

# 4 Profitability of the industry

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## Introduction

4.1. The chapter begins with an indication of the financial results of the main car manufacturers worldwide and of the scale of operations in Europe of the manufacturers which have a significant presence there. This is followed by a description of the structure of the industry in the UK and a note of a number of characteristics which need to be borne in mind when considering the financial information on the UK operations of individual suppliers. A summary of such information follows.

4.2. As international businesses, automotive companies make substantial transfers of both vehicles and parts between their subsidiaries in different countries. As a result, the financial results in each country are influenced to a considerable extent by the prices set for such transfers. It is therefore difficult to arrive at a firm view on the extent to which reported results reflect the overall effect on a supplier group of its operations within the UK, or whether comparisons between different suppliers in respect of a particular country are valid.

4.3. The chapter summarizes the arrangements under which suppliers of new cars also engage in the provision of finance for new car purchases. Finally, an outline is given of the results of dealers in the UK and the extent to which the sale of new cars contributes to their overall financial results.

## Overview of the world automotive industry

4.4. As shown in Table 4.1, some 60 per cent of worldwide output of new cars in 1997 by volume was accounted for by the six largest manufacturers, while the ten largest accounted for over 80 per cent. In this section of the report on the world automotive industry (that is paragraphs 4.4 to 4.7), the names of car companies refer to the worldwide group in each case, whereas elsewhere in the report we use these terms to refer to the UK distribution companies.

TABLE 4.1 Car production worldwide, 1997

	<i>m units</i>	%
General Motors	5.2	14.0
Ford/Mazda	4.6	12.4
Toyota	4.1	11.0
Volkswagen	3.9	10.4
Fiat	2.7	7.3
Peugeot/Citroën	2.2	5.9
Nissan*	2.2	5.9
Honda	2.2	5.9
Renault*	2.0	5.4
Mitsubishi	1.1	3.0
Others†	<u>7.2</u>	<u>18.8</u>
Total	37.4	100.0
Six largest suppliers		61.0
Ten largest suppliers		81.2

Source: EIU, *Motor Business International*, third quarter 1998.

\*In 1999 Renault and Nissan entered into a partnership which involved Renault taking a 36.8 per cent stake in Nissan and participating in the management of the company. This arrangement was not in place in 1997, the year to which the data in the table relate.

†DaimlerChrysler was formed in 1998 as a result of a merger between Daimler-Benz AG and Chrysler Corporation. Data in the table relate to 1997 when neither of the merging companies was one of the ten largest car suppliers.

4.5. A summary of the financial results for the three years 1996 to 1998 of the six largest car manufacturers worldwide is shown in Table 4.2. These results have been extracted from the published accounts of the companies concerned and translated into sterling at the exchange rates ruling at 31 December each year. It should be noted that:

- (a) The group results include sales of commercial vehicles and components as well as of new cars.
- (b) The results in some cases are not exclusively for automotive operations, but include other group activities for which a separate analysis is not available in the published accounts. Some manufacturer groups have significant interests in financial services, usually in connection with the finance of vehicles in the distribution chain and sales to end-customers.
- (c) Direct comparisons of the profitability of the groups cannot be made due to differences in the accounting policies and conventions adopted by each group and the volatility of exchange rates.
- (d) Because the results have been translated into sterling, the changes from one year to another are affected by exchange rate movements as well as by developments internal to each supplier group.

TABLE 4.2 Summary of the financial results of the total operations of the six largest car suppliers worldwide\*†

	<i>£ million</i>		
	1996	1997	1998
<i>Turnover</i>			
General Motors	99,352	101,182	92,559
Ford	85,909	93,390	86,788
Toyota‡	61,651	54,597	67,922
Volkswagen	37,968	38,271	48,446
Fiat	16,334	17,440	17,542
Peugeot	-	19,046	23,824
<i>Operating profit</i>			
General Motors	4,485	2,194	3,915
Ford	9,251	12,244	10,224
Toyota‡	3,349	3,767	4,514
Volkswagen	263	788	1,679
Fiat	181	505	(76)
Peugeot	-	70	771
<i>Assets employed</i>			
General Motors	69,893	99,910	111,236
Ford	109,309	122,109	94,348
Toyota‡	48,859	48,802	59,090
Volkswagen	27,897	26,120	31,758
Fiat	-	15,838	17,907
Peugeot	-	13,791	17,340
<i>per cent</i>			
<i>Operating margin</i>			
General Motors	4.8	2.2	4.2
Ford	10.7	13.1	11.8
Toyota‡	5.4	6.9	6.6
Volkswagen	0.7	2.1	3.5
Fiat	1.1	2.9	(0.4)
Peugeot	-	0.4	3.2
<i>Return on assets employed</i>			
General Motors	6.4	2.2	3.5
Ford	8.5	10.0	10.8
Toyota‡	6.9	7.7	7.6
Volkswagen	0.9	3.0	5.3
Fiat	-	3.2	(0.4)
Peugeot	-	0.5	4.4

Source: Company accounts.

\*The financial results include commercial vehicle sales and in some cases the results of other activities of the relevant group.

†Foreign currencies have been translated into sterling at the exchange rates ruling on 31 December in each relevant year. The changes for each manufacturer group from one year to another are affected by exchange rate movements in addition to internal developments within the business.

‡The financial year end of Toyota is 31 March. The results in each column in the table are those for the year ended on the 31 March following the calendar year end, translated at the calendar year-end exchange rate.

4.6. Set out in Table 4.3 is a summary of new car registrations in Western Europe in 1997 and 1998, showing the shares of the major manufacturers.

TABLE 4.3 New car registrations in Western Europe by supplier, 1997 and 1998

	1997		1998	
	'000	%	'000	%
Volkswagen	2,293	17.1	2,588	18.0
General Motors	1,624	12.1	1,645	11.5
Peugeot	1,515	11.3	1,634	11.4
Fiat	1,589	11.8	1,562	10.9
Renault	1,326	9.9	1,540	10.7
Ford	1,510	11.3	1,456	10.1
BMW	821	6.1	819	5.7
Mercedes-Benz*	492	3.7	631	4.4
Toyota	377	2.8	429	3.0
Nissan	403	3.0	422	3.0
Subtotal	<u>11,950</u>	<u>89.1</u>	<u>12,726</u>	<u>88.7</u>
Total	13,406	100.0	14,341	100.0

Source: EIU, *Motor Business International*, April 1999.

\*Now part of the DaimlerChrysler group, formed by a merger between Daimler-Benz AG and Chrysler Corporation in 1998.

Most of the automotive groups with significant European operations include some segmental information by business or on a geographic basis in their accounts, showing a breakdown of sales together with information on profitability and assets employed. This is not on a sufficiently consistent basis to permit comparisons between suppliers on a basis similar to that in Table 4.2. In the case of the European-based companies—Volkswagen, Peugeot, Fiat, Renault, BMW and Mercedes-Benz (before the merger which created DaimlerChrysler)—the bulk of the business is in Europe and hence the group financial results are substantially determined by the European activities. In the case of the US and Japanese companies, Europe is a relatively small part of the worldwide operations.

4.7. General Motors and Ford, which are the two largest new car suppliers in the UK, file Form 10K statements with the US Securities and Exchange Commission (SEC) and the information in Tables 4.4 and 4.5 is from that source.

TABLE 4.4 **General Motors: segmental information, 1996 to 1998**

	<i>\$ million</i>		
	<i>Years ended 31 December</i>		
	1996	1997	1998
<i>Business sectors</i>			
<i>Automotive:*</i>			
Revenue	148,190	161,767	143,031
Net income before tax	3,722	5,380†	1,534
Total assets	126,991	123,668	125,628
Return on total assets (%)	2.9	4.4†	1.2
<i>Financing:</i>			
Revenue	15,695	16,485	18,284
Net income before tax	1,241	1,318	1,422
Total assets	97,875	108,084	131,751
Return on total assets (%)	1.3	1.2	1.1
<i>Geographic areas</i>			
<i>Revenue:</i>			
North America	122,622	139,433	122,335
Europe	30,553	29,029	29,842
Latin America	7,300	8,295	7,684
Other	3,410	1,495	1,454

*Source:* Form 10K filing with the SEC.

\*Includes the Delphi components and systems businesses and the Hughes businesses (defence, telecommunications etc).

†Includes a \$4.5 billion gain resulting from the disposal of the Hughes defence business. Excluding this gain the return on total assets in 1997 was 0.9 per cent.

TABLE 4.5 Ford: segmental information, 1996 to 1998

	\$ million		
	Years ended 31 December		
	1996	1997	1998
<i>Business sectors</i>			
<i>Automotive:*</i>			
Revenue	118,023	122,935	119,083
Income before tax	2,571	7,082	6,958
Total assets	79,658	85,079	88,744
Return on total assets (%)	3.2	8.3	7.8
<i>Financial services:†</i>			
Revenue	28,968	30,692	25,333
Income before tax	4,222	3,857	18,438‡
Total assets	183,209	194,018	148,801
Return on total assets (%)	2.3	2.0	12.4‡
<i>Geographic areas</i>			
<i>USA:</i>			
Revenue	98,987	105,581	100,957
Profit before tax	6,163	8,270	N/A
Return on sales (%)	6.2	7.8	N/A
<i>Europe:</i>			
Revenue	30,748	27,618	27,026
Profit before tax	(43)	849	N/A
Return on sales (%)	(0.1)	3.1	N/A
<i>Source: Form 10K filing with the SEC.</i>			

\*Includes the Visteon automotive parts business.

†Includes the Hertz leasing and car hire business.

‡In 1998 there was a non-cash gain (not taxed) of \$16 billion on spin-off of The Associates business. Excluding this gain, the return on total assets of the financial services operation in 1998 was 1.7 per cent.

It will be seen that in terms of revenue the European automotive business of GM is about one-quarter the size of the equivalent US business, whereas in the case of Ford the proportion is somewhat greater. The resources invested in financial services are considerable: in 1998 total assets in financing were in the case of GM some 90 per cent of automotive revenue for the year and in the case of Ford some 125 per cent. In 1996 and 1997 Ford provided some information on the split of profit before tax by geographic area. This showed that returns on sales in Europe were below those in the USA in these years.

## Structure and characteristics of the industry in the UK

4.8. There are over 50 marques of passenger car currently available in the UK from a smaller number of supplier groups. We sought financial and other information from the suppliers of the 14 marques with a recent UK market share of 2 per cent or more, and which accounted for well over 90 per cent by number of new UK car registrations in 1998 (see Appendix 5.4). For analysis, we distinguished between the seven suppliers with manufacturing facilities in the UK (of which six also import significant numbers of cars) and the seven suppliers which import all the new cars they sell in the UK (all are wholly owned or majority owned by an overseas car manufacturer). In three cases—Ford (Ford and Volvo), Peugeot (Peugeot and Citroën) and BMW (BMW and Rover)—a manufacturer group includes more than one of the 14 major marques, though there are separate companies undertaking distribution in the UK for the different marques. The acquisition of Volvo by Ford took place in 1999. In other cases the UK distribution company deals with more than one marque produced by the manufacturer group: thus in the UK, Volkswagen, Audi, Seat and Skoda vehicles are distributed by the same company; Toyota also distributes Lexus vehicles; and Fiat also distributes Alfa Romeo vehicles. Of these, however, only the Volkswagen, Toyota and Fiat marques are included within the top 14 in the UK by reference to market share. The entity undertaking distribution of new cars to franchised dealers in a particular country may be

an independent company or the associate or subsidiary of a manufacturer. Such distribution organizations are referred to in this report as national sales companies (see Glossary).

4.9. There are a number of characteristics of the industry which need to be borne in mind when considering the background material set out in this chapter:

- (a) Of the seven suppliers which manufacture cars in the UK, all but Rover import substantial numbers of new cars from other companies within the same group. The importation of new cars normally takes place at transfer prices that are set in negotiation with the parent company or its European umbrella organization, or under a formula agreed with them. The result of these arrangements is that transfer prices of imported cars are usually set on a basis sometimes referred to as 'net back'; that is the imported car is priced by reference to its retail list price in the UK (excluding all taxes) less a margin for UK marketing and distribution costs and an element of profit for the national sales company. Although the suppliers told us that the transfer prices were intended to be broadly representative of market prices, we have not been able to examine costs and profit margins associated with them. The Inland Revenue, in the normal course of discharging its functions, monitors transfer prices from overseas companies (see paragraph 4.10). We noted that some UK suppliers disclosed in their published accounts that there were ongoing negotiations with the Inland Revenue concerning the basis of their transfer prices.
- (b) Among the companies which both manufacture and import cars in the UK, three—Honda, Nissan and Toyota—carry on UK vehicle manufacture in a legal entity separate from the company which imports and distributes cars in the UK (both imported cars and cars manufactured in the UK). In the case of Honda, the UK car manufacturing company is 75 per cent owned by the national sales company (see paragraph 4.15). Transfer prices to the UK national sales companies are set, therefore, both for imports and for UK-manufactured cars.
- (c) The other four suppliers referred to in (a) above—Ford, Peugeot, Rover and Vauxhall—operate in the UK as integrated businesses as far as their manufacturing and wholesale distribution operations are concerned. In accounting terms, for cars which are both manufactured and sold in the UK, no invoicing of finished cars takes place until ownership of the cars passes from the UK company to the dealer or (in the case of direct sales) the end-customer. This contrasts with the position applying to imported cars which, as explained above, are invoiced at a transfer price from the manufacturing company abroad to the wholesale distribution arm of the UK company, and then invoiced to the dealer when title passes.
- (d) Transfer prices for cars manufactured in the UK and exported are set in a comparable manner to those for imported cars.

4.10. The Inland Revenue can adjust the level of transfer prices between companies<sup>1</sup> where either the buyer or the seller is controlled by the other party to the contract, or both are controlled by the same person, and any sale between them takes place at a price other than market price at the time of completion. If the price is below market price, the latter is substituted in computing the seller's profits; whereas if the price is above market price the latter is substituted in computing the buyer's profits. In 1995 and 1996 the Organisation for Economic Co-operation and Development (OECD) published its report *Transfer pricing guidelines for multinational enterprises and tax administrations* and supplementary material, containing guidelines on the general principles to be applied in determining transfer prices. Three methods of pricing were considered to be consistent with Article 9 of the OECD Model Tax Convention:

- (a) the comparable uncontrolled price method, where independent parties are trading in similar circumstances in the same or very similar goods and their price is readily verifiable;
- (b) the resale price method, which deducts from the price paid by an independent party for the final product an appropriate mark-up to cover the relevant part of the seller's expenses and to generate a reasonable profit; and

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<sup>1</sup>Section 770A with Schedules 28A and 28AA of the Income and Corporation Taxes Act 1988, as amended by section 108 of the Finance Act 1998.

- (c) the cost-plus method, which adds a suitable mark-up to the cost of the selling subsidiary or division.

The transfer pricing method in general use for imports of cars in the UK automotive industry, which is described in paragraph 4.9(a), corresponds to the resale price method. The profitability of UK suppliers is further affected by transfer prices for components (both imports and exports) and for vehicles exported from the UK. In the case of most UK suppliers, invoicing of intra-group trade takes place in sterling with the exchange rate risk being borne elsewhere in the group.

4.11. It follows that the financial information on companies set out in this chapter is substantially dependent upon internal transfer prices determined within multinational groups of companies. As noted (see paragraph 4.9), we have not been able to examine the relationship between transfer prices and manufacturing costs and to this extent our analysis of the financial situation of the industry in the UK must be seen as incomplete. The role of dealer councils established by suppliers as a forum for discussions with dealers is described in paragraphs 6.34 and 6.35. We noted that the minutes of a meeting of the UK dealer council of one of the suppliers—the Audi Business Development Group—in March 1998 included a statement that ‘the factory has acknowledged the UK as the most profitable market in the world for Audi’. We discussed this statement in the course of a hearing in September 1999 with the supplier and its response is summarized in paragraph 9.1251.

4.12. Another feature of the industry is that all the manufacturers and importers sell replacement parts, as well as new cars, through their dealer networks. The perception of the manufacturers and importers is that the sale of replacement parts is an integral part of their overall businesses, which they consider essential to provide the required after-sales support to users of their new cars. Some suppliers also engage in arrangements under which selected used cars of their marque are sold by dealers under guaranteed used car schemes. Finally, some suppliers also have significant retail dealership interests, in particular Ford, Peugeot and Renault.

4.13. The structure of the 14 major suppliers and the relationship with their ultimate holding companies vary. In addition there are differing arrangements among suppliers for the provision of financial services, both for stockholding by dealers and for sales to final customers; these are considered further in paragraphs 4.35 and 4.36. An outline of the current position for each major supplier group is set out below.

### ***Suppliers with manufacturing facilities in the UK***

#### ***Ford***

4.14. Ford Motor Company Limited (Ford),<sup>1</sup> which supplies cars in the UK, is a subsidiary of Ford Motor Company of the USA. As noted (see paragraph 4.8), Ford manufactures cars both for the UK market and for export; it also imports cars from other Ford factories overseas. In 1998 40 per cent by number of Ford’s vehicle output in the UK (including light commercial vehicles) were exported and 44 per cent by number of new Ford vehicles registered in the UK were imported. The UK interests of Ford Motor Company are grouped under Ford Automotive Holdings (an unlimited company) and include—in addition to Ford UK—Jaguar Limited, Aston Martin Lagonda Limited and Cosworth Racing Limited. In 1999 Ford Motor Company acquired Volvo Cars AB of Sweden from AB Volvo. Integration of the Volvo car business into the Ford group is still in progress. However, we understand that the national sales company for Volvo in the UK—Volvo Car UK Ltd (see paragraph 4.27)—will continue to operate independently of Ford in the UK. Ford UK has a sales company in Ireland and a company which provides financial assistance to Ford franchised dealers; in addition there are 49 per cent holdings in the sales company Iveco Ford Trucks and in Polar Motor Group Limited (a retail motor dealer with a number of Ford franchised dealerships). In 1999 Ford extended its retail dealer investments with the purchase of a 49 per cent holding in the Ford dealerships of the Pendragon group. Financial services in connection with new car sales are mainly provided via Ford Credit Europe PLC. Ford Motor Company also owns Hertz, a global car, truck and equipment rental and leasing company.

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<sup>1</sup>Referred to as Ford UK where it is necessary to distinguish it from other companies in the Ford Motor Company group, but generally simply as Ford.

### *Honda*

4.15. Honda Motor Europe Limited (Honda), which supplies Honda cars in the UK, is a subsidiary of the Japanese company Honda Motor Co Ltd. Honda distributes manufactured products of the Honda group within Europe (including motorcycles, lawnmowers, generator units and outboard motors), acts as European re-invoicing centre and sells and markets Honda products in the UK. The Honda Motor Europe group includes Honda of the UK Manufacturing Limited, which manufactures vehicles in the UK and is 75 per cent owned by Honda Motor Europe Ltd and 25 per cent by Honda Motor Co Ltd, together with a number of other subsidiaries engaged in power equipment, distribution of spare parts, motorcycle marketing and financial services.

### *Nissan*

4.16. Nissan Motor (GB) Limited (Nissan) markets and distributes motor vehicles and spare parts manufactured by the Nissan group in Japan, Spain and the UK. The Nissan car-manufacturing operations in the UK are carried on by Nissan Motor Manufacturing (UK) Limited. Both Nissan and Nissan Motor Manufacturing (UK) Limited have Nissan Motor Co Ltd in Japan as their ultimate parent company, but neither has a shareholding in the other. The Nissan group in the UK includes a car retailer with seven Nissan dealerships. A finance company, Nissan Finance (GB) Limited, was sold to the Renault group in 1999.

### *Peugeot*

4.17. Peugeot Motor Company PLC (Peugeot) is engaged in the manufacture and distribution of motor vehicles, replacement parts and accessories in the UK. The UK manufacturing facilities were acquired by Peugeot from Chrysler in 1979. Peugeot is a subsidiary of Automobiles Peugeot which, together with Automobiles Citroën (paragraph 4.22), is a subsidiary of Peugeot SA in France. In 1998 94 per cent of the vehicles manufactured in the UK by Peugeot were destined for RHD markets. 12 per cent of vehicles manufactured (including some RHD vehicles) were export specification vehicles for a variety of countries, most notably France, Australia and Japan. Imports accounted for 71 per cent by number of the registrations of new Peugeot vehicles in the UK. Subsidiary companies within the Peugeot group in the UK include an export company, a finance company and a retailer operating a number of Peugeot car dealerships.

### *Rover*

4.18. Rover Group Limited (Rover), which manufactures and distributes Rover, Land Rover, MG and Mini marque vehicles in the UK, is a subsidiary of BMW AG of Germany. BMW marque cars are marketed in the UK by a separate company within the BMW AG group (see paragraph 4.21). The Rover group includes export companies in a number of overseas territories. A fellow subsidiary of Rover within the BMW AG group provides financial services in connection with the sale of Rover vehicles.

### *Toyota*

4.19. Toyota (GB) PLC (Toyota), which distributes Toyota marque cars in the UK, is 51 per cent owned by Toyota Motor Corporation of Japan, with the 49 per cent minority being held by a subsidiary of Inchcape. Manufacture of Toyota cars in the UK is undertaken by a wholly-owned subsidiary of Toyota Motor Corporation, Toyota Motor Manufacturing (UK) Limited. The Toyota group in the UK includes companies engaged in car finance, mechanical breakdown insurance and IT equipment and services. From February 1999, Lexus cars have been distributed by Lexus (GB) Limited, a wholly-owned subsidiary of Toyota.

### *Vauxhall*

4.20. Vauxhall Motors Limited (Vauxhall), which manufactures and markets cars, recreational vehicles and light vans in the UK, is a subsidiary of GM. Vauxhall's ultimate UK holding company is

General Motors Holdings (UK), an unlimited company. Vauxhall both exports vehicles made in the UK and imports vehicles from GM plants overseas for sale in the UK. In 1998, 54 per cent by number of Vauxhall's vehicle production was exported and 60 per cent of new registrations of Vauxhall cars in the UK were imported. The Vauxhall group includes a property company and some investments in retail dealerships. Financial services for the wholesale and retail trade in Vauxhall vehicles are provided by General Motors Acceptance Corporation (GMAC), a subsidiary of GM.

### ***Importing companies***

#### ***BMW***

4.21. The supplier of BMW cars in the UK is BMW (GB) Limited (BMW) whose ultimate holding company is BMW AG of Germany (see paragraph 4.18). BMW has two subsidiaries dealing respectively with the preparation of motor vehicles for distribution and motor vehicle retailing. Financial services in connection with the sale of BMW vehicles in the UK are provided through another subsidiary of BMW AG.

#### ***Citroën***

4.22. Citroën UK Limited (Citroën), which supplies Citroën cars in the UK, is a subsidiary of Automobiles Citroën and its ultimate holding company is Peugeot SA (see paragraph 4.17). Financial services related to the supply of new cars are provided through a company jointly owned by a subsidiary of Peugeot SA and First National Finance Corporation PLC.

#### ***DaimlerChrysler***

4.23. DaimlerChrysler UK Limited (DaimlerChrysler), which supplies Mercedes-Benz cars in the UK, is a subsidiary of DaimlerChrysler AG, a German company formed by the merger of Daimler-Benz AG and Chrysler Corporation. The company imports and distributes Mercedes-Benz products in the UK, mainly passenger cars and commercial vehicles, and until November 1999 was known as Mercedes-Benz (United Kingdom) Limited. Apart from a pension trustee company, there are no trading subsidiaries in the UK group, but there is a 50 per cent interest in a contract hire company. Financial services are provided through another DaimlerChrysler AG group company, MB Finance Limited. From January 2000, DaimlerChrysler has taken over importation and distribution in the UK of Chrysler and Jeep marque vehicles, which were previously handled by a third party.

#### ***Fiat***

4.24. The supplier of Fiat cars in the UK (and of Alfa Romeo cars) is Fiat Auto (UK) Limited (Fiat), the ultimate parent of which is Fiat SpA of Italy. Fiat has two subsidiaries which respectively provide motor vehicle finance and fleet management services.

#### ***Renault***

4.25. Renault UK Limited (Renault) supplies Renault cars in the UK and its ultimate holding company is Renault SA, which is incorporated in France. The Renault group in the UK includes, in addition to the car importing company, Renault Retail Group Limited which is engaged in car retailing through a number of Renault dealerships; there is also a company providing consultancy services. Renault Acceptance Limited (a subsidiary of another Renault group company) has a joint venture with Capital Bank plc, called RFS Limited, which provides financial services for new car sales.

## *Volkswagen*

4.26. VOLKSWAGEN Group United Kingdom Limited (VW)<sup>1</sup> imports and distributes Volkswagen, Audi, Seat and Skoda vehicles and parts in the UK. The ultimate holding company of VW is Volkswagen AG in Germany. Financial services are provided by a specialist fellow subsidiary of Volkswagen AG, while insurance services for new car sales are provided through an associated company in which VW has a 49 per cent holding. The VW group now includes Rolls-Royce & Bentley Motor Cars Limited and Rolls-Royce & Bentley Motor Cars Export Limited, both of which were acquired during 1998 and are held by VW as investments.

## *Volvo*

4.27. Volvo Car UK Limited (Volvo), which supplies Volvo cars in the UK, was until 1999 a subsidiary of AB Volvo of Sweden. In the course of 1999, Volvo Cars AB (which dealt with the car activities of AB Volvo) was acquired by Ford Motor Company and Volvo became a subsidiary of Ford Motor Company. Some financing in connection with new car sales is undertaken by Volvo Car Finance Limited, another subsidiary of Volvo Cars AB. The Volvo group in the UK has a 49 per cent holding in VOCS Finance Limited.

## ***Other alliances***

4.28. In addition to the relationships within supplier groups described above, there have been a number of developments within the industry involving the acquisition by one supplier of a substantial shareholding in another, together with participation in the management (see paragraph 3.21). At present there are such alliances between Ford and Mazda, Renault and Nissan, and GM and Saab (GM has recently acquired the 50 per cent of Saab it did not already own). There are also a number of smaller strategic holdings and cross-shareholdings between supplier groups with a view to cooperation over such matters as product development.

## **Financial results of manufacturers and importers in the UK**

4.29. In the light of the structure and characteristics of the industry, in particular the role of transfer prices and the lack of information on the underlying costs and profit margins, we consider that a meaningful assessment of the financial position of individual companies both in the UK and in Europe is not possible. However, as an indication of the profitability of companies in the industry in the five years 1994 to 1998, a summary of the published results of each of the 14 suppliers in the UK with a recent share of the new car market of 2 per cent or more is set out in Appendices 4.1 to 4.14. In addition, the results of the three Japanese-owned companies with manufacturing facilities in the UK separate from the national sales company—Honda, Nissan and Toyota—are set out in Appendices 4.15 to 4.17.

4.30. Most of the companies covered in Appendices 4.1 to 4.17 have substantial amounts owing to and from other companies in their respective groups. Their return on assets employed is affected by whether such balances result from normal trading transactions or effectively represent a source of capital. Since the accounts of the companies do not distinguish between these categories, the return on assets employed is shown on two bases in the appendices: first with the net balance with other group companies treated as trading items and included in assets employed; and second with the group balances excluded from assets employed and so treated as a source of capital (or a deduction from sources of capital for the net operating assets of the car business where a net amount is owed by other group companies).

4.31. Tables 4.6 (which covers supplying companies with integrated manufacturing facilities in the UK), 4.7 (importing and wholesaling companies) and 4.8 (Japanese manufacturing companies) are based on Appendices 4.1 to 4.17 and show a summary of the operating margins and the return on net operating assets for the relevant companies. Appendices 4.1 to 4.17 also indicate whether the source of information

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<sup>1</sup>The UK distribution company is referred to in this report as VW, and Volkswagen is used for the make of car.

is the company's own accounts or its group accounts (ie including the results of any subsidiaries owned by it). Two Japanese companies (Nissan and Toyota) each have manufacturing facilities in the UK owned by a company separate from the company which imports and distributes cars. The results of the importing and wholesaling company in each case are, therefore, shown in Table 4.7 and the results of the manufacturing company in Table 4.8.

### ***Suppliers with integrated manufacturing facilities in the UK***

4.32. Table 4.6 shows details of the financial performance of the national sales companies of the four suppliers with integrated manufacturing facilities in the UK, together with those of Honda which has a majority shareholding in the UK manufacturing company.

**TABLE 4.6 Summary of financial results of suppliers with manufacturing facilities in the UK, 1994 to 1998**

	<i>per cent</i>				
	1994	1995	1996	1997	1998
<i>Operating margin</i>					
Ford	1.9	(1.2)	(3.9)	2.6	3.3
Honda*	(1.9)	(1.6)	0.2	0.6	0.6
Peugeot	0.5	0.2	1.2	1.6	1.7
Rover	N/A	0.8	0.1	2.3	(7.7)
Vauxhall	3.0	0.5	0.7	0.9	2.0
<i>Return on assets employed, group balances included in assets employed</i>					
Ford	19.2	(10.0)	(57.3)	35.1	54.3
Honda*	(9.1)	(7.2)	1.0	2.6	2.4
Peugeot	1.7	0.6	5.1	8.9	6.7
Rover	N/A	2.1	0.3	5.7	(19.2)
Vauxhall	72.3	37.0	48.2	16.9	26.3
<i>Return on assets employed, group balances included in sources of capital</i>					
Ford	4.4	(2.6)	(10.5)	6.9	7.5
Honda*	(11.6)	(9.2)	1.2	3.3	2.8
Peugeot	2.5	0.8	6.9	8.4	8.9
Rover	N/A	1.6	0.2	4.3	(11.5)
Vauxhall	15.7	1.8	3.3	4.4	10.3

Source: Company accounts.

\*Group results including those of Honda of the UK Manufacturing Ltd (see Table 4.8). Honda has a 31 March year end and the results of each year shown in the table are those for the year ended on the 31 March following the calendar year.

As Table 4.6 shows, operating margins (operating profit as a percentage of turnover) did not exceed 4 per cent in any one year, while Ford and Honda each incurred operating losses in two of the five years. As a result of restructuring in 1998, Rover incurred an operating loss of £421 million (7.7 per cent of turnover). Excluding years in which losses were incurred, the returns on assets employed (operating profit as a percentage of net operating assets—including group balances) ranged from under 1 per cent to over 70 per cent. When group balances are treated as a source of capital the range was from under 1 per cent to nearly 16 per cent.

### ***Importing and wholesaling companies***

4.33. Among the importing suppliers shown in Table 4.7, BMW produced operating margins of over 10 per cent in 1997 and 1998, while Fiat reported margins of between 6 and 7 per cent in 1994 and 1995. Operating margins for the other companies (and the remaining years in the case of BMW and Fiat) were 4 per cent or less while Citroën reported an operating loss in 1994 and Nissan operating losses in 1995 and 1996. With group balances included in assets employed, VW had negative operating assets in three of the five years as a result of having substantial cash holdings. Returns on assets employed for other companies ranged up to 357 per cent though the assets employed of several of the companies were not substantial in relation to the sales value of the business transacted and some companies incurred losses in

one or more years. Factors which affect the level of net assets employed in the business include the extent to which stocks of imported vehicles are held and the way in which they are financed. With group balances treated as a source of capital the returns on assets employed widens, ranging as high as 440 per cent in the case of BMW in 1998, though the asset bases were relatively small in most cases.

TABLE 4.7 Summary of financial results of importers and wholesalers, 1994 to 1998

	<i>per cent</i>				
	1994	1995	1996	1997	1998
<i>Operating margin</i>					
BMW	1.1	(0.1)	4.2	10.9	12.5
Citroën	(1.8)	1.8	2.0	2.0	2.3
DaimlerChrysler*	3.3	4.1	2.5	2.5	2.9
Fiat	6.7	7.0	3.3	0.5	4.1
Nissan	0.1	(1.0)	(1.4)	2.1	2.3
Renault	1.4	2.0	1.6	1.7	2.0
Toyota	2.5	2.4	3.0	3.3	2.6
VW	0.6	0.5	2.0	3.4	2.6
Volvo	0.4	0.4	2.6	1.8	0.6
<i>Return on assets employed, group balances included in assets employed</i>					
BMW	16.9	(2.8)	N/A	150.6	77.7
Citroën	(57.7)	34.1	30.8	18.3	40.0
DaimlerChrysler*	62.7	80.3	63.8	86.8	139.5
Fiat	357.1	N/A	74.2	6.0	28.1
Nissan	2.0	(19.1)	(26.0)	44.7	39.7
Renault	17.2	22.4	44.4	53.1	53.6
Toyota	32.8	60.6	63.6	78.7	91.4
VW	7.6	N/A	N/A	N/A	23.7
Volvo	11.8	8.3	114.3	27.0	5.6
<i>Return on assets employed, group balances included in sources of capital</i>					
BMW	10.6	(1.7)	162.5	N/A	440.5
Citroën	(6.2)	5.3	6.0	6.2	9.2
DaimlerChrysler*	54.4	107.6	119.4	287.5	125.0
Fiat	100.0	91.9	46.0	4.7	25.9
Nissan	0.4	(3.7)	(6.9)	9.1	7.4
Renault	5.2	10.9	8.0	7.8	13.5
Toyota	32.8	58.8	63.6	78.7	32.0
VW	3.4	8.0	124.2	N/A	17.0
Volvo	7.4	5.6	51.6	21.7	6.8

Source: Company accounts.

\*DaimlerChrysler imports Mercedes-Benz cars (see paragraph 4.23).

### *Japanese-owned manufacturers*

4.34. The results of the companies shown in Table 4.8 cover manufacturing only and hence exclude the wholesale distribution of cars. Honda incurred operating losses in two of the years and Toyota in one.

TABLE 4.8 Summary of financial results of Japanese-owned manufacturers in the UK, 1994 to 1998

	<i>per cent</i>				
	1994	1995	1996	1997	1998
<i>Operating margin</i>					
Honda of the UK Manufacturing Limited*	0.3	3.7	4.1	(2.1)	(5.2)
Nissan Motor Manufacturing (UK) Limited	0.2	0.4	1.1	4.0	0.7
Toyota Motor Manufacturing (UK) Limited	1.3	4.4	3.2	(2.1)	3.4
<i>Return on assets employed, group balances included in assets employed</i>					
Honda of the UK Manufacturing Limited*	0.6	9.7	10.3	(5.2)	(14.2)
Nissan Motor Manufacturing (UK) Limited	0.4	0.8	2.4	10.6	2.0
Toyota Motor Manufacturing (UK) Limited	2.0	7.1	6.7	(3.0)	7.6
<i>Return on assets employed, group balances included in sources of capital</i>					
Honda of the UK Manufacturing Limited*	1.0	25.0	28.7	(11.2)	(31.8)
Nissan Motor Manufacturing (UK) Limited	0.4	1.1	2.9	14.2	2.8
Toyota Motor Manufacturing (UK) Limited	1.4	5.7	6.5	(2.6)	6.6

Source: Company accounts.

\*Honda of the UK Manufacturing Limited has a 31 March year end and the results of each year shown in the table are those of the company for the year ended on the 31 March following the calendar year.

Operating margins in all years were 4 per cent or below. Returns on assets employed ranged up to 11 per cent with group balances included in assets employed and up to 29 per cent with group balances treated as a source of capital.

## Financial services

4.35. As noted in paragraph 4.13, a number of suppliers have in-house finance companies offering services both to dealers and to their customers. In general, dealers are not obliged to use the in-house financial services available from their suppliers. Table 4.9 summarizes the position on the availability of retail finance within the main franchised networks.

TABLE 4.9 Summary of provision of retail finance by suppliers

<i>Supplier</i>	<i>Source of finance</i>	<i>PCP scheme*</i>
BMW	BMW Financial Services	BMW Select
Citroën	Citroën Finance	Elect 3
DaimlerChrysler	MB Finance	Opportunities
Fiat	Fiat Auto Financial Services	Easiplan
Ford	FCE Bank	Options
Honda	Honda Finance Europe	Aspirations
Nissan†	Nissan Finance (GB)	Preferences
Peugeot	PSA Finance	Passport
Renault	RFS	Selections
Rover	Rover Financial Services	Select
Toyota	Toyota Financial Services	Toyota Terms
Vauxhall	GMAC	Choices 1 2 3
VW	Volkswagen Financial Services UK	Solutions
Volvo	Volvo Car Finance	Advantage

Source: Sewells International.

\*Personal contract purchase, a form of leasing for retail customers.

†In 1999 Nissan Finance (GB) Limited was sold to the Renault group (see paragraph 4.16).

All seven of the suppliers with manufacturing facilities in the UK have linked finance companies. In three cases—Ford, Peugeot and Vauxhall—the parent group has a separate finance business which provides services to the UK national sales company; Peugeot also has a finance subsidiary. Honda and Nissan each have a finance subsidiary within the UK group; Rover operates through an associated company with an independent finance company as the other partner; and Toyota has a company which it jointly owns with a finance company subsidiary of Toyota Motor Corporation. Of the seven importing companies, two—Fiat and BMW—have finance company subsidiaries; four—Citroën, DaimlerChrysler, VW and Volvo—use the services of a fellow subsidiary specializing in finance; and Renault has a joint venture company which provides finance.

4.36. By way of example we looked at the results of the finance company servicing one of the companies in each of the two groups of suppliers in order to ascertain the scale of operations and the level of profit earned. In the group of suppliers with UK manufacturing operations, Vauxhall conducts business with GMAC. In 1998 the finance company earned a pre-tax profit of £21.0 million on gross income of £183.8 million, a return of 1.2 per cent on the assets employed of £1.7 billion. Among the importing companies, RFS Limited (see paragraph 4.25) earned a pre-tax profit in 1998 of £22.6 million on turnover of £163.8 million, a return of 2.0 per cent on the assets employed of £1.1 billion.

### **Profitability of retailing**

4.37. According to SMMT estimates, there were over 7,000 dealer outlets at March 1999, representing over 50 marques of new car. The dealer networks representing the six leading marques accounted for 40 per cent of the outlets with Ford having 13 per cent of outlets, Vauxhall 8 per cent, Rover 6 per cent, Peugeot 5 per cent and both Renault and Volkswagen 4 per cent. Further details of the distribution of dealers are given in Table 6.1. Some 46 per cent of outlets represented European-owned marques, 27 per cent US-owned marques, and 19 per cent represented Japanese-owned marques. The residual category included Korean- and Malaysian-owned marques. The ONS sector review of the motor trades showed an aggregate turnover of £85 billion in 1998 for businesses selling motor vehicles, including £23 billion of retail new car sales. The relevant SIC classification (50.10), however, is wider than the franchised dealer sector and includes large numbers of used car dealers. We were told by the RMI that a reasonable estimate of the combined turnover in 1998 of franchised dealers would be £75 billion.

4.38. Ownership of dealers is widely spread with the largest group in terms of overall sales (Pendragon) having a turnover in 1998 of £2 billion. Turnover of the ten largest dealer groups was £10.1 billion. The structure of dealer groups is discussed further in paragraphs 6.67 and 6.68. Some of the larger dealers groups are listed companies, while others are part of holding companies with a diverse spread of interests. Despite the size of the large dealer groups in terms of turnover, the stock market appears to regard their growth prospects as limited and their performance as cyclical and hence they tend not to attract a premium rating. The characteristic of a modest capitalization in relation to turnover is a feature of most distribution businesses. For instance, Pendragon with a turnover in 1998 of £2 billion had a market capitalization of £112 million at 30 September 1999. Table 4.10 shows some statistical details for those of the ten largest dealer groups which are listed on the International Stock Exchange in London.

TABLE 4.10 Financial information on large listed dealer groups, September 1999

	Market capitalization £m	Gross yield* %	Price/ earnings ratio† Number	Equity beta‡ Number
<i>Specialized dealer</i>				
Pendragon	112	7.5	8.3	0.79
Reg Vardy	193	0.3	10.3	0.87
Sanderson Bramall	76	3.7	6.7	1.04
<i>Part of a diversified group</i>				
Lancaster§	1,929	5.3	10.8	N/A
Inchcape	294	7.0	N/A	1.14
Arriva	798	4.5	10.6	0.87
Lex Service	660	3.9	12.5	1.20
<i>Equally weighted sector averages¶</i>				
Vehicle distribution	124	5.8	7.1	0.89
Industrial components distribution	119	3.4	9.5	0.89
Hardlines retailers	259	3.2	8.6	0.91
Overall market	730	3.2	11.8	0.91⌘

Source: London Business School Risk Measurement Service: October to December 1999.

\*The gross yield is the gross dividend per share expressed as a yield on the market price of the share.

†The price/earnings ratio is the share price divided by the earnings per share. It records the numbers of years' purchase of profits that the market price represents.

‡The equity beta represents the sensitivity of the share to market movements. A share with a beta of 1.0 tends to perform in line with the market index; one with a beta of 1.2 tends to change in value by 1.2 per cent for each 1 per cent movement in the market index. The calculation of the equity beta for a share involves the covariance between the expected returns from the share and the overall market, divided by the variance of the return on the market.

§Part of Jardine Matheson. Jardine Matheson, although listed in London, is an overseas company and accordingly it is not included in the LBS Risk Measurement Service. The source for the details shown for this company at end September 1999 was the *Financial Times*.

¶FTSE Actuaries classifications.

⌘With the use of equally weighted averages the beta for the overall market is not 1.0; with market capitalization weighted averages the overall beta is 1.0.

4.39. The sale of new cars is, in nearly all cases, carried out by dealers which are appointed by the supplier of the relevant marque of car. The range of services that dealers provide includes the sale of new and used cars, the sale of parts, the provision of car servicing, bodywork and repair facilities, the sale of petrol and other items on the forecourt, car rental and car hire services and miscellaneous services. Of these services new and used car sales, parts and servicing are undertaken by virtually all dealers. Most dealers will arrange finance for new and used car sales and the resulting commission on such deals, either with the supplier's own in-house finance company or with a third party, constitutes an income stream for dealers.

4.40. Most suppliers operate a scheme involving the collection of financial information from dealers in order to permit inter-firm comparisons. In most cases such information is provided monthly by dealers to an independent third party which collates it and compiles aggregate profiles for different categories of dealer (all dealers, by geographical area or by size of dealer) against which individual dealers can benchmark themselves. The supply of information and the extent to which the supplier has access to it are discussed further in paragraphs 6.103 and 6.104. The information and its presentation are, in principle, standardized within a particular marque, but differ between marques. Although suppliers provide guidance to dealers on how the financial information is to be presented, we were told by a number of sources that compliance by dealers with the guidance from suppliers was not complete, also that not all dealers provided returns.

4.41. In order to obtain information on a common basis we asked a sample of dealers to complete a financial questionnaire. From the 500 questionnaires sent out we received 123 replies. Although the response rate was only 25 per cent and not all returns covered all five years included in the survey, we consider that the resulting aggregate profiles of dealer performance are sufficiently robust for use as background material. The questionnaire results were broadly consistent with trade publications and with the inter-firm comparisons of individual suppliers.

4.42. As noted in paragraph 4.39, most dealers sell new cars alongside other products and services. For inter-firm comparison purposes and for our questionnaire dealers allocated direct costs to the different departments. However, there are also indirect overheads which dealers do not normally allocate to departments or which they allocate in a variety of different ways. Accordingly, although the profitability of individual departments—for instance, new cars, parts and used cars—can be measured at the gross profit level, it cannot be measured at the level of net profit before interest and tax. Only overall dealership profits can be measured on the latter basis. Most dealerships do not allocate capital employed between departments and, as a result, returns on assets employed are available only at the level of the dealership as a whole. Where there is more than one dealership within a legal entity, the capital employed may not be allocated between dealerships.

4.43. Details of the sales mix and departmental profit mix of the dealers covered by our survey for the years 1994 to 1998 are shown in Appendix 4.18. The position in 1998 is shown in Table 4.11: the respective contributions of departments to sales and profit were broadly similar in earlier years. Appendix 4.18 and Table 4.11 show the relative importance of individual departments to the sales and profitability of the dealership as a whole.

TABLE 4.11 Sales and departmental profit mix of a sample of dealers in 1998\*

<i>Department</i>	<i>per cent</i>	
	<i>Sales</i>	<i>Departmental profit</i>
New cars	45.6	33.5
Used cars	35.3	11.7
Car parts	9.1	19.7
Workshop and servicing	4.8	26.5
Bodyshop	1.7	6.3
Forecourt	2.6	0.9
Other	<u>0.9</u>	<u>1.4</u>
Total	100.0	100.0

Source: Commission survey.

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\*Departmental profit is the profit earned by a department after deducting all direct costs related to that department, but before deducting unallocated indirect costs.

As indicated by Table 4.11 and Appendix 4.18, there is considerable variation in the contribution of different departments to the overall profits of the dealership. Whereas new car sales normally constitute nearly half of the dealership turnover, they generate only a quarter to a third of the departmental profit. In addition to some variation from year to year there is also a variation depending on whether a dealer represents a volume or a specialized marque, with results for dealers representing specialized marques generally being better. Used cars show a similar position, with the proportion of departmental profit less than half that of the proportion of turnover. On the other hand, the parts, servicing and bodyshop departments together generate over half the departmental profit from around 15 per cent of turnover.

4.44. The gross profit and departmental profit for different departments as a percentage of turnover for the years 1994 to 1998 are shown in Appendix 4.19: the position in 1998 is shown in Table 4.12.

TABLE 4.12 Gross and departmental profit margins earned by departments in 1998

<i>Department</i>	<i>per cent</i>	
	<i>Gross margin</i>	<i>Departmental profit margin</i>
New cars	4.6	3.9
Used cars	5.7	1.7
Car parts	21.1	11.4
Workshop and servicing	63.7	28.8
Bodyshop	51.8	19.5
Forecourt	4.6	1.8
Other	15.1	8.0

Source: Commission survey.

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Appendix 4.19 indicates that the margins for departments other than new cars are relatively stable from year to year. Although the margins on new car sales may only vary by one or two percentage points from year to year, the effect on net profit is considerable in view of the proportion of overall turnover accounted for by new cars.

4.45. Table 4.13 shows average margins and returns on assets employed for dealers.

TABLE 4.13 Average margins and return on assets, 1994 to 1998

	<i>per cent</i>				
	1994	1995	1996	1997	1998
<i>Operating margins</i>					
Gross margin*	11.4	9.7	9.7	9.8	10.3
Departmental margin†	5.4	4.7	4.8	5.1	5.3
Net margin‡	1.5	1.3	1.5	1.8	1.8
Return on assets employed§	8.9	9.7	11.5	15.3	14.9
<i>ONS reported returns¶</i>					
Manufacturing companies	7.7	9.2	10.1	10.8	11.0
Service companies	14.4	14.0	14.3	15.0	14.0
Non-UKCS companies	11.5	11.9	12.4	12.7	12.2
All private non-financial companies	11.6	12.1	12.9	12.9	12.2

Source: ONS.

\*Gross profit as a percentage of turnover.

†Departmental profit (see paragraph 4.42 and footnote to Table 4.11) as a percentage of turnover.

‡Net profit before interest and tax as a percentage of turnover.

§Net profit before interest and tax as a percentage of assets employed.

¶Operating surplus as a percentage of capital employed on the basis of current replacement cost.

The average returns on assets employed shown above for dealers conceal wide variations between dealers, depending in part on the way the business is structured and how the balance sheet assets employed are presented.