicators on the national segment level. Where appropriate, we are going to present the summary results in the main body of the text and show the details in appendices.

This section starts with a short exposition of the theory. This is followed by an analysis of the ability and the incentive of manufacturers to engage in foreclosure. The fourth part aims at quantifying a potential foreclosure effect and the fifth part presents some qualitative arguments.

5.1.1 Economic theory of foreclosure

The term **market foreclosure** describes commercial practices that reduce the buyer's access to a supplier (so called *upstream foreclosure*) or conversely limit the supplier's access to a buyer (so called *downstream foreclosure*). There are many different tools that can result in market foreclosure. One such possibility arises when a supplier signs exclusive dealing or a non-compete clause with his buyers or distributors. Such an arrangement effectively removes the tied buyers from the market and reduces market opportunities of competing suppliers.

Exclusive dealing may create first mover advantages and increase entry costs for new competitors as those have to build their own distribution networks. Theoretically, the Chicago School of thought would argue that dealers would not find it profitable to sign an exclusive dealing contract when potentially more efficient firms might enter the market. However, Segal and Whinston (2000)[75] show that it may be individually rational for each dealer to sign an exclusive dealing contract, even if it is not optimal for them jointly. This theory hinges on two assumptions: (1) dealers cannot coordinate and (2) no single dealer is sufficiently large to ensure market entry of a new supplier.

Historically, the position of European car manufacturers has been strong in their home countries, supporting the idea of a first mover advantage. However, in order to empirically test whether exclusive dealing in the car industry has been able to foreclose entry, further considerations are required. In particular, there the manufacturers' ability and incentive to foreclose require additional examination. This is considered in the following two sections.

5.1.2 Manufacturer's ability to foreclose: market shares

A manufacturer's ability to foreclose is carefully discussed in the Guidelines on Vertical Restraints and the *de minimis* rule[76] and is closely related to the manufacturer's market share. If the market share tied with an exclusive obligation is low, the foreclosure effect is unlikely. This

[74] Frank Verboven "Quantitative Study to Define the Relevant Market in the Passenger Car Sector", 17 September 2002.

[75] Segal and Whinston (2000): "Naked Exclusion: Comment", American Economic Review, 90, 296-309.

[76] The de minimis rule is a common term for the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (Official Journal C 368 , 22/12/2001 P. 0013 – 0015).

is reflected in point 8 of the *de minimis* notice, which exempts exclusive obligations of suppliers whose market share of sales does not exceed 5%. This reasoning was applied by the Commission in its Porsche decision, which even under the current MVBER essentially allowed Porsche to establish a single-branded, exclusive retail network based on the fact that in no country Porsche's market share exceeded 5%.[77]

However, even if no single manufacturer enjoys a market share large enough to allow it to foreclose a significant fraction of the market unilaterally, foreclosure effects can nonetheless take place if there is a cumulative effect. It takes place when a number of major suppliers enter into similar non-compete contracts with a large number of buyers.[78] According to the Guidelines, when all companies have market shares below 30% a cumulative foreclosure effect is unlikely if the total tied market share is less than 40%.[79] Additionally, if the market share of the largest supplier is below 30% and the aggregate market share of the five largest suppliers (CR5) is below 50%, the foreclosure effect, individual or cumulative, is also unlikely.

As of 2008 the market share of the largest supplier, calculated on a **pan-European** basis, (Volkswagen/Porsche) is about 20% and the cumulative share of the five largest suppliers (Volkswagen/Porsche, PSA, Ford, General Motors and Renault) is about 61%. So, if we take the market definition by the European Commission, the concentration of the new car market as measured by CR5 is only about 11 percentage points above a threshold that would rule out foreclosure, individual or cumulative, according to the Guidelines on Vertical Restraints.[80]

The (volume) weighted average market share of the largest manufacturer on a **national level** amounts to 26.8%. The CR5 measures are slightly higher on a national than on a pan-European level. The (volume) weighted average for 27 European Union countries is 69.8%.[81] The highest concentration, 81.6%, has been found in Malta and the lowest, 55.0%, in Lithuania. Some of the largest markets have concentrations relatively close to the average: 72.4% for Germany, 70.6% for Italy and 65.0% for the UK.[82]

Additionally, according to the Guidelines, possible negative effects of vertical restraints can be reinforced when multiple suppliers organise their distribution networks in the same way.[83] The Commission was concerned about this effect in the automotive industry and hence one of the goals of the current MVBER was to increase diversity of existing distribution systems. However, the MVBER has not achieved this goal. Just as under the previous MVBER nearly all manufacturers chose to organise their networks as a combination of exclusive and selective distribution. Under the current MVBER the dominant preferred choice of the manufacturers is quantitative selective distribution.[84]

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[77] Porsche decision (IP/04/585); "*In line with the general "de minimis" rules, Porsche may ask its dealers to sell other competing car brands in separate showrooms and by separate sales personnel or not to open secondary outlets even after the exemption of so called "location clauses" for dealers will run out on 30 September 2005.*"

[78] Guidelines on Vertical Restraints, Paragraph 142.

[79] Guidelines on Vertical Restraints, Paragraph 149.

[80] On the pan-European segment level, the (volume) weighted average market share of the largest manufacturer amounts to 24.4%. The (volume) weighted average for the C5 is 72.7%.

[81] The unweighted average amounts to 66.8%.

[82] On the national segment level, the (volume) weighted average market share of the largest manufacturer amounts to 31%. The (volume) weighted average for the C5 is 78.9%.

[83] Guidelines on Vertical Restraints, Paragraph 119(7).

[84] Commission's report, Section III(B).

However, the uniformity of distribution systems under different regimes also strongly suggests that suppliers choose the most efficient distribution system available to them within a legal framework of existing regulation. In the situation of strong inter-brand competition, the goal of forcefully imposing different distribution systems on different networks amounts to unnecessary over-regulation, which is likely to lead to inefficiencies.

To summarise, in the context of the automotive industry, if we take the market definition approach of the European Commission at face value only in a few exceptional cases manufacturers have market shares above 30%, so generally a finding that individually they can tie-up a fraction of the market large enough to have a significant foreclosure effect seems unlikely. The only possible foreclosure effect comes from the cumulative actions of multiple manufacturers with market shares over 5% each.[85] There are a few countries where the concentration measure C5 is significantly above the threshold level of 50%. Therefore collective foreclosure cannot be excluded entirely.[86]

5.1.3 Manufacturer's incentive to foreclose: level of inter-brand competition

The manufacturer's incentive to foreclose depends on the existing level of inter-brand competition. If the inter-brand competition is intense, most of the profits are competed away and there are no significant incentives to foreclose. Thus, in this section, we look at the level of current inter-brand competition. The London Economics' 2006 report describes the market for sales of new cars as

> *The European market for sales of new cars is a highly competitive market. Vehicle manufacturers compete actively for their market shares, and real prices show a slight downward trend. This is clearly to the benefit of consumers and appears to reflect the workings of strong competitive forces.*

Furthermore, the evaluation report of the Commission examines the actual level of competition on the inter-brand level, finding a general increase in the competitive pressure. The report examines the market concentration, volatility of market shares, market entry, R&D investments, price trends and the evolution of manufacturers' operating margin.[87]

In the following, we report, comment and expand the available information on those indicators. The overall picture confirms that inter-brand competition is intense and has increased over recent years.

5.1.3.1 Market concentration and volatility of market shares

In terms of market concentration the Commission finds that "*…the EU market for passenger cars has become less concentrated since 2002*"[88] as on the basis of pan-European market shares the Concentration Ratio CR4 (the share of the four largest manufacturers) declined from 57% (or 54%

[85] Based on the *de minimis* rule and confirmed in the Porsche decision, manufacturers with market shares under 5% will be unaffected by the change to VBER, since they can operate brand exclusive outlets even under the current MVBER regulation.

[86] Note, however, that such assessments depend crucially on the definition of the relevant market on which concentration is measured. As we report elsewhere, markets may also be analysed on the level of segments in a country.

[87] Staff working document No. 2, page 8ff.

[88] Staff working document No. 2, page 10.

according to ACEA) in 2002 to 54% (or 52% according to ACEA) in 2006. On the basis of average country-specific market shares, the CR4 declined by 2.8% from 2002 to 2006.

Decreased concentration is confirmed in Figure 4, which illustrates the evolution over time of the Herfindahl-Hirschman Index (HHI) for the car industry on a national level.[89] The HHI is a concentration measure of the industry that takes into account the relative size of the individual market participants as opposed to absolute concentration measure like CR3 or CR4.[90] In the first decade of the XXI century there were quite a few changes in brand ownership and industry structure. In order to make comparisons over time meaningful, the index is calculated based on recent ownership (January 2009) structure of brands in the industry applied retroactively to all previous years. In general, the brands have been allocated to manufacturers based on the list of manufacturers provided by the International Organization of Motor Vehicle Manufacturers (Organisation Internationale des Constructeurs d'Automobiles, OICA)[91], with the exception that Kia and Hyundai brands have been assigned to Hyundai, and all Volkswagen brands have been assigned to Porsche.[92] Also, some of the smallest brands (selling below 10,000 cars per year in 2008) have been aggregated together. The effect of these additional aggregations has slightly increased the values of the concentration index as compared to calculations based on the original OICA classification.

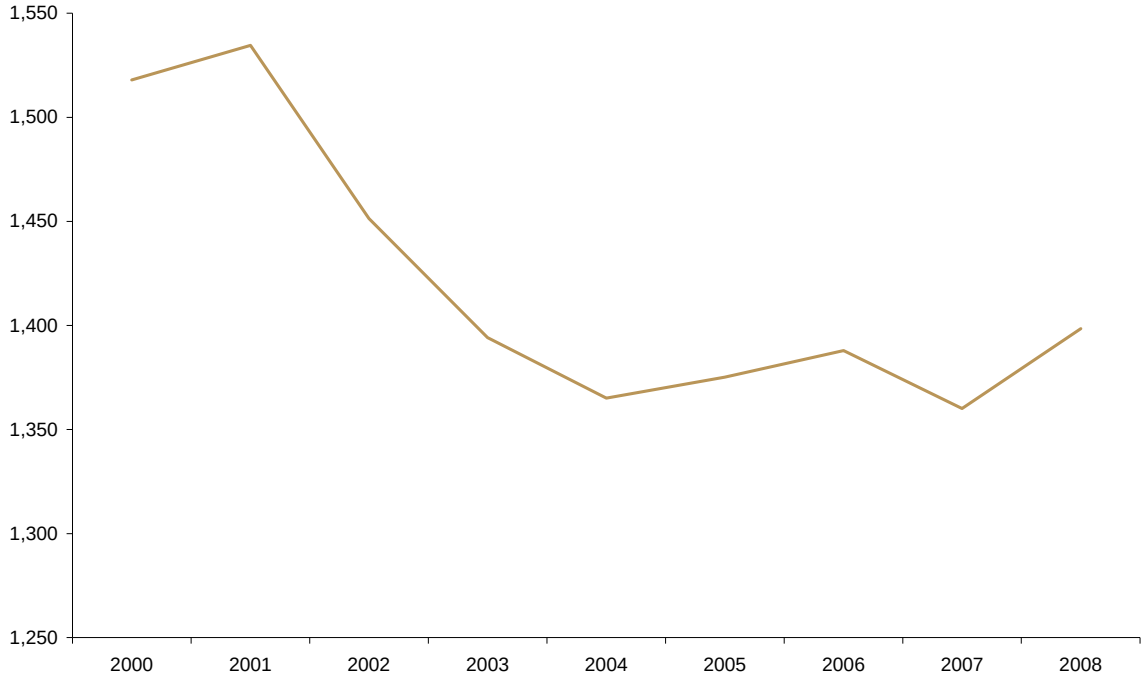
[89] The graph is based on MAPIS data which is an internal data source of Daimler AG, compiled by the market intelligence unit of Daimler. The data we received is at the model (series) level. For each car model (e.g. VW Phaeton), the following information is available: (1) model brand (Volkswagen), (2) EU segment (A, B, C, etc.) to which the model belongs, (3) more detailed than EU segmentation (e.g. A-segment is further divided into "standard micro car" and "premium micro car", G-segment is split into 6 sub-segments), while there are 10 EU segments, there are over 40 more detailed segments, this segmentation was not used within the analysis, (4) volume of sales of the model in each country (all 27 EU countries + Switzerland and Norway) and each year from 2000 to 2008. In the report, the MAPIS data is used to calculate descriptive statistics of the market such as HHIs, C5, market share volatility as well as to extend the multi-branding analysis of Section 5.1.4 to the segment level.

[90] The HHI is calculated by summing the squares of the market shares of each individual firm. It can range from 0 to 10,000 where 0 indicates a highly fragmented market where each market participant has got a minimal market share and 10,000 represents the monopoly situation. Thus, a higher HHI represents a more concentrated market structure and can be seen as an indicator of a higher level of market power. It shows the volume weighted averages of the national HHIs over 27 countries.

[91] Available online at: http://oica.net/wp-content/uploads/world-ranking-2007.pdf.

[92] Kia Motors is a subsidiary of Hyundai motors and as of January 2009 Porsche owns a majority stake in Volkswagen Group.

Figure 4: (Weighted average) HHI in the car industry (national level, 2000-2008)



Note: Brand ownership structure as of January 2009; average of 27 countries weighted with sales volumes.

Source: MAPIS data, ESMT CA.

As can be seen from the graph, the value of the index has slightly declined at the beginning of the decade and currently fluctuates around 1350-1400. This is consistent with a moderately concentrated market (with HHI in the 1000-2000 range).[93] The weighted average HHI decreased from 1,451 in 2000 to 1,398 in 2008. For more detail on the country level industry-wide HHIs, see Appendix A2.1. Concentration indices increase if computed on the level of segments within a country which represents the narrowest possible cut of the available data. However, even then HHI stay on average below the 2,000 threshold. On segment and country level, the weighted average HHI decreased from 2,003 in 2000 to 1,849 in 2008.[94] Furthermore, assuming a wider geographic market reduces the levels of concentration further.[95]

In terms of **volatility of market shares** the Commission finds that incumbents' market shares have been sufficiently volatile to "point to competitive pressures".[96] Furthermore, in most national markets incumbents lead the market by only a small gap in market share to their successor. Furthermore, the Commission finds that "*no manufacturer enjoys market power*"[97] as the European-wide largest manufacturer Volkswagen had a market share of 20% in 2006, followed by Peugeot SA (13%).[98]

[93] "Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings", Official Journal C 031 , 05/02/2004 P. 0005 – 0018, paragraphs 19 and 20.

[94] For an analysis on segment level see Appendix A2.2.

[95] For an analysis of HHI on a pan-European industry level, see Appendix A2.1 and for an analysis on pan-European segment level see Appendix A2.2.

[96] Staff working document No. 2, page 10.

[97] Staff working document No. 2, page 9.

[98] Market shares according to the Commission working document No. 2.

To further assess the volatility of market shares over time for each manufacturer we have calculated the coefficient of variation of their market shares. The coefficient of variation is a common dimensionless and normalised measure of dispersion defined as the ratio of standard deviation and the average market share. The weighted average coefficient of variation for the 21 manufacturers on a national level is equal to 13%.[99] One interpretation of that number is that between 2000 and 2008 on average the national market share of a manufacturer differed by 13% from its long term mean. In comparison, weighted average coefficients on the level of national segments is equal to 25%. The weighted coefficients of variation in this level vary from around 20% to around 36%.[100] Coefficients are reduced when the geographic scope of the market is broadened to the European level. For example, the weighted average coefficient of variation industry-wide is then about 9%, thus 4 percentage points lower than the national equivalent.[101]

The largest coefficients of variation belong to the manufacturers with relatively small sale volumes: Ssangyong (84%), Isuzu (57%) and Avtovaz (51%). There are at least two reasons for that. First, as these manufacturers have expanded their European sales, their market share has increased which accounts for higher variability of their market share than that of some of the incumbent manufacturers. Second, because the denominator in the coefficient of variation is close to zero for the low volume manufacturers, the measure is more sensitive to small changes in these instances. The smallest value of the coefficient of variation has been found for Porsche/Volkswagen (6%), Ford (7%) and Daimler and Peugeot (9% both). For more detail on the country level industry-wide volatility, see Appendix A2.3.

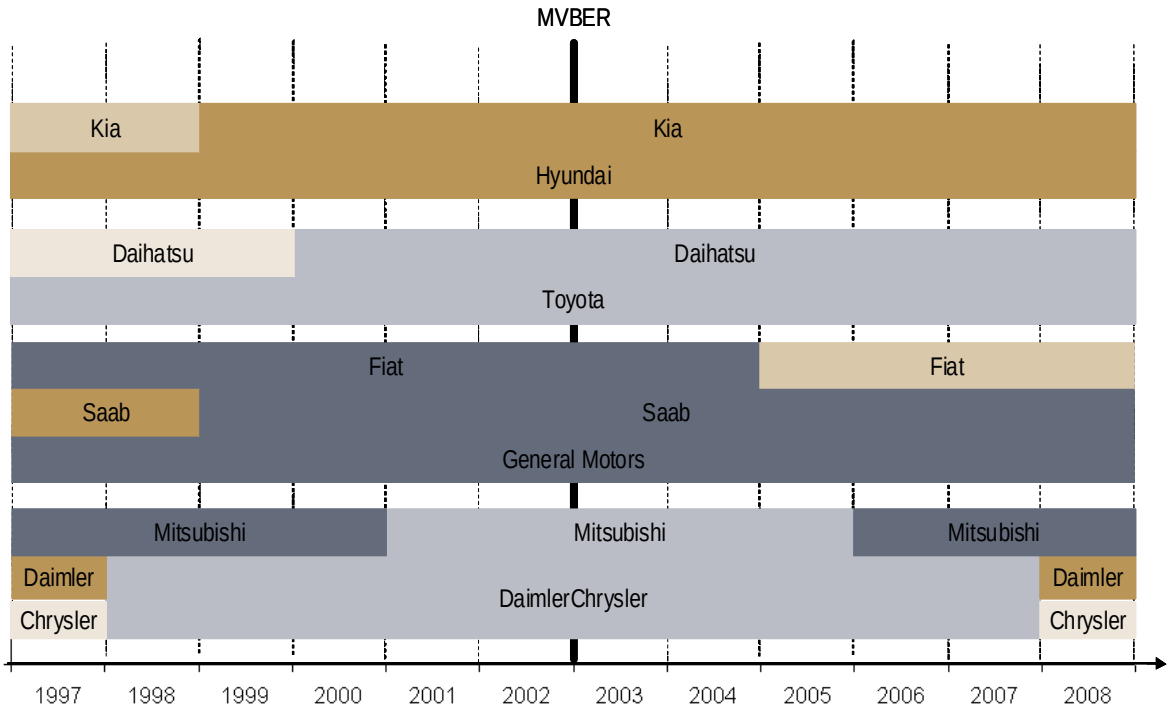
Further analysis reveals that the legislative process of the current MVBER has been set against a backdrop of a significant **consolidation trend among carmakers**. Figure 5 shows a timeline displaying major ownership changes, mergers and divestitures since 1997.

[99] For this analysis, annual market shares of each manufacturer are calculated for each country and each year from 2000 to 2008. We dropped years at the beginning of the time series as well as at the end if those years for which sales were consecutively zero. Then for each manufacturer the coefficient of variation is calculated as the ratio of standard deviation over the mean. This gives us a total of 21 (manufacturers) times 27 (countries) coefficients, i.e. 567. The weighting process then proceeds in two stages: (1) in order to generate the weighted average coefficient of variation for each country, the coefficients are weighted by manufacturers' average sales volume in that country over the 9 years (for the results on country level see Appendix A2.3 and (2) the weighted averages for countries are then again weighted by the average total sales volumes of this country over the nine years.

[100] For an analysis of volatility on segment level see Appendix A2.4.

[101] For further analysis, see Appendix A2.3 and Appendix A2.4.

Figure 5: Timeline of consolidation and divestiture (1997-2008)



Source: Internet resources, ESMT CA

As can be seen, at the time of the introduction of the current MVBER, consolidation was on the advance. In particular, there were the acquisition by Volkswagen of Skoda and Seat in the early 1990's, the Daimler-Chrysler merger in 1998 and the Nissan Renault alliance in 1999. Additionally, around that time a number of companies acquired significant stakes in Asian and European carmakers: General Motors invested in Fiat, Daewoo, Saab, Subaru and Suzuki; Ford invested in Mazda and Volvo; Toyota became a majority owner in Daihatsu in 1999 and DaimlerChrysler acquired a significant, controlling stake in Mitsubishi in 2001. At that time, there could have been legitimate concerns about the intensity of intra-brand competition in the market if these trends continued.

Since then the trend to consolidate has been partially reversed. Faced with economic difficulties and cash flow problems the American manufacturers have sold or are in a process of selling their non-core brands. Daimler-Chrysler has sold off its stake in Mitsubishi in 2005 and two years later the unsuccessful merger of the two companies was unwound. Amid the recent crisis in the industry there are prospects of new alliances. However, it is not obvious that these alliances will change the number of groups active in Europe. While a Chrysler/Fiat partnership would reduce the number of groups an Opel/Fiat alliance (if seen in isolation) would not and a take-over of Opel by a financial investor could increase the number of groups. The recently announced merger of Volkswagen and Porsche would reduce the number of groups but only affect competition in the upper market segments.

However, the MVBER regulation does not concern itself directly with the horizontal structure of manufacturing in the automotive industry and consolidation trends in the industry are driven primarily by the outside economic and financial factors and largely independent of the provisions of the MVBER.

5.1.3.2 Market entry and expansion

Japanese and South Korean car manufacturers have successfully entered and expanded since 2002. The following list briefly characterises other, smaller Indian, Chinese and other Asian brands which have also practically explored entering the European market.

- **SsangYong:** Korean manufacturer SsangYong, a subsidiary of Chinese SAIC, has sold almost 12.000 cars in the EU in 2008, out of which over 7.000 were SUVs. To put this number in perspective, its sales in the SUVs segment were nearly equal to Dodge's (around 7300) and only 25% less than Citroen, Peugeot or Porsche (each at around 10,000 SUVs sold in 2008). The future of the company is uncertain, as it has entered bankruptcy in early 2009.

- **TATA:** An Indian manufacturer, TATA Motors has developed dealership networks in Italy, Spain and Poland. The company has sold over 5.000 cars in Europe in 2008, mostly in the Pickup and B-segment. The company has also acquired Land Rover and Jaguar brands from Ford in 2008, to give itself a better foothold and positioning in the European market.

- **Mahindra:** Another Indian brand, Mahindra, has a network of dealerships in 10 EU countries, mainly in the Mediterranean region. In 2008, the company sold nearly 1000 SUVs, mostly in Italy, Spain and France.

- **Great Wall:** Chinese brand Great Wall's attempt at entry into the segment of mini-cars with its model GWPeri was thwarted because it lost a lawsuit over intellectual property issues. An Italian court effectively prevented the entry from happening when it ruled that the car is too similar in its design to Fiat Panda. The company nevertheless sold over 1000 cars in the other (cross-over) segment and was considering opening a factory in Bulgaria to expand its European operations.

- **Chery:** Another Chinese manufacturer, Chery, has sold almost 2000 SUVs in Italy in 2008. To better position itself on the market, the company is planning to divide its growing model portfolio into four sub-brands.

- **Proton:** Recently, a Malaysian manufacturer, Proton, entered the market.

Also, the market has seen only very limited exits (Rover brand, Marcos manufacturer). Lastly, the barriers to switch from one market segment to another appear to be low as many manufacturers have broadened their product portfolio across segments.

Using MAPIS data we have identified which brands had positive sales in 2002 and 2008 in different segments and then compared the number of brands active in each segment over time. The results are presented in Table 4.[102] In this exercise, we counted a brand as present in a particular segment if it had positive sales within this segment in at least one of the 27 countries analysed.

[102] The segmentation of the car market applied in this report is commonly used throughout the industry and also by the Commission in their annual pricing reports. For more detail on the various segments, see Appendix 0.

Table 4: Number of brands with positive sales in a segment (pan-European level, 2000 vs. 2008)

Segment	Brands in 2002	Brands in 2008	Percentage change
A-Segment	21	25	19%
B-Segment	31	36	16%
C-Segment	42	40	-5%
D-Segment	39	45	15%
E-Segment	31	35	13%
F-Segment	12	11	-8%
G-Segment	50	53	6%
MPVs	27	29	7%
Pickup	20	22	10%
SUVs	41	52	27%
Others*	6	31	417%
Total	320	379	18%

Notes: *= Vehicles not belonging to any of the other categories. Segmentation of the industry according to Daimler internal data MAPIS.

Source: ESMT CA calculation based on MAPIS data.

As can be seen, the number of brands available in each segment increased in almost all segments of the market. Between 2002 and 2008 only segments C and F lost two and one brand, respectively. On the other hand, apart from uncategorised vehicles, the largest growth took place in the SUV segment, where the number of available brands increased by 11 (27%) and in the smallest cars A and B segments, with 4 and 5 additional brands, respectively.[103]

5.1.3.3 Price trends

The Commission closely monitors new car retail prices at the model level and since at least 1993 publishes biannual reports on car prices.[104] The latest reports consistently find that new car prices are declining in real terms and that car price differentials remain relatively stable among the EU countries. Furthermore, the Commission also finds that the gap in prices between old and new member states of the European Union is systematically closing. The latest Commission report states that price dispersion - the average standard deviation of prices – is equal to 6.5% for the 27 EU countries and is equal to 4.5% for the Euro zone countries.[105] Since the Commission collects pre-tax prices and given the differences in tax regimes across EU countries, new car

[103] The dynamic nature of the industry is also visible through changes that took place among most popular brands by segment. Except for the A-, C- and F- segment, the leading brand has changed at least once in the 2000-2008 period, for more detail see Appendix A2.2.

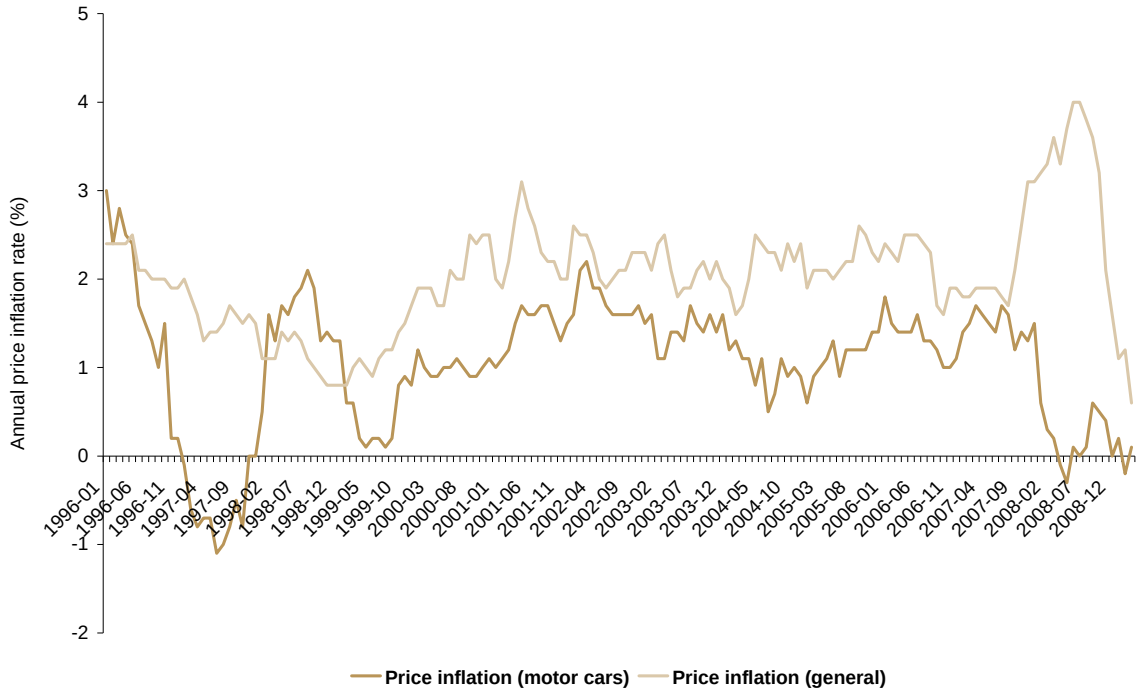
[104] The Commission's new cars price reports can be found online at : http://ec.europa.eu/competition/sectors/motor_vehicles/prices/archive.html.

[105] Car price report available at: http://ec.europa.eu/competition/sectors/motor_vehicles/prices/2007_05_a.pdf

prices appear to be fairly well harmonised. Finally, according to the Commission, price indicators seem to suggest that car manufacturers compete more aggressively in countries where cars are relatively more expensive for consumers. By facilitating arbitrage opportunities, the location clause of MVBER may have helped somewhat in price harmonisation between different countries.

Given the extensive amount of effort and research the Commission puts into monitoring new car pricing trends and convergence, there is little that can be added in that respect. In Figure 6 we compare the motor cars inflation rate with general inflation as reported by Eurostat.

Figure 6: Monthly annual price inflation rate for motor cars and consumer prices in general (1996 - 2008)



Source: ESMT CA based on Eurostat data

As can be seen from the graph, since 1999 new car prices in the Euro zone have consistently increased less than general inflation i.e. have decreased in real terms. In 2008 there were also a number of months for which car prices have decreased in nominal terms year-to-year. The difference between new car prices and the general price index was the largest in the summer of 2008, when car prices were essentially stable year-to-year, while the general inflation was about 4%. No clear change of trend can be seen on the graph in or around 2002, which indicates that MVBER did not have any significant effect on general level of car prices.

5.1.3.4 Profitability of dealers and manufacturers

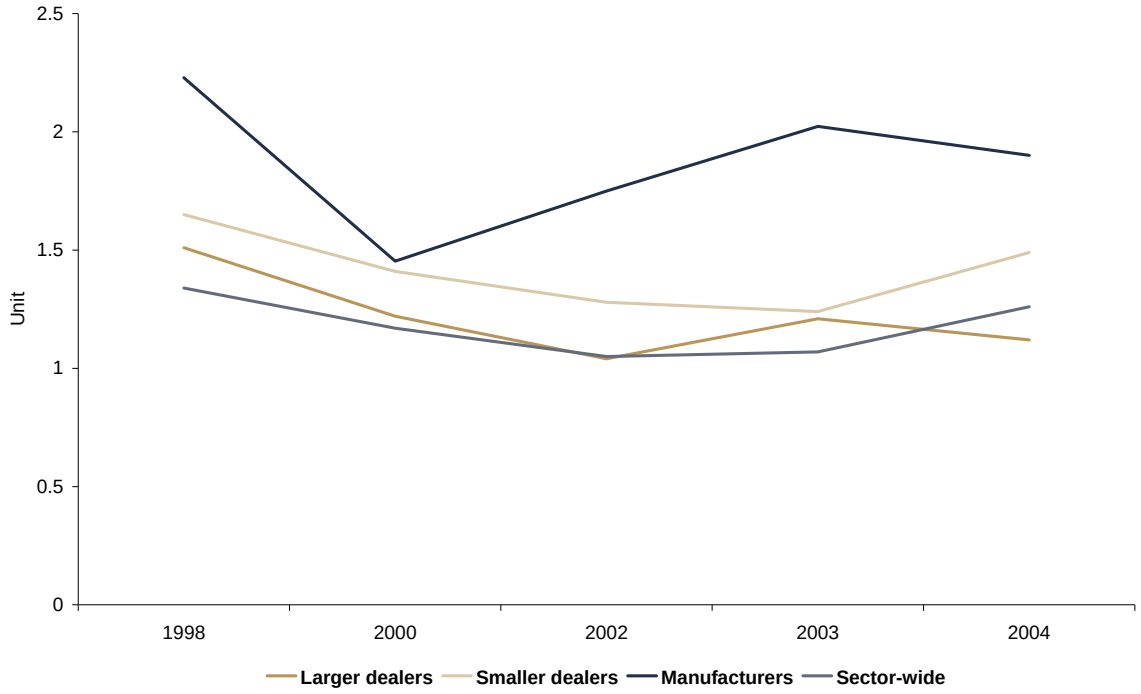
The Commission finds low profit margins of both manufacturers and dealers on new vehicle sales operations (as benchmarked to worldwide margins in the car industry and other industries like chemical manufacturing, tools/appliances industry and technical/scientific industry), which makes it unlikely that the consumers are being harmed.[106] According to the London Economics

[106] Staff Working Document No 2, page 14.

report, most manufacturers' net operating margins on their European operations appear to be lower than their global margins, indicating high competitiveness of the new car market in Europe.[107]

Figure 7 reproduces some of the data from the LE report (2006) and shows profit margins for small and large dealers and manufacturers over time.

Figure 7: Operating margins in the car industry (1998 -2004)



Source: London Economics 2006 report

It is important to emphasise that the sector-wide dealer margin is calculated not as a simple or weighted average of margins, but rather it is the ratio of aggregate dealer profit and aggregate dealer turnover.

Manufacturers' margins as reported in the London Economics report and displayed in Figure 7 appear to relatively more volatile than dealers' margins. The data on manufacturers' margins is however generally incomplete. Both the Commission and London Economics report state that individual car manufacturers' profit margins fluctuate a lot. They also observed that profitable periods for one manufacturer often coincide with low profits or even losses for others manufacturers, which may help explain why the average profit margin for all manufacturers (i.e. average industry profit) reported in Figure 7 does not exhibit as much variability.[108]

While there is apparently variability in profitability among individual dealers, the aggregate dealers' operating margin seems to be relatively low and quite stable over time. Higher volatility of manufacturers' margins than dealer margins indicates that manufacturers are actively shielding their core dealers from excessive losses. For example, there are reports that Ford has

[107] London Economics report, page 109.

[108] Staff Working Document No 2, page 14.

dropped volume requirements from its dealership bonus program to make it easier for the dealers to qualify for the bonuses. The move was intended to boost dealer profitability, which the manufacturer considered one of its priorities.[109]

While we do not place too much weight on simple observations of profitability indices that are not adjusted for risk, the data at least confirms that there is little evidence for persistent excessive profits achieved by pricing above the competitive level.[110]

It is also important to note that margins of dealers with below-average turnover (smaller dealers) are consistently above margins of dealers with above average turnover (larger dealers). This can indicate absence of any significant economies of scale or scope on the dealer side. This issue is more carefully analysed in Section 5.3.

5.1.3.5 R&D investments

The Commission finds that the market is characterised by high and constant R&D spending (benchmarked to other industries like electrical engineering and aerospace) as a lack of new models translates immediately into falling market shares. This has led to a reduction in life cycles from ten to six years.[111]

5.1.3.6 Excess capacity

Excess capacity - the amount of volume that a company could produce over the volume actually produced - is a major feature of the European car industry. While excess capacity is difficult to quantify, one estimate is that the industry has entered the current downturn with about 15% overcapacity.[112] The overcapacity has likely substantially increased since the global economic slowdown has started because the demand for new cars has dropped drastically. Investment bank Goldman Sachs forecasts that new-car sales in Western Europe in 2009 will fall by more than 20 percent as compared to 2008, to 10.7 million units. In response, many plants have suffered controlled slowdowns, temporary shutdowns and reductions in work force. A recent report on the automotive industry by Global Insights estimates that capacity utilisation rates have fallen to about 65%.

One possible source of excess capacity can be a sudden and unanticipated downward shift in demand. Overcapacity may also occur when the management realises that the industry is in decline and that some companies will need to exit the industry. By investing in excess capacity, a company can seek to demonstrate their commitment to staying in the market, thus deterring others from making investments. Such investments can also help to them better position themselves and to emerge strengthened as the industry recovers.[113]

Regardless of its causes, excess capacity is a powerful catalyst for fierce competition. In a business environment with overcapacity the marginal costs of production are relatively low and

[109] "Ford Dumps Dealer Targets For Dealer Bonuses", Automotive News, January 2008.

[110] In general, when interpreting financial indicators such as accounting profit margins it is important to realise that often they may not be perfect indicators of economic profits or price mark-ups.

[111] Staff Working Document No 2, pp. 12-13.

[112] "16 European plants at risk", Automotive News Europe, 2 March 2009.

[113] Michael C. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems", Journal of Finance, July, 1993, pp. 831-880.

the break-even level of production is relatively high. Thus, the companies with overcapacity have a very strong incentive to cut prices in order to stimulate demand, which would put their excess capacity to productive use and allow them to reach the break-even point.

5.1.3.7 Summary on current level of competition

Having analysed a number of indicators on the current level of inter-brand competition we can conclude that:

- Overall, the industry concentration as measured by HHI is moderate; the weighted average over 27 countries amounted to 1,398 in 2008, representing a slight drop since 2002 when the same index stood at about from 1,451. This compares to a weighted average HHI at the level of national car segments in 2008 of 1,849. Computations on pan-European levels decrease the level of concentration only slightly.

- The industry is characterised by a fairly high volatility of market shares: national industry market shares on average differ by about 13% from their long run mean. In comparison, the weighted average coefficient on the level of national segments is equal to 25%. Coefficients are reduced when the geographic scope of the market is broadened to the European level.

- Entry and expansion took place: some Chinese, Indian and Malaysian carmakers have chosen the fast growing SUV segment as their preferred target for entry. At the segment level, the number of brands per segment increased in all but 2 segments.

- There is no evidence of long-run excess profits. Instead we observe relatively stable dealership profitability at a relatively low level (~1%) and higher volatility of manufacturers' margins.

- There exist significant levels of excess capacity within the industry.

All these facts provide supporting evidence that the intensity of inter-brand competition in the car industry is high.

5.1.4 Magnitude of potential multi-branding impact on foreclosure

To assess the magnitude of the potential impact of the MVBER multi-branding provisions on facilitating entry and expansion and preventing foreclosure we have undertaken a simple empirical analysis. It has two major components.

- First, we have **identified instances**, i.e. brands for which and countries in which multi-branding provisions of the MVBER might have substantially helped entry and expansion.

- Second, we have tried to **quantify the positive effect** that multi-branding had on increased competition in the instances identified in the first step.

The first step of the analysis has been performed using sales volumes, number of outlets and exclusivity data from the GMAP European Car Distribution Handbooks published annually by HWB International. We used data from handbooks for 2002 (pre-MVBER) and 2007 (most recent

available). The relevant data available in the handbooks include the volume of cars sold and number of dealer outlets per country and brand. Another important piece of information in the handbooks is the number of exclusive outlets which is also available for each country and brand. While ideally we would have preferred to use data on multi-branding rather than exclusivity, to our knowledge data on multi-branding is not systematically tracked and is not available. However, exclusivity data can also be informative about multi-branding; if an outlet is brand-exclusive, by definition it cannot be multi-branded. The converse is not necessarily true: even if the outlet is not exclusive, it is not necessarily multi-branded as interpreted by the MVBER as it can be a corporate exclusive outlet (Lancia/Fiat). By interpreting non-exclusive outlets as multi-branding outlets we are conservative, in the sense that we are likely to overestimate the actual prevalence and importance of multi-branding.

The data on some of the smallest markets (such as Cyprus or Malta) were not readily available and in consequence were excluded from the analysis. We have also excluded five brands (Dacia, Ferrari, Maserati, MG Rover and Lada): the MG Rover brand has left the European market, and for the remaining four brands the data was not complete enough to perform the analysis. In the end we have analysed market information on 34 brands in 22 different EU countries, implying a total of 748 brand country/combinations.

5.1.4.1 Identifying the extent of multi-branding

The **identification of brand/country pairs** where multi-branding could possibly have had a significant effect on facilitating entry and/or expansion followed three simple, consecutive steps:

- **Entry:** In the first step, we identified brand/country pairs where entry or expansion took place between 2002 and 2007 (entry/expansion events).
- **Expansion of dealer network:** In the second step, in the identified instances, we checked whether entry/expansion took place by expanding the existing dealer network.
- **Non-exclusive outlets:** In the last step, we analysed these instances where entry/expansion took place via an expansion of the existing dealer network, by analysing the extent of non-exclusive outlets.

At the **first step of the identification** we have pinpointed the brands that were particularly successful in entering or expanding in individual European Union countries. Specifically, for each of the 748 country and brand pairs we have compared the volume of cars sold in 2002 and 2007. For each country, we have first identified brands that (1) had an initial market share below 2% in 2002 and (2) have gained at least 1% market share from 2002 to 2007. The first requirement – low initial market share - was chosen because manufacturers with substantial market share (incumbents) must have already had developed retail networks before the current MVBER regulation went into effect and therefore the risk of foreclosure in these cases was relatively low.

Out of the 748 brand/country pairs in our data, 476 satisfy the low market share requirement. Some of the incumbent brands, such as Volkswagen, Citroen or Opel/Vauxhall had market shares above 2% in all 22 countries analysed and in consequence were excluded from further analysis. Other brands usually had market shares above 2% in some countries and below 2% in others and

were considered as entrants in these countries where their market share was low and as incumbents in the remaining ones.

The median market share of the 748 observations in our sample was 0.94% and the average market share was 2.94%. Upon increasing the low initial market share threshold from 2% to 3% 536 brand/country pairs satisfied the requirement. This rather modest increase in the number of events when the threshold was set above average market share, and the fact that the threshold was at over twice the median value indicate that our choice of the threshold was quite conservative.

The second requirement - gain of at least 1% market share - was chosen to focus on brands which have gained substantial market share under the MVBER which could indicate that the regulation's multi-branding provisions were helpful in facilitating entry or expansion. Conversely, one could argue that for brands which didn't gain much market share, the MVBER multi-branding provisions were likely not effective in preventing foreclosure.

In 125 out of the 748 cases analysed, a brand has increased its market share in a country by at least 1%. Some brands, such as Alfa Romeo, Porsche or Saab have not achieved such an increase in any of the countries and were subsequently excluded from further analysis. On the other hand, some brands were quite successful in increasing their market share. Kia increased its market share by at least 1% in 17 of 22 countries analysed, Hyundai in 11 out of 22 and BMW and Ford in 10 out of 22 countries. There was also a lot of variation among countries. In some of the more mature markets, such as France, Germany or Italy, only 2 brands have managed to increase their share by at least 1%. In contrast, in some of the newest members of the EU such as Estonia, Latvia or Lithuania the increase was achieved by 16, 14 and 12 brands respectively.

The lower the market share gain requirement, the larger the number of events which satisfy it. With the market share threshold lowered to 0.75%, there are 166 events when a brand increased its market share by at least that amount in a national market. However, there is a practical limit to how low the threshold can be set. Setting it at too low of a level results in potentially triggering "false positives" – events where market shares increased due to random fluctuations in demand or potential inaccuracies in the data. We have decided that a threshold of 1% is large enough to reject events caused by minor fluctuations in the data, and at the same time low enough to include genuine events of substantial entry and/or expansion.

Overall, of the 748 brand/country pairs in the sample, 73 simultaneously satisfy both requirements. The results of this first step of identification are summarised in second column of Table 5 (by brand) and Table 6 (by country). The brands and countries are listed in the decreasing order of events they have qualified for. Out of 34 brands, 14 did not meet the criteria for entry or expansion in any of the countries and are not listed in the table.

Table 5: Results of the identification stage by brand

Brand	Step 1	Step 2	Step 3
Kia	17	17	13
Hyundai	8	8	5
Honda	5	3	1

Brand	Step 1	Step 2	Step 3
BMW	4	4	4
Ford	4	4	4
Mazda	4	2	2
Nissan	4	3	2
Audi	3	2	2
Daewoo	3	3	3
Mitsubishi	3	3	3
Peugeot	3	3	3
Subaru	3	3	3
Chrysler Jeep	2	0	0
Lexus	2	2	2
Skoda	2	0	0
Suzuki	2	2	1
Daihatsu	1	1	0
Mercedes Benz	1	0	0
Mini	1	1	1
Seat	1	1	1
Total	**73**	**62**	**50**

Source: ESMT CA based on HWB International data

Table 5 shows that the number of entry events is highest for the two Korean brands, Kia and Hyundai, which jointly account for 25 out of the 73 events (34%). Honda, BMW, Ford, Mazda and Nissan, with 4-5 events each, account jointly for another 21 events. A number of other brands account for less than three events each.

Table 6: Results of the identification stage by country

Country	Step 1	Step 2	Step 3
Estonia	11	8	7
Latvia	11	10	8
Lithuania	8	8	7
Slovakia	7	6	5
Finland	5	3	3
Greece	5	3	1

Country	Step 1	Step 2	Step 3
Denmark	4	4	4
Poland	4	4	2
Slovenia	4	3	3
Austria	2	2	2
Czech Republic	2	2	2
Hungary	2	2	0
Ireland	2	2	2
Sweden	2	1	1
Belgium	1	1	1
Netherlands	1	1	1
Portugal	1	1	1
Spain	1	1	0
Total	**73**	**62**	**50**

Source: ESMT CA based on HWB International data

The second column of Table 6 shows the breakdown of identified entry/expansion events by country. Estonia, Latvia, Lithuania and Slovakia account jointly for 37 of the 73 events (51%). In contrast to some of the largest, most mature markets such as Germany, France, Italy or UK we have not identified a single event for which the criteria for entry or expansion had been met and hence these countries are not listed.

The **second step of identification** involved comparing the number of sales outlets over time in instances identified in the first step. For 11 out of the 73 brand/country pairs the expansion was achieved without increasing the number of sales outlets, but instead by significantly increasing sales volume per outlet in existing outlets. The results of the second step of identification are summarised in the third column of Table 5 (by brand) and Table 6 (by country).

Because the growth in sales was achieved within the existing network of sales outlets, it is quite safe to assume that multi-branding did not play a significant role in the expansion and subsequently these events have been excluded from the next step of the analysis. However, since we do not observe the identity of the dealers, we cannot rule out the possibility that even though the number of dealers at the beginning and end of the period is the same, the identity of the dealers may have changed. Therefore, some of the old dealers could have been exclusive dealers while the new dealers are multi-branding dealers. If that was the case, then one could plausibly argue that our assumption has lead to an understating of the importance of multi-branding. This scenario is however unlikely, because the dealership contracts are usually long term and hence the turnover among the dealers is low. For the hypothetical scenario above to have a meaningful effect it would have to involve a significant fraction of the dealership network.

The number of events excluded in the second step could have been significantly larger if we allowed a positive threshold. For example, in additional 10 of the 73 events the 1% market share expansion was achieved by increasing the number of sales outlets by 1. It appears quite unlikely that a single additional outlet was crucial in expansion and, even if it was, this single additional outlet could have been exclusive rather than multi-branding. Nevertheless, we have taken a conservative approach and at this stage of the analysis excluded only those events for which the number of sales outlets did not increase at all.

In the **third step of the identification** we have further focused on the remaining 62 brand/country pairs by trying to determine the percentage of multi-branding dealerships in these instances. We didn't have any multi-branding data that could be used for that purpose, but HWB International publishes exclusivity data in their handbooks that can be informative. In particular, if the percentage ratio of brand-exclusive outlets is very high, it implies that the multi-branding ratio must be very low, and hence multi-branding wasn't a significant factor in the expansion. The converse is not necessarily true, i.e. even if the exclusivity ratio is low it is possible that non-exclusive outlets are multi-branding outlets within a manufacturer's group (intra-branding), which wouldn't be considered multi-branding according to the MVBER definition of multi-branding. So in this sense our approach is conservative.

At this stage we excluded events which exceeded the 90% threshold of exclusive outlets. As it turns out, with the 90% threshold we were able to rule out additional 12 of the 62 events remaining after the second stage. The results of the third step of identification are summarised in the last, fourth column of Table 5 (by brand) and Table 6 (by country).

To **summarise the identification stage**, of the 748 brand country pairs analysed, we have identified 73 events in which a brand entered or expanded significantly on a national market. Of these 73 events, 11 were achieved without expanding the dealership network at all, but rather by increasing the sales per existing dealer outlet. In 12 out of the remaining 62 events, the expansion was achieved through a highly exclusive network of outlets (at least 90% exclusive). For the remaining 50 entry/expansion events multi-branding could have played some positive role, however this number of events could be an overstatement because non-brand exclusive outlets could still be corporate exclusive.

We believe that this assessment is quite conservative, i.e. it likely overstates the overall impact of MVBER multi-branding provisions on preventing foreclosure and facilitating entry. There are a number of reasons for that:

- The non-exclusive outlets identified in the third stage could be nevertheless corporate exclusive. If that is the case, they are not multi-branding, even though our analysis would classify them as such, overstating the impact of multi-branding.

- As discussed in more detail in Section 4.2, there are instances where manufacturers and dealers incentives to multi-branding coincide, regardless of the MVBER provisions. Our data does not allow us to reliably identify these instances and in consequence we treat all multi-branding as defined by the MVBER, likely overstating the impact of the MVBER on multi-branding.

On the other hand, we did not have reliable data on the number of outlets, sales and exclusivity/multi-branding strategies of some of the smallest brands, e.g. these discussed in Section 5.1.3.2. To the extent that multi-branding was important for these brands, this effect

has not been identified in our analysis so far, due to the lack of reliable data. We will address the issue to an extent, however, when we quantify the positive effects of multi-branding.

5.1.4.2 Quantifying the positive effects of multi-branding

Having identified the set of instances where multi-branding could possibly have had a positive impact on preventing foreclosure and facilitating entry, we will now attempt to **quantify the upper bound on the potential positive effects** of multi-branding. Jointly, the 50 country/brand combinations identified after the three step analysis account for 161,330 vehicles out of the total 15.6 million new cars sold in 2007. The volume affected by multi-branding is therefore slightly above 1% of the total volume, also if calculated with 2008 data.

Furthermore, the low end segments of the market are likely to be more affected than the high end segments since most brands that have potentially expanded through multi-branding are concentrated in those segments: Kia is the brand that has likely benefited most from multi-branding. This brand operates mostly in the low end car segments (A, B and C) and MPV and SUV segments. This implies that the upper bound in terms of value directly affects by multi-branding might even be lower than 1%.

An alternative way of quantifying the potential positive effects is by analysing the change in the market structure of the industry in the respective country of entry. The higher the industry concentration, the higher is the potential economic benefits of an entry event. The **industry concentration** in countries in which we have identified most entry and expansion events is in general lower than the average. For example, the three countries of Estonia, Latvia and Lithuania account for 22 out of the 50 (44%) of the remaining entry events and have industry concentration levels in 2008 as measured by the HHI lower than the EU weighted average of 1,398: 916 for Estonia, and 954 for Lithuania and 998 for Latvia.

To further quantify the impact of multi-branding on competition, we performed additional calculations of concentration indices. Specifically, for each country we calculated the hypothetical change in HHI at the brand level that would take place absent multi-branding. That is, for each country we calculated the HHI for 2008 in two different ways:

1. Using the actual new car sales volume data for 2008.

2. Without taking into account sales in the events identified in our prior analysis, as these might have benefited from multi-branding.

By construction, the hypothetical HHI calculated in the second way is larger than the one computed using the first method. The difference between the two measures can be thought of as a proxy for the upper bound of the impact that exclusivity might have had on foreclosure. The results are reported in Table 7. The countries are sorted in the decreasing magnitude of the difference between the two concentration indexes.

Table 7: Hypothetical impact of multi-branding on lowering concentration (based on 2008)

Country	Actual HHI	Hypothetical HHI with no multi-branding	Difference
Austria	1,322	1,434	-112

Country	Actual HHI	Hypothetical HHI with no multi-branding	Difference
Belgium	1,118	1,151	-33
Czech Republic	1,994	2,313	-319
Denmark	1,076	1,260	-184
Estonia	916	949	-33
Finland	1,136	1,270	-134
Greece	896	938	-42
Ireland	1,068	1,109	-40
Latvia	998	1,023	-25
Lithuania	954	1,338	-384
Netherlands	980	1,006	-26
Poland	1,064	1,151	-88
Slovakia	1,462	1,824	-362
Slovenia	1,179	1,270	-92
Sweden	1,387	1,426	-38
Weighted average	**1,398**	**1,417**	**-19**

Note: only those countries are displayed that have seen entry events as identified in the previous section.

Source: ESMT CA based on HWB International data

Not surprisingly, in general the impact on the concentration index was the largest in countries for which most entry/expansion events were identified (Latvia, Estonia, Lithuania, Slovakia), although the order is slightly different. Also, for countries in which no events were identified, by construction, there is no difference in the two calculated indices. This was the case for some of the largest new car markets, such as Germany, France, Italy or UK.

To take into account the relative importance of different countries we have also calculated the overall impact of multi-branding on concentration as the weighted average of the differences, using the respective sales volumes weights. The overall impact of multi-branding measured this way is equivalent to lowering the HHI concentration measure by slightly less than 19 points. This represents a decrease of about 1.3%. In addition, we approximated the hypothetical change in HHI on segment basis. This analysis shows that also on segment level the potential benefit on consumers is limited. It would involve on average a decrease in the HHI of 38 points. This represents a decrease of about 2%. The analysis is found in Appendix 3.

These results would likely be very similar even if we included smaller brands discussed in Section 5.1.3.2 such as Mahindra, SsangYong or TATA, for which we did not have sufficient data to include them in our earlier analysis. Since the market share of these brands is very low, the impact of their entry on lowering concentration is so far rather limited.

Furthermore, the benefits of the entry events which were potentially facilitated by the MVBER provisions are found in some of the smaller markets. However, in particular in those markets the analysis might overestimate the entry facilitated by multi-branding and the impact of the shift to the VBER in these markets on consumers is likely to be limited due to the following factors:

- **Multi-branding may prevail:** the identified smaller markets could be exactly those regions where a higher level of multi-branding would have arisen regardless of the regulation as both dealers and manufacturers prefer multi-branding to single-branding in those regions. Some of the demographics of these markets seem to suggest this.

- **Entrants have other options:** many recent entrants have successfully expanded using their own existing network suggesting that multi-branding is just one of several options to expand. Therefore, even if multi-branding could have been prevented by manufacturers, recent entrants might have expanded with their own existing dealer networks.

5.1.5 Arguments against and in favour of multi-branding for entrant manufacturers

Although entry through multi-branding may be less costly, it may also be less desirable due to several reasons: multi-branding might hinder the build-up of a brand identity and might signal lower commitment to the end consumer. Therefore, an entrant with the strategy to build up a strong brand name within Europe is likely to prefer entry by exclusive dealers in comparison to an entrant with a weaker brand.

Entry through multi-branding implies less long-term commitment of the brand to stay in the market. Consumers may be afraid to purchase such a brand, since if the entry is unsuccessful they will be left with cars that are difficult to service, obtain spare parts, etc. To the contrary, entry through exclusive, dedicated outlets can signal manufacturer's commitment and can induce consumers to purchase the cars. A similar commitment argument is used by Chrysler and General Motors in their argument against filling for bankruptcy: consumers will not want to buy cars of a bankrupt company due to a fear that there will be no entity to honour warranties, offer services, spare parts, etc. Just as entering into bankruptcy could have a strong negative effect on sales, so could the negative perception affect the sales of a multi-branding entrant.

Different opinions were expressed in manufacturers' and their associations' comments during the current MVBER review process and in the automotive press. For example, the European brand Seat puts forward that

> *Seat is very strong in Spain but weak outside its home market. Despite this, the automaker prefers to have exclusive dealerships.*[114]

Also, in the experience of members of the Japan Automobile Manufacturers Association (JAMA), authorised dealers generally prefer to operate a new car showroom dedicated to a single brand.[115] Among the reasons for such preferences they list customers' expectations of individual brand experience and the necessity for staff focus and attention to one brand in the fiercely competitive inter-brand market. In contrast, the Korea Automobile Manufacturers Association

[114] Automotive New Europe, 12 May 2008.

[115] Japan Automobile Manufacturers Association (JAMA) comment on MVBER.

(KAMA) is of the opinion that the possibility of dealers to sell brands of competing manufacturers within the same showroom is a vital element for foreign manufacturers.[116] They are concerned that dealers in many regions are mostly multi-franchised and that absent the MVBER provisions the situation would change. But according to press trade articles, even Korean brands recognise the benefits of dealers focusing on a single brand. For example, Automotive News Europe, quoting an opinion of Hyundai's European dealer network development manager, Jens Nagl, stated that the Korean automaker prefers to work with dealers that sell only the Hyundai brand and that multi-brand dealers offer the manufacturer a chance to be represented in countries with lower local potential, such as Switzerland and Scandinavia.[117] As we have argued previously, in rural regions where multi-branding is economically desirable it is likely to remain the preferable method of new car distribution, even absent the MVBER regulation.

The difference in opinions on multi-branding of Japanese and Korean manufacturers is also quite informative. As our empirical analysis in Section 5.1.4 shows, Korean manufacturers have in general benefited most from multi-branding. This is consistent with their position that restrictions in multi-branding could allow incumbent manufacturers to displace foreign brands from the market by using their advantageous position.[118] Japanese manufacturers associated in JAMA, however, are of the opinion that market forces and objective circumstances should decide if multi-branding is desired or not.

This difference in position on multi-branding is unlikely to be a consequence of different market shares. Of the Japanese manufacturers associated in JAMA only Toyota has a volume of cars sold significantly larger than Hyundai and brands such as Mazda or Mitsubishi have volume of sales much smaller than Kia, see Table 8. If one takes into account strong corporate ties between Kia and Hyundai, they are the second largest Asian manufacturer by volume, behind Toyota.

Table 8: Volume of sales - Korean and Japanese brands

Brand	Cars sold in EU in 2007
Toyota	855 512
Nissan	304 561
Hyundai	304 539
Honda	301 183
Suzuki	280 241
Kia	239 346
Mazda	232 417
Mitsubishi	171 618
Lexus	39 234
Subaru	33 625

Source: ESMT CA based on HWB International data

[116] Korea Automobile Manufacturers Association (KAMA) comment on MVBER.

[117] "Multibrand dealers OK", Sylviane de Saint-Seine, Automotive News Europe, July 9, 2007.

[118] Korea Automobile Manufacturers Association (KAMA) comment on MVBER.

Instead, the difference in opinion might be due to the different aims in relation to brand strength. Arguably, the perceived value of Japanese brands is larger than that of Korean brands. This information, combined with the facts gathered during our interviews that even the brands that are pro multi-branding, such as Hyundai and Kia, avoid joint sales outlets, indicates that the desire to free ride on other brands' investments can be a more significant factor for the Korean brands than any foreclosure effect. This may be especially true given that Kia and Hyundai appear to be concerned about potential sales cannibalisation between the two brands.[119]

5.1.6 Multi-branding versus intra-branding of incumbent manufacturers

The strategies of multi-brand manufacturers can also be informative with regard to their motives for brand exclusivity. If foreclosure was the main driver for exclusive dealing, and a dealer needed to offer another brand to achieve sufficient profitability to stay in business, then manufacturers should prefer to offer him one of their own brands (intra-branding) rather than a competing manufacturers' brand (multi-branding). Instead, manufacturers appear to prefer multi-branding to intra-branding. Such an exclusive strategy within the manufacturer's group of brands strongly indicates that the negative effect of brand dilution perceived by manufacturers is much stronger than any possible foreclosure effect.[120]

As evidence for such reluctance to intra-branding, we find that different manufacturers follow different strategies with regard to multi-branding and exclusivity. On the one hand, some manufacturers pursue multi-branding strategies within their group, e.g. Chrysler/Dodge/Jeep (Chrysler's brands), Fiat-Alfa Romeo or Fiat-Lancia dealerships are common (outside Romania Dacia shares a lot of outlets with Renault). On the other hand, some manufacturers continue to separate dealerships of different brands. For example Volkswagen is gradually physically separating its Audi and Volkswagen dealerships.[121] According to the dealership association CECRA, it is out of question for dealers who represent the brands of the Volkswagen Group to sell several of these brands in the same showroom, because Volkswagen explicitly prohibits them to do so.[122] It should be noted that for brands belonging to the same group, the manufacturer can prohibit to sell these brands in the same showroom without violating provisions of the MVBER, because the MVBER defines multi-branding only for brands of separate undertakings.

Moreover, some of the manufacturers do not allow the dealers to combine their own brands, while they have no problems if the dealers offer brands of competing manufacturers. For example, D'Ieteren Auto, which distributes Volkswagen, Audi, Skoda, Seat, Porsche, Lamborghini and Bentley in Belgium, as a policy does not combine these brands in a single dealership, but does not have any problems if a dealer, who sells for example Seat, wants to add another manufacturer's brand to become more profitable.[123]

5.1.7 Foreclosure: summary

Our findings in this section can be summarised as follows:

[119] "Hyundai, Kia form separate identities", Automotive News Europe, 29 September 2008.

[120] For a detailed exposition of the concept of brands and brand dilution, see Section 6.1.

[121] European Car Distribution Handbook 2008, page 5.

[122] CECRA response, page 10.

[123] "Van Kan favors small dealer groups", Wim Oude Weernink, Automotive News Europe, October 13, 2008.

- **Limited ability to foreclose:** on the national level, no market participant has an industry-wide market share large enough to be able to foreclose unilaterally and foreclosure can only potentially be achieved through a cumulative action of multiple participants. This result is fairly robust with respect to a broader or narrower market.

- **Inter-brand competition strong:** numerous indicators show that inter-brand competition in the automotive industry is high, which implies that manufacturers have rather limited incentives to foreclose.

- **Limited relevance of potential volume increase due to multi-branding provisions:** under fairly conservative assumptions, we have estimated that foreclosure could have affected at most 50 (6.7%) out of the 748 country/brand combinations identified. However, the affected countries and brands account for only about 1% of the total volume of cars sold in the EU.

- **Limited benefit to consumers:** the MVBER multi-branding provisions have at best decreased the average level of concentration, as measured by the Herfindahl-Hirschman Index, by about 19 points. This represents a decrease of about 1.3%. In addition, we approximate the hypothetical change in HHI on segment basis. This analysis shows that even on segment level the potential benefit on consumers is limited. It would involve on average a decrease in the HHI of 38 points. This represents a decrease of about 2%.

If there had been a positive effect of the multi-branding provisions, this would have been more likely for brands in some of the smaller markets. However, even there the impact of the shift to the VBER in these markets on consumers is likely to be limited due to the following factors:

- **Multi-branding may prevail:** the identified smaller markets could be exactly those regions where a higher level of multi-branding would have arisen regardless of the regulation as both dealers and manufacturers prefer multi-branding to single-branding in those regions. Some of the demographics of these markets seem to suggest this.

- **Entrants have other options:** many recent entrants have successfully expanded using their own existing network (other brands in the same group) or by setting up single-brand network. Multi-branding is just one of several options to expand. Therefore, even if multi-branding could have been prevented by manufacturers, recent entrants are likely to have expanded with their own dealer networks – as this was the choice of many manufacturers for many brands in many countries.

These findings alone suggest that from a competition policy perspective the specific and general regulation of multi-branding in the MVBER is not required. This finding is reinforced when considering the costs of multi-branding provisions.

Notwithstanding this finding the multi-branding provisions are one of several elements affecting the division of bargaining power between dealers and manufacturers. We address the potential indirect effects arising from a shift of bargaining power to manufacturers below.

5.2 Lowering search costs of consumers

Multi-branding is said to lower the search costs of consumers. The argument is that when models of multiple brands are displayed next to each other, it is easier for the consumer to compare features, quality and prices, and make an informed decision.

It can be argued, however, that multi-branding is not a significant factor in lowering consumers' search cost. Because new cars are large ticket items, consumers have a lot of incentives to use the Internet and other easily available data sources to perform research and gather information, price quotes and make feature comparisons. Marketing reports indicate that many customers decide on a specific brand and model to buy before visiting a dealer and then they prefer to go to a dealer specialising in the product they have chosen.[124] Anecdotal evidence suggests that some consumers may come to the dealership knowing more about the car than salespeople.[125] In this context, having sales personnel dedicated exclusively to a single brand can help maintain the quality of service and information provided and preserve a positive brand image.

5.3 Overhead costs and economies of scale/scope

Some argue that by multi-branding dealers can spread their overhead costs over multiple brands and hence achieve some economies of scope. For example, in the BMW case the Commission didn't even mention a foreclosure effect, but instead focused its investigation on the inefficiencies created by restrictions that required dealers to unnecessarily duplicate their investments in order to sell other brands.[126]

Empirical evidence seems to suggest, however, that economies of scale for the dealerships do not necessarily exist. Consequently, the likelihood of substantial economies of scope through multi-branding is accordingly small. The ICDP Management Brief 39 (2006)[127]: "Where are the scale benefits in retailing cars?" looks in more detail into potential sources of benefits of scale in new car retailing from the management perspective. The authors find that for the largest international dealership groups there are no benefits of scale due to factors such as marketing, property management, operations at the group level and operating practices. Economies of scale might however be achieved within the following business functions:

[124] "Car dealerships 2008" Ernst&Young, JAMA response II(a). The fact that consumers decide on the brand before visiting various dealerships is not related to the fact that manufacturers are concerned about brand dilution when several brands are within one showroom. The brand identity is a long term marketing concept. Brand identity can be affected when different brands are within one showroom – independent of whether at a specific shopping trip the consumer already decided about the brand.

[125] "Loccisano feels pinch from credit crunch", Luca Ciferri, Automotive News Europe, October 27, 2008.

[126] "*With regard to multi-brand sales and servicing, various provisions in the contracts were hindering BMW dealers and repairers from using their existing facilities to sell or service cars of competing brands, without having to unnecessarily duplicate investments.*" Press Release IP/06/302.

[127] "The International Car Distribution Programme is a collaborative research programme into all aspects of car distribution including the supply and retailing of new and used cars, after-sales, network structures and operations. It has been conducting independent investigations since 1992. It is funded by participants from car makers, dealers, car industry suppliers, representative bodies and governments. ICDP's reports are published and available to researchers worldwide. ICDP does not represent any of its members or their individual policy views."

- **Purchasing**: larger dealers might be able to extract larger volume discounts. However, currently volume discounts are not widespread and the typical incentive programmes rather entail bonus structures based on individual targets. Therefore, this type of **scale** benefit is rather unlikely. Furthermore, purchasing economies are certainly not a source of economies of **scope** unless the different brands are of the same manufacturer which is not the relevant case under multi-branding in the sense of the MVBER.

- **Property management**: larger dealer groups might be able to better manage their property portfolio for example by eliminating duplication. "*A scale advantage could be argued to exist also in property management, where larger groups could manage their property portfolio far more strategically than at present. This could entail a structural realignment and redeployment of their property portfolio to eliminate duplication and foster consolidation, some functional specialisation and new formats. So far, however, the traditional single-branded outlet is a resilient feature of auto retailing even for the big groups***"** (page 3).

- **Funding**: there are likely some benefits of scale in the cost of funding as scale can usually cut costs.

- **Operations – outlet level**: it is not unlikely that there are some benefits of **scale** to be realised on the outlet level through increases in size. This hypothesis might be supported by increases in volume sales per outlet observed in recent years. However, while bigger outlets can spread fixed costs over greater volumes, according to ICDP the benefits of a larger **scale** and **scope** can be thwarted by increased complexity. This is supported by evidence on lower profit margins for larger outlets. The ICDP Management Brief 46 (2007): "What is happening to dealer economics?" examines both margins at group and outlet level. At the outlet level, the brief presents information on dealers in Spain, France and Germany, distinguishing volume and specialist brand dealers. For Spain, return on sales respectively return on capital (RoCE) is regressed on total turnover. They find that for specialist dealers the size in terms of turnover has little explanatory power with respect to the profitability indicators. Furthermore, on volume dealers they find mixed results: a larger dealer has lower return on sales (where turnover however only explains 2% of the variation in returns on sales) and higher return on capital (where turnover explains more of the variation but still only 18%). For Germany, results are more clear-cut: return on sales and return on capital both appear to decrease with total turnover on outlet level.[128] For France they find consistently over 5 years that smaller outlets selling fewer cars have a higher return on sales. Thus, on outlet level ICDP does not identify significant scale economies. This is consistent with the experience of the largest dealer groups who own multiple franchises. For example, according to CEO of Pendragon, the largest dealer group in the UK, the company does not operate many multi-brand outlets and has no such plans in the future, because the added complexity and cost of additional franchises outweigh the small incremental benefits that the additional franchise contributes.[129]

- **IT systems**: there are likely some benefits of **scale** to be realised within the IT systems. However, ICDP states that economics of **scope** might not exist since the connection

[128] Here no regression results are presented. Instead data is displayed in turnover categories and presumably average profitability indicators per category.

[129] "European prospects for Chinese cars are good, says Pendragon CEO", Automotive News Europe, June 25 2007.

required within the IT system to deal with a number of different brands might increase complexity significantly.

- **Inventory management**: according to ICDP there is less scope for economies in this area, since within a pull marketing system stock matters significantly less than in a push marketing system, which is for example the standard in traditional food retailing.

Empirical data on margins at the dealer group levels supports the hypothesis that economies of scale are small: there is little evidence that larger dealers are more profitable than smaller ones. For example, the LE report (2006) displays margin information on group level which does not show significantly better margins for larger dealers. To the contrary, it seems that larger dealers are less profitable than smaller dealers.[130] They compared margins of two subsets of dealerships: those with lower than average turnover (smaller dealerships) and those with higher than average turnover (larger dealerships). To the contrary to their prior expectations they found out that generally smaller dealerships are more profitable than their larger counterparts. They summarise their findings as:

> *This is a somewhat surprising result as we expected to find some evidence of economies of scale in car distribution. The data from the Amadeus database, however, does not support this view.*

Figure 7 in Section 5.1.3.4 reproduces some of the data from the LE report (2006) and shows profit margins for dealers and manufacturers over time. As can be seen, operating margins for dealers with turnover below average are consistently higher than operating margins for dealers with turnover above average, which indicates absence of any significant economies of scale. The sector-wide dealer margin isn't calculated as a simple average of margins, but rather it's the ratio of aggregate dealer profit and dealer turnover. The fact that the sector wide profit margin calculated in such a way exceeds the average profit margin is another indication that smaller dealers tend to be more profitable than larger ones.

Summary: There appears to be little evidence that theoretical potential benefits of multi-branding such as lowering search costs of the consumers and achieving economies of scale and scope exist. In particular, on the outlet level where allegedly the economies from multi-branding should be kicking in, the evidence suggests to the contrary that smaller outlets are more profitable. In any case, if such economies existed, it is likely that manufacturers would like to exploit them in order to achieve a competitive advantage over their rivals. It seems unlikely that the MVBER multi-branding provisions would be necessary or useful to mandate achieving benefits of scale if such indeed exist.

[130] The ICDP Management Brief 40 (2006): "Economies of scale for dealer groups: fact or fiction?" investigates the profitability of seven large UK car dealers in terms of gross margins, cost ratios, turnover per employee, return on sales and return on capital employed. On none of those indicators do they find a clear trend associated with the overall size of the business (as measured in total annual turnover).

6. Anti-competitive effects of multi-branding

The multi-branding provisions of the MVBER also come with costs: vertical restraints often can have positive effects, for instance by improving quality of services through non-price competition. Appropriately structured vertical contracts can enable suppliers to increase their efficiency by optimising their manufacturing or distribution processes. Vertical restraints may be helpful in this respect because the usual arm's length dealings between a supplier and a dealer determining only price and quantity can lead to a sub-optimal level of investments and sales.[131] Thus, vertical agreements can improve efficiency of a chain of production or distribution by improving coordination between the parties. In particular, they can reduce transaction and distribution costs of the parties and help them optimise their sales and investment levels.[132]

The potential scope of the benefits of such optimisation in the automotive industry is huge, because costs of the distribution account for about 30% of the total cost of a new car.[133] As recently summarised by Commissioner Kroes:[134]

> *[T]here were certain overly restrictive sector-specific provisions regarding the sale of new cars, which, while not necessary for safeguarding competition, could in fact be hampering the flexible and efficient adjustment of car manufacturers' networks to changing market conditions. This may be having a significant impact on the competitiveness of the European car industry, particularly in the current economic climate. The resulting inefficiencies would add to the industry's distribution costs, which would imply higher prices for consumers.*

While there is insufficient data to systematically and quantitatively evaluate the magnitude of these costs and related inefficiencies, there is substantial evidence provided by all parties to the consultation process, which indicates that the overall effect is substantial. In this section, we discusses and analyse the following costs of multi-branding: (1) brand dilution on its own as well as the associated strategic methods of car manufacturers to circumvent brand dilution in the presence of multi-branding and (2) low investment levels of manufacturers due to free riding effects. Potentially, also the shift in bargaining power implies some welfare loss. This issue is further discussed in Section 8.1.

6.1 Brand dilution

Car manufacturers have expressed significant concerns about potential brand dilution in case of a multi-branding retailer, where multi-branding relates in particular to same showroom multi-branding. This section explains the concept of a brand, what brand dilution means and how multi-branding can potentially induce brand dilution.

[131] Guidelines on Vertical Restraints, paragraph 115.
[132] MVBER, Recital 5.
[133] Mario Monti "Who will be in the driver's seat?", Speech/00/177.
[134] Answer to question P-1363/09, 1 April 2009.

A **brand** is a marketing tool facilitating the differentiation of products. It consists of two main characteristics, the brand identity and the brand meaning. Brand identity is constituted by certain attributes such as name, logo, slogan or jingle of the brand. Brand meaning instead reflects customers' perceptions and beliefs concerning the brand. Consequently, the brand meaning is the part which creates value for the customer. The following example illustrates the concepts:

> *[T]he identity of BMW is captured by elements such as its distinct name and logo whereas its meaning – 'the ultimate driving machine'- reflects the mental associations that target customers make with the brand.*[135]

Together, brand identity and brand meaning determine the strength of a brand which influences how valuable a brand is to the manufacturer. Roughly speaking, the strength of the brand is reflected by the price premium which customers are willing to pay in comparison to a generic product.

Brand dilution denotes the process thereby consumers stop associating a brand with a specific product or a group of highly similar products.[136] This reduces the consumers' valuation of the brand:

> *Brand dilution occurs when consumers no longer associate a brand with a specific product or highly similar products and start thinking less of the brand.*[137]

Manufacturers create the brand through significant investment. Thus, they are keen in preserving its value. There are a number of ways how multi-branding can negatively affect the value of the brand. Among other factors, multi-branding dilutes the point of sale experience. Furthermore, it is likely that consumers' comparison process changes through the existence of multi-branding. The remainder of the section discusses those two concerns in more detail.

Multi-branding dilutes the brand's promise at the point of purchase. It is well recognised that a retailer's or a shop's image heavily depends on the atmosphere created in the shop, where atmosphere relates to the physical characteristics projecting a certain image. The atmosphere is likely to impact on customers' enjoyment of the shopping trip.[138] Therefore, the atmosphere in the shop impacts on customers' perception of the brands that it carries and influences the likelihood of purchases. In consequence, manufacturers are usually keen in influencing the shopping experience of their potential customers.[139] This is reflected by the fact that brand

[135] See Chernov (2008): "Strategic Marketing Management", 3rd edition, Brightstar Media, Chicago, page 101.

[136] The specific term brand dilution is often associated with the concept of product line extensions under a brand. Brand extension denotes the introduction of a group of new products under an existing strong brand name. Where the introduction of new products under a given brand has certain advantages such as the facilitation of product acceptance, its biggest risk is the dilution of the brand itself. See for example Corstjens and Corstjens (1995): "Store Wars – The Battel for Mindspace and Shelfspace" JohnWiley & Sons Ltd, Chichester, England, page 66.

[137] See Kotler and Keller (2006): "Marketing Management 12e", Pearson Education Inc., Upper Saddle River, New Jersey, page 299.

[138] See for example Berman and Evans (2006): "Retail Management – A strategic approach", 10th edition, Pearson Education Inc., Upper Saddle River, New Jersey, page 544.

[139] This can also be seen in the rise of vertical marketing systems integrating producers', wholesalers' and retailers' interest, see Kotler and Keller (2006): "Marketing Management 12e", Pearson Education Inc., Upper Saddle River, New Jersey, page 487.

marketing often involves specific features at the point of purchase: recently, Apple invested USD 293 million in dedicated retail stores to "*fuel excitement for the brand*".[140]

In the automobile industry, multi-branding dilutes the brand promise in-store as it is difficult or even impossible to create an atmosphere within a single room which fits several brands equally well. For example, it may be difficult to create an atmosphere reflecting the luxury and performance image of "The Ultimate Driving Machine" associated with the BMW brand next to a "Volvo for life" conveying safety as the major brand meaning. In order to keep their brands sufficiently differentiated in a situation of multi-branding, manufacturers might react in several ways discussed further below.

Another way in which multi-branding impacts the brand's value is by **changing the comparison process of customers**. There is empirical evidence which supports the hypothesis that consumers, when confronted with multiple choices simultaneously, decide differently as opposed to a situation where they have to make single choices sequentially. In particular, Nowlis and Simonson (1997)[141] find evidence that consumers' preferences change systematically when they have to chose between brands (in comparison based tasks) than when they have to evaluate them individually (for example in purchase likelihood ratings). They make the point that

> *In particular, "comparable" attributes which produce precise and easy-to-compute comparisons (e.g. price) tend to be relatively more important in comparison based tasks. Conversely, "enriched" attributes (e.g., brand name), which are more difficult to compare but are often more meaningful and informative when evaluated on their own, tend to receive relatively greater weight when preferences are formed on the basis of separate evaluations of individual options.*[142]

They point out that this finding has several implications for marketing practitioners; in particular it impacts the optimal store display format and optimal distribution. For example, high quality brands might profit more from a display at the end of an aisle than low quality brands. Furthermore, high quality brands might also profit more than low quality brands from an exclusive distribution channel that does not offer competing products, or from separate display in a showroom.

Another paper by Hsee et al. (1999)[143] makes a similar point in their evaluability theory. This theory says that

> *In SE [Separate Evaluation], difficult-to-evaluate attributes have little impact in differentiating the evaluations of the target options, so that easy-to-evaluate attributes are the primary determinants of the evaluations of the target options. In JE [Joint Evaluation, people can compare one option to the other. Through this comparison, difficult-to-evaluate attributes become easier to evaluate and hence exert a greater influence.*[144]

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[140] See Kotler and Keller (2006): "Marketing Management 12e", Pearson Education Inc., Upper Saddle River, New Jersey, page 277.

[141] Nowlis and Simonson (1997): "Attribute-task compatibility as a determinant of consumer preference reversals" Journal of Marketing Research, Vol 34 (2), pp 205-218.

[142] See Nowlis and Simonson (1997): "Attribute-task compatibility as a determinant of consumer preference reversals" Journal of Marketing Research, Vol 34 (2), pp 205.

[143] Hsee, Loewenstein, Blount and Bazerman (1999): "Preference reversals between joint and separate evaluations of options: a review and theoretical analysis" Psychological Bulletin, Vol. 125 (5), pp. 576-590.

[144] See Hsee, Loewenstein, Blount and Bazerman (1999): "Preference reversals between joint and separate evaluations of options: a review and theoretical analysis" Psychological Bulletin, Vol. 125 (5), p. 578.

Evaluability is a consumer's ability to evaluate an attribute level with confidence. This implies that, for example, price is more important in choice tasks, because a price without reference is not confidently assessed as high or low. In contrast, established brands distinguish themselves from less established brands precisely in terms of confidence of assessment. Thus, established brands are more evaluable in the sense of Hsee et al. and should play a bigger role in isolation. Therefore, this theory also predicts that determinants such as price become more prominent in choice tasks at the expense of factors which are more difficult to compare directly, but might hold valuable information such as brand.

Welfare effects of this reversal phenomenon are difficult to draw. However, it could be concluded that by attributing lower weight in a comparison-based decision to the brand might imply that the consumer is downgrading rich and complex information. The effect on high brand manufacturers is that they suffer from a loss in the value of their brands. This particular type of dilution of the brand appears to be difficult to counter for the manufacturer.

Brand dilution implies overall weaker brands and therewith a potential decrease in the overall demand for cars. Therefore, manufacturers have a significant incentive to avoid brand dilution. Since the MVBER has rendered the direct mean of requesting single-branding for the manufacturers unattainable, it is conceivable that manufacturers have been looking for alternative ways within the framework of the MVBER in order to preserve brand identity. However, these alternative ways of preserving brand identity might result in costs which could be avoided with multi-branding. One way of preserving the brand would include overall higher brand specific investment of the manufacturer itself, e.g. more advertising campaigns. In the following sections, further strategic responses are discussed.

6.1.1 Higher brand specific investment

In relation to dealer standards and payment systems, the literature has identified two types of strategic reactions to the entry into force of the MVBER in relation to the preservation of brand identity: (1) an increase in brand specific investments for dealers and (2) an increase in uncertainty in the payment structure, i.e. a shift from fixed to variable margins.

Carmakers are allowed to set the showroom standards to protect their brand identity. It is widely accepted that following the entry into force of the MVBER, "*most car manufacturers had concluded new contracts containing a large number of increasingly detailed and investment intensive rules and standards on the set-up of dealer and repairer outlets including equipment, corporate identity and operational infrastructure*."[145] With a prospect of single-showroom multi-branding seriously picking up, and to prevent their brand deterioration, the manufacturers increased their showroom standards. This has translated into higher investment costs for the dealers to comply with increasing requirements.[146] Many participants in the consultation process

[145] Competition Policy Newsletter Nr. 2 Summer 2006: Multi-brand distribution and access to repairer networks under MVBER 1400/2002: the experience of the BMW and General Motors cases", page 35.

[146] See for example Luca Ciferri (2008): "Mocarelli: Automakers still too demanding", Automotive News Europe, October 27 or Leonardo Buzzavo, Claudio Pizzi (2005): "Trade Marketing and Vertical Restraints: The Case of Automotive Distribution in Italy". This trend is to some extent documented in the LE report (2006). They have run a set of regressions of required marketing, technological and non-technological investment on time and found out that, with the exception of Nissan dealers, all coefficients which were statistically significant at 10% level were positive. This finding indicates an increasing trend of investment requirements over time.[146] However, the report does not analyse whether there is a structural break with the introduction of the MVBER. Since no annual information on required marketing, technological and non-technological investment is displayed, further analysis of the data is impossible.

complained that these cost have no sound efficiency justification and they seem to be an unintended consequence of the MVBER non-compete obligation provisions.[147]

Given the missing rationale for increases in brand specific investment other than the prevention of brand dilution in the presence of a potential increase of multi-branding following the MVBER, it appears that the welfare effects of this strategic reaction are clearly negative. Although part of the costs of increased investment requirements will be sunk, it is likely that part of the requirements involve recurring costs for existing dealers. Furthermore, new dealers under the MVBER would have to bear those inflated investment costs. It is likely that if manufacturers were able to protect their brand identity directly through exclusive contracts, they would have incentives to lower their investment requirements, and thus overall distribution costs, with the benefit for the final consumers.

It is important to emphasise that these costs are quite universal, in the sense that they are borne by most dealers of most brands who have responded to MVBER by increasing their requirements. This is due to the fact that manufacturers are unable to discriminate the standards for the selective distribution system between dealers. Thus, manufacturers are unable to demand different standards from dealers which decided to multi-brand and dealers which decided to single-brand.

The minimum number of models required to be displayed within an outlet is an example of dealer standards that have been raised since the introduction of the MVBER. Car manufacturers can prescribe a minimum number of models per outlet.[148] This contract obligation might de facto have the effect of a non-compete clause for smaller dealers. Despite this indirect effect, such a minimum number obligation has been judged legitimate within the recent Porsche, BMW and GM enforcement proceedings.[149]

Those proceedings involved an analysis of indirect non-compete obligations.[150] Part of the contentions in the BMW case was the minimum number of models required to be displayed in the showroom. On this the Commission concluded that, if such requirements aim at an even and effective representation of a range of the carmaker's models, the restriction should not be considered an indirect non-compete obligation and therefore does not imply the loss of exemption benefits. This decision left the manufacturers with a possibility to apply non-discriminatory, selective criteria on the number of models required to be displayed in an outlet. To the extent that this option has been used to prevent multi-branding it may have also had negative consequences. Not all outlets in a dealer network are identical, and the Commission has conceded that "*showrooms below a certain size may in certain cases simply not be suitable for*

[147] See for example, response by CECRA, page 10: „It is true that manufacturers have used BER to introduce a lot of standards which are by no means necessary to improve sales."

[148] An increase in the minimum number of models required per outlet is effectively similar to requirements of increased brand-specific investment. However, this form of increased investment affects dealers in an asymmetric way: since manufacturers have only limited ability to differentiate the number according to the circumstances of the dealer, larger dealers might not be affects to the same extent by an increase in the required number as they would carry this number of models anyway. In contrast, smaller dealers would need to invest more than they usually would. For this reason, we decided to display this specific investment requirement separately.

[149] See for example Competition Policy Newsletter Nr. 2 Summer 2006: Multi-brand distribution and access to repairer networks under MVBER 1400/2002: the experience of the BMW and General Motors cases" or EC MEMO/06/120 (http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/120&format=HTML&aged=0&language=EN&guiLanguage=en).

[150] The line between indirect non-compete obligations and efficiency enhancing vertical restraints can be quite blurry and often need to be resolved on a case-by case basis.

displaying a representative range of cars by more than one brand, without additional investment."[151]

The establishment and or increase of the minimum number of models per outlet is likely to have increased operating costs for smaller outlets. Applying uniform criteria to all outlets regarding the minimum number of models per outlet under the MVBER could have meant that some outlets, for which the requirement was too high given the market conditions, went out of business. This might have adversely impacted brand geographical coverage and thus harmed the consumers. To the extent that higher uniform number of models per outlet increased with the MVBER, this can be considered costs of the promotion of multi-branding in all outlets - regardless of whether the outlets are suitable for multi-branding.

Another strategic response of manufacturers to the problem of brand dilution through multi-branding is an apparent increase in the level of uncertainty faced by the dealer. To this effect Buzzavo and Pizzi (2005) notice that:

> *"Over time manufacturers have tended to reduce the size of the dealer margin (also as an attempt to reduce the size of rebates to customers) and, more important,* ***have begun to transform growing portions of the margin into variable bonuses****. This phenomenon has recently acquired high proportions, with almost all manufacturers in all markets having adopted a highly sophisticated margin structure, meant also as a strategic response to the new regulatory regime (EC Regulation 1400/02) [emphasis added]."*[152]

Theoretically, an increase in uncertainty might induce higher effort/investment levels of dealers: for example, as dealers are unsure about whether they are going to reach the bonus thresholds they are going to put more effort/investment in order to gain security about reaching the relevant thresholds.[153] The rationale for higher investment levels has already been discussed. The manufacturer might also want to induce higher effort levels under multi-branding due to an intensification of the moral hazard problem in the presence of multi-branding.[154] However, independent from the moral hazard problem, the manufacturer might also want to increase effort levels of dealers in order to differentiate its brand from the second brand at the dealer's outlet.

The welfare effects of these strategic responses are ambiguous. On the one hand, one can expect a positive effect of strengthening dealers' incentives by offering performance-driven bonuses. But on the other hand, it could lead to an overall increase in uncertainty that dealers

[151] See EC MEMO/06/120 (http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/120&format=HTML&aged=0&language=EN&guiLanguage=en). The dealer association CECRA also supports that position: CECRA response, page 10: *"[A] dealer requires a showroom that is big enough in order to present cars of several brands in it. Since virtually all brands have growing model ranges, the existing showrooms often were not big enough in the past. That means that in such a case, a dealer first has to build an additional showroom if he wants to take up an additional brand."*

[152] Leonardo Buzzavo, Claudio Pizzi (2005) "Trade Marketing and Vertical Restraints: The Case of Automotive Distribution in Italy".

[153] The effects of uncertainty have for example been recognised in the Michelin case (Case 322/81).

[154] Principal-agent or moral hazard issues arise, because pricing decisions and the provision of sales and after-sale services in the automotive industry is to a large extent unobservable and decentralised. Provision of additional information and other services to the buyer is hard to monitor but can significantly increase the probability of closing the transaction. The industry must therefore heavily rely on incomplete contracts, because parties have asymmetric information and many of the variables are difficult to measure and verify. This is a main reason why most of the distribution system is organised by franchise as the manufacturer can in this way save on monitoring costs and improve overall efficiency: Independent dealers are residual claimants on the income from car sales. This gives them strong incentives to exert more effort and better aligns their incentives with carmakers.

face and therewith a tendency of dealers to overshoot in their efforts in order to secure the bonus. This is especially true if the requirements necessary to receive the bonus are not very transparent or at least not clear to the dealer.[155]

In analogy to the increase in investment requirements it should also be noticed that it is likely that uncertainly attached to the payment structure has increased for most dealers. Thus also these costs are universal.

6.1.2 Shrinking sales network

Another possible reaction to the problem of brand dilution due to multi-branding -in particular within the same showroom- could be that manufacturers reduce the overall density of the distribution network. This would have a positive externality on all remaining outlets in terms of profits. Such a strategy is in particular likely to increase the capacity utilisation rate of the remaining dealers. As outlined in Section 4.2 dealers with relatively low levels of capacity utilisation are the most likely to engage in multi-branding. If, by reducing network density, the manufacturers succeed in increasing the capacity utilisation rate, this might reduce the risk of multi-branding of those dealers significantly.

This potential reaction was pointed out by the European Car Distribution Handbook 2008 of HWB International:

> *True multi-franchising (among competing corporations) does not appear to be rising, manufacturers preferring to shrink sales networks to make exclusivity affordable to dealers.*

To the extent that the network density is reduced due to the motive of the prevention of multi-branding, a decrease in the network density is suboptimal and therefore entails costs to the consumers.

However, network density is a key strategic factor for manufacturers: the degree of network coverage is an essential factor determining the level of sales for a brand. Therefore, the above citation from the European Car Distribution Handbook 2008 should be interpreted with care. Unless empirical analysis shows that manufacturers decreased network density in order to make single-branding more attractive, it appears more likely that other factors determine the degree of network density. In an environment of a decrease in density due to rationalisation processes – see also Section 4.3.3- the increase in the attractiveness of single-branding to retailers might only be a side-effect. So far, there are no direct indications from the industry (other than the above citation) that the rationalisation process of sales networks was strategically driven by the aim of reducing the attractiveness of multi-branding to dealers. We therefore consider this type of costs of minor importance.

6.1.3 Vertical integration

The prospects of multi-branding could result in carmakers integrating downstream and acquiring dealerships and service outlets. After vertical integration, the carmakers, as owners of the dealership, have veto power over the decision of carrying rival brands and therefore are in a

[155] "Loccisano feels pinch from credit crunch", Luca Ciferri, Automotive News Europe, October 27, 2008.

much better position to prevent brand dilution due to multi-branding.[156] As documented in LE report (2006), many carmakers do not allow multi-branding in outlets they own: no multi-branding is allowed in the manufacturer-owned outlets of the brands Citroen, Peugeot, Daewoo, Opel/Vauxhall, Saab, Mercedes Benz, and Nissan.[157]

6.1.3.1 Development of vertical integration

Table 9 shows the total number of integrated outlets from 2004 to 2008 according to the European Car Distribution Handbook. However, it should be noted that integrated outlets in the Handbook are referred to as outlets owned either by the manufacturer or the national distributor, who itself may or may not be owned by the manufacturer. It also shows the number of total main outlets and the number of franchised outlets, as well as the percentage of integrated outlets on all outlets.

Table 9: Outlets by type (2004-2008)

	2004	2005	2006	2007	2008
Integrated outlets (manufacturer/importer)	2,256	2,397	2,297	2,820	2,527
Franchised outlets	70,925	52,272	51,881	52,271	53,709
All (main) outlets	73,181	54,669	54,178	55,091	56,236
Percentage of integrated outlets on all outlets	3.1%	4.4%	4.2%	5.1%	4.5%

Source: European Car Distribution Handbook by HWB International Ltd., ESMT CA.

Overall, vertical integration seems to be on the rise, although it remains an exception rather than the rule. In 2008, out of the total 56,236 main dealer outlets in the EU, 2,527 (4.5%) were owned by the manufacturer or the national importer.[158] There is quite a lot of variation between brands and countries. Five brands account for nearly half of the integrated outlets: Mercedes-Benz (374 integrated outlets), Peugeot (281), Volkswagen (195), Citroen (191) and Renault (174). Geographically, Germany (566), France (350), Spain (180), Austria (177) and the UK (171) account for 57% of all the integrated outlets.

In terms of the absolute number of manufacturer owned dealers, the LE report (2006) provides some evidence that there is a trend towards a higher level of forward integration.[159] Furthermore, in terms of the turnover-adjusted role of manufacturer owned outlets, there is evidence that vertical integration has gathered speed since the introduction of the MVBER. Table 10 shows the average annual increase in vertical integration as measured by the percentage of integrated outlets' turnover on total outlets' turnover from 1997 to 2002. This can be compared

[156] In fact, manufacturers do not need to fully vertically integrate to prevent multi-branding. We understand that it is sufficient that the manufacturer owns the real estate upon which the dealership is located, see paragraph 150 of Guideliness on Vertical Restraints: "Where the buyer operates from premises and land owned by the supplier or leased by the supplier from a third party not connected with the buyer, the possibility of imposing effective remedies for a possible foreclosure effect will be limited. In that case intervention by the Commission below the level of dominance is unlikely."

[157] See LE report (2006), Figure 43.

[158] European Car Distribution Handbook 2008, page 16.

[159] The absolute number in the UK between 1999 and 2004 more than doubled for example.

to the equivalent average annual growth rate from 2002 to 2004 on a country base. It shows that in all countries except Spain, the vertical integration process gathered speed since 2002.

Table 10: Average annual growth rate in vertical integration measured by percentage of integrated turnover on total turnover (1997-2002 vs. 2002-2004, by country)

	1997-2002 (in %)	2002-2004 (in %)
Denmark	-2.1	15.5
Germany	3.1	6.2
Spain	6.4	-13.1
France	0.2	0.6
Italy	27.5	33.3
Netherlands	1.8	4.1
Poland	1.9	14.8
Portugal	-2.6	13.4
UK	-5.9	24.4

Note: For Estonia, Hungary and Sweden the growth rates could not be calculated.

Source: ESMT CA based on LE report (2006), Figure 31.

6.1.3.2 Evidence on efficiency of vertically integrated outlets

Theoretical and empirical results indicate that vertically integrated networks on average are less efficient than independent ones and therefore costly. In a situation of vertical integration, principal-agent or moral hazard issues arise. Pricing decisions and the provision of sales and after-sale services in the automotive industry are to a large extent unobservable or difficult to measure and verify and decentralised. Thus, parties have asymmetric information and the industry must heavily rely on incomplete contracts. In this context, by assigning the decision right to the dealers, the manufacturer can save on monitoring costs and improve overall efficiency. Independent dealers are residual claimants on the income from car sales. This gives them strong incentives to exert more effort and better aligns their incentives with carmakers. Provision of additional information and other services to the buyer is hard to monitor but can significantly increase the probability of closing the transaction. Autonomous salesmen have also more incentives to bargain over price (and trade-in value), which allows them to better price discriminate.

In terms of empirical evidence, Arruñada, Garicano and Vázquez (2005) report that in the manufacturer-owned dealerships they studied, 70-80% of the total compensation of managers was unrelated to performance. This supports that incentives in manufacturer-owned outlets are weaker, since their managers neither fully bear the costs nor fully enjoy the benefits of their decisions.[160]

[160] According to Alfred Sloan, this was the reason why American car manufacturers decided to franchise distribution. See Alfred Sloan, "My Years with General Motors", McFadden, New York (1964), p. 282.

Furthermore, empirical work seems to confirm the theoretical prediction that integrated outlets are less efficient than independent outlets. For example, Arruñada and Vázquez (2003) indicate that contractual solutions are preferable to vertical integration. Their empirical study of car dealers in Spain finds out that, on average, independent dealers were 35% more profitable than integrated outlets. Also, in integrated outlets worker's productivity was 6% lower and average labour costs were 11% higher than in independent outlets.[161]

Additionally to the inefficiencies associated with vertical integration within the principle-agent literature, manufacturer-owned outlet might result in sub-optimal levels of investment. Unlike in the case of independent outlets which often spans generations, the managers at company-owned dealerships tend to be in place for only a few years. As they focus on good short-term financial results, they invest too little and the dealership may get run down in the longer term. In contrast, for smaller and more entrepreneurial independent outlets it is often easier to motivate staff and make faster decisions, because there is no need to consult the headquarters.[162]

Furthermore, there might be other costs associated with an increase in the level of vertical integration: dealer associations acknowledge the increased amount of vertical integration under the current MVBER and its undesirable effect on intra-brand competition.[163] For example, Jaap Timmer, chairman of the European Opel dealers association, has stated that vertical integration of manufacturers into retail creates mistrust among dealers and suspicion that integrated outlets are obtaining special advantages.[164]

6.1.3.3 Summary on vertical integration

As owners of a sales outlet, the decision to engage in multi-branding resides with the manufacturer. Therefore, the multi-branding provisions of the MVBER might have stipulated a higher decree of vertical integration which is overall less efficient than separate ownership due to principal agent problems.

However, vertical integration comes with relatively high costs for manufacturers. First of all, manufacturers have to engage in significant capital investment. But also as shown in the previous paragraph vertical integration is costly in terms of efficiency losses. These costs explain the current predominant model of franchised retail. The decision to vertically integrate in a certain location or not is likely to be based on strong strategic arguments. For example, some dealership locations might be particularly expensive to operate, yet strategically important for the manufacturer such as dealerships located in city centres.[165] In such cases, manufacturers might decide to vertically integrate despite the high capital outlays required for, as well as efficiency losses of vertically integrated outlets. It is questionable whether the incentive to prevent multi-branding at a certain location can be strong enough to induce the required investment by the manufacturer and accept the associated cost.

[161] Benito Arruñada, Luis Garicano, Luis Vázquez, "Completing Contracts Ex Post: How Car Manufacturers Manage Car Dealers" Review of Law and Economics, 2005, 1(1), footnote 5.

[162] "Factory-owned dealerships increase", Automotive News Europe, April 30 2007.

[163] CECRA's response, page 8: "Vertical integration in motor vehicle distribution and services has increased despite the entry into force of BER 1400/2002."

[164] Timmer expects 'modified block exemption', Automotive News Europe, March 3, 2008.

[165] "*[T]he chronic difficulty in maintaining networks in metropolitan centres with their significantly higher establishment costs indicates that further, perhaps radical development of the traditional integrated dealer approach to market coverage is required*" in ICDP Management Briefing #46. See also ICDP Management Briefing #44 "Sustaining representation in metropolitan areas".

So far there is no strong evidence that vertical integration increased due to multi-branding provisions in the MVBER. We therefore consider this type of costs of minor importance.

6.2 Underinvestment by manufacturers due to free-riding

Another commonly recognised problem that the contracts between manufacturers and dealers need to address relates to horizontal externalities and the problem of free riding. Free riding by manufacturers on other manufacturer's investments can be a problem: for example, manufacturers may invest in their brand by providing training to sell or repair the product or initiating an advertising campaign designed to entice customers to visit the sales outlet. Then another manufacturer can take advantage of the increased traffic in the sales outlet or additional skills of the dealer's workforce to sell its own products. The undesirable result of free-riding is under-provision of valuable services to the consumers. Thus, an increase in multi-branding could also lead to inefficiencies in terms of under-investment in non-brand specific investment.[166]

A common remedy to prevent free riding among manufacturers is exclusive dealing, which allows manufacturers to protect non-brand specific investment in their dealers. Non-compete obligations are however ruled out by the MVBER as one of the specific conditions.[167]

This problem of sub-optimal levels of manufacturer investment may also provide manufacturers with additional incentives to integrate forwards to avoid the externality as manufacturer-owned dealerships do not need to accept rival brands. However, as laid out above, vertically integrated outlets need not be equally efficient as independent outlets, which could be another cost of multi-branding.

This particular type of costs is likely to be focused in local markets where dealers are actually multi-branding. Since the level of multi-branding is currently still relatively low, this type of cost is expected to be relatively limited in geographic terms.

6.3 Summary on costs of multi-branding

Costs inherent to multi-branding are difficult to measure precisely. They mostly arise as the manufacturers strategically adjust the organisation of their retail networks to the constrained "second best". In other words, the efficiency of manufacturers' network with forced multi-branding is lower than if they did not face this constraint. These costs can take a number of forms, among others:

- **Brand dilution:** the strength of a brand might be weakened through the joint display with another brand, this is likely to reduce demand for cars overall. Strategies of multi-

[166] See e.g. Verboven (2007) „Efficiency enhancing or anti-competitive vertical restraints? Selective and exclusive car distribution in Europe" section 3.1.3.

[167] MVBER, Articles 1(1)(b) and 5(1)(a).

brand manufacturers, who often avoid mixing their own brands in a single showroom, underpin the importance of this factor and indicate that factors such as creating and maintaining strong brand image, and not foreclosure, are primarily responsible for exclusivity policies.

- **Higher brand specific investment of manufacturer (overinvestment):** in order to avoid brand dilution, manufacturers invest more than without multi-branding in their brands (e.g. advertisement). This type of cost is not restricted to certain geographic areas or consumer types.

- **Higher brand-specific investments of dealers at the point of sale:** in order to avoid brand dilution, manufacturers ask for higher brand specific investment of the dealers in order to differentiate brands more clearly. These costs are quite universal. The establishment or increase in the minimum number of models requested on display per outlet is a special form of higher brand-specific investments which is more likely to affect smaller dealers.

- **Lower non-brand specific investment of the manufacturer (underinvestment):** due to free-riding effects of other manufacturer's brand also displayed within a single dealership, the manufacturer is less inclined to engage in non-brand specific investment (e.g. events at a certain dealership). These costs are likely to apply only to areas where dealers engage in multi-branding.

While there is no sufficient data to precisely estimate the magnitude of these costs, the available information strongly indicates that all of these costs are to some extent empirically present.

7. Balancing benefits and costs of multi-branding

In the previous two sections we have focused on the pro- and anti-competitive effects of same showroom multi-branding. In this section, we assume that, consistent with our counterfactual scenario, the move from the MVBER to the VBER shifts certain decision rights over multi-branding from the dealer to the manufacturer and assess the overall welfare effects. This section is above all a summary of previous arguments. The balancing between costs and benefits is also found in the Executive Summary.

As we have noted in Section 4.2, while there are circumstances in which both dealers and manufacturers would consider multi-branding as their optimal choice, in other settings a manufacturer would prefer exclusivity, whereas a dealer would prefer multi-branding. So other things equal, when shifting certain decision rights over multi-branding from the dealer to the manufacturer, we would expect an overall decrease in multi-branding, although not its complete elimination. We expect multi-branding to remain present in some situations dictated by the market circumstances - for example in low density rural areas with poor geographic coverage – where multi-branding may be necessary from the manufacturer's perspective to ensure its dealer's viability.

Among the **potential benefit of the multi-branding provisions** in the MVBER we have identified a reduced risk of foreclosure, reduction in consumers' search costs and reduction in dealers' operating costs due to reduced economies of scope. Of these potential benefits only limiting foreclosure is listed explicitly in the MVBER regulation.[168] Moreover, we find reasons why the latter two are unlikely to be significant. Thus, the report focuses on the effects on foreclosure. Our findings in relation to foreclosure can be summarised as follows:

- **Limited ability:** on national level, no market participant has a market share large enough to be able to foreclose unilaterally. Foreclosure can only potentially be achieved through cumulative action of multiple participants.

- **Limited incentive:** inter-brand competition in the automotive industry is high, which implies that manufacturers have rather limited incentives to foreclose.

- **Limited relevance of potential volume increase due to multi-branding provisions:** under fairly conservative assumptions, we have estimated that foreclosure could have affected at most 50 out of the 748 (6.7%) country/brand combinations identified. However, the affected countries and brands account for only about 1% of the total volume of cars sold in the EU.

- **Limited benefit to consumers:** the MVBER multi-branding provisions have at best decreased the average level of concentration, as measured by the HHI, by about 19 points. This represents a decrease of about 1.3%. In addition, we approximate the

[168] Recital 29 of MVBER: "*In addition, specific conditions are required to exclude certain restrictions, sometimes imposed in the context of a selective distribution system, from the scope of the exemption. This applies in particular to obligations which have the effect of preventing the members of a selective distribution system from selling the brands of particular competing suppliers, which could easily lead to foreclosure of certain brands.*"

hypothetical change in HHI on segment basis. This analysis shows that even on segment level the potential benefit to consumers is limited. It would involve on average a decrease in the HHI of 38 points. This represents a decrease of about 2%.

- **Overstatement**: If there had been a positive effect of the multi-branding provisions, this was more likely on brands in some of the **smaller markets**. However, even there the impact of the shift to the VBER on consumers is likely to be limited due to the following factors:

    - **Multi-branding may prevail:** To a large extent these can be exactly the regions with lower potential where multi-branding would have arisen regardless of the regulation. If that is the case, as some of the demographics of these markets seem to suggest, then the impact of shifting from the MVBER to the VBER in these regions will also be limited, because it is uncertain if manufacturers will indeed chose exclusive distribution outlets over existing multi-branding outlets.

    - **Entrants have other options:** many recent entrants have successfully expanded using their own existing network (other brands in the same group) or by setting up single-brand network. Multi-branding is just one of several options to expand. Therefore, even if multi-branding could have been prevented by manufacturers, recent entrants are likely to have expanded with their own dealer networks – as this was the choice of many manufacturers for many brands in many countries.

The above suggests that the benefits of multi-branding in terms of preventing foreclosure are limited and restricted to certain smaller countries. However, the **multi-branding provisions of the MVBER also come with costs**: vertical restraints often can have positive effects, for instance by improving quality of services through non-price competition. Appropriately structured vertical contracts can enable suppliers to increase their efficiency by optimising their manufacturing or distribution processes. The potential scope of such optimisation in the automotive industry is significant, because costs of distribution account for about 30% of the total cost of a new car.[169]

Costs inherent to multi-branding are difficult to measure precisely. Some arise as manufacturers strategically adjust the organisation of their retail networks to the constrained "second best". Others may reflect negative effects on manufacturers that are not fully internalised by dealers. In other words, the efficiency of manufacturers' network with forced multi-branding is lower than if they did not face this constraint. These costs can take a number of forms such as brand dilution, higher brand specific investment of manufacturer (overinvestment), higher brand-specific investments of dealers at the point of sale, reduction in the geographic representation of brands (minimum number of models), decrease in network density, increase in vertical integration and lower non-brand specific investment of the manufacturer (underinvestment).

Many of those **costs are quite universal** in their nature as they affect the industry on an overall level and are not related to specific niche brands or specific geographic areas. Only some of the costs are restricted to certain areas; for example increases in the minimum number of models are likely to affect smaller dealers and therewith should be overrepresented in rural areas or increases in the extent of vertical integration are likely to affect urban areas relatively more often.

[169] Mario Monti "Who will be in the driver's seat?", Speech/00/177.

Taken the reported analyses together, the following factors suggest that from a competition policy perspective a move from the MVBER to the VBER will have harmed rather than benefited consumers: (1) The potential beneficial effect of the multi-branding provisions on entry is limited to specific countries and brands. (2) The potential beneficial effect appears very small. (3) The multi-branding provisions induce costs, most of which will impact all brands and all countries. These findings suggest that a specific regulation in the automotive sector might no longer be appropriate and reinforce the European Commission's statement that a "*more effects-based and flexible approach would deliver better results for consumers*".[170]

[170] Commission Evaluation Report on the Operation of Regulation (EC) No. 1400/2002 concerning motor vehicle distribution and servicing, page 12.

8. Other effects of the MVBER on consumer welfare

The previous sections examined in detail the changes in the extent of multi-branding likely to be induced by a shift to the VBER and the resulting overall effects on consumer welfare. This section looks into further effects associated with a move from the MVBER to the VBER and respective other industry regulations. As outlined in Section 3.4, a move from the MVBER to the relevant counterfactual is not expected to generate significant effects in a number of areas: safe harbour provisions, provisions affecting parallel trade, provisions promoting competition between authorised and independent repairers and provisions promoting spare parts producers' access to the aftermarket. This section thus concentrates on effects induced through a shift in bargaining power between dealers and manufacturers (Section 8.1) and the advantages and disadvantages of linking sales and services (Section 8.2).

8.1 Shifting of bargaining power to dealers and consumer welfare

The MVBER contains a number of provisions with the objective of strengthening the weak contractual bargaining power of dealers when negotiating with vehicle manufacturers. These measures in the MVBER include: the right of the dealer to sell the franchise to another business already holding a contract with the same manufacturer, the requirement for a written cause to be given for termination, minimum notice periods for termination of franchise contracts and the right of either party to call for arbitration. The VBER has no provisions addressing imbalances in bargaining power.[171] Therefore the move from the MVBER to the VBER would likely have some impact on dealers.

Furthermore, as mentioned previously with regard to multi-branding, the move to the VBER is similar to shifting certain decision rights from the dealer to the manufacturer. Thus, also in this respect the move to the VBER would reduce the bargaining power of dealers. Similarly, the non-exemption of location clauses increases the bargaining strength of dealers.

This section addresses the expected effects of changes in the bargaining power of dealers and manufacturers. First, the general point is made that balancing bargaining powers between members of a supply chain is usually not part of competition policy. The next subsection sheds some light on potential efficiency reasons for a shift towards more bargaining power on the side of the dealer. The third subsection then looks into potential costs of such a shift.

8.1.1 General competition policy point of view

From the competition policy standpoint, balancing the interests of small companies in negotiating and contracting with larger companies is not a competition issue per se. It is not size in itself that creates a competition issue, but rather the degree of dominance and market power.

[171] However, the provisions regarding minimum notice periods and arbitration mechanisms could be part of a self-binding industry commitment which would enter into force following the expiry of the MVBER according to ACEA and JAMA.

Generally, the distribution of negotiation strength has foremost effects on the allocation of rents within a bilateral bargaining situation: when two parties are sharing a pie of a given size, the distribution of bargaining power determines which party earns how much of the pie. In particular, in the European Union countervailing power is not explicitly recognised as a competitive instrument, and hence support of dealer groups and big dealers can be questionable.

Also, it should be noted that dealers do not constitute a homogenous set of market participants. Some dealers operate at the level of the single franchise; other dealers are part of large dealer groups such as Pendragon, the largest dealer group in the UK. Such dealer groups are likely to have a different level of bargaining power than their smaller competitors. However, the same regulations in relation to the protection of dealer rights within the current MVBER apply to them.

Furthermore, in the context of the MVBER, some of the provisions in favour of dealers can be resolved elsewhere, e.g. in a code of good practice that would be binding for the participants. While one could potentially argue that providing reassurances for the dealers by means of an industry code of conduct has lower value than through block exemption regulation, the exact means of providing and enforcing such assurances are a legal issue and not an economic issue.

8.1.2 Pro-competitive effects of strengthening dealers' bargaining power

Whereas the distribution of bargaining power directly affects the sharing of rents within a vertical relationship, it might indirectly also affect the size of the pie that is going to be shared, meaning that the allocation of bargaining power might have repercussions on the efficiency of the vertical relationship. In the subsequent sections we discuss the following potential efficiency rationales of shifting bargaining power to the dealer: an amelioration of the problem of double marginalisation and the hold-up problem.[172]

8.1.2.1 Double marginalisation

Double marginalisation is an inherent problem in any vertical supply chain with market power. It arises if there are multiple firms in the vertical supply chain which have the incentive and ability to mark up the product's price above its marginal cost. Sequential mark-up at each level of production and distribution leads to a higher retail price for the consumers and lower combined profit for the supply chain than would arise if it was vertically integrated. In consequence, both the consumer surplus and industry profits rise if firms in the same supply chain can avoid double-marginalisation.

Because double-marginalisation only arises if undertakings at multiple levels of the distribution chain mark-up the price of the product above their marginal costs, the problem of double-marginalisation is avoided altogether if at most one of the supply chain stages has market power. Otherwise the problem of double-marginalisation can be solved by vertical integration or by contractual means such as non-linear pricing. Under vertical integration, the merged firm internalises the double mark-up which results in more efficient pricing. Under non-linear pricing the profits at each level of the supply chain are extracted by means other than marginal mark-up; common provisions include two-part tariffs, minimum purchase requirements or quantity forcing discounts.

[172] The exposition of potential efficiency rationales is kept deliberately short as the main focus of the report is on the effects of a change in multi-branding.

In case of **linear pricing structures** within an industry, increasing the bargaining power of the downstream firms eventually leads to a reduction of the wholesale prices paid by the downstream firm. This could in turn lead to a reduction in consumer prices. However, the theory of double marginalisation does not explicitly model the bargaining process between the parties. Therefore, in order to quantify potential benefits from strengthening the bargaining power of the downstream market participant, the impact of the distribution of bargaining power on wholesale prices would need to be modelled explicitly. This modelling process would need to take into account that the linear pricing structure does not lead to an efficient bargaining outcome.

Furthermore, in order for this efficiency to materialise the following would need to be shown: (1) the industry is characterised by linear prices and a change in bargaining power would not reverse this fact and (2) there exists market power on both levels of the supply chain: the upstream and downstream market.

Since bargaining models of the vertical supply chain usually do not incorporate efficiency losses due to double marginalisation, it is unlikely that the strengthening of dealers bargaining power leads to gains in terms of double marginalisation.

8.1.2.2 Hold-up and opportunism

Whenever there is need for relationship-specific investments to be made by either the supplier or the buyer, there is a potential for a hold-up problem to occur.[173] Generally speaking, hold-up problems can occur when complete contracts on relationship-specific investments cannot be written: suppose an authorised service centre needs to purchase specific machines and tools in order to be able to perform repairs of a particular brand of cars. Suppose further that the manufacturer can terminate the relationship with the service outlet any time and that such termination does not induce additional costs for the manufacturer. In such an environment, the bargaining power lies with the manufacturer after the investment decision of the service outlet. Therefore, the service outlet might fear that the manufacturer reaps the rents of its investment effort. It is thus not going to invest to the socially optimal level.

Generally, parties will have no incentives to commit to socially efficient investment levels unless they are in a stable contractual relationship, which gives the investor sufficient prospects of recovering the investment costs over time. The more relation-specific is the investment, the longer and more restrictive a contract may be required to induce it. For the hold-up problem to occur a number of specific conditions on the investment must be met:

1. An investment must be relationship-specific in the sense that it can only be used in conjunction with a particular brand, cannot be used profitably with alternative brands and cannot be resold without incurring a significant loss.

2. The investment must be long-term in nature and cannot be recouped in the short run.

3. The investment must be asymmetric, i.e. one party must invest significantly more than the other party.

[173] Guidelines on Vertical Restraints, Paragraph 116(4).

When these conditions are met, there is usually a good reason to have a vertical restraint for the duration it takes to depreciate the investment.[174] It is usually achieved by granting the dealer exclusive distribution rights in a territory or an exclusive consumer group.

In extreme cases, the hold-up problem can only be solved by vertical integration of the affected parties. In the light of the hold-up problem, dealers will not make necessary brand-specific investments unless there are contractual assurances in place that allow them to recoup the costs of the investments. Therefore clauses such as **minimum prior notice** before termination; providing **objective reasons for termination** or the right to call for **arbitration** can be seen as reducing the possibility of the hold-up problem to occur, and therefore as increasing the investment incentives of dealers.[175] However, if hold-up is a real possibility parties are likely to have economic incentives to structure their relationship in such a way as to mitigate the problem, even absent any regulatory provisions. This intuition is consistent with the fact that manufacturers proposed provisions to that effect in their code of good practice.

Furthermore, empirical analysis of contracts between dealers and manufacturers indicates that in practice reputation effects can mitigate the hold-up problem: Arruñada, Garicano and Vázquez (2005) analyse in detail performance and features of hundreds of manufacturer-dealer contracts in Spain under the previous MVBER, when dealers' interests were not as strongly protected against the manufacturers' opportunism.[176] In particular, the paper analyses the asymmetric nature of the relationship between manufacturers and dealers; for example, manufacturers can decide what constitutes underperformance on the part of a dealer. In theory, they could abuse that right and terminate the contract appropriating the dealer's economic rents under the guise of underperformance, as it is difficult for an independent third party to distinguish between opportunistic and disciplinary cancellation. This apparent asymmetry seems to expose dealers to a large risk of expropriation by manufacturers. However, the authors find that termination of the contract only plays a role as a disciplinary device of a last resort. They concluded that termination is mostly used to punish repeated and serious non-performance. They argued that the long term harm to the brand's reputation would well outweigh any short-term opportunistic gains: [177]

> *"The large investments made by manufacturers to create a brand name provide an implicit guarantee of their honest behavior. Manufacturers are involved in repeated transactions with a large number of dealers all over the country. A strategy of expropriation of dealers' quasi-rents would therefore be costly to them: not only because the possibility of finding good dealers would decrease, but also*

[174] Guidelines on Vertical Restraints, Paragraph 116(4).

[175] The manufacturer may also use opportunistic behaviour other than unjustified contract termination to expropriate dealers' rents. For example, he can increase the number of dealerships selling his cars in the same local market, which would make it more difficult for the incumbent dealer to recover his sunk costs. Clearly, in this context some MVBER provisions making exclusivity more difficult such as the location clause may have a negative impact on preventing hold-up to occur. However, increasing the number of dealership clearly comes at different costs to the manufacturer than terminating the relationship with a specific dealer. Another way to extract dealers' rents is through a so called ratchet effect (Xavier Freixas, Roger Guesnerie, Jean Tirole "Planning under Incomplete Information and the Ratchet Effect", The Review of Economic Studies, Vol. 52, No. 2 (Apr., 1985), pp. 173-191). It takes place if the manufacturer opportunistically revises his incentive schemes and over time raises the sales targets that dealers must attain to take into account market information provided by the dealers. Ratchet effects can result in dealers purposefully underperforming to avoid even more demanding requirements in the future.

[176] Benito Arruñada, Luis Garicano, Luis Vázquez, "Completing Contracts Ex Post: How Car Manufacturers Manage Car Dealers", Review of Law and Economics, 2005, 1(1), Article 8.

[177] Benito Arruñada, Luis Garicano, Luis Vázquez, "Completing Contracts Ex Post: How Car Manufacturers Manage Car Dealers", Review of Law and Economics, 2005, 1(1), Article 8, Section 4.1.

> *because current dealers would reduce their quality of service in order to recover the quasi-rents associated with their specific investments as soon as possible."*

In another paper, Williams (1999) analyses a similar issue using a large database of franchisees in the US.[178] In the data, the conditional probability of termination decreases significantly as outlet performance increases, while theory predicts the opposite relationship if franchisors were primarily motivated by opportunism. He concludes that terminations of franchise contracts are usually motivated by efficiency considerations and not by opportunism:

> *Finally, the results of this study are relevant to several ongoing policy debates. First, the majority of franchise contracts grant to franchisors the right to terminate franchisees. These so-called "at-will" termination provisions are viewed with a cynical eye by policy-makers who are concerned that franchisors may use the right to terminate to appropriate the investments of franchisees. However, the results of this study suggest a more benign rationale for termination provisions. By enabling franchisors to screen out "bad" franchisees after having the benefit of observing their performance over time, termination provisions economize on the cost of precontractual screening franchisees. Thus, termination provisions are efficient contracting.*

To summarise, while in theory the hold-up problem might occur in the automotive industry, in practice it is mitigated in particular by reputation effects.

8.1.2.3 Summary on efficiency considerations for stronger dealers

In relation to a shift in negotiating power towards the dealers, we find that efficiency rationales might be present. However, their reach seems to be limited. A stronger position of dealers might reduce the wholesale prices they pay and thereby reduce the effects of potential double marginalisation within the industry. Still, this is unlikely to be the case, since double marginalisation usually does not emerge in bargaining models of vertical supply chains. While theoretically there is a cause for introducing specific contractual rights for the dealers within a sector regulation, there is empirical evidence that reputation effects are sufficient to keep the contract termination rights of the manufacturer in check. Furthermore, there is evidence that, to the contrary, manufacturers might use the contract termination rights efficiently as an instrument of screening bad dealers out of the network.

We conclude that efficiency rationales do not warrant the general enforcement of increased dealer powers, in particular in the light of the self-regulating forces of the industry. Furthermore, in the following subsection, we look into potential negative effects resulting from the accompanying stipulation of dealer consolidation.

8.1.3 Anti-competitive effects of strengthening dealers' bargaining power

The strengthening of bargaining power for dealers might also induce costs: on the one hand, certain provisions might stipulate dealer concentration, which might ultimately lead to local market power for dealers. On the other hand, manufacturers might be hindered in the design of an optimal distribution network.

[178] Darrell L. Williams, "Why do entrepreneurs become franchisees? An empirical analysis of organizational choice" Journal of Business Venturing, Volume 14, Issue 1, January 1999, Pages 103-124.

8.1.3.1 Fostering of dealer concentration

The regulation can have lasting, undesirable economic effects. The unencumbered right of the dealer to sell its franchise to another dealer facilitates consolidation, which can be undesirable for the consumers. The possible harmful effects of excessive local dealer concentration, in particular higher local prices (double marginalisation) and lower service levels, have been recognised. For example, in the UK in order to maintain local competition as a condition of an approval of a merger, some dealer groups have been required to divest some outlets.

Additionally to the right to sell its franchise to another dealer, which is a necessary condition for dealer consolidation, a general increase of bargaining power makes the consolidation process for dealers more attractive as increasing bargaining power facilitates the appropriation of rents from the manufacturer. Thus, an acceleration of consolidation could be expected.

As already pointed out in Section 4.3, there is a trend for fewer and larger dealer outlets. Thus, it is not surprising that also dealer concentration is on the rise. This is evidenced for example by Figure 35 of the LE report (2006) which is reproduced below, see Table 11. This shows that the share of the top 20 dealers in terms of total turnover increased in all selected countries significantly. The country with the lowest increase of 23% between 1997 and 2004 is Spain, whereas France shows the highest increase with 76% during the same period.[179]

Table 11: Index development of share of top 20 dealers by country (total turnover, 1997-2004)

Country	1997	1998	1999	2000	2001	2002	2003	2004
Germany	100	100	104	114	129	145	156	162
Spain	100	98	101	107	113	116	120	123
France	100	95	97	104	110	120	142	176
Italy	100	119	138	153	161	164	166	165
Netherlands	100	99	96	96	106	117	126	131
Poland	100	124	148	167	175	175	172	173
UK	100	83	91	97	108	104	117	142

Source: LE report (2006), Figure 35.

Table 12 shows similar effects on development of the share of top 50 dealer groups since 2001, based on research by ICDP. It shows that the share of the 50 largest dealer groups varies by country and that the UK displays the highest share of the top 50. Furthermore, it indicates that in all four countries the share of top dealers is increasing since 2001, where the growth appears to be dependent on the level of the market share: countries with already high levels of market shares in 2001, like the UK and France, display significantly lower average annual growth rates than countries with lower initial levels of market shares (Germany and Italy).

[179] This information is based on a survey that London Economics send to manufacturers.

Table 12: Development of market share of top 50 dealer groups by country (in %, 2001-2006)

Country	2001	2003	2006	Average annual increase (in %)
Germany	10	14	17	11.2
France	19	22	23	3.9
Italy	11	15	18	10.4
UK	32	33	34	1.2

Note: dealer groups exclude manufacturer owned dealers; a dealer group is defined as a company operating two or more outlets; market shares include LCV (light commercial vehicles).

Source: ICDP Research Report 1/08: "Dealer Group Trends in Europe", page 3; ESMT CA.

Thus, in an environment of increasing levels of dealer concentration, regulation favouring further concentration should be carefully considered. In particular, when the available margin and profitability data indicate that larger dealers are not necessarily more efficient, as shown in Section 5.3. However, the above data relates to countries as opposed to local/regional markets. It should be noted that concentration in local/regional markets can generate market power and ultimately negative effects on consumers. Concentration in local/regional markets is not necessarily correlated with national markets. Therefore, the above should be interpreted with care.

8.1.3.2 Design of optimal distribution network

In light of changing demand and supply conditions such as increases in the number of models per brand, it is conceivable that there is a constant need for the manufacturer to adjust the distribution network accordingly. This adjustment and rationalisation process might be hindered by certain provisions strengthening dealers' powers.

8.1.4 Summary on shift in bargaining power

Moving from the MVBER to the VBER gives manufacturers more leeway in preventing multi-branding of any type resulting in a general shift of bargaining power to manufacturers. This and other provisions in the MVBER which do not exist under the VBER, like the right to sell their franchise (and contract with the manufacturer) without consent of the manufacturer, may shift the bargaining power from dealers to manufacturers. A shift in bargaining power implies foremost a change in the distribution of rents between manufacturers and dealers. From an efficiency and consumer perspective, changes in bargaining power only matter if it impacts the efficiency of the vertical relationship.

In relation to pro-competitive effects of strengthening dealers' bargaining power we find that in some industries a shift in bargaining power to retailers or other downstream units may be desirable in order to lower the margins upstream and, hence, unit costs (and ultimately prices). However, there appears little evidence of a lack of competition. Hence, excessive margins at the manufacturer level seem unlikely. Furthermore, specific contractual rights for the dealer might be justified by the fear that manufacturers may use the right to terminate a contract in order to appropriate the investments of dealers. However, there is empirical evidence that reputation

effects are sufficient to keep the contract termination rights of the manufacturer in check. Furthermore, there is evidence that, to the contrary, manufacturers might use the contract termination rights efficiently as an instrument of screening bad dealers out of the network.

At the same time, shifting bargaining power to dealers may also result in consumer harm since it might lead to dealer concentration in relevant anti-trust markets. Additionally, such a shift may also prevent the optimisation of dealer networks as it becomes more difficult to rationalise the network. The optimisation of dealer networks is further hindered by forbidding location clauses in dealer agreements undermining quantitative selection.

Competition policy arguments can therefore not serve as a *general* justification for "protecting" dealers' bargaining power, even if this may be desirable under specific circumstances.

8.2 Unbundling sales from services and consumer welfare

The MVBER -in contrast to the VBER- withdraws the benefit of the exemption from any agreements that make access to the authorised retailer network conditional on an obligation to also provide repair services or vice versa. Thus, in this section we shed some light on potential costs and benefits of the explicit separation of sales and services. This section focuses on the effects of a restriction of sales contracts not to be conditional on services contracts. As will be argued below, the reverse case is of no practical importance.

8.2.1 Level of stand-alone outlets

While the MVBER tried to promote diversity in distribution formats, virtually all car manufacturers have opted to use qualitative selective repair systems and quantitative selective distribution systems. Quantitative selective distribution allows carmakers fairly close control over the size and geographic distribution of their sales networks. In contrast, under qualitative selective distribution carmakers have only limited control over the size and geographic distribution of their service networks, since they have to authorise any service outlet which satisfies the specified set of criteria.[180]

One consequence of these differences in the distribution formats chosen for sales and services, together with the unbundling of the sales and service contracts, lead to a relative proliferation of stand-alone authorised service centres. We have no exact information on the number of dealers/repairers that hold only sales or only service contracts. However, the European Car Distribution Handbook 2008 provides some information on the total number of service contracts. This number includes dealers/repairers that hold only a service contract as well as those that hold a service and a sales contract. Furthermore, the European Car distribution Handbook 2008 displays some information on the total number of sales contracts, again including sales only contracts as well as dealers/repairers that hold both types of contracts.[181] These data show that

[180] Yet, manufacturers have tried to retain some control over the size of the qualitative selective network by increasing the access requirements to the network. The effect on consumers is ambiguous: on the one hand, higher requirements presumably lead to a higher level of service which should benefit consumers. On the other hand, it is uncertain to what extent the increase in the requirements was productive with its main goal to regain some control over the size of the authorised service network.

[181] See European Car Distribution Handbook 2008, page 6.

the total number of service contracts increased from around 50,000 to 55,000 in 2002 to 76,000 in 2008. In comparison, the total number of sales contracts decreased from around 50,000 to 55,000 in 2002 to about 45,000 in 2008. This indicates that the number of service only contracts increased considerably within that period.[182]

The industry regulation preceding the current MVBER imposed an obligation for manufacturers to appoint only dealers which also offered after-sales services. Therefore prior to 2002, there existed no dealers which held only sales contracts. With the introduction of the MVBER, some dealers holding only sales contracts might have emerged. However, it appears that this development is nowhere close to the development of service only repairers given the development of the total number of sales and the total number of service contracts.

This phenomenon that only a small number of stand-alone dealers emerged can be explained by the profit structure: dealers' profits are generally generated by after-sale activities rather than through the sale of new motor vehicles.[183] For that reason specialisation in sales is relatively unattractive in comparison to specialisation in servicing.

8.2.2 Qualitative selective repair systems and their relation to Article 4(1)(h)

As already pointed out, virtually all car manufacturers have opted to use qualitative selective repair systems.[184] It is unlikely that this choice is going to be affected with a move to the VBER, since in most cases the authorised networks exceed a market share of 30%.

Since a requirement to sell new cars for a repairer does not constitute a qualitative, but rather a quantitative criterion, such a requirement is not allowed under qualitative systems.[185] Therefore, as long as qualitative repair systems prevail, Article 4(1)(h) –namely that agreements are not exempted that require the repairer to also sell new cars- is redundant.[186]

In the following, we focus on the effects of Article 4(1)(g), which does not exempt agreements making the sale of new cars conditional on repair services.

8.2.3 Pro-competitive effects of unbundling sales and services

Marketing studies indicate that people are willing to travel much further to purchase a car than to have it serviced.[187] This implies that from the consumer's perspective the desirable service network density is likely higher than the sales network density. This provides a sound economic justification for unbundling sales from services and for the existence of stand-alone authorised repairers. However, as argued above, it is not going to be possible to condition repair contracts

[182] The exact development of service only contracts cannot be deducted as we only have information on total number of sales and total number of service contracts. By the same token, the development of sales only contracts cannot be deducted from the available sources.

[183] Staff Working Document 2 to the Commission Evaluation Report, page 20.

[184] Commission Evaluation Report.

[185] Commission Evaluation Report, page 8.

[186] Staff Working Document 4 to the Commission Evaluation Report, page 25.

[187] See e.g. "Block exemption regulation. The bar room brawl series" PricewaterhouseCoopers, page 51.

to sales of new cars under the selective distribution under the VBER. Therefore, the benefits of a denser service than sales network are likely to remain in place.[188]

With respect to Article 4(1)(g), which does not grant exemption for agreements restricting the sales dealer's ability to subcontract repair services, the Commission's aim was to free-up additional space within the dealerships in order to facilitate multi-branding in the short run.[189] In previous sections, the pro- and anti-competitive effects of multi-branding have been discussed. It is argued that, firstly, the expected change in multi-branding due to a shift in decision rights is limited, and secondly, a higher extent of multi-branding is likely to be welfare decreasing on balance. Furthermore, the Commission raises the question whether the provision was apt in the first place to facilitate multi-branding:

> *One may also question its relevance, since it is difficult to imagine how contracting out could have any impact on intra-brand competition in vehicle sales, even if the difference in margins between sales and after-sales were to be ironed-out. It seems in particular unlikely that freeing-up space in dealers' premises would lead to an expansion of multi-branding, given that on the one hand, dealers show no appetite for selling more than one brand in the same showroom, and that on the other hand, the spatial requirements for a workshop are very different from those of a showroom. Article 4(1)(g) can therefore be seen to have been ineffective and to lack relevance.*[190]

While it appears that the provision contained in Article 4(1)(g) is ineffective in stipulating multi-branding, it might well have some undesired negative effects due to the loss of contractual flexibility for the manufacturer. This issue is further discussed in the following section.

8.2.4 Anti-competitive effects of separation

This section looks into possible foregone efficiencies of forcing the separation of sales contracts from the servicing part of the business. If bad service has an overall damaging effect on the brand, the manufacturer has a strong interest to incentivise the repairer to deliver high service levels. We understand that currently manufacturers try to keep service levels by implementing high standards within the qualitative selective distribution network. However, there might be other or complimentary ways to ensure high service levels by allowing more flexible contracts between manufacturers and dealers/repairers. This section develops the idea that linking sales and service contracts enables the manufacturer to incentivise dealers in their services such that they take into account the negative reputation effects of bad services on the brand image.[191]

[188] Prior to the MVBER, the bundling of sales and services was obligatory. Therefore, the fact that we did not see separate service outlets does not imply that manufacturers had an interest in keeping sales and services together. Since the nature of consumer demand determines the optimal network density from the point of view of the manufacturer, it is not immediately clear why a manufacturer would prefer to always bundle sales and servicing in comparison to a denser servicing network. Therefore, it is unclear whether a specific regulation with respect to separating sales from services would be needed.

[189] Commission Evaluation Report, page 4.

[190] Staff Working Document 4 to the Commission Evaluation Report, page 12.

[191] It is understood that for an integrated sales outlet, comprising sales and services functions, low levels of service negatively affect sales at the outlet level: as consumers in their purchasing decision take after-sales services into account, a low expected level of services at the dealer is going to reduce the likelihood of purchase. However, low service levels might not only affect sales at that particular outlet, but might also negatively affect the brand's reputation overall and therewith reduce overall sales of the brand. This effect is however not internalised by the dealer/repairer itself and the manufacturer needs to find a way to induce higher service levels. By linking sales contracts with service contracts an optimal service level can be achieved.

The idea can be illustrated within two stylised settings: (1) a setting where different dealers/repairers provide different levels of service (heterogeneous dealer types) and (2) a setting where providing high levels of service is costly for the dealer/repairer (moral hazard). In the first setting with **heterogeneous dealer types** some outlets provide high levels of service and some outlets provide low levels of service. Intuitively, it is always optimal for the manufacturer to induce more sales by dealer/repair shops with high service levels than by ones with low service levels. The reason is that an additional sale of a new car has the same impact on the downstream revenue and profits in each local market. When the high-type dealer sells an additional car, however, this raises the average level of repair services and, therefore, the brand value or nation-wide sales of new cars. In practise, the manufacturer can achieve more sales of high types by setting a lower price for new cars for high-type dealers than for low-type dealers (and at the same time asking for a higher fixed fee from high-type dealers than from low-type dealers). Notice that the logic behind this example is extremely robust suggesting that a per-se prohibition of linking sales and service contracts is unwarranted.

In the second setting, all dealers/repairers can theoretically supply high and low levels of services. However, the provision of **high service levels is costly** to the dealer/repairer. This is a standard model known in the economics literature as moral hazard.[192] Generally, there are contractual solutions which induce the right level of effort by the agent available without linking different business departments. So also in the present situation it is possible to solve the moral hazard without conditional contracting of sales and services: a manufacturer can simply offer a bonus to dealers/repairers with high effort levels.[193] However, it might be preferable to solve the moral hazard problem by reducing the wholesale price for new cars in case of high effort levels. In vertical relationships different members of the supply chain often put separate mark-ups at each stage of the chain. This leads to the double marginalisation problem.[194] This problem of double marginalisation can be reduced if conditional sales and services contracts are allowed. The intuition is simple: linking service contracts to sales contracts enables the manufacturer to set repair service incentives by reducing the mark-up problem. This does not only increase producer surplus, but will in addition also lead to an increase in consumers' well-being by reducing the price of new cars and increasing the average service level.

Overall, welfare might increase due to more contractual flexibility between manufacturers and dealers/repairers.

8.2.5 Summary on separation of sales and services

The negative effects of a transition from the MVBER to the VBER in relation to the provisions on unbundling sales and services are considered to be minimal or inexistent:

- Agreements rendering services conditional on sales (Article 4(1)(h)): since most repair networks are organised, and have to be organised, under the qualitative selective system, Article 4(1)(h) is effectively redundant. A requirement to sell new cars does not qualify as a qualitative criterion for the selective system. Thus, service contracts conditional on the sales of new cars are also not exempted under the VBER.

[192] For more detail on the moral hazard problem in the automobile industry, see Section 6.1.1 and 6.1.3.

[193] We assume that the manufacturer can monitor the dealer and thus gets a signal about the level of services provided.

[194] For further information on the double marginalisation problem, see Section 8.1.2.

- Agreements rendering sales conditional on services (Article 4(1)(g)): although this provision has no counterpart within the VBER, the removal of this provision is unlikely to have any negative effects for the following reasons. First, not many dealers have taken up the opportunity to become stand-alone dealers. Since dealers profits are mainly generated within the repair section, this is not a surprising result. Second, it appears that the provision is ineffective in stipulating multi-branding, which it was supposed to do by freeing-up capacity within the dealership.

While there are no or minimal negative effects, there exist positive effects of a transition from the MVBER to the VBER due to increases in contractual flexibility. In the presence of a positive impact of high service levels on overall brand perception, linking sales contracts to services contracts can induce higher overall levels of service as dealers take into account the negative reputation effects of bad services on the brand image. By doing so, overall welfare can be increased. Since most dealer outlets are currently combined outlets, it is likely that significant efficiencies are foregone due to the fact that no linkage is possible.

Appendix 1 Theories of harm associated with distribution systems

The anticompetitive effects of vertical agreements are less straightforward than those of horizontal agreements. In the following, we provide a brief overview of two vertical competition issues that the MVBER was supposed to address when introduced in 2002. These relate to the combination of selective and exclusive distribution which was possible under the predecessor of the MVBER. Since a combination of selective and exclusive distribution is not possible under the VBER, we present those theories only in the Appendix:

- **Limitation of cross-border trade**: The combination of selective and exclusive distribution which was accepted under the older regulation of the industry might have restricted parallel trade and therewith allowed for the possibility of international price discrimination.

- **Limitation of intra-brand competition:** The combination of the two distribution systems might have hindered intra-brand competition on the national level leading to softer competition on the inter-brand level.

A1.1 Limitation of cross-border trade

A limitation of international trade might result in international price differentials. However, this does not necessarily imply that consumers are worse off or total welfare decreases in comparison to a world of uniform prices, because as a number of theoretical papers show, price discrimination may instead intensify competition between oligopolists, leading to lower prices for all consumers. There is no usual welfare trade-off between different consumers' groups which is characteristic of monopolistic price discrimination. The intensified competition due to price discrimination may make all firms worse off and as a result firms may wish to find a way to commit to the uniform (non-discriminatory) pricing.[195]

In the following, we first discuss the empirical evidence on price differentials. Then, the incentive for manufacturers to engage in price discrimination is examined and the empirical evidence on the change in consumer welfare is illustrated.

There is empirical evidence that suggests that prior to the MVBER there have been only limited parallel imports.[196] In particular, persistent price differentials are taken as an indication for this. However, there are many reasons for the existence of international price differentials, such as differences in distribution costs, different tax regimes, different tastes, etc. Empirical research by Goldberg and Verboven (2001) indicates that substantial year-to-year volatility of these price differentials is to a large extent explained by exchange rate fluctuations and the incomplete response of local currency prices to these fluctuations.[197] Goldberg and Verboven (2001) estimate

[195] This possibility is described for example in Kenneth S. Corts "Third-Degree Price Discrimination in Oligopoly: All-Out Competition and Strategic Commitment" The RAND Journal of Economics, Vol. 29, No. 2 (Summer, 1998), pp. 306-323, Mark Armstrong and John Vickers, "Competitive Price Discrimination", The RAND Journal of Economics, Vol. 32, No. 4 (Winter, 2001), pp. 579-605 and Dobson and Waterson (2005): "Chain-Store Pricing Across Local Markets", Journal of Economics & Management Strategy, Volume 14, Number 1, Spring 2005, 93–119.

[196] See Goldberg and Verboven (2001): "The Evolution of Price Dispersion in the European Car Market", Review of Economic Studies, 68, 811-848.

[197] Goldberg and Verboven (2001): "The Evolution of Price Dispersion in the European Car Market", Review of Economic Studies, 68, 811-848.

to which extent international differences in prices can be attributed to differences in actual mark-ups. Differences in mark-ups might be driven by several factors such as differences in tastes across countries, mark-up adjustment in response to local cost differences such as exchange rate fluctuations or different tax systems and differences in firm conduct (collusion). They find that the main drivers of international price differences are actually differences in distribution costs:

> *"Local costs explain two thirds of observed incomplete exchange rate pass-through, the phenomenon that exporters only partly lower their local prices when the foreign currency appreciates (and vice versa). Markup adjustment explain the remaining part."*[198]

The original paper uses panel data from 1980 to 1993, before the Euro was introduced. With the introduction of a common currency the incomplete pass-through of currency rate fluctuations was eliminated. Not surprisingly, their more recent research using newer data shows gradual convergence of international car prices within the European Union.[199]

Apart from the question whether there exist international differences in prices that result in higher mark ups in one country as compared to another, it is essential to examine the incentive of manufacturers to engage in international price discrimination: Do manufacturers benefit from international price discrimination in comparison to uniform pricing? The answer to this question depends on a number of factors such as the number of firms in the market or the competitiveness of the market. The ability to charge different prices in different countries would clearly benefit a monopolist. In a competitive setting, however, under certain conditions this ability enhances competition. Therefore, in oligopolistic markets suppliers' profits can be lower when price discrimination is allowed.

For the European car market, Brenkers and Verboven (2006)[200] analyse the question empirically. They find that profits would not significantly decrease if companies are bound to uniform pricing, and under certain condition might even increase. Furthermore, Brenkers and Verboven find little evidence for substantially negative effects on total consumer welfare. However, there appear to be big distributional effects among customers (from UK to continental European customers). Consequently, if the distribution arrangements that lead to a potential limitation in cross-border trade and therefore the sustainability of international price discrimination have even minor efficiency reasons, the overall welfare effects of price discrimination are likely to be positive.

In terms of evidence on the impact of the MVBER, the evaluation report of DG Competition (2008) looks at the following indicators in relation to limitation in cross-border trade:[201]

- *Price differentials*: Price differentials across European countries are decreasing since the entry into force of the MVBER.

[198] Verboven (2007): "Efficiency enhancing or anti-competitive vertical restraints? Selective and exclusive car distribution in Europe", mimeo, footnote 28.

[199] Goldberg and Verboven (2005): "Market Integration and Convergence to the Law of One Price: Evidence from the European Car Market", Journal of International Economics, 65(1), 49-73.

[200] Brenkers and Verboven (2006): "Liberalizing a distribution system: the European Car Market", Journal of the European Economic Association, 4, 216-251.

[201] Staff working document No. 2, page 23f.

- *Parallel imports*: there seems to be very limited evidence on the extent and evolution of parallel trade.

Summary: The effects of a stipulation of international intra-brand competition are theoretically ambiguous. Empirically, only a very limited effect on consumer welfare could be found. Efficiencies associated with vertical agreements might therefore outweigh the limited negative consumer welfare effects due to international price discrimination.

A1.2 Limitation of national intra-brand competition and softening of inter-brand competition

A1.2.1 Relationship between inter- and intra-brand competition

Modern industrial organisation theory suggests that when assessing competitive effects of vertical agreements, it is important to distinguish between inter-brand and intra-brand competition. According to the Guidelines on Vertical Restraints:

> *[F]or most vertical restraints competition concerns can only arise if there is insufficient inter-brand competition."*[202]

If inter- brand competition is strong then vertical restraints may actually be helpful in allowing suppliers to efficiently organise their own distribution networks and excess profits will be competed away between networks.

So, in general, vertical restraints that reduce inter-brand competition raise much more significant concerns than the ones limiting intra-brand competition.[203] Furthermore, vertical restraints that reduce intra-brand competition, but at the same time strengthen inter-brand competition, may be desirable and efficiency enhancing. For example, quantity forcing is used in order to ameliorate the double marginalisation problem, but may also restrict intra-brand competition. However, it leads at the same time to lower retail prices and an increase in inter-brand competition.

In contrast, some vertical restraints that reduce intra-brand competition may at the same time limit inter-brand competition: a limitation of national intra-brand competition on the dealer level by imposing exclusive territories can under certain circumstances lead to a situation of limited inter-brand competition between manufacturers and loss of consumer welfare, see Rey and Stiglitz (1995).[204]

[202] Guidelines on Vertical Restraints, Paragraph 119(1).

[203] Guidelines on Vertical Restraints, Paragraph 119(2).

[204] See Rey and Stiglitz (1995): "The Role of Exclusive Territories in Producers' Competition", RAND Journal of Economics, 26(3), 431-451. Rey and Stiglitz find that imposing exclusive territories which limit national intra-brand competition between dealers may under certain assumptions lead to a situation where it also is used to limit inter-brand competition between manufacturers and as a result entail negative consumer welfare effects.

A1.3 Inter-brand and intra-brand competition in MVBER

The combination of the selective and exclusive distribution systems might not only have hindered international intra-brand competition (i.e. cross-border trade within a brand), but national intra-brand competition as well by effectively strengthening the market power of the dealer in a given country.

Brenkers and Verboven (2006) quantify the possible competitive effects from introducing the MVBER on the car market with a view to the findings by Rey and Stiglitz on welfare effects of exclusive territories. In the absence of clear prior empirical evidence, they first distinguish between two different hypotheses most likely to apply to the car market before the enactment of the MVBER, namely that (1) the distribution systems had been limiting international intra-brand competition only and that (2) the distribution systems also limited national intra-brand competition. Depending on the hypothesis, the main effect of the MVBER on intra-brand competition would then be either to reduce international price discrimination or national double-marginalisation.

They find from the data that the (total) consumer welfare effects in Europe remains small under the first hypothesis, while they are much higher under the second hypothesis. What is more noteworthy, however, is that the effect on manufacturer's profits under both hypotheses is negligible or even positive. Brenkers and Verboven conclude from these findings that a limitation of intra-brand competition (international or national) does not constitute the manufacturers' central profit motive. Therefore, they call for caution when it comes to regulating vertical restraints or at least narrowing down the scope of exempted vertical restraints. Since manufacturers must have had a rationale other than profit considerations by upholding the system (e.g. public goods aspects in providing after-sales services), Brenkers and Verboven cannot rule out potential large efficiency losses or at least a reduction in the net welfare gains through regulation.[205]

In terms of evidence on the impact of the MVBER, the evaluation report of DG Competition (2008) finds only limited support for a stipulation of national intra-brand competition. The evaluation reports looks at the following indicators:[206]

- *Diversity of distribution formats*: Distribution formats are still largely homogenous and there is no expectation that this is going to change in the near future. Most dealers chose the selective distribution system with fairly similar basic selection standards. There appears to be also relative homogeneity in the remuneration system and most manufacturers have concluded unlimited duration contracts.

- *Dealer concentration and network density*: There has been a rationalisation process in place which has reduced the number of dealer outlets by around 6% from 2002 to 2006, accompanied by an increase in the average throughput of each outlet. Efficiencies and economies of scale have been put forward as the main drivers of the concentration. However, the process of concentration started well before the entry into force of the new MVBER, with decline in dealer outlets by 30% during 2000 to 2003. Even though concentration is rising on the retailing side, the level of concentration is still modest;

[205] Brenkers and Verboven (2006): "Liberalizing a Distribution System: The European Car Market", Journal of the European Economic Association 4(1): 216-251.

[206] Staff working document No. 2, page 14ff.

the largest 50 dealers have a (volume) market share of 10% (which is lower than in the US).[207]

- *Vertical integration*: There appears to be disagreement about the actual level of vertical integration on the dealer level and its increase. The market share of integrated importers/wholesalers however has increased since 2002, especially for selected brands.

- *Innovations in distribution*:

    - *Specialisation in sales*: The percentage of stand-alone dealers which do not provide repair and maintenance services is marginal. According to the dealers, the stand-alone business is not attractive due to higher margins in the repair and maintenance segment.

    - *Multi-branding*: According to a report by LE report (2006),[208] the number of dealers selling several brands has increased over all (from 7% in 1997 to 17% in 2004). However, there is large variation across Europe. Furthermore, multi-branding is more common for dealers selling volume brands (as opposed to premium brands) and dealers selling small brands that recently entered the market. Multi-branding has not increased for dealers that show the brands in the same showroom.[209] Instead, multi-branding seems to have mainly increased due to large dealer groups with several outlets selling different brands.

    - *Secondary sales and delivery outlets*: Since 2005, there has been no significant uptake of the possibility to open secondary sales and delivery outlets (according to DG COMP questionnaire in 2007) despite the reported interest (according to LE report (2006)).

- *Evolution of dealers' operating margins*: The average dealer margin is estimated to be around 1-2% and fairly stable over time.

Summary: Theoretically, a limitation of national intra-brand competition could result in a softening competition effect on brand level. However, there is no clear empirical support for this. This suggests that efficiencies associated with a limitation of national intra-brand competition or exclusive dealing might outweigh the anti-competitive effects.

[207] Examining the level of dealer concentration might be informative with respect to the level of intra-brand competition: lower levels of dealer concentration indicate higher level of intra-brand competition. Since dealer concentration increased since the introduction of the MVBER, it cannot be concluded that the MVBER stipulated intra-brand competition.

[208] LE report (2006): "Development in car retailing and after-sales markets under Regulation No. 1400/2002", Final report to EC DG Competition.

[209] There are three models of multi-branding: (1) different brands in different outlets at different sites of the same dealer (typical for dealer groups), (2) different brands in different showrooms on the same site of a dealer (typical for larger dealers) and (3) different brands in the same showroom.

Appendix 2 Market concentration and volatility of market shares

A2.1 Market concentration on industry level

Figure 8 shows the evolution of the HHI on **pan-European level**. It is computed applying recent brand ownership structures as of January 2009 to all prior years. For more detail see comments on Figure 4.

Figure 8: HHI in the car industry (2000-2008, pan-European level)

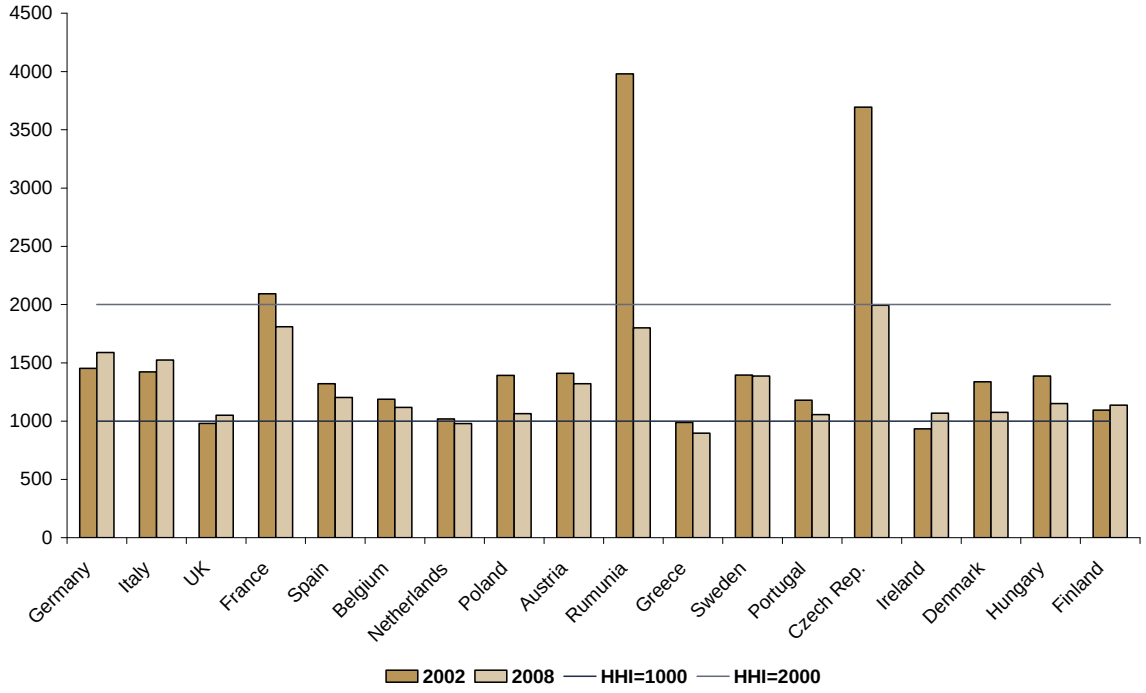
Note: Brand ownership structure as of January 2009.

Source: MAPIS data, ESMT CA.

As can be seen from the graph, the value of the index has slightly declined at the beginning of the decade and currently fluctuates around 1,000. This is exactly the boundary between an unconcentrated market (with HHI under 1,000) and a moderately concentrated market (with HHI in the 1,000-2,000 range). In the context of mergers, for unconcentrated and moderately concentrated markets the Commission is unlikely to identify horizontal competition concerns, although for moderately concentrated markets some additional analysis may be required.

In the following, we present further detail on the concentration at the **national level**. Figure 9 illustrates the differences in the level of concentration in the 18 largest EU countries in 2002 and 2008. The countries are ordered by decreasing volume of sales in 2008. Countries with a level of sales below 100,000 units in 2008 are not displayed, because for many of these countries the market share data in 2002 were not readily available for comparison. In 2008, the highest HHI within the group of excluded countries is found in Malta (1916), followed by Slovakia (1462). The lowest HHI in the excluded group is in Estonia (916).

Figure 9: HHI in the car industry by country (2002 and 2008)



Source: ESMT CA calculation based on MAPIS data.

As can be seen from the graph, in 2008 the HHI in all countries was smaller than the critical threshold of 2,000. The unweighted average HHI for all 27 EU countries in 2002 was 1,915 and decreased to 1,268 by 2008. This was significantly affected by the dramatic drops in Czech Republic, France and Romania; the HHI in all three countries was substantially above the 2,000 level in 2002 and dropped below it in 2008. While the HHI increased slightly in the three largest markets (Germany, Italy and the UK), the HHI decreased in 12 out of the 18 analysed countries. The average HHI weighted by sales has also decreased, much less substantially than the unweighted average, from 1,451 in 2002 to 1,398 in 2008.

A2.2 Market concentration on segment level

Competition manifests itself also within different segments of the market.[210] On the segment level, an increase in competition has also taken place through portfolio expansion of the existing manufacturers. In other words the existing manufacturers have entered new segments of the market. This trend is evident in the number of brands offering their models for sale in different segments of the market, see Section 5.1.3.2.

Before looking into the level of concentration on segment level, this section presents a short introduction into the nature of the different segments. In particular, it illustrates the recent trend in volume and value terms. To start, Table 13 provides a **brief description of different market segments**, their relative importance as measured by volume of sales in 2008 and an example of a car model belonging to the class.

[210] See Verboven (2002): "Quantitative Study to Define the Relevant Market in the Passenger Car Sector".

Table 13: Segmentation of car market (2008, pan-European level)

Segment	Description	Volume of sales (2008)*	Sample model
A-Segment	mini (micro) cars	1,270,501	Fiat Panda
B-Segment	small cars	3,775,686	Peugeot 207
C-Segment	compact cars	3,346,721	VW Golf
D-Segment	Mid-size cars	1,734,650	VW Passat
E-Segment	Full-size cars	345,005	BMW 5 Series
F-Segment	luxury cars	42,317	Mercedes-Benz S-Class
G-Segment	sports cars	562,138	BMW 3 Series Coupe
MPVs	multi purpose vehicles, minivans	1,717,534	Citroën C4 Picasso
Pickups	pickup trucks	134,004	Nissan Navara
SUVs	sport utility vehicles	945,656	VW Tiguan
Other	crossovers, specialty cars	378,868	Nissan Qashqai
Total		14,253,080	

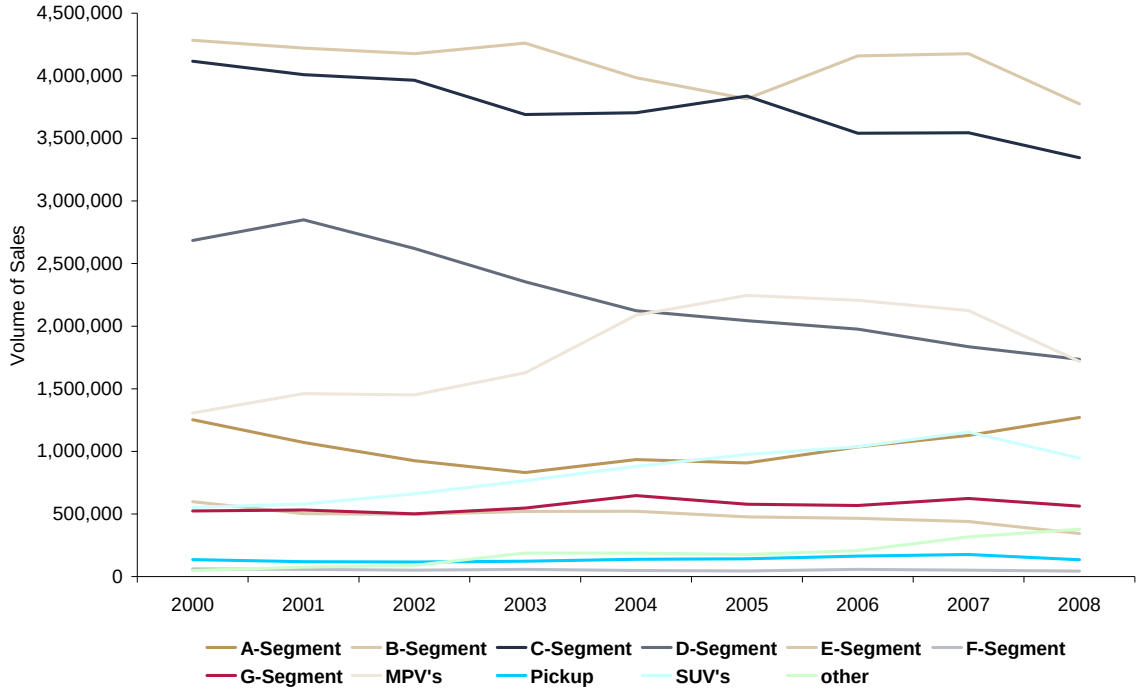
Note: * Volume of sales within the 27 European countries. Segmentation of the industry according to Daimler internal data MAPIS.

Source: MAPIS data.

Because the average price of a car in the upscale E-, F- and G-segments is significantly higher than prices in lower-end segments (A, B and C), Table 13 likely understates the relative importance of the upscale segments versus the lower-end segments. While based on volume the differences between the low and high segments are large, they are much smaller if value instead of volume is considered.

As the consumers' preferences and total cost of ownership have changed over time, the **relative importance** of different car segments has also varied and is illustrated in Figure 10.

Figure 10: Trends in volume of sales by segment (2002-2008, pan-European level)



Note: Segmentation of the industry according to Daimler internal data MAPIS.

Source: MAPIS data

The three largest segments by volume in 2008 - the small cars B-segment, the compact cars C-segment and the mid-size cars D-segment – have significantly decreased in sales over the 2000-2008 period. The MPVs segment has nearly doubled between 2000 and 2005, but sales in this segment have significantly dropped in 2008. The mini cars A-segment has experienced a gradual decline from 2000 through 2003. But since then the sales in this level have rebounded back to their levels from the beginning of the decade. The volume of sales in the SUV segment has doubled from 2000 to 2007 followed by a steep decline in 2008. The E-, F- and G- segments, while smaller in terms of volume of sales, are the upscale segments with higher average car prices and hence also important. The E- and F- segments have significantly declined since 2000 but sales in the sports car G-segment remain relatively stable. The sales of pickups have increased by over 30% from 2000 to 2007, only to return to their levels from the beginning of the decade in 2008. Finally, the sales of other cars, such as crossovers and other specialty cars have increased more than sevenfold since 2000.

There are also significant differences between segments in different countries, which for the 6 largest European markets are summarised in Table 14.

Table 14: Relative share of different segments in six largest countries (2008)

Segment	Germany	Italy	UK	France	Spain	Belgium
A-Segment	5.65%	20.50%	6.17%	10.59%	3.84%	5.67%
B-Segment	18.33%	31.89%	25.71%	34.95%	25.28%	22.66%
C-Segment	24.32%	14.76%	26.05%	18.39%	30.22%	22.08%

Segment	Germany	Italy	UK	France	Spain	Belgium
D-Segment	16.38%	7.31%	13.28%	8.45%	12.19%	13.86%
E-Segment	5.07%	1.04%	2.66%	0.95%	1.43%	3.25%
F-Segment	0.72%	0.12%	0.35%	0.10%	0.15%	0.24%
G-Segment	6.73%	2.04%	6.80%	2.65%	2.81%	4.45%
MPVs	12.98%	11.23%	9.40%	17.69%	13.41%	17.69%
Pickup	0.40%	0.53%	1.16%	0.52%	0.70%	0.78%
SUVs	7.66%	6.80%	6.37%	3.62%	7.30%	6.90%
Other*	1.76%	3.78%	2.05%	2.09%	2.67%	2.43%

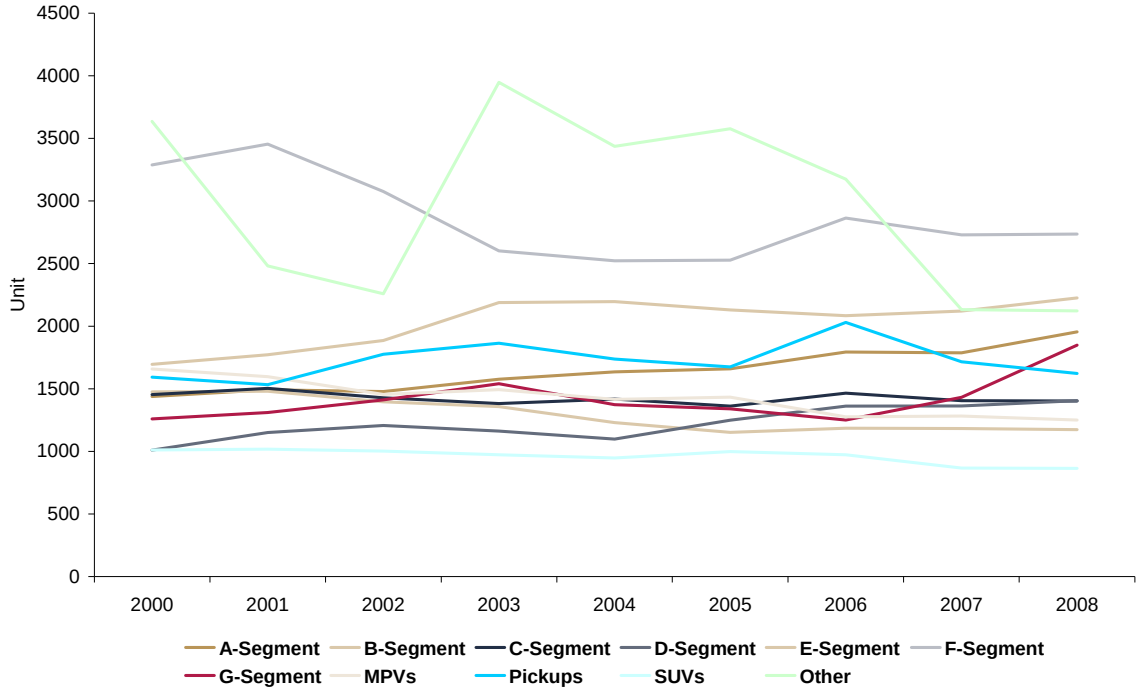
Note: *= Vehicles not belonging to any of the other categories. Segmentation of the industry according to Daimler internal data MAPIS.

Source: ESMT CA based on MAPIS data

For example, the share of A-segment in all car sales is over 20% in Italy, 10% in France and much lower in Germany, Spain, UK and Belgium. Jointly A- and B- segments account for over 52% of new cars sold in Italy and 45% of cars sold in France, but only for 32% cars sold in the UK and 24% of cars sold in Germany. Similarly, sales of MPVs constitute nearly 18% of sales of new cars in France and Belgium, but only about half of that in the UK.

Concentration at the segment level is somewhat higher than for the industry as a whole, which confirms the fact that many manufacturers specialise in some of the sectors more than others. The trends in concentration over time on a **pan-European level** are shown in Figure 11.

Figure 11: HHI in the car industry by segment (2000-2008, pan-European level)



Note: Segmentation of the industry according to Daimler internal data MAPIS.

Source: MAPIS data.

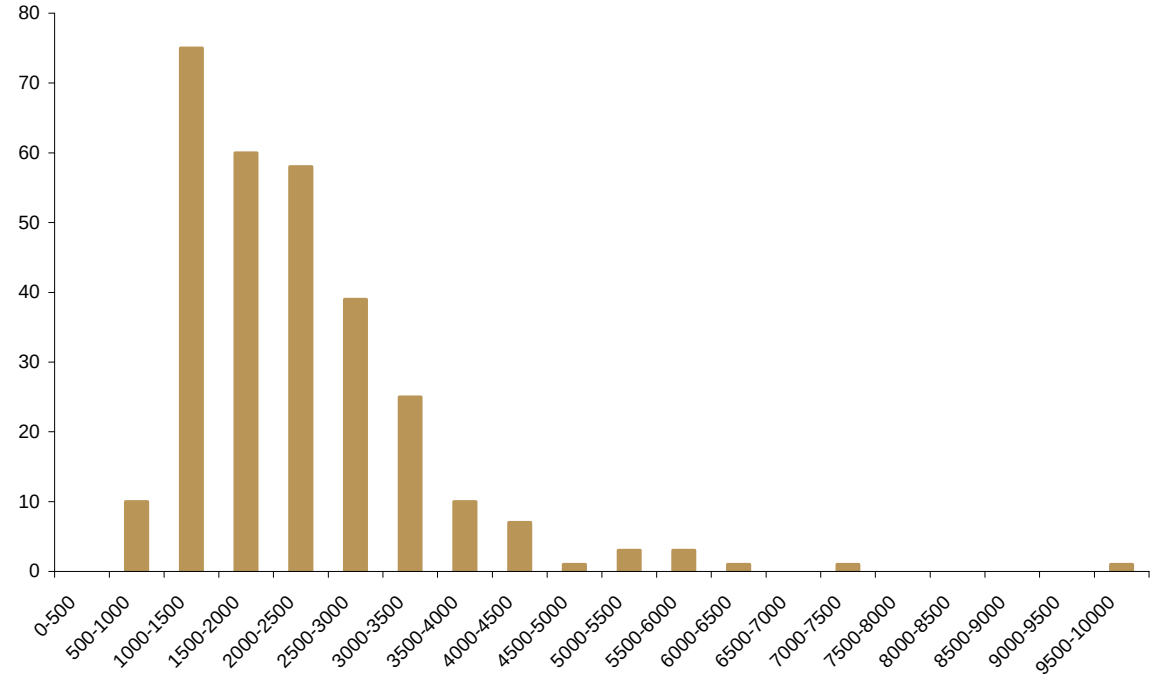
The bulk of the HHIs lies below the threshold level of 2,000. However in 2008, the HHI in the F-, E- and other-segments exceeded the threshold. The concentration index has also varied significantly over time, increasing by over 30% in G-, D-, A- and E- segments and falling by over 20% in the other-, MPVs- and B-segments.

Finally, we have also analysed the concentration at **national and segment level**, the most refined level available in our data.[211] For that purpose we treated 27 countries as separate geographic markets and 11 segments as separate products markets, which resulted in a total of 297 potential markets.[212] Analysis of data at the more refined level allows gaining some additional insight into the industry structure. Typically, the more narrow the market definition the higher the concentration index, so by using an overly narrow definition of a market one can see the conservative values of the concentration measures. The histogram in Figure 12 shows the distribution of HHI in 2008 for the 294 markets (297 markets minus 3 for which no positive sales were registered) analysed. The two most extreme outliers are the F-segment in Malta (HHI 10,000) and pickups in Romania (HHI 7,337).

[211] While we do not address the issue of the definition of the relevant markets in this report, the markets constructed in this way are likely more narrow than relevant markets in the antitrust sense. For example, Verboven's paper quoted earlier concludes that likely A-segment and B-segment constitute a single product market. Also, geographically small countries are likely parts of larger markets.

[212] According to the data, there were no sales in some of the potential markets. In 2008, positive sales were in 294 out of the 297 possible combinations.

Figure 12: Distribution of HHI in 2008 for 294 country/segment combinations



Note: Segmentation of the industry according to Daimler internal data MAPIS.

Source: ESMT CA based on MAPIS data.

In 2008 the unweighted average level of concentration as measured by the HHI for the 294 country/segment markets with positive sales was 2,218, which is significantly lower than the average level of 3,180 calculated for 2000, when there were positive sales in 283 markets. These averages are driven up quite significantly by a few outliers in small countries, for which the quality of data is suspect, especially in 2000.[213] This can be confirmed by calculating the average HHI weighted by sales in each of the markets. The weighted average has decreased from 2,003 in 2000 to 1,849 in 2008. The medians were 2,244 in 2000 and 2,025 in 2008 also confirming the drop in concentration levels from 2000 to 2008.

The concentration as measured by HHI has decreased in 181 out of the 281 country/segment combinations for which data both for 2000 and 2008 were available, while increased in the remaining 100.

The same analysis confirms that the SUV segment is the least concentrated among the segments. The unweighted average HHI for the 27 countries in that segment was 1,118 in 2008 as compared to 1,875 in 2000. Again, to minimise the potential impact of outliers on these calculations we have also computed the weighted average for each country. The results are shown in Table 15. The second and third column of the table show average HHI in a segment calculated as a weighted average of the 27 countries. The fourth column shows the absolute change in the index from 2000 to 2008 and the last column includes the percentage change of the index in the same time frame.

[213] It is important to keep in mind that in 2000 not all of the countries in the sample were Member States of the European Union.

Table 15: Weighted average HHI by segment (2000 and 2008)

	HHI 2000	HHI 2008	Change in HHI	Percentage change in HHI
A-Segment	2,659	2,768	109	4%
B-Segment	2,299	1,714	-586	-25%
C-Segment	1,857	1,735	-122	-7%
D-Segment	1,483	1,769	285	19%
E-Segment	2,145	2,488	342	16%
F-Segment	3,561	2,924	-638	-18%
G-Segment	1,475	1,965	490	33%
MPVs	2,151	1,709	-442	-21%
Pickup	2,584	2,878	294	11%
SUVs	1,294	1,091	-202	-16%
Other*	4,369	2,781	-1,588	-36%
Weighted average	**2,003**	**1,849**	**-154**	**-8%**

Note: *= Vehicles not belonging to any of the other categories. Segmentation of the industry according to Daimler internal data MAPIS.

Source: ESMT CA calculation based on MAPIS data

From 2000 to 2008 the average HHI has decreased in 6 of the 11 segments and increased in 5 of them. The average decrease was nearly 600 points, while the average increase was just over 300 points. The average HHI exceeded the 2,000 threshold in 7 segments in 2000 and in 5 segments in 2008. The table confirms that the SUV segment remains least concentrated, while the luxury car F-segment, the pickup segment and mini car A-segment are the highest concentrated in 2008. The results for the "other" segment should be interpreted with caution as the inclusion of cars in this segment has varied from 2000 to 2008.

Evidence of high competitiveness of the car market is also visible through changes that took place among most popular brands by segment. Table 16 shows for each segment and year the brand that has achieved the highest volume of cars sold.

Table 16: Brand leaders by segment (2000-2008, pan-European level)

Segment	2000	2001	2002	2003	2004	2005	2006	2007	2008
A	Fiat	Fiat	Fiat	Fiat	Fiat	Fiat	Fiat	Fiat	Fiat
B	Fiat	Peugeot	Renault	Peugeot	Peugeot	Peugeot	Renault	Peugeot	Peugeot
C	VW	VW	VW	VW	VW	VW	VW	VW	VW
D	VW	VW	VW	VW	VW	VW	VW	VW	Audi
E	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	BMW	Audi	Audi	BMW

Segment	2000	2001	2002	2003	2004	2005	2006	2007	2008
F	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes
G	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	Mercedes	BMW	BMW
MPV	Renault	Renault	Renault	Opel	Renault	Renault	Renault	Renault	Renault
Pickup	Mitsubishi	Mitsubishi	Mitsubishi	Mitsubishi	Nissan	Nissan	Nissan	Nissan	Toyota
SUV	Land Rover	Land Rover	Toyota	Toyota	Toyota	Toyota	Toyota	Toyota	VW
Other*	Honda	Chrysler	Chrysler	Ford	Ford	Ford	Ford	Nissan	Nissan

Note: Brand leaders are based on highest volume within the respective brand on a pan-European basis. *= Vehicles not belonging to any of the other categories. Segmentation of the industry according to Daimler internal data MAPIS.
Source: MAPIS data.

Except for the A-, C- and F- segment, the leading brand has changed at least once in the 2000-2008 period.

A2.3 Volatility of market shares on industry level

On a **pan-European** industry wide level, the unweighted average coefficient of variation for the 21 manufacturers is equal to 17%. One interpretation of that number is that between 2000 and 2008 on average the market share of a manufacturer differed by 17% from its long term mean.

The largest coefficients of variation belong to the manufacturers with relatively small sale volumes: Ssangyong (77.9%), Hyundai (24.3%) and Isuzu (19.4%). The smallest value of the coefficient of variation has been found for Ford (1.6%), Daimler (2.7%) and Porsche/Volkswagen (3.0%). At 8.8% the average value of the coefficient of variation weighted by the volume of sales for the 21 manufacturers is only about half of its unweighted value, which highlights the point that market shares of larger firms are relatively more stable than of smaller entrants.

To analyse industry-wide market share volatility at the **national level** we have first calculated annual market shares of each manufacturer, each country and each year from 2000 to 2008. We dropped years at the beginning of the time series as well as at the end if those years for which sales were consecutively zero.[214] Then for each manufacturer the coefficient of variation was calculated as the ratio of standard deviation and the mean of the 9 observations covering 9 years from 2000 to 2008. This in theory should have given us a total 567 coefficients (21 manufacturers times 27 countries), however for 10 country-manufacturer combinations there were no sales (e.g. Ssangyong in Finland or AvtoVaz in UK), so the actual total number of actual pairs analysed was 557. In order to generate the weighted average coefficient of variation for each country, the coefficients were weighted by manufacturers' average sales volume in that country over the 9 years. Table 17 shows for each country the average weighted coefficient of variation as well as the range of values of that measure.

[214] This is in particular important for the analysis on the more narrower units of country and segment. In this analysis we observe many manufacturers which enter (or exit) a certain segment later in the analysed time period. In order not to count the trailing zeros in market shares and therewith bias the volatility of the market share, we have dropped those observations.

Table 17: Coefficients of variation of manufacturers' market shares by country

Country	(Weighted) average coefficient of variation	Minimum coefficient of variation	Maximum coefficient of variation
Austria	9.3%	4.7%	91.4%
Belgium	10.0%	3.9%	120.4%
Bulgaria	60.2%	17.2%	277.3%
Cyprus	40.1%	11.1%	228.6%
Czech Republic	18.8%	11.1%	96.2%
Denmark	17.8%	5.5%	129.8%
Estonia	60.9%	1.2%	168.5%
Finland	20.1%	8.7%	211.1%
France	9.3%	3.4%	117.0%
Germany	9.1%	3.7%	100.5%
Greece	17.5%	4.8%	218.7%
Hungary	16.9%	3.7%	88.3%
Ireland	16.4%	6.3%	89.7%
Italy	11.3%	5.0%	80.5%
Latvia	61.2%	0.0%	169.9%
Lithuania	54.7%	1.3%	141.4%
Luxemburg	14.4%	5.6%	119.7%
Malta	13.8%	4.0%	101.2%
Netherlands	12.5%	3.4%	142.2%
Poland	29.3%	9.8%	184.5%
Portugal	15.5%	7.4%	210.7%
Romania	45.4%	23.5%	244.7%
Slovakia	30.9%	6.2%	171.3%
Slovenia	24.9%	5.8%	144.9%
Spain	11.3%	4.0%	83.7%
Sweden	13.1%	2.9%	219.8%
UK	13.5%	5.3%	62.3%
Weighted average total	**12.5%**	**4.8%**	**105.4%**

Note: Coefficient of variation covers a time span of 9 years from 2000 to 2009.

Source: ESMT CA calculation based on MAPIS data

As mentioned earlier, the numbers can be interpreted as the average deviation of manufacturer's market share from its long-term mean. For example, for Italy on average a manufacturer's market share differed by 11.3% from its long term average. For the manufacturer with most stable market share (in this case Ford), the market share deviated by 5% from its long-term mean. For the manufacturer with most volatile market share (in this case Ssangyong), the share was usually about 80.5% off its long term average value.

Overall, the largest coefficients of variation at national level belong to the manufacturers with relatively small sale volumes: Ssangyong (84% weighted average), Isuzu (57%) and Avtovaz (51%). The smallest value of the coefficient of variation has been found for Porsche/Volkswagen (6%), Ford (7%) and Daimler and Peugeot (9%). By country, the lowest coefficients of variations were found in Austria, France and Germany (9% each). The largest values were identified for Latvia (61%), Lithuania (55%) and Estonia (61%). This is consistent with our other findings indicating that market changes in these countries were most dynamic.

A2.4 Volatility of market shares on segment level

As discussed earlier, the competitiveness of the industry is much better captured when analysed at the segment level. The coefficients of variations calculated at this refined level indicate much larger variability of shares.

Table 18 presents for each segment the minimum, maximum and weighted average coefficient of variation on a **pan-European level**.

Table 18: Coefficients of variation of manufacturers' market shares by segment (pan European level)

Segment	(Weighted) average coefficient of variation	Minimum coefficient of variation	Maximum coefficient of variation
A-Segment	32.9%	8.9%	207.6%
B-Segment	15.5%	4.6%	144.1%
C-Segment	15.7%	2.7%	97.7%
D-Segment	21.0%	11.9%	106.5%
E-Segment	23.6%	13.8%	157.5%
F-Segment	24.5%	19.7%	52.8%
G-Segment	29.0%	16.8%	231.8%
MPVs	27.5%	14.8%	167.3%
Pickup	25.8%	14.8%	159.5%
SUVs	33.3%	14.6%	107.9%
Others*	69.2%	32.5%	158.7%
Weighted average total	**21.5%**	**8.5%**	**135.9%**

Note: Coefficient of variation covers a time span of 9 years from 2000 to 2009. *= Vehicles not belonging to any of the other categories. Segmentation of the industry according to Daimler internal data MAPIS.
Source: ESMT CA calculation based on MAPIS data.

As can be seen from the table, average segment-wise coefficients of variations vary from around 15% (small and compact cars) to around 33% (mini cars and SUVs).

Table 19 presents for each segment the minimum, maximum and weighted average coefficient of variation on a **national level**. In comparison to the other tables Table 19 does not report minimum and maximum coefficients. On segment level it is likely that some manufacturers have zero variation as they display only positive sales for a single year. Likewise, we find very high coefficients for single manufacturers on this level of disaggregation.

Table 19: Coefficients of variation of manufacturers' market shares by segment (national level)

Segment	(Weighted) average coefficient of variation
A-Segment	36.7%
B-Segment	19.7%
C-Segment	20.1%
D-Segment	24.3%
E-Segment	25.1%
F-Segment	27.1%
G-Segment	33.9%
MPVs	31.6%
Pickup	33.2%
SUVs	36.5%
Others*	63.3%
Weighted average total	**25.4%**

Note: Coefficient of variation covers a time span of 9 years from 2000 to 2009. *= Vehicles not belonging to any of the other categories. Segmentation of the industry according to Daimler internal data MAPIS.
Source: ESMT CA calculation based on MAPIS data

Average segment-wise coefficients of variations on the national level vary from around 20% (small and compact cars) to around 36% (mini cars and SUVs). These coefficients are only slightly different to their computation on pan-European level.

Appendix 3 Quantification of potential multi-branding benefits on segment level

This appendix briefly presents the methodology and summary of additional results which approximate the quantitative effects identified in Section 5.1.4.2 on the segment level. The main methodology has been described in the body of the report. For each of the 748 country/brand pairs we identified instances when a brand had an initial (in 2002) market share below 2% and increased it by at least 1%. Then we looked if the number of outlets had actually increased and ruled out cases where it has not. Finally, we also ruled out the cases where at least 90% of the outlets were exclusive. The remaining 50 brand/country combinations were interpreted as instances in which multi-branding facilitated entry (or expansion). This identification process was undertaken using HWB International data (from their European Car Distribution handbooks).

The HWB data does not contain segment level information, so to perform the segment level analysis below we have merged our earlier identification results based on HWB data with the MAPIS data, which provides segment level data. In other words, the instances of entry (or expansion) identified with HWB data were analysed again at segment level using MAPIS data.

We have performed the following hypothetical experiment. In the first step, the actual HHI for 2008 has been calculated for each segment/country combination using MAPIS data, see also Appendix A2.2.[215] In the second step, the same calculation was repeated, but this time those brands that have been identified as having benefited from the multi-branding provisions were entirely excluded from the calculation. This implies that we assume that those brands without the multi-branding provisions would have been foreclosed entirely from the market (i.e. would exist the market).[216]

Table 20: Hypothetical change in HHI at a country/segment level due to foreclosure

Hypothetical difference in HHI due to multi-branding	Segment A	Segment B	Segment C	Segment D	Segment E	Segment F	Segment G	MPVs	Pickup	SUVs	Other*
Austria	541	91	326	12	40	0	30	52	0	129	1
Belgium	110	26	86	5	1	0	0	16	0	-60	5
Bulgaria	0	0	0	0	0	0	0	0	0	0	0
Cyprus	0	0	0	0	0	0	0	0	0	0	0
Czech Republic	385	361	686	73	76	0	143	131	0	-5	0
Denmark	506	164	234	301	6	0	174	180	888	196	38
Estonia	298	37	60	6	281	870	85	-68	335	143	0
Finland	185	180	293	48	0	0	101	113	63	149	2

[215] This analysis was performed at the manufacturer level.

[216] It was assumed that the total number of cars was reduced (i.e. sales were "lost" due to foreclosure and were not allocated to different manufacturers; the final result this is mathematically equivalent to allocating the sales proportionally to the existing market shares of the remaining brands/manufacturers).

Hypothetical difference in HHI due to multi-branding	Segment A	Segment B	Segment C	Segment D	Segment E	Segment F	Segment G	MPVs	Pickup	SUVs	Other*
France	0	0	0	0	0	0	0	0	0	0	0
Germany	0	0	0	0	0	0	0	0	0	0	0
Greece	0	0	62	211	1,066	757	484	0	0	109	96
Hungary	0	0	0	0	0	0	0	0	0	0	0
Ireland	-170	120	71	2	0	0	-22	45	0	-92	0
Italy	0	0	0	0	0	0	0	0	0	0	0
Latvia	644	62	171	-5	308	880	71	27	4,309	23	0
Lithuania	517	595	609	187	13	0	184	403	0	337	-2,401
Luxemburg	0	0	0	0	0	0	0	0	0	0	0
Malta	0	0	0	0	0	0	0	0	0	0	0
Netherlands	35	18	58	3	1	0	0	44	0	-172	0
Poland	593	165	41	11	10	0	27	63	0	105	539
Portugal	0	0	0	0	0	0	0	0	0	0	0
Romania	0	0	0	0	0	0	0	0	0	0	0
Slovakia	323	468	898	17	931	3,798	254	291	758	109	1,367
Slovenia	88	57	120	4	0	0	18	111	0	-70	867
Spain	0	0	0	0	0	0	0	0	0	0	0
Sweden	1	36	78	3	0	0	0	74	0	13	1
UK	0	0	0	0	0	0	0	0	0	0	0

Note: Segmentation of the industry according to Daimler internal data MAPIS. *= Vehicles not belonging to any of the other categories.

Source: ESMT calculation based on HWB International and MAPIS data.

There are some rather drastic changes in the table above (e.g. over 4,300 points change for pickups in Latvia or nearly 3,800 increase for F-segment in Slovakia). However, most of the markets have been affected by multi-branding only marginally. Furthermore, those markets that have been affected more heavily are of relatively small size. Overall, multi-branding has decreased the mean weighted HHI of the 294 markets by 38 points, from 1,887 to 1,849 (or by about 2%), while the median HHI was reduced by only 12 points, from 2,037 to 2,025 (or by about 0.6%).

Put differently, if there was no multi-branding, foreclosure would have increased average HHI from 1,849 to 1,887. This number is directly comparable with the actual decrease in HHI from 2,003 in 2000 to 1,849 in 2008 reported in the main body of the report. These numbers allow

quantifying the increase in competition due to multi-branding. Of the 154 point actual drop in HHI from 2000 to 2008 (from 2,003 to 1,849) 38 points are attributable to multi-branding (from 1,887 to 1,849). In other words, multi-branding is responsible for about 25% (38/154) of the decrease in concentration, while the remaining over 75% are likely due to other factors.

It may seem surprising that the HHI in some instances would decrease when brands are foreclosed from the market. This counterintuitive result is a consequence of the assumption that brands and not manufacturers were foreclosed. For example, in the A-segment in Ireland, there are two brands of the same manufacturer, Hyundai and Kia. The initial analysis showed that Kia has benefited from multi-branding, while Hyundai has not. By fostering Kia's entry multi-branding increased Hyundai's (as a manufacturer not a brand) share and hence increased consolidation. A similar effect is responsible for other negative entries in the table.

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