PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 5: Analysis of potential foreclosure as a result of vertical relationships

Introduction

1. We have considered whether the vertical relationships between parties involved in the provision of private motor insurance (PMI) and those supplying inputs for repair services might give rise to harm. This paper presents our assessment of the foreclosure concerns that arise from these agreements, in particular in relation to the supply of paint,[1] parts (including glass) and repair cost estimation systems.[2] Other harm that might arise from the vertical relationships with respect to paint is discussed in a related working paper 'ToH 5: Analysis of vertical agreements for the supply of paint (excluding foreclosure)'.

2. The sourcing of inputs for insurance-related repair services is a vertical supply chain with three levels: the upstream input manufacturer supplies the repairer (downstream) which provides repair services for the PMI insurer (further downstream), as shown in Figure 1. Foreclosure concerns may arise from vertical agreements within this supply chain either because they raise downstream rivals' costs (input foreclosure) or because they reduce upstream rivals' revenues (customer foreclosure), as set out in our Guidelines for Market Investigations.[3]

[1] Where we refer to paint, we mean paint used in vehicle repairs, as opposed to in the manufacture of vehicles. We understand that this type of paint, also known as 'refinish paint', is applied at much lower temperatures than paint used in car manufacture to avoid damage to parts which are not resistant to high temperatures. In addition, such paint must cover a wider colour range in order to replicate the colours used for different makes and models of cars and in order to match changes to the colour due to age (see, for example, the European Commission's decision in a related merger case (Case No IV/M.1363 – DuPont/Hoechst/Herberts, paragraph 14)).
[2] We include in this analysis the supply of glass used in repairs where there is wider damage but exclude glass used in glass-only repairs. The supply of glass for glass-only repairs differs from the supply of glass used for the repair of wider damage.
[3] See *Guidelines for market investigations*: *Their role, procedures, assessment and remedies*, April 2013, paragraphs 268 & 269.

Summary

3. The general mechanism by which harm from vertical foreclosure may arise is the same for each of the inputs we considered: paint, parts (including glass) and repair cost estimation systems. Therefore, in this paper we often refer generally to 'inputs'.

4. As our guidelines explain, in case of vertical integration (eg through supply contracts) foreclosure may be achieved by practices that restrict access to essential inputs or raise rivals' costs, or limit rivals' ability to acquire sufficient customers to benefit from economies of scale, learning effects and/or network effects. Foreclosure can be total (where rivals are forced to exit from the market or are prevented from entering) or partial (where rivals or potential entrants are materially disadvantaged and consequently compete less effectively).[4]

5. Where the upstream party to the vertical relationship harms the ability of its down-stream rivals to compete, for example by raising effective input prices to its rivals, or by refusing to supply them completely, such actions may harm the ability of the integrated firm's downstream rivals to provide a competitive constraint in the future (ie raising rivals' costs/input foreclosure). Similarly, if one or several rival input suppliers are materially disadvantaged because the vertical supply agreement(s) reduces their access to customers and thus their revenues, competition upstream may be reduced as these rivals, selling less, may face higher costs and may then be a less effective constraint on the integrated companies (ie reducing rivals' revenues/ customer foreclosure).

6. The ultimate question in assessing such concerns is whether end customers are harmed because the higher input prices are passed on as higher prices downstream.

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[4] ibid.

7. With respect to paint, parts (including glass) and repair cost estimation systems, we saw no reason for such harm to arise, as explained below.

8. For paint, the supply shares of paint manufacturers appear too low and expansion by rivals relatively easy (ie even the largest paint manufacturer appears constrained by competitors in its pricing). Moreover, the available customer base of repairers carrying out repairs for PMI insurers appears large and is not consistent with paint distributors being foreclosed by paint supply contracts involving PMI insurers because repairers working for those insurers are captive customers.

9. For both original equipment manufacturer (OEM) parts and non-OEM parts we found that the proportion of costs of either type of part in the overall repair bill (and thus in insurers' claims costs) was very low and would not allow for harm either from 'raising rivals' costs (in PMI provision)' or 'reducing rivals' revenue (in providing the part)'. Glass accounts for a share of parts used in the repair of wider damage to vehicles and therefore by extension could not give rise to such concerns.

10. We ruled out concerns from contracts for the provision of repair cost estimation systems (eg by Audatex or Glassmatix) given the low share of the costs of such systems in the total repair bill.

11. Our analysis for all of the inputs we considered was based on the underlying presumption that input suppliers compete unilaterally (ie they do not coordinate). This is relevant since an inability to raise input prices and thus rivals' costs unilaterally does not exclude that input suppliers may be able to raise them jointly (by

coordinating their behaviour). However, we saw no evidence to suggest that we should investigate this possibility.[5]

12. Since we concluded that the vertical supply contracts for paint, parts (including glass) and repair cost estimation systems would not allow suppliers to raise rivals' costs or reduce rivals' revenues, our current view is that harm to end customers of repairers or PMI providers could not arise through these means. This does not imply that these supply contracts could not lead to harm for other reasons and, in particular, we discuss the supply contracts for paint in another working paper, 'ToH 5: Analysis of vertical agreements for the supply of paint (excluding foreclosure)'.

13. This paper discusses first the general characteristics of vertical supply contracts for these repair inputs, then briefly reviews the mechanism by which such agreements may 'raise rivals' costs' or 'reduce rivals' revenues'. We then present our findings for each of the inputs in turn (paint, parts/glass and repair cost estimation systems). We present some of the underlying evidence on which our analysis is based in the Appendix.

General characteristics of vertical supply contracts

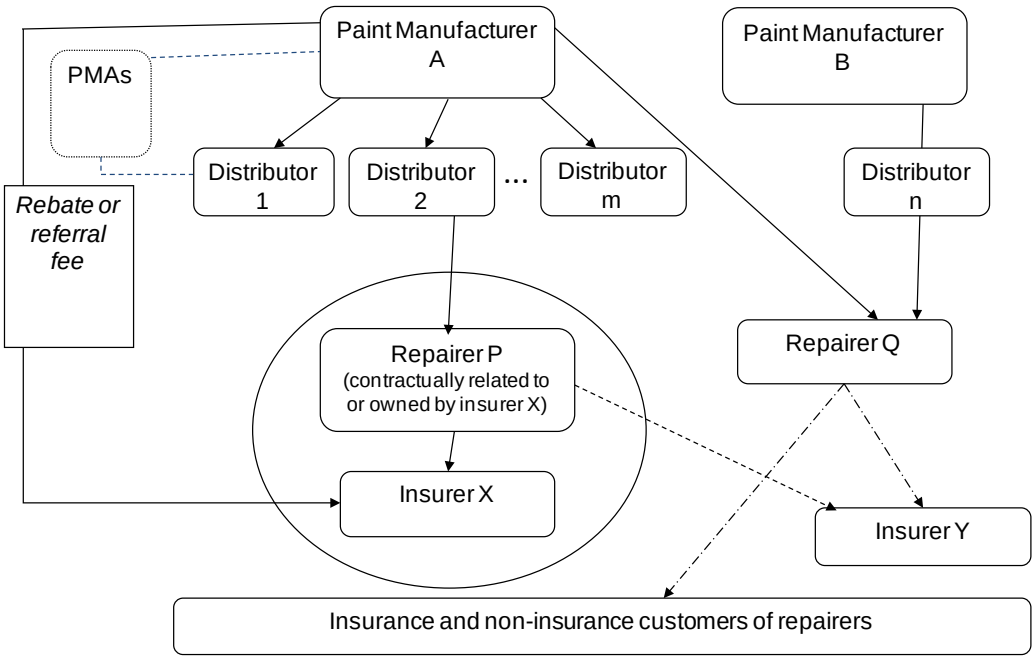
14. Certain PMI insurers (and other repair work providers, ie claims management companies (CMCs))[6] have contracts with some suppliers of goods used in vehicle repair, namely paint, parts (including glass) and repair cost estimation systems. Typically these contracts stipulate that the insurer will recommend the given supplier to its owned or approved repairers in return for per-repair referral fees and fixed fees (eg signing fees or annual fees). However, some repairers told us that they felt forced

[5] We did not receive any complaints about coordinated behaviour (collusion) in the supply of paint, parts (including glass) or repair cost estimation systems or any evidence suggesting such behaviour.
[6] Since these agreements have the same structure as the agreements relating to PMI insurers, we do not refer to them separately in this paper.

to use the 'recommended' supplier, such that use of the supplier was effectively mandated.[7,8] Figure 1 shows the interactions between the relevant parties.

FIGURE 1

Vertical supply contracts on the example of paint



Source: CC analysis.

15. This stylized figure shows an insurer X which has a paint supply contract with paint manufacturer A and recommends it to an owned or contractually-related network repairer P. Repairer Q is included to show that not all repairers which provide repair services covered by PMI policies are related to insurers (contractually or by owner-ship). In the illustration, repairer Q sources paint from paint manufacturer B, which is not involved in a contract with a rival insurer or another supplier.[9]

[7] [✂]
[8] One independent repairer told us that 'there [was] some leeway in distributors though often the recommendation [was] such that the business consider[ed] it to be mandated.' Similarly, another repairer told us that [✂] would 'dictate' it to use [✂] for paint, [✂] for tyres and [✂] for windscreens and that 'commercial [✂] was used'.
[9] [✂]

Raising rivals' costs downstream/input foreclosure

16. A vertical supply contract between an input supplier and a PMI insurer could foreclose competing repairers which provide repair services covered by PMI policies either by reducing the supply of the input generally to achieve an increase in its market price or by increasing prices charged to repairers working for rival insurers (partial foreclosure) or by ceasing to supply them with the input altogether (total foreclosure).

17. If foreclosure is successful, the input price paid by the integrated firm's[10] rivals would increase, putting its downstream rivals at a disadvantage. This might increase the integrated firm's profits downstream if its rivals have to increase their prices to cover their higher costs causing some customers to switch to the integrated firm. In the context of PMI repair work, if other repairers increase their prices to cover their higher input costs, some repair customers (insurers or end customers) might switch to the integrated repairer. To the extent that rival insurers increase their PMI premiums to cover their higher repair costs, they may lose customers to the integrated insurer. Alternatively, the integrated repairer or insurer might follow the price increase of its rivals and gain higher profits without increasing its market share.

18. When assessing the likelihood of harm from 'raising rivals' costs' the usual approach is to consider the issue under three headings:

- **Ability:** Would the companies involved in the vertical supply contract have the ability to harm rivals, for example by increasing price or by refusing to supply them in a way that significantly impacts the price the rivals have to pay?
- **Incentive:** Would it find it profitable to do so?

[10] We refer to an integrated firm even though the integration we are considering in this paper is achieved by contracts between two firms.

- **Effect:** Would the effect of this activity (either full or partial) be sufficient to reduce competition downstream to the extent that harm to end customers arises?

Reducing rivals' revenues upstream/customer foreclosure

19. If the downstream companies (ie PMI insurers and their repairers) which are parties to vertical supply contracts account for a large part of the total customer base, these contracts may have the effect of foreclosing access to a sufficient number of customers for the actual or potential rivals in the upstream input market such that their ability to compete is reduced. In turn, this may raise rival repairers' costs by making it harder for them to obtain supplies of the input under similar prices and conditions as in the absence of such supply contracts (because foreclosing rival input suppliers reduces competition upstream). As a consequence it may also raise rival insurers' costs if they consequently face higher repair bills. Vertical supply contracts which reduce rivals' revenues in an upstream input market may thus lead to higher prices in the downstream markets for both repair services and PMI. Efficiencies arising from such contracts, such as cost savings due to a better alignment of the supply chain, would at least partly offset any such negative effects if the parties pass on these savings as price reductions.

20. We assess the likelihood of harm from reducing rivals revenues under the same three headings as we assess the likelihood of 'raising rivals' costs', as follows:

- **Ability:** Do the supply contracts lead to a situation where upstream rivals are foreclosed from a significant part of the customer base for the input so that they are less effective competitors than in the absence of these contracts?
- **Incentive and effect:** These questions are the same as for 'raising rivals' costs' (see paragraph 18).

Approach to assessing foreclosure

Raising rivals' costs

Ability

21. Our Guidelines,[11] and general economic theory, point to three conditions which are necessary for vertically integrated companies to have the ability to raise rivals' costs (input foreclosure), which we discuss in turn.

The importance of the input

22. All else being equal, if the input accounts for only a small part of the total repair costs incurred, the integrated firm will be less able to harm its downstream rival repairers' ability to compete than if the input accounts for a greater part of the total repair costs. This is the case since a small increase in a large total repair cost would have a small effect on rival repairers' costs.

The existence of market power

23. In the absence of market power, the input supplier would not be able to drive up the input price. Therefore, to identify whether any of the upstream companies involved in vertical supply contracts have sufficient market power, we used a filter based on market shares. We used 30 per cent as a threshold since our merger guidelines[12] suggest that a market share of 30 per cent or less would not usually give rise to concerns. In addition, we considered additional factors, such as the ease of entry and expansion, which may act as competitive constraints on input suppliers.

The absence of timely and effective counter strategies

24. Rival repairers (or PMI insurers) downstream could avoid a price increase by switching away from the input. Therefore, if downstream rivals can turn to many good

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[11] The joint CC/OFT *Merger Assessment Guidelines*, September 2010, paragraphs 5.6.6 & 5.6.10 and similarly the CC *Guidelines for market investigations*, op cit, paragraph 274.
[12] The joint CC/OFT *Merger Assessment Guidelines* say that 'a market share for the merged firm of less than 30 per cent will not often give the OFT cause for concern over input foreclosure', paragraph 5.3.5.

substitutes for the input, the integrated companies will be unable to achieve an increase in the input price.

Incentive and effect

25. Since we concluded for all the inputs we considered that vertical supply contracts do not enable the parties involved to 'raise rivals' costs' (see paragraphs 41, 47, and 50) we did not assess incentive or effect.

Reducing rivals' revenues

Ability

26. Two factors are important to determine whether the parties to a vertical supply contract can foreclose rivals from a sufficiently important part of the customer base, which we discuss in turn.

Large proportion of customer base

27. For customer foreclosure to be a concern, it must be the case that the vertical agreement(s) involves companies which (at least jointly) account for a large proportion of sales.

Reduced sales increases average costs

28. Furthermore, rival input suppliers' ability to compete can only be hampered by such foreclosure if reducing the production volume or reducing the number of different goods produced increases the average cost per unit (ie there are economies of scale or scope). In that case, foreclosure from a significant part of the customer base may make some suppliers less efficient competitors or may even force them to leave the market. If this is not the case, a reduction of the customer base available to upstream rivals would not increase the input price to downstream rivals.

Incentive

29. Since we could exclude harm from customer foreclosure either because the contracts did not foreclose rival input suppliers from a significant part of the customer base or based on the screening described under 'effects' below, we did not assess incentive.

Effect

30. We considered whether there were factors or circumstances relating to vertical supply contracts which would allow us to exclude harm due to customer foreclosure (ie which could serve as a screen or filter with respect to this concern).

31. We identified that in order for the vertical supply contracts to have negative effects for downstream rival repairers or PMI insurers (and thus possibly for end customers) the input must represent an important part of the overall repair cost. If customer foreclosure reduced competition upstream and thus increased the cost of a supply input but this input was not an important part of repairers' costs then downstream products would not be affected.[13]

32. For one input, paint, we based our view on the size of the available customer base of insurers (and thus repairers) not party to such contracts (see paragraph 27). For the remaining inputs we based our view on the importance of the input price (see paragraph 31). Therefore, we did not consider other aspects related to effects.

Findings for paint

Raising rivals' costs

33. To assess whether the vertical contracts for the supply of paint could give rise to harm, we considered first whether the cost of paint accounts for an important part of

[13] In this context, the importance of the input price is necessary in order for the harm upstream to be transmitted downstream; in the context of input foreclosure, the importance of the input price is necessary for harm to arise at all.

the overall repair bill. We found that the average paint cost represented about 20 per cent of the average repair bill. In our view this was too high to rule out such a concern. However, we noted that the amounts repairers actually paid for paint were significantly lower than the amounts shown on the bill. Some repairers told us that they would make a significant margin on paint because they would pay around 20 to 40 per cent of the Audatex paint basket price, but would charge 50 to 80 per cent of this price to insurers (see the Appendix, in particular Table 3).

34. Since we could not rule out concerns on the basis of a low importance of paint in the total repair bill, we continued our assessment by considering the supply shares of paint providers.[14] We looked at the shares for refinish paint in the UK, as summarized in Table 1.

TABLE 1 **Supply shares of paint manufacturers for refinish paint in the UK in 2012**

	per cent	
	Volume share	*Value share*
PPG	[✂]	[✂]
DuPont*	[✂]	[✂]
Akzo Nobel	[✂]	[✂]
BASF	[✂]	[✂]
Lechler	[✂]	[✂]

Source: CC analysis.

*In June 2013 DuPont Performance Coatings (U.K.) Ltd. changed its name to Axalta Coating Systems UK Ltd. Since we are using information and data for 2012, we use the former name in this paper.
Note: The shares are adjusted to reflect the fact that [✂] per cent of paint is supplied by other paint manufacturers (ie the shares of the five companies shown sum to [✂] per cent). Volume and value figures were supplied by the paint manufacturers. The total market size is taken from the ABP UK body repair industry yearbook 2012.

35. We found that only PPG had a share of supply higher than the 30 per cent threshold suggested by our merger guidelines. Therefore, we considered whether other factors meant that PPG was constrained from profitably raising its paint price to repairers carrying out work for rival insurers.

[14] We understand that some 'budget' paint brands do not have the full colour range to enable the repairer to reproduce/match certain colours, may have less sales support and do not have manufacturer approval. However, we noted that the production process appears to be very similar and for this reason supply-side substitution between different brands is easy (see, for example, Case No IV/M.1363—DuPont/Hoechst/Herberts, paragraph 10). Submissions to us from paint manufacturers supported this view.

36. Paint manufacturers told us that paint supply deals were negotiated in a highly competitive environment, where customers could select from a wide range of choices from multiple suppliers. They said that they would expect their customers to compare their prices with those of competitors and would switch to an alternative supplier in the event of a 5 or 10 per cent price increase. Most of the paint manufacturers also said that they could increase production to accommodate an increase in demand. Akzo Nobel added that, in its view, 'the available capacity in the market adds to the already significant levels of competition between suppliers.'

37. Some of the large PMI insurers confirmed this view, telling us that, in response to a 5 to 10 per cent increase in the paint price, they would consider switching to an alternative paint supplier. Other insurers told us that this would be a decision which they would make in consultation with their repairers, while others said that they would leave their repairers to decide.

38. The paint manufacturers also told us that barriers to entry were generally low. This was because a manufacturing presence in the UK was not required to enter the UK and there were no licensing or regulatory requirements for the supply of paint. We understand from information provided by one of the paint manufacturers that, in addition to smaller paint brands, PPG had started to sell its Novol brand and Valspar had started to sell its Octarol brand, but we noted that these were only new brands from existing suppliers and no new paint manufacturers had started to sell paint to PMI insurers in the UK.

39. Given this evidence from paint manufacturers and insurers, it appears to us that, despite PPG's share of supply, competitive constraints in the paint market would imply that PPG would be unable to raise significantly its paint price to repairers of rival insurers (or the price for its paint brands generally).

40. We also considered the supply of paint by paint distributors. We found that there are at least 28 paint distributors, and none of them have a large share of supply. The largest distributor, Morelli Group, accounts for around 12 per cent of paint supplied.[15] For this reason, it appears to us that no paint distributor has market power, and thus could not profitably achieve an increase in the paint price paid by rival repairers downstream.

41. Overall, in our view, the vertical supply contracts of PMI insurers and CMCs for paint would not allow any of the paint suppliers involved to raise the paint price.

Reducing rivals' revenues

42. To come to a view on the likelihood that paint supply contracts would allow those paint manufacturers involved to 'reduce rivals' revenues' we looked at the potential customer base not involved in such contracts. In particular, we looked at the proportion of PMI policies written by those insurers without vertical supply contracts for paint. We found that, of the ten largest PMI insurers, Ageas Insurance, Aviva, CISGIL (Co-op), esure and LV did not have supply agreements, and these insurers accounted together for about 9 million PMI policies (ie 38 per cent of all PMI policies).[16] On the basis of around 23.8 million insured private vehicles and 3.2 million claims,[17] we estimated that around 1.2 million repairs were dealt with under PMI policies sold by insurers which do not have paint supply contracts ([✂]) if LV is excluded given its contract with WNS which is party to a vertical supply agreement for paint (see Table 2)). We noted that this was a conservative estimate since it considered only the ten largest PMI insurers and many smaller PMI insurers also do not have paint supply contracts.[18]

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[15] See the APR UK body repair yearbook, p31.
[16] See UK Insurance – Key Facts, p 7 available on the ABI website.
[17] See UK Insurance – Key Facts, p 7 available on the ABI website.
[18] The five largest paint manufacturers did not tell us of any supply contracts they had with insurers outside of the top ten. However, some CMCs also have paint supply contracts and it is not clear how many of the claims in Table 2 they managed.

TABLE 2 **Policies sold and estimated number of claims for insurers in the UK in 2012**

£'000

	Average number of policies in year	*Estimated number of claims*
Insurers without paint contract		
Ageas Insurance	[✂]	[✂]
Aviva	[✂]	[✂]
CISGIL	[✂]	[✂]
Esure	[✂]	[✂]
LV*	[✂]	[✂]
Total without contracts	**8,969**	**1,202**
Insurers with paint contract		
DLG	[✂]	[✂]
Admiral	[✂]	[✂]
RSA	[✂]	[✂]
Zurich	[✂]	[✂]
AXA	[✂]	[✂]
Total with contracts	**9,819**	**1,316**
Total	**18,788**	**2,518**

Source: CC analysis.

*LV does not itself have a paint supply contract but it has a contract with WNS for the management of repairs under which it negotiates details such as the labour rate but leaves the sourcing of paint and parts to WNS.
Note: Based on the number of policies supplied by each insurer and the average number of claims per policy in the industry.

43. In our view, the size of the five insurers which are not party to vertical supply contracts for paint is a large enough potential customer base such that paint manufacturers are unlikely to be foreclosed from a significant part of the customer base by the contracts of other insurers.

44. Moreover, we noted that paint manufacturers produce paint not just for the UK, but for an international market. Therefore it appears unlikely that paint contracts involving PMI providers in the UK could prevent them from reaching an efficient scale of production such that harm from customer foreclosure could arise.

45. We also considered paint distributors but, given that at least five insurers accounting for 1.2 million claims ([✂] excluding LV) are not party to vertical agreements, it appears to us highly unlikely that paint distributors could be foreclosed from a significant customer base.

Findings for parts (including glass)

Raising rivals' costs

46. We looked at whether the cost of parts was sufficiently important to allow individual parts suppliers involved in vertical contracts with PMI insurers to raise rival repairers' costs. For OEM parts produced by a car manufacturer we found that an upper bound of the share of their cost in the average repair bill was 6 per cent (see the Appendix, paragraph 16). We found that the importance of non-OEM parts in the average repair bill was slightly lower at no more than 4 per cent (see the Appendix, paragraph 19). We noted that, since glass is a subset of the parts used in repairing wider damage, the importance of its cost in the average repair bill could not be higher than for OEM or non-OEM parts.[19]

47. Given these average shares of parts costs or glass costs in the average repair bill (OEM, non-OEM and glass), it appears to us that vertical supply contracts for such parts could not raise rivals' costs.[20]

Reducing rivals' revenues

48. Vertical supply contracts which foreclose competitors might reduce upstream rivals' revenues but will only have an effect on downstream rivals (and thus end customers) if the given input accounts for a significant share of the overall repair cost (see paragraph 31). Since we found that this share was not important for OEM parts, non-OEM parts or glass, it appears to us that vertical supply contracts could not lead to harm for customers.

[19] The apparent discrepancy between these findings and the figure of 40 per cent for the cost of all parts in the overall repair bill (see the Appendix, Table 2) is due to the fact that these findings are for individual providers of OEM parts (since we assume that input suppliers compete unilaterally), while the figure of 40 per cent applies for all parts jointly.
[20] As explained in the introduction the supply of glass for glass-only repair is different and glass supplied for such repairs is not considered here.

Findings for repair cost estimation systems

Raising rivals' costs/reducing rivals' revenues

49. The two largest suppliers of repair cost estimation systems are Audatex and Glassmatix and the cost of these systems account for at most around 2 per cent of the average repair bill (see the Appendix, paragraph 3).

50. As for parts, we therefore see no reason to believe that vertical supply contracts between suppliers of repair cost estimation systems and PMI insurers are likely to cause harm to end consumers.

Initial screen

1. In this appendix we set out details of our initial screen considering the importance of the costs of the individual inputs in the overall repair bill.

Input prices for repair cost estimation systems in vehicle repairs

2. Table 1 presents information from four repairers on the cost of the Audatex system.

TABLE 1 **Cost of Audatex repair cost estimation system as part of costs of vehicle repair, 2012**

				£
	[✂]	[✂]	[✂]	[✂]
Cost of Audatex estimate per repair	[✂]	[✂]	[✂]	[✂]

Source: Repairers.

3. Table 1 shows that Audatex costs around £[✂] per estimate. This amounts to less than 2 per cent of the average repair bill for fault and non-fault claims (which is generally in a range of £1,000 to £1,500).[1]

4. Based on information provided by Audatex, its cost per estimate (including subscription fees) is around £[✂] if only revenue from cost estimation software is included or £[✂] if all revenue is included. Both of these amounts are reduced by £[✂] if the rebates granted to insurers by Audatex are included. This is consistent with the repairers' estimates of the costs of the system.

5. Glassmatix told us that it charged an annual subscription fee which encompassed the creation of unlimited estimates, and a transmission fee for estimates which were sent to insurers through its communication systems. The licence fee was £1,800 for up to five users and the transmission fee was between £[✂] and £[✂], though Glassmatix

[1] See working paper, 'ToH 1: Overcosting and overprovision of repairs'.

told us that its recent deals with repairers had been at the lower end of this range due to its weakened market position.

6. Glassmatix told us that it could not determine how many estimates were produced by its system as many were created without transmission. However, it has estimated the number of estimates produced on the basis of the number of online registration checks which are run through its system on the DVLA database (as almost all estimates will require such a check) and, on this basis, Glassmatix estimates that its system costs repairers about £[✂] per estimate (including subscription revenue). This suggests that the costs of Audatex's repair cost estimates are an upper bound of such costs in general.

7. Overall, the cost of repair cost estimation systems is less than 2 per cent of the average repair bill for PMI repairs.

Input prices for paint and parts in vehicle repairs

8. We looked at the importance of paint and parts in the provision of vehicle repairs. Table 2 presents information from four large insurers.

TABLE 2 **Cost of paint and parts as part of cost of mostly insurance-funded vehicle repairs, 2012**

per cent

	Ageas Insurance	*Aviva*	*AXA*	*LV*	*Average*
Proportion of paint costs per repair	[✂]	[✂]	[✂]	[✂]	21
Proportion of part costs per repair	[✂]	[✂]	[✂]	[✂]	41

Source: Insurers.

9. Table 2 shows that paint accounts for approximately 20 per cent of repair costs and parts account for approximately 40 per cent of repair costs.

10. Trend Tracker reports that paint and materials as a percentage of the average repair job has increased from 14 per cent in 2002 to an estimated 22 per cent in 2012.

Labour as a percentage of the average repair job has been relatively stable at around 40 per cent, but parts have fallen from 45 per cent in 2002 to an estimated 38 per cent in 2012.[2]

11. However, repairers told us that the paint costs they incurred on an average repair were below the costs they charged for paint to the insurer. We found that the actual paint costs per repair were [✂] less than 20 per cent of the average repair. We note that Trend Tracker also reports that paint can be a significant contributor to the profitability of a repairer.[3] Table 3 summarizes evidence we received from five independent repairers about the paint prices they pay.

TABLE 3 **Use of paint in vehicle repair, 2012**

[✂]	[✂]	[✂]	[✂]	[✂]
Makes a margin of [✂]% on paint (it pays about [✂]% of the Audatex paint index and receives from insurers about [✂]% of the index).	Makes a margin of [✂] to [✂]% on paint (it pays about [✂]% of the Audatex paint index and receives from insurers about [✂]% of the index).	Pays around £[✂] per average paint job.	Pays around £[✂] to £[✂] per repair job (at about [✂]% of the trade price), with little difference between paint brands, and bills insurers about £[✂].	Makes a margin of [✂] to [✂]% on paint (it pays about [✂] to [✂]% of the Audatex paint index and receives from insurers about [✂]% of the index (though this can be as low as [✂]%).

Source: Repairers.

Additional considerations regarding parts

12. The parts used in vehicle repairs are either OEM parts or non-OEM parts.[4] OEM parts are supplied by the original manufacturer (often via an interim distributor); non-OEM parts are copies of the OEM parts and can be supplied by manufacturers that have no relationship with the original manufacturer.

Original equipment manufacturer parts

13. OEM parts are usually distributed to repairers by franchised dealers of the car manufacturers. [✂] told us that competition between franchised dealers to supply

[2] 2012–2017 Trend Tracker report, p3.
[3] 2012–2017 Trend Tracker report, p27.
[4] There are also original equipment supplier (OES) parts, which are made by the OEM but not sold under the vehicle manufacturer's brand. However, we were told by repairers and insurers that these parts constituted a very small proportion of all parts used in repairs, both by volume and value.

parts to repairers was strong and margins were low (in particular when taking into account the credit risk). [✂] told us that it ordered OEM parts from local dealerships and some dealerships offered better discounts than others (eg [✂]). There are some distributors other than the franchised dealers but these are unlikely to have a significant share of supply.

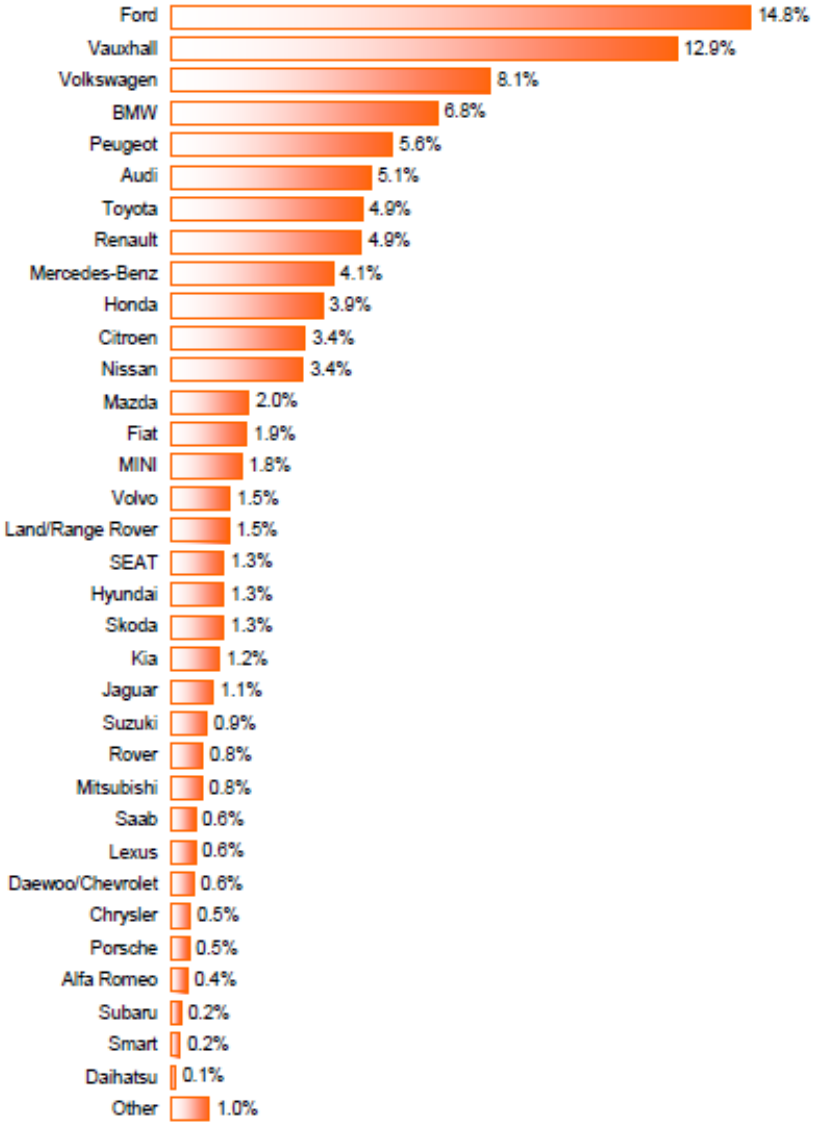
14. [✂] told us that there was, in practice, no alternative to using franchised dealers, as importers took too long to supply parts (because they lacked critical mass and could not stock a lot of product). [✂] said that franchised dealers competed with each other strongly on the popular brands (eg Ford and Vauxhall), but less so where there were fewer dealers around (eg Hyundai). [✂] told us that [✂] had centralized all its part supply operations into [✂] and no longer used the traditional franchised dealers for the majority of its parts supply. [✂] noted that the other vehicle manufacturers appeared to be considering similar structures. [✂] said that it received discounts off the Audatex list price of around [✂] per cent from Ford and Vauxhall, [✂] per cent on German vehicle manufacturer brands and as low as [✂] per cent on the far Eastern vehicle brands. It said that it gave insurers a [✂] per cent discount on the list price.

15. As OEM parts supply is ultimately controlled by the car manufacturers, we considered the shares of supply (for repairs) according to the main car manufacturers. Figure 1 shows this data as reported by Trend Tracker.[5]

[5] 2012–2017 Trend Tracker report, p40. Trend Tracker states that its estimate is based on Audatex data and covers 1.6 million repairs.

FIGURE 1

Analysis of mostly insurance-funded repair volumes by vehicle manufacturer brands



Source: Trend Tracker data for 2011.

16. Figure 1 shows that the two largest manufacturers each accounted for around 13 to 15 per cent of total repairs (ie Ford and Vauxhall). This suggests that no single manufacturer accounts for a significant part of the overall costs of repairers. For example, VW Group (which encompasses VW, Audi, Seat and Skoda) together account for less than 16 per cent of total repairs, which means that they account for less than 6 per cent of the average repair bill (assuming that total parts costs are

40 per cent of total repair costs (see Table 2)). This can be considered as an upper bound of the importance of OEM parts costs in the repair bill since other makes account for a similar or smaller repair volume than VW Group.

17. We also note that *(a)* not all manufacturers have part rebate agreements with insurers; and *(b)* it does not appear that contracts with car manufacturers are exclusive (ie more than one insurer can have a contract with a car manufacturer).[6]

Non-OEM parts

18. Some repairers and insurers told us about the use of non-OEM parts in vehicle repairs:

(a) Aviva said that non-OEM parts were only available for around 5 to 15 per cent of all parts. In particular, safety-related parts were often not available other than from the OEM due to the high development cost.

(b) Three insurer-owned repairers told us about their use of non-OEM parts, with one repairer not using them at all and the other two repairers saying that they were responsible for between 2 and 3 per cent of all parts costs).

(c) The National Accident Repair Group (NARG), which is a marketing association for repairers, told us that there were only two or three large suppliers of non-OEM parts and the main products they supplied were external body panels, cooling systems, lights and bumpers. In value terms, only [✂] of parts that were used in vehicle repairs were non-OEM parts. NARG said that repairers were reluctant to use non-OEM parts as they were more difficult to fit than OEM parts and OEM parts could be pre-painted which reduced repair times.

(d) [✂] told us that in 35 per cent of repairs it fitted no non-OEM parts, while in the remaining 65 per cent of repairs non-OEM parts accounted for about 20 per cent of parts (ie non-OEM parts accounted for around 15 to 20 per cent of all parts

[6] [✂].

used). However, it added that, in terms of value, this percentage would be lower. It said that the cost saving from using non-OEM parts was about 35 to 40 per cent. [✂] also said that, if it had a choice, it would not fit non-OEM parts as there were sometimes delays in getting the parts and it had to use more than one supplier.

(e) [✂]told us that non-OEM parts accounted for around [✂] to [✂] per cent of all parts fitted (in volume terms) but there were no non-OEM parts for low volume parts. The main non-OEM parts fitted were headlamps, radiators and coolers.

(f) [✂] told us that 5 to 10 per cent of parts expenditure was on non-OEM parts, with an average saving of 30 per cent compared with the alternative OEM part.

(g) [✂] told us that non-OEM parts constituted around 35 per cent of all parts used. [✂] said that non-OEM parts tended to be fitted on cars older than three years, so for these cars the percentage of non-OEM parts used rose to about 60 per cent.

(h) [✂] said that non-OEM parts were responsible for around [✂] to [✂] per cent of its total parts costs, with the proportion of parts volumes attributable to non-OEM parts being slightly higher (due to the lower price of non-OEM parts than OEM parts). It said that the largest non-OEM parts suppliers were Eurocarparts/Autoclimate, SEL and Direct Automotive. Other suppliers were smaller and generally did not offer a full range.

19. It appears to us that the use of non-OEM parts in PMI-related vehicle repairs is typically up to around 20 per cent in terms of the volume of parts used and up to around 10 per cent in terms of value. Given that all parts (OEM and non-OEM) account for around 40 per cent of the total average repair bill to insurers, and less in terms of what repairers pay for parts (because repairers generally get more parts discounts from their suppliers than they invoice to insurers), non-OEM parts appear to account for no more than 4 per cent of the average repair bill invoiced to insurers.